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Legal Issues for Landowners to Consider in Negotiating Wind Energy Easements

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Overview

Wind energy agreements pose financial potential for landowners, but do create legal risk. Before entering into an agreement a landowner should have the agreement carefully evaluated to determine if the financial benefits of the agreement truly outweigh the associated risk.

Liability Concerns- When Will Civil Damages Be Awarded to a Landowner?

By leasing out or granting easements over a portion of their land to wind energy developers for the installation of high-tech aerogenerators, rural landowners hope to diversify overall income and provide additional stability to the variability of farm income. However, the development of wind power stations presents numerous legal issues that landowners must carefully consider before entering into an agreement with a wind development company.

Tort liability. There are several legal liability issues that may arise from the construction, maintenance, and energy production from wind aerogenerators on agricultural land. Tort law concerns liability for such common law actions as negligence, nuisance and trespass.

Typically, a landowner is required to enter into written contractual agreements before a wind aerogenerator is constructed on the land. It is important to keep in mind that tort liability may be assessed in cases where harm results as a result of a party's negligence with respect to the construction or maintenance of wind aerogenerators.

Note: To establish a claim for negligence, the plaintiff must prove by a preponderance of the evidence that the defendant owed the plaintiff a duty to act in a certain manner, that the duty was breached, and that the breach of the duty caused the plaintiff's damages.

A rural landowner must be careful to specify in any contract that he is not liable for the negligence of others with respect to wind turbines. A farmer may further protect himself from negligence liability by taking reasonable care in the operation of the wind aerogenerators and

having liability insurance in place to cover all unexpected claims. Generally, if a farmer is not in charge of the maintenance or operation of the wind aerogenerator, a low-level standard of care will apply. This does not mean, however, that a farmer or landowner will be immune from liability in a negligence suit.

The tort concept of nuisance concerns the unreasonable interference with another person's use and enjoyment of their property. Nuisance is a common law tort that can arise in the context of wind energy production. To be held liable for a private nuisance (a nuisance action between to private parties), the interference must be substantial and unreasonable. A public nuisance, on the other hand, is an "unreasonable interference with a right that is common to the general public," meaning that it interferes with "public health, safety, comfort, or convenience or is illegal."

Listed below are some potential tort liability concerns associated with wind energy development. Many of these issues can be couched in the concept of nuisance. Landowners should give thought to addressing each of these issues in the body of a wind energy agreement.

- Damages to adjacent property caused by the alteration of the flow of surface water due to the construction of access roads.
- Aesthetic damage (nuisance-related liability).
- Damages and/or injury caused by ice throws.
- Stray voltage from the aerogenerators (this may be a particular concern for nearby dairy operations).
- Interference with electromagnetic fields.
- Fire caused either by malfunction of an aerogenerator or as a result of a lightning strike.

Note: It may be wise to include an inspection clause in a wind energy agreement. A good rule of thumb is that rotor blades and internal components should be inspected annually, and that reconditioning of component parts be required on a periodic basis - perhaps every five years (at the most).

- Possible interference with television and radio signals.
- Death of birds and/or bats that are protected by state and/or federal environmental laws.
- Adverse health impacts on adjacent landowners.

Other Legal Issues – The Agreement Itself

There are two parts to a typical wind development agreement. The first part involves an agreement for prospecting and development of the property, the terms of which will give the prospecting company the right to enter the premises, evaluate the property for potential wind energy development, and construct the necessary turbines and related structures if the developer deems the property to have the potential for wind energy development. This part of the agreement will typically give the developer the exclusive right to develop the property for a limited amount of time (usually 2- 5 years), and may contain an option for the developer to extend the length of the development term. At the present time, development agreements are providing landowners with annual payments within a range of \$2 to \$10 per acre subject to the agreement. If wind energy development does not occur during the term of the agreement, the

landowner may negotiate a new wind energy agreement with another developer, if possible and if desired.

The second part of the agreement involves the contract for the development and operation of wind turbines on the property. This part of the agreement will involve a much longer term (typically 20-50 years) with an option (or multiple options) to extend the agreement even further. Landowner compensation under this part of the agreement may be based on the number of turbines placed on the property, per megawatt of energy generated or on a royalty based compensation structure. A key point for landowners is to make sure that the compensation structure contains an inflation adjuster clause.

