

LANDOWNER GUIDELINES FOR EVALUATING WIND ENERGY PRODUCTION CONTRACTS

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The process of evaluating a wind energy development contract can be complex, and the signing of such a contract involves a long-term commitment by the landowner. Contracts can be as short as a few pages or as long as a hundred pages. As a general rule, longer documents provide more detailed responsibilities for the contracting parties and are more likely to provide specific answers for disputes that arise in the future. It is also important to note that nearly all contracts are option contracts and do not guarantee that wind energy will be developed on the property. A modest fee (\$5 to 10 per acre) is paid for the option of developing the property for wind energy generation. Whether this option is exercised will depend upon a number of factors (e.g., adequacy of the wind resource, electricity prices, proximity to the electrical grid, local regulations, etc.)

Wind energy development contracts are typically provided in two forms – as leases or as easements. In legal terms, a lease “gives a right of ...occupation, whereas...easements...involve rights of use.”¹ In the case of wind energy contracts, the contract deals with the occupation or use of land and airspace. Regardless of the type of contract used, the issues involved in a lease or an easement are similar – the duration of the contract (ranging from a period of years to a permanent transfer of rights), the landowner’s compensation payments, the liability of each party, the transfer of the contract to third parties, and many other issues – must be resolved between the parties negotiating the contract.

This worksheet is designed to help landowners consider some important issues that should be considered when negotiating a contract and some of the alternatives that might be considered to address those issues. This worksheet is divided into sections related to key issues in wind energy contracts. Where appropriate there are comments to help you understand some alternatives to consider for each issue. It is strongly advised that you obtain legal assistance to better understand the provisions presented in the contract. **This worksheet is not a substitute for obtaining legal counsel regarding the contract – it is intended to help focus your discussions with qualified legal counsel.**

I. Basic Details of the Contract

Name of agent/company offering the contract _____

Description of land parcel(s) and portions of parcel(s) included in the contract _____

Contact person/company _____

II. Introductory Issues

- A. What are your long-term (25 to 35 years) plans for the land parcel(s) covered by the contract?
- | | |
|---|--|
| <input type="checkbox"/> Retain in farming | <input type="checkbox"/> Commercial development |
| <input type="checkbox"/> Recreational use (e.g., hunting) | <input type="checkbox"/> Keep as “natural” as possible |

1 Roger A. Cunningham, William B. Stoebuck, and Dale A. Whitman. *The Law of Property* 2nd Rev. Ed. St. Paul, MN: West Publishing, 1993.

- Sell to others Other _____

Wind energy contracts are long-term contracts, with the shortest in length being 20 to 25 years and the longest as much as 99 years. If you or your heirs have plans to use these parcels for another purpose during the life of the contract, you may be prevented from doing so by the contract or because the parcel is less desirable for the purpose you envision in the future.

- B. To what degree will the contract payments help or hinder your plans or goals?
- | | |
|--|---|
| <input type="checkbox"/> Very important for plans or goals | <input type="checkbox"/> Somewhat hinders plans or goals |
| <input type="checkbox"/> Somewhat important for plans or goals | <input type="checkbox"/> Significantly hinders plans or goals |
| <input type="checkbox"/> Limited importance for plans or goals | <input type="checkbox"/> Neither helps nor hinders plans or goals |

The contract payment might help achieve your plans or goals and will likely affect your financial options in the future. If the contract payments help achieve your financial objectives, then the contract might be useful in meeting your future goals. On the other hand, if the contract prevents your use of the property for other purposes, then the contract may hinder your longer term goals or plans.

