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- by Roger McEowen***

Overview

Farmers have long used wind energy. Beginning in the 1800s, farmers installed several million windmills across the Midwest and Plains to pump water and generate power for lights and radios. Today, farmers, ranchers, and other rural landowners in suitable areas are utilizing wind energy in a different manner. By leasing out or granting easements over a portion of their land to wind energy developers for the installation of high-tech wind turbines, rural landowners can diversify their income and provide some stability to the variability of farm income.¹ However, wind farming presents numerous legal issues that landowners must consider carefully before entering into an agreement with a wind development company.

The Potential for Wind Energy Development

Wind farms are clusters of wind turbines that generate electricity. They tend to be located in areas with reliable and favorable wind speeds that are near electric power transmission lines and, in some instances, large cities.² Private companies are developing most of the wind farms in the U.S. by using either their own land or leasing or obtaining easements over land from private landowners or from the government. The developers sell electricity from the wind farms to power marketers, electric utilities, and, in some instances, directly to specific companies or government agencies. Presently, wind generates only about one percent of the power utilized in the U.S., but it is believed that by 2020, six percent of the nation's power will be generated by wind.³ Because wind turbines require large areas of land with strong, steady

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¹ The advantages of wind energy production include the creation of a clean, non-polluting, renewable resource that can displace imported foreign oil, the prevention by a single wind turbine of 5,000 tons of carbon dioxide emissions annually, the creation of more jobs per dollar of investment than any other energy technology, and a shorter construction time as compared to conventional power plants.

² The leading states in wind energy production are California, Texas, Iowa and Minnesota. The top five states for wind energy potential are North Dakota, Texas, Kansas, South Dakota and Montana.

³ According to the Wind Energy Association, wind could produce over 10 billion kilowatts annually. That is three times the amount of power used presently in the United States.

winds, certain parts of the country have the potential to be a significant player in the future development of wind farming.

Government Incentives for Wind Energy Production

Both the federal government and numerous states have provided incentives to encourage wind energy development. The federal Renewable Energy Production Tax Credit provides an income tax credit per kilowatt-hour for the production of electricity from a qualified wind energy facility placed in service after December 31, 1993, and before January 1, 2009.⁴ The credit is presently 1.9 cents per kilowatt-hour and is adjusted annually for inflation. The credit applies to each kilowatt-hour of electricity produced from wind that is sold to unrelated parties during the first 10 years after a wind energy facility is placed in service. Likewise, the Renewable Energy Production Incentive program provides financial incentive payments for electricity produced and sold by new qualifying renewable energy generation facilities. For depreciation purposes, renewable energy systems placed in service after 1986 are classified as 5-year property utilizing the double-declining balance method. At the state level, some states exempt renewable energy property from state property tax.⁵

The Mechanics of Wind Turbines

The typical wind turbine sits atop a tower that ranges from 170 to 320 feet high. The blade diameter is 75 to 100 feet with a weight between 8,000 and 10,000 pounds. The cost to install is approximately \$1 million per megawatt of installed capacity, with the typical turbine having an installed capacity of 750 kilowatts to 1.5 megawatts. A 1.5-megawatt turbine can generally produce enough energy to power 400-500 homes annually. A section of land can house anywhere from six to twelve turbines. The turbines are very sophisticated machines with computerized controls. A turbine's generator output increases as wind speed increases, with maximum power typically generated with wind speeds of 30-35 mph. The turbines are usually programmed with a cut-out wind speed of between 55 and 65 mph.

Legal Issues for Landowners

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:

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

⁴ I.R.C. §45.

⁵ See, e.g., Kan. Stat. Ann. §79-201.

- 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.)
- If the agreement offers an up-front lump-sum payment, is the payment representative of a fair amount for the rights involved?
- What are the tax consequences of the 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; the area is in an almost constant state of flux.)
- Does the developer want to develop the land or simply use a portion of the surface for a term of years?
- 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?
- Are payments under the agreement based on revenues generated by the wind turbines? Can the landowner get information as to how the owner's revenue will be calculated?
- 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?
- What termination rights does the landowner have? How does the landowner exercise those rights?
- If the agreement is terminated, whether by agreement 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?

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.⁶ Key provisions to a wind energy agreement that require careful attention by legal counsel for landowners contemplating a wind farm include the following:

⁶ Of particular concern is a provision in many wind energy agreements under which the landowner agrees to indemnify and reimburse the developer if a third party on the property with the landowner's permission damages the wind farm structures. For example, if a landowner contracts with a custom cutter to harvest crops on the premises that is also subject to a wind energy lease, and the custom cutter's activities set the field on fire that causes damage to the wind farm structures, the landowner, under such an indemnification provision, is liable for the resulting damage. Another concern is that with some wind energy agreements, the developer the landowner executes the contract with is a shell corporation created for liability purposes.

- 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 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?
- 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, include a provision specifying which party gets the rock that gets excavated to build the wind energy structures.

- Require the agreement to be recorded (not just a memorandum of the 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.
- 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.
- Evaluate the agreement with an eye toward the risk faced by the landowner. That 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.

Clearly, wind farming has the potential to provide significant economic benefits for rural landowners. However, substantial peril exists that landowners who don't carefully evaluate proposed agreements with developers can be taken advantage of significantly. Landowners should have any proposed agreement evaluated by legal counsel and attempt to negotiate any unfavorable terms. Failure to do so could result in many years of dissatisfaction for landowners.