While both parts may be contained in a single document, landowners may benefit from having the two parts separated out and put in different agreements.

A wind energy agreement should never be negotiated without first having the agreement reviewed by legal counsel. Wind energy agreements are long-term agreements that will impact the land subject to the agreement for many years, likely beyond the lifetime of the landowner who executes the agreement. The following is a list of questions that landowners should ask when analyzing any wind energy agreement:

Scope Questions:

- How much of the land will be subject to the agreement?
- How long will the land subject to the agreement be affected?

Note: The lease agreement will have a clause creating a development/construction period during which time the developer has the time to determine whether the property is suitable for installing aerogenerators. This period generally runs from 2-5 years. Landowners should carefully read such a clause to make sure that the developer is not given an option at the end of the term to extend the term to make construction decisions. Clearly, 5 years is sufficient time for the developer to make construction decisions. Indeed, such a decision can likely be made within 2 years. There is no need for the land to be tied up for any longer period of time to allow the developer time to decide what to do.

Based on the property rights that are given up, are the proposed payments adequate for the present time and for the life of the agreement?

Note: The answer to this question requires an understanding of the mechanics and economics of wind energy production. In addition, it is essential that payments be tied to a CPI inflation adjustment.

Estate planning issues. Numerous issues related to estate planning can be implicated when entering into any type of long-term contractual arrangement involving farmland. One big issue is whether it is planned that the farming operation will expand in the future. If so, how will the placement of wind turbines on the property impact the farm's potential development and/or expansion? Also, another important consideration is whether the issue of wind turbines development been discussed with the on-farm heirs. The lease agreement is a long-term agreement that will transcend generations and will be binding on subsequent heirs to the land. In addition, certain estate tax post-death planning options could be hindered by a wind energy agreement.

Payment questions. Numerous questions should be raised and the answers evaluated in determining whether any particular lease agreement is favorable for the landowner. Here's a listing of some of the more important issues to be addressed:

- Is the landowner entitled to any or all energy credits related to the project?
- If the agreement offers an up-front lump sum payment, is the payment representative of a fair amount of the rights involved?
- What are the tax consequences of wind energy payments that will be paid under the agreement? (Note: The answer to this question depends on tax changes at the federal and state levels – an area which is in an almost constant state of flux.)
- Are payments under the agreement based on revenues generated by the wind turbines?

Note: This is a very important point. In early 2010, the author received copies of letters that landowners in northwest Iowa received which informed the landowners that their payments were being reduced because the company's revenues were down due to the lack of wind.

- Can the landowner get information as to how the owner's revenue will be calculated?
- If the wind energy company puts additional equipment on the towers and collects compensation for such placement is the landowner entitled to some of the additional compensation?

Does the agreement guarantee that a set number of wind energy turbines will be constructed on the land by a specific date and, if not, is the developer willing to guarantee a minimum amount of payments?

What are the developer's rights? When evaluating a wind energy lease agreement, it is also important to determine the developer's rights granted by the agreement. Here are some of the key issues:

- Does the developer want to develop the land or simply use a portion of the surface for a term of years?
- Is the developer able to sell or transfer without the landowner's consent any of the land use rights obtained under the agreement? If so, will the original developer remain liable if the new developer or holder of the easement right does not pay the landowner or otherwise defaults?
- What events trigger the developer's right to terminate the contract? Can the developer terminate the contract at any time without cause? If so, how are payments due under the agreement to be handled?

Note: The lease agreement should be examined to determine if the landowner may terminate the lease only on the happening of a "material default" on the part of the developer or assignee while the developer/assignee must be given a period of time to cure a default. Some clauses even give the developer more than the stated time to cure, if needed.

Cost questions. When evaluating the costs associated with entering into a wind energy lease agreement, the following questions should be asked:

- Will any portions of the property require gating, fencing or limiting of access in any manner? If so, who pays for the cost of building and/or repairing such measures for restricting access?
- Is there any potential for environmental contamination or the release of hazardous materials onto the premises because of the presence of wind turbines on the property? If so, how are associated costs to be borne?
- Are any additional costs associated with compliance with governmental regulations of wind turbines, present and in the future, the responsibility of the landowner, developer or wind energy company?
- What is the cost of the landowner becoming an additional insured on the insurance policy of the wind energy company?
- Are there any potential costs of construction liens that might be placed on the property?
- If the agreement limits the ability of the landowner to expand the farm or make improvements (such as installing irrigation equipment, field tile, or additional structures), what are the economic costs to the overall operation of such limitations?
- The development of the property will require the construction of roads. Does the agreement provide compensation for any damage to existing drainage tile and/or additional costs associated with the change in the flow of surface water that could negatively impact adjacent property? Also, while the agreement may give the developer/assignee the responsibility for tile damage repair, that will also give the company the ability to choose the company that repairs the tile – which may not be in the landowner’s best interest.