- C. Who is offering the contract?
- | | |
|---|--|
| <input type="checkbox"/> A leasing agent | <input type="checkbox"/> A community wind project |
| <input type="checkbox"/> A Michigan wind energy developer/utility | <input type="checkbox"/> An out-of-state wind energy developer/utility |
| <input type="checkbox"/> An international wind energy developer/utility | <input type="checkbox"/> Other _____ |

There are many firms offering wind energy contracts. Some firms assemble contracts for a block of land that could be developed into a wind farm and then sell the contracts to a wind developer for a fee. Another firm may offer contracts and intend to develop the wind project itself. Issues to consider are: Does the firm have prior experience in developing wind projects and, if not, is there a good chance it will succeed with the project? Would you prefer to have a contract with a community-based project, an in-state firm, or a firm located out of state or in a foreign country? Regardless of who originally offers the contract, there may be an assignment clause in the contract. Be sure to see section IV below for details about assignment clauses. If you are dealing with a firm from outside Michigan, see section IX below for issues related to out-of-state firms.

- D. Does the contract have a confidentiality clause?
- Yes No

Some legal analysts advise against signing a contract containing a confidentiality clause. This clause may prevent discussion of the contract with other landowners involved in the project and may inhibit family communications. In any case, the contract should specify exactly what is required by the confidentiality clause.

III. Duration of the Contract

Wind energy contracts can last for a wide range of durations. A contract can be permanent easement or an agreement "in perpetuity" (both meaning that the landowner is transferring a permanent right to the developer), or a contract can have a series of time periods. The usual time periods might be: 1) an evaluation phase, 2) a production phase, and 3) an option for extension of the production phase. The sum of these phases can be quite long, and landowners should be aware of the duration of each phase and the total duration of the contract.

- A. Evaluation or discovery phase
1. What is the time permitted for the evaluation phase? _____ Years
 2. If the developer is permitted to extend the evaluation phase, how long is the extension? _____ Years

In the evaluation phase, the developer will collect information about wind quality and conduct an economic analysis to determine the viability of the project. In some cases, the contract will permit the evaluation phase to

be extended by the developer. It is usually desirable for the landowner to keep this phase as short as possible. With a long evaluation phase, a developer can control the property for several years while waiting for the project's viability to improve (e.g., easier access to the electricity grid, finding financial resources, higher electricity prices). During this time, you would not be permitted to sign a contract with another developer who has more immediate plans to develop the property. Note: This issue is of such critical importance that some states (e.g., South Dakota) have limited the phase to 5 or 7 years by law. Michigan has no such law and the parties must resolve this issue in the contract.

B. Production phase.

What is the length of the production phase? _____ Years

The length of the production phase in the contract is usually 20 to 30 years. A long production phase is necessary because the investment has a long payback period. Usually, a shorter phase is desired because this provides an earlier opportunity for the landowner to renegotiate the terms of the contract or use the land for other purposes.

C. Renewal or extension of the production phase

What is the length of time the production phase may be extended by the developer? _____ Years

Some developers claim that an extension clause is necessary to obtain financing for the project. Most wind projects, however, have financing terms of 12 to 15 years, well within the range of the initial production phase. Consider the following issues if faced with this decision: What land use decisions might you, your heirs, or a buyer want to make? Will the contract payments be sufficient 30 years from now? It is generally in the landowner's best interest to be able to renegotiate the terms of the contract before it is renewed, or to be able to terminate the contract at the end of the production period. By avoiding an automatic extension clause, you might be able to protect your future land use options. If the developer seeks an extension clause, then additional financial compensation should be negotiated.

D. Total contract period

To determine the maximum time the parcel will be committed to the contract, use the following:

Is the contract (either as a lease or as an easement) "permanent" or "in perpetuity," or does the contract permit the developer to extend the contract for an indefinite period at the developer's discretion?

Yes No

If yes, then the contract is either a permanent transfer of the use right ("permanent" or "in perpetuity"), or it provides the developer an open-ended right of use. If no, then the duration of the contract should be calculated as:

Evaluation Phase (A.1) _____ + Evaluation Phase Extension (A.2) _____ + Production Phase (B) _____ + Production Phase Extension (C) = _____ Total Years Committed

IV. Compensation Clauses

Because there are many payment options, the determination of the compensation clause is a difficult issue in any contract for wind energy development. Careful attention must be paid to the payment method's impact on the landowner's returns for the entire length of the contract.

