

A Reprint from *Tierra Grande*

Wind Rights and Wrongs

By Judon Fambrough



The state's landscape is changing both physically and legally, especially in West Texas. Wind turbines appear on previously barren horizons, ushering in a new revenue source for landowners and new questions for attorneys.

Similarities exist between older, more familiar mineral leases and the newer wind leases. Knowledge of one helps in understanding the other. For example, landowners receive a per-acre bonus payment for signing either. However, bonus payments for mineral leases far exceed those for wind leases.

More than Wind Data

Both mineral and wind leases are divided into two terms. In mineral leases, the two are known as the primary and secondary terms. The length of the primary term is negotiable, averaging three to five years. If, at the end of the primary term, the oil company (lessee) is drilling or producing a well, the lease enters the secondary term automatically. Thereafter, the lease lasts for as long as production continues. Otherwise, the lease terminates at the end of the primary term.

In wind leases, the first term is known as the option or testing period. This period averages two to seven years, but extensions are common.

Wind companies (also called lessees) need to collect wind data for at least two years to determine if wind turbines are economically feasible at a specific location. To do so, they erect towers and install anemometers (instruments that measure the force and speed of wind). If the data reveal commercial potential, the lessee may exercise the option to enter the second phase of the lease, known as the production period. Entry is not automatic and is solely at the lessee's discretion for all or a part of the property.

Lessees consider more than just wind data when making the decision to enter the production period. Availability and capacity of transmission lines to transport electricity play a major role. Currently, electrical production equals or exceeds



A HORIZONTAL SEVERANCE CLAUSE limiting the lease to a specified height above the surface is a crucial element in a wind lease. These gargantuan turbines in West Texas are state of the art today, but in the future, technology may allow wind harvesting at higher elevations. A horizontal severance clause allows landowners to seek additional compensation when that happens.

transmission capacity in many parts of the state. Future production requires installation of additional lines.

Tax Credits Expire in 2008

Another critical factor in making the decision to enter the production period is the lessee's ability to secure favorable tax abatement provisions from local officials. Tax abatements, if granted, may last a maximum of ten years according to Texas law.

Availability of the federal tax credit may be the most important factor. The production tax credit of 1.9 cents per kilowatt hour expires for any towers not in service by Dec. 31, 2008. If the lessee meets the deadline, the credit lasts for ten years.

Other considerations include the results of environmental studies, surveys and core tests for tower sites as well as availability of financing and securing purchase agreements for the electricity.

The production phase lasts for a set period, generally 20 to 35 years. When the period ends, the lease terminates unless the lessee exercises the option to extend the production phase for successive 20- to 35-year periods as granted in some leases.

Royalties Average Less

In the case of both mineral and wind leases, landowners reserve a portion of the production for which they receive a royalty. In Texas, royalties on mineral leases average about 20 percent, while wind leases average between 3 and 6 percent. How the reserved portion of production is transformed into money for royalty payments is a key issue.

Wind leases base the payment on a percentage of "gross revenue" as defined in the lease. Landowners need to be sure the definition includes as many sources of revenue as possible (such as the sale of carbon credits) and avoids as many costs as possible (such as transportation and handling costs buried in the purchase agreements).

Frequency of royalty payments is another concern. The lease should stipulate when the first royalty payment is due after production begins and the frequency of subsequent payments. The Texas Natural Resource Code protects mineral owners in this regard, but landowners with wind leases have no statutory protection.

With wind leases, landowners may negotiate a royalty increase every five to ten years and each time the lessee opts to extend the production period. Landowners may attempt to get an increase whenever the lessee recoups the cost of a tower from its revenues. However, with wind energy being so heavily subsidized, the calculation of recovery costs may be difficult.

Finally, minimum royalties need to be addressed. This subject is discussed later.

Horizontal Severance Clause

Landowners need to negotiate both a horizontal and a vertical severance clause in wind leases to keep one tower from holding the entire leased premises from the surface to the heavens for the duration of the lease term.

In mineral leases, a horizontal severance clause is better known as a *depth clause*. Instead of one well holding all the area between the surface and the center of the earth, it limits

the lease to a particular formation or to a particular depth. With wind leases, the clause limits the lease to the first 300 or 400 feet above the surface. All heights above this level are reserved.

Higher elevations are exposed to greater wind velocity. Future technology may allow wind production at these heights. A horizontal severance clause forces lessees to obtain new leases for the higher elevations.

Vertical Severance Clause

A vertical severance clause in a mineral lease is generally referred to as a Pugh Clause or Freestone Rider. Instead of one well holding all the land described in the mineral lease, it limits the lease to a certain number of acres around each well. The rest of the acreage reverts to the mineral owner at some predetermined time, such as the end of the primary term.

In wind leases, the clause may take several forms. It may limit the lease to a given area around each tower or cause a termination of the lease on all commercial sites devoid of towers after a certain time. Such time is measured either from the beginning of the production phase or the beginning of construction of the first tower. Likewise, the clause may cause termination of all or a part of the leased premises if the lessee fails to install a specified number of towers by a given date or install towers able to generate a specified amount of electricity at maximum (plate) capacity.

Surface Rights Not Automatic

A primary concern with both mineral and wind leases is compensation for surface use and damages. In mineral leases, the lessee automatically has the right to use as much of the surface as is reasonably necessary to explore for and produce the minerals without asking permission from the surface owner and without having to pay surface damages.

With wind leases, the lessee has no automatic right to use the surface. Permission springs from the terms of the lease. When granting this permission, landowners may exact a payment, enact restrictions or both.