Note: With respect to access roads, it is in a landowner’s best interest to place a limitation on the construction of the roads and lanes. Language should be included to require the shortest or most direct route or the nearest feasible route that is consistent with the least interruption with existing farming practices.

- If the development of the property with wind turbines increases the ad valorem real property valuation of the property, must the landowner pay the additional taxes?
- If an adjacent landowner files a lawsuit against the landowner based on nuisance or other tort theories, will the wind energy company pay the landowner's legal costs and any resulting judgment rendered against the landowner directly tied to the presence of the wind turbines?
- When the agreement ends or is otherwise terminated, does the landowner bear the cost of removing wind energy structures?

What are the landowner’s rights? It is critical to make sure that a landowner understands the rights the landowner retains under the terms of the agreement and what rights have been given up. The landowner should be adequately compensated for rights given up.

- What termination rights does the landowner have? How does the landowner exercise those rights?

Note: Wind energy agreements often contain termination clauses designed to minimize the risk of termination to the developer so as to aid the developer in receiving financing. Accordingly, wind energy agreements typically prevent a landowner from terminating (or taking action against the wind energy company) an agreement due to noise, flicker, vibrations, air turbulence, electromagnetic interference with global positioning systems, and other effects caused by the wind turbines.

- If the agreement is terminated, whether by consent of the parties or otherwise, what happens to the wind energy structures and located facilities erected on the property? What is the developer required to remove? How soon must structures be removed? Who pays for their removal?

Crafting an Equitable Agreement

When a wind energy agreement is being negotiated, certain issues are critical to the creation of an equitable agreement. Unfortunately, a common problem with many wind energy agreements is that once they are proposed and submitted to a landowner, the company wanting to execute an agreement tends to refuse to negotiate changes to the terms of the agreement. The company's ability to refuse to negotiate terms of the proposed agreement will depend largely on whether a landowner has meaningful options and competent legal representation.

Key provisions to a wind energy agreement that require careful attention by legal counsel for landowners contemplating a wind farm include the following:

- Is the proposed contract a lease or an easement? If a lease is involved, it should be long enough for the developer to recoup its investment (probably at least 20 years).
- Does the developer have a right of renewal? If so, does the landowner have the right to renegotiate any of the lease terms?
- Any lease should not be perpetual- a violation of the rule against perpetuities might be involved (at least in those states that have retained the rule).
- If an easement is involved, does the easement include turbine sites, substations, air space, buffer areas, vegetation restrictions, building restrictions, transmissions, and associated rights of way?
- Is a sale of the land contemplated? If so, how is the selling price computed? Any sale price should consist of the fair market value of the land plus the wind energy value.
- What are the setback requirements and fees to neighboring landowners?
- What is the amount of compensation to be paid? Take care to ensure that the definition of "gross revenue" is done properly. Is it defined as the sale of electrons or the sale of green credits, or is it calculated in some other manner?
- Is the revenue to be a flat amount annually, an annual payment per tower, a percentage of gross proceeds, a payment of a certain amount of kilowatt hours generated annually, or an amount based on the selling price of megawatts per year, whichever amount is greater?

- Is an inflationary factor built into the contract payment provisions? To protect the landowner's interest, there should be.
- Does the agreement cover land that will not be needed for the wind farm and related structures? From the landowner's perspective, there shouldn't be such coverage.
- An up-front lump-sum payment has tax consequences- make sure they are understood.
- What are the intentions of the developer concerning the use of the land? That makes understanding the use provisions of the agreement of primary importance. The construction clause should limit the construction of wind energy structures to not more than 3 or 4 years with adequate compensation paid to the landowner for restricting the use of the land during that time.
- Can the developer assign the agreement? If so, a clause should be inserted that ensures the original developer's liability if the assignee defaults under the terms of the agreement.