A. What is the payment being offered during the evaluation phase of the contract? _____\$/Acre

This payment is offered for the option of developing the parcel for production of electricity from wind. Be aware that a firm offering a higher payment does not imply that the firm is more committed to actually developing the

property for wind energy. Thus, do not become too concerned with this payment – instead, focus on the payments during the production phase for the contract. Production payments are much more critical in determining the landowner’s long-run returns from the project.

B. What method is used to determine payments for the electricity generated during the production phase of the contract?

- | | |
|---|--|
| <input type="checkbox"/> A lump-sum payment at the beginning of the contract (\$_____) | <input type="checkbox"/> An annual fixed payment per turbine (\$_____) |
| <input type="checkbox"/> A payment based on a percentage of the electricity sales (____%) | <input type="checkbox"/> A payment based on an annual fixed payment <u>and</u> a percentage of the electricity sales (\$ _____ annually and ____%) |
| <input type="checkbox"/> Other_____ | |

If the contract offers a lump-sum payment at the beginning of the contract, then this payment will be the only payment you will receive during the life of the contract. There might be situations in which having access to an immediate payment is desirable, but care should be taken with this option. What are the tax consequences of a lump-sum payment? How does it compare to a contract with payments over time? To compare the options, use a standard financial annuity formula to convert the lump-sum payment into annual payments. It is important to make this calculation so you are fully informed about your decision.

The option of a fixed payment per turbine guarantees the landowner’s payment regardless of how much electricity is generated. Thus, the developer will bear the risk related to variations in the electricity generated. At the same time, you will receive this payment only if the project is actually developed. With this option, it is important to know the size of the turbine because the payment offered should be higher for larger turbines.

Another option is for the contract to share a percentage of the electricity sales with the landowner. Thus, returns can vary based on variations in wind speed and the landowner will share in the risk associated with the quantity of electricity produced. To obtain an estimate of the payment received under this contract, obtain the following information about the Power Purchase Agreement (PPA) that the developer has negotiated with the electricity buyer (the electricity generated is usually measured at the connection to the grid or at the turbine site):

- *The electricity sale rate (Dollars per kilowatt-hour);*
- *An estimate of the annual kilowatt-hours of electricity generated per turbine at the point where the power is measured (this will be affected by the quality of the wind resource and the size and type of turbine installed);*
- *Your percentage share of the electricity sales specified by the contract.*

By multiplying these three estimates, you can calculate your estimated annual returns per turbine. With this payment option, there could be many unknowns because the PPA, the wind resource strength, and the type of turbine to be installed might not be known at the time of the signing of the contract.

C. How many turbines will be installed on your property? _____

For contracts offering a fixed payment per turbine or a percentage of electricity sales, it is necessary to estimate the number of turbines to be installed on your property. This payment will vary by the size of turbine installed. With larger turbines, the payment per turbine should probably be larger. The number of turbines multiplied by the expected annual payment per turbine will equal the total annual payment.

D. Will “pooling” be used to calculate the value of electricity sales?

- Yes No

This procedure might be used if the contract payment is based on a percentage of the electricity sales. If pooling is used, then your returns will be based on your share of the acreage in the project. If you own 10% of

the total acreage in the project, then your share would be 10% of the electricity sales from all the turbines in the project, even if you had more or less than 10% of the turbines on your property.

- E. Does the compensation clause include the sale of the Renewable Energy Credits (RECs)?
 Yes No

Electricity from renewable energy projects (including wind) has two sources of value: 1) the value of the electricity generated (Dollars per kilowatt hour) and 2) the value of the Renewable Energy Credits (RECs). When negotiating the PPA, the developer might sell both the electricity and the RECs, or the developer might sell only the electricity, with the RECs being sold to another buyer. In either case, does the contract share the value of the RECs with the landowner? How will the value of the RECs be determined? Landowners should be aware that some analysts expect the value of the RECs to increase in the future as the states or the federal government enact Renewable Portfolio Standards or new regulations on climate change issues.