A nonexclusive list of compensable surface uses and damages associated with wind leases includes payments for:

- tower sites (advanced lump sum for each site plus annual rentals);
- construction sites around each tower (lump sum plus restoration);
- road construction (lump sum based on rods or footage);

- installation of transmission lines both above and below the ground (lump sum based on rods or footage);
- guy wires (advanced lump sum plus possible annual rentals);
- substations (advanced lump sum for each location plus annual rentals);
- operational and maintenance buildings (advanced lump sum for each building and surrounding area plus annual rentals);
- loss of revenue from hunting and recreational use of the property (generally payable annually during production phase only);
- loss of pasture, pasture rental and other agricultural uses (generally payable annually during production phase only);
- loss of use of pivotal irrigation systems (generally payable annually during both testing period and production phase), and
- loss of use of property when prohibited from erecting structures over certain heights such as additional windmills for watering stock (negotiable).

In addition to exacting surface damages, landowners may stipulate that their prior consent is necessary for the location of each tower, building, substation and so forth. Consent cannot be unreasonably withheld. Landowners may require restoration of the site when the property is removed.

Other Lease Considerations

The list of other provisions that may be addressed in wind leases includes, but is not limited to, the following:

Time is of the essence. Without specifying *time is of the essence* in the lease, there are no deadlines. The lessee has a “reasonable time to comply” with time constraints if the wording is absent.

Property taxes and tax rollbacks. The lessee should be responsible for the property taxes levied on the improvements (towers and buildings, for example). If the towers or the wind farm cause a loss of either the open-space (1-d-1) or ag-use (1-d) appraisal status, the lessee should pay for the rollback and any additional annual property taxes caused by the loss during the lease term and possibly thereafter until open-space appraisal status can be restored.

Indemnification. The lessee should indemnify and hold the landowner harmless from any lawsuits, judgments, unpaid bills and environmental claims caused by its operations. Wording is crucial, primarily to ensure compliance with the



SURFACE RIGHTS ARE NOT AUTOMATIC in wind leases. Unlike mineral leases, which permit the lessee to use as much of the surface as is necessary to produce minerals, wind leases specify compensation for and restrictions to most surface uses.

Express Negligence Rule set forth by the Texas Supreme Court (*Ethyl Corp. v. Daniel Const. Co.*, 725 S.W.2d 705 [Tex. 1987]). Otherwise, the provision may be unenforceable.

Acquisition of wind data and test results. Landowners should request copies of wind data and results of other tests conducted on the premises. This information may prove invaluable for future wind leases.

Water usage and extraction. The lessee may need water for various projects. The lease should specify the source of water and the amount of payment for its extraction and use.

Assignments. The lease gives the lessee the right to assign all or a part of the lease at any time. Landowners may wish to prohibit assignments whenever the lessee owes the landowner money or is in breach of the lease. Prior consent to assign may be sought, but consent cannot be unreasonably withheld.

Minimum royalties. During the production phase, landowners need assurance of receiving a minimum income from the lease via minimum royalty provisions. The assurance may come from a minimum annual income per tower, from each acre held by the lease or from a combination of these and other factors.

Defaults. The remedies for a breach, short of litigation, should be addressed. Mediation or payment of liquidated

damages is a possibility. If the lease terminates because of the breach, an advanced notice to cure should be included prior to the termination.

Exit strategies. Assurances for the removal of towers and equipment, as well as for cleanup, restoration and other exit activities should be placed in the lease. This may include such things as the posting of bonds and/or letters of credit. Alternatively, the landowner may require the lessee's forfeiture of the towers, buildings, equipment, and so on, if not removed within a certain time after the lease terminates. ➦

Fambrough (judon@recenter.tamu.edu) is a member of the State Bar of Texas and a lawyer with the Real Estate Center at Texas A&M University.

THE TAKEAWAY

Wind leases differ from mineral leases in significant ways. For example, signing bonuses are less for wind leases, terms are of different length, royalty payments are not protected by statute and surface rights are not automatic.



MAYS BUSINESS SCHOOL

Texas A&M University
2115 TAMU
College Station, TX 77843-2115

<http://recenter.tamu.edu>
979-845-2031

Director, Gary W. Maler; **Chief Economist**, Dr. Mark G. Dotzour; **Communications Director**, David S. Jones; **Associate Editor**, Nancy McQuiston; **Associate Editor**, Bryan Pope; **Assistant Editor**, Kammy Baumann; **Art Director**, Robert P. Beals II; **Graphic Designer**, JP Beato III; **Circulation Manager**, Mark Baumann; **Typography**, Real Estate Center.

Advisory Committee

D. Marc McDougal, Lubbock, chairman; Ronald C. Wakefield, San Antonio, vice chairman; James Michael Boyd, Houston; Catarina Gonzales Cron, Houston; David E. Dalzell, Abilene; Tom H. Gann, Lufkin; Jacquelyn K. Hawkins, Austin; Barbara A. Russell, Denton; Douglas A. Schwartz, El Paso; and John D. Eckstrum, Conroe, ex-officio representing the Texas Real Estate Commission.

Tierra Grande (ISSN 1070-0234) is published quarterly by the Real Estate Center at Texas A&M University, College Station, Texas 77843-2115. Subscriptions are free to Texas real estate licensees. Other subscribers, \$20 per year. Views expressed are those of the authors and do not imply endorsement by the Real Estate Center, Mays Business School or Texas A&M University. The Texas A&M University System serves people of all ages, regardless of socioeconomic level, race, color, sex, religion, disability or national origin. Photography/Illustrations: Brian Harkin, p. 1; Judon Fambrough, p. 2; Real Estate Center files, p. 3.