Note: Developers want the ability to assign the agreement and subordination language.

- Is the landowner willing to consent to a mortgagee of the developer? If so, a clause should be included that limits the landowner's obligations to the mortgagee.
- Consider including an indemnification clause that indemnifies the landowner for any liability incurred as a result of permissive activities (such as crop tenants, custom harvesters, and subsurface tenants) on the property subject to the wind energy agreement.
- What are the landowner's rights concerning usage of the property? For example, will the landowner be able to lease the property for hunting or other recreational activities? Will the landowner be able to mortgage or insure the property? Can the landowner develop any other potential mineral or renewable energy exploration?
- Consider the use of a clause that requires the landowner to be treated as favorably as neighbors (consider how to define "neighbor") executing similar agreements.
- Include a clause requiring the removal of all improvements the developer makes upon termination (whether voluntary or otherwise) of the agreement. Relatedly, for developments in the Flint Hills (eastern Kansas), include a provision specifying which party gets the rock that gets excavated to build the wind energy structures. Note: Regardless of whether termination is voluntary or involuntary, it is critical to set forth timing and costs associated with decommissioning.
- Require the agreement to be recorded (not just a "memorandum of agreement") to eliminate the necessity of having to locate a copy of the lease in the event of sale or mortgage of the property.
- Never agree to confidentiality clauses concerning the terms and conditions of the agreement.
- Have the contract reviewed by the landowner's insurance agent for analysis of any additional risks created by the wind energy project. In addition, consideration should be made as to whether a bonding should be required. Similarly, a landowner should consider being a payee on the developer's insurance policy.

Note: A bond or surety should be set aside for the removal of the facilities upon termination of the lease.

- Will the agreement violate any USDA land use restrictions if the subject land is enrolled in a USDA program? If such a possibility exists, consider including in the agreement a clause requiring the developer to indemnify the landowner for any lost government payments or the imposition of any penalties.
- Will the wind farm development be designed so as to minimize interference with aerial crop dusting activities?
- Can the landowner sell the property, or can portions of the property be sold?
- Evaluate the agreement with an eye toward the risk faced by the landowner. This includes environmental concerns, issues that could be raised by neighbors (i.e., nuisance related concerns), and potential violation of applicable zoning and set-back requirements.
- What happens if the wind energy company files bankruptcy? The agreement should contain language that protects landowners in the event of the company files bankruptcy. Major questions to be addressed include the rights to landowners to continued lease payments, and whether the company is responsible for decommissioning costs.

Conclusion

Wind energy development has been spurred in recent years by political support and public subsidies. When compared with other energy sources, wind energy production is incredibly inefficient. In addition, wind energy will do little to nothing to address the concerns that some have over “global warming.” While there are landowners that have undoubtedly benefitted financially from the placement of aerogenerators on their property and are pleased with their lease agreements, legal issues abound.

On that issue, from a landowner's perspective, many wind energy leases and/or easements are inadequate, unfair and offer limited economic benefits when compared to the revenues generated (and tax subsidies received) by largescale wind energy developers. The most common shortcomings of such agreements include: (1) contractual terms extending too long into the future; (2) contractual language that binds landowners to unilateral amendments; (3) inadequate compensation clauses (and compensation clauses that are difficult to understand); (4) provisions that are the result of unequal bargaining power. While some landowners are reporting better experiences in recent months - better contract terms and compensation levels - that may be the result of greater competition among wind energy developers, greater education on the part of landowners and lawyers, and increased oversight by state regulators (the vast majority of wind energy developers are not subject to the regulatory rules that most utilities are subject to).

Clearly, a wind energy agreement is an important, long-term business agreement, and must be viewed as such by landowners. Wind energy companies are in the business first and foremost to make profit (albeit largely at taxpayer expense), and landowners must always keep that fact in mind. Remember, some oil companies are also invested in wind energy for business reasons. So, entering into an agreement out of a sense of protecting the environment or because of “eco-guilt” can lead to an unfair agreement with impacts lasting for many years. The fact remains, substantial peril exists for landowners who don’t carefully evaluate proposed agreements with developers. That lack of scrutiny can result in landowners being significantly taken advantage of.

After review by a lawyer, any unfavorable terms should be subjected to negotiation. Failure to do so could result in many years of dissatisfaction for landowners.