- F. Does the compensation clause have an inflation adjustment provision?
 Yes No

Because of inflation, a dollar ten years from now will have less value than a dollar today. It is desirable, therefore, to have a compensation contract that increases your payment to adjust for inflation at specific intervals (e.g., annually or every five years). The developer is likely to have an inflation adjustment included in the PPA with the utility. Therefore, the landowner should request an inflation adjustment clause to protect the value of future payments. Otherwise, the inflation-adjusted value of your payment will diminish significantly over the 20 to 30 year life of the contract.

- G. Does the compensation clause include payment for the land removed from existing uses by the developer (such as permanent roadways or structures) during the production phase?
 Yes No

During the production phase, the developer must have access to the turbines and may need to construct other structures on the land. The contract should specify the landowner's payment per acre for the use of this land.

- H. Does the compensation clause include payment for the land used by the developer during the construction phase, such as temporary roadways, temporary structures, space for large equipment such as cranes, etc.?
 Yes No

During the construction phase, the developer might need access to land on a temporary basis. If such use interferes existing with uses of the land (e.g., prevents the planting of a crop or destroys an existing crop), the contract should specify the landowner's payment per acre for the use of this land during this phase. In addition, the contract should specify that land used on a temporary basis will be returned to its original state by the developer before the construction is concluded.

- I. Does the contract contain a Force Majeure clause?
 Yes No

A Force Majeure clause permits the developer to extend the time of the contract if a delay is caused by any law, legal action, or requirement of a government agency, court, or utility. The clause might also apply to natural causes that prevent the development or use of the project. During the time this clause is in effect, any payment due to you could be delayed or avoided by the developer. These clauses are common in oil and gas contracts.

IV. Assignment Clauses

A. Does the contract have an assignment clause?

- Yes No

An assignment clause permits the wind developer to sell/transfer the contract rights to another party. Thus, a contract with this clause might mean that a different company will own the rights to the contract in the future. If the contract has an assignment clause, you may want to consider at least two options. First, you may want to negotiate a higher payment rate as compensation for the risk you face in dealing with another party in the future. Second, you may want to negotiate a provision in which the developer is liable if the contract is assigned to a third party and the third party fails to satisfy the terms of the contract (especially the payment terms). In a similar matter, does the contract permit the developer to mortgage the contract rights to a third party without the landowner's permission? If the developer mortgages the property under contract to a third party, and the developer then defaults to the third party, the landowner's rights relative to the developer and the third party might be affected. A contract should specify the conditions under which a mortgage may be exercised by the developer and the landowner's right of approval in such a case. In addition, the contract should limit the landowner's obligations to the third party.

VI. Property Taxes

A. Does the contract specify who will pay the property taxes associated with turbine(s), other equipment, or any other improvements on the property?

- Developer Landowner

The turbine(s) and any other associated improvements are likely to be considered improvements in the property and therefore subject to property tax. In some cases, contracts specify that the developer is liable for the property taxes associated with the wind project. If the landowner is to be liable for such tax increases, the compensation received by the landowner should reflect such an expense.

VII. Liability Issues

A. Who will be responsible for liability coverage?

- Developer Landowner

Several liability issues should be considered in the negotiation of a contract. First, is the landowner liable for damage he/she commits to the turbine and other facilities on the property? Second, is the landowner liable for damages caused by a third party whom the landowner grants permission to use the property? For example, assume the landowner gives permission for a third party to hunt on the land. If the hunter damages a turbine, is the landowner liable for those damages? Third, is the developer liable for damages to the landowner's property at each phase (evaluation, construction, production) of the contract? Fourth, is the developer liable for damages that occur to a third party? For example, assume a third party is injured by ice that falls from the blades of a wind turbine. Is the developer or the landowner liable for the third party's injuries? Fifth, is the developer liable for the injury of a worker that occurs on the landowner's property? Finally, does the contract require the developer to carry insurance on the turbine and associated facilities? In addition to consultation with an attorney, the landowner should have the contract reviewed by his/her insurance agent.

- B. Who will pay the cost of any litigation with a third party?
 Developer Landowner

Litigation with a third party can arise in many situations. For example, assume a neighbor, claiming to be affected by the noise or flicker of the turbine, sues to halt the operation of the turbine. Will the cost of responding to that lawsuit be borne by the developer or the landowner?

VIII. Other Restrictions on Land Use

- A. Does the contract contain other restrictions (e.g., a prohibition of hunting) that prevent the landowner from using the property for other desirable purposes?
 Yes No

The contract may contain provisions that limit the landowner's use of the land. At the very least, the contract is likely to limit the height or location of building construction near the turbine(s), the height of trees or other obstructions near the turbine(s), and other activities that could interfere with the operation of the turbine(s). While some provisions are necessary to permit the efficient operation of the turbine(s), landowners should be sure that such clauses are narrowly written to prevent interference with other activities on the property.

- B. Who will pay the cost (e.g., fines, etc.) for violations of land use regulations caused by the project?
 Developer Landowner

Wind projects can be subject to many local land use and zoning regulations (e.g., setback regulations). If the project violates a regulation, and a fine or other penalty must be paid, which party will be liable for such a violation? The contract should specify (a) each party's responsibility in complying with such regulations during the life of the contract and (b) each party's responsibility in the case of violations of such regulations.

- C. Is the turbine or an associated structure located on land enrolled in the Conservation Reserve Program (CRP) or Farmland and Open Space Preservation Program (PA-116)?
 Yes No

Wind turbines may be placed on land enrolled in the CRP, but such projects must be approved by USDA as "consistent with the conservation of soil, water quality, and wildlife habitat." Landowners should consult with the Farm Service Agency and/or the Natural Resources Conservation Service regarding the placement of turbines or other structures on CRP acreage. The contract should also specify which party is liable for any penalties or fines imposed for violations of CRP regulations. Also, if the land is enrolled in the PA-116 program, be sure to contract does not void participation in this program.

- D. Is the turbine or an associated structure located on land enrolled in USDA commodity programs?
 Yes No

If a turbine or facility is located on land enrolled in USDA commodity programs, how will the developer's use of that land affect the landowner's farm program payments? Does the contract payment received by the landowner justify the loss of commodity program payments? Landowners should consult with the Farm Service Agency to determine the impact of the developer's use of the land on commodity program payments.

IX. Choice of Law/Choice of Venue Clauses

- A. Does the contract contain a choice of law clause or choice of venue clause?
 Yes No

If you are considering a contract with a developer from outside Michigan, you should examine the contract for both a choice of law clause and a choice of venue clause. A choice of law clause might specify that any litigation that arises under the contract must apply the laws of the state in which the developer is located. While the dispute might be heard in a Michigan court, the court would be required to apply the laws of the developer's home state. If the contract contains a choice of venue clause, the case would be heard by a court in the developer's home state. It is usually in the landowner's best interest to have all legal disputes resolved under Michigan law by a Michigan court.

X. Termination of the Contract

- A. Does the contract specify the events that permit the developer to terminate the contract?
 Yes No

A particularly important issue is whether the developer is permitted to terminate the contract "at any time without cause." If so, what are the landowner's rights to any remaining payments under the contract?

- B. Does the contract specify the landowner's rights of termination?
 Yes No

Particular attention should be paid to how the landowner must exercise the right of termination (including the issue of whether arbitration – including binding arbitration – is required).

- C. Is the process defined for the removal of the turbine and associated facilities (i.e., structures, roads) at the conclusion of the contract?
 Yes No

You should be aware that some local zoning codes specify the conditions that must be met at the time of termination. Contact local zoning officials to determine if such regulations apply to your property.

- D. Who must pay the costs of removing the turbine and facilities at the conclusion of the contract?
 Developer Landowner

The cost of installing and removing a wind turbine can be substantial. The contract should specify which party will pay the costs of removing the turbine and associated facilities when the contract is terminated. Some contracts require the developer to pay these costs and to retain funds in escrow that will be sufficient to pay these costs. The contract should also specify the condition of the land after the removal/clean up process.

XI. Other Issues

There are many more issues that should be considered in negotiating a wind energy contract. Only the assistance of competent legal counsel can address the full list of issues that should be considered. The following is a partial list of other issues that should be considered.

- A. Does the contract grant broad access and use of the land parcel to the developer? In general, such provisions should be narrowly written to limit the use of the land to those portions necessary for the conduct

of the project.

- B. Is the landowner an LLC or other form of business organization other than a sole proprietorship? Michigan contract law might treat contracts between an LLC and a developer in a different manner than discussed here.
- C. Does the contract require the developer to include the landowner on the developer's insurance policy?
- D. Does the contract address the issue of default during the project? What are the landowner's rights if the developer defaults, leaving an unfinished project?
- E. Does the contract require that disputes be submitted to mediation or arbitration before a lawsuit can be filed? If so, what is the mediation/arbitration process? Is the arbitration process binding on the parties?
- F. Does the contract include any other form of mineral rights or property rights? If the contract includes any other form of property rights, be sure that the contract includes compensation for the purchase of other rights.
- G. Does the contract specify which party is liable for enforcing trespass laws and the actions of trespassers?
- H. Does the contract or a local zoning regulation require bonding by either party during the project?
- I. If a change in a law invalidates one portion of the contract, does the remainder of the contract apply as written?

XII. Conclusion

The development of electricity generated from wind has the potential to be a viable industry in Michigan. To participate in this industry, landowners should be aware of the economic benefits and the potential legal risks associated with negotiating a contract for the generation of electricity from wind. Above all, landowners should be aware that signing a wind contract should be a matter of negotiation. The landowner should be aware of the terms of the contract and should seek greater compensation for terms of the contract that are less favorable to the landowner. The contract provisions listed above, along with many other aspects of the contract, should be considered carefully given the long term of commitment required by many contracts. Negotiation of an equitable contract requires the assistance of effective legal counsel. If satisfactory terms or compensation are not provided in the contract, new or additional terms should be negotiated or the contract should not be signed.

XII. Other Resources

Noling, Bernard. *Guidelines for Landowners in Negotiating Wind Energy Leases*. Southwest Kansas Royalty Owners Association, 2003. (Retired attorney reviews the problems that landowners can experience with a poorly negotiated lease. A must-read for any landowner). Available at <http://www.swkroa.com/formspublications.html>

McEowen, Roger A. *Wind Energy Production: Legal Issues and Related Concerns for Landowners*. Center for Agricultural Law and Taxation, Iowa State University. Available at <http://www.calt.iastate.edu/windenergy.htm>

Windustry. *Leasing Your Land to a Developer*. Available at <http://www.windustry.com/leases>

Windustry. *Leases and Easements*. (Includes "webinar" presentations from Iowa State University and Colorado State University). Available at <http://www.windustry.com/taxonomy/term/120>

Stoel Rives, LLP, Attorneys at Law. *The Law of Wind: A Guide to Business and Legal Issues*. 2006. (If your attorney is unfamiliar with wind energy contracts, be sure to direct him/her to this website.) Available at http://www.stoel.com/webfiles/LawOfWind_WEB_02_07.pdf (Also at <http://www.windustry.com> above.)