

Wind Development in Montana: Leases, Options, and Update

I. General Introduction:

What is a Wind Lease? A Wind Lease is a Contract to use the surface of the land for a term of years for a specific purpose. The agreement may be formatted as:

- a lease
 - a lease with easements
 - an option
 - an option with a lease
 - an option with a lease and easements
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- Not every Lease Agreement results in a wind farm
 - Compatible with ranching and farming
 - Climate in Montana, Wyoming, North Dakota conducive
 - Generation of potentially substantial compensation (see below)

II. Experience

I have been involved in numerous transactions since 2006 in Wyoming and in Montana.

Mostly, I represent landowners; however, I have worked for several development companies.

When representing landowners:

- First, I ask them if they want to continue ranching or farming after they have leased their land for a wind project. If so, I explain to them that negotiating good terms in the non-financial, *operational* portions of the agreement are even more important than the compensation terms.
- Second, I explain that a wind project agreement is for a minimum of 30 years and may last for 100 years – long-term commitment.
- Third, I explain that a 100 MW wind farm will be worth hundreds of millions of dollars, which means the value of the land is dwarfed by the value of the wind project being built on the surface of the land. (important for indemnity, default, and lien language negotiations). A wind project agreement could cause the landowner to go bankrupt.

- Fourth, I explain that the market is just developing Montana and pressure to sign now or miss the market is not valid. It is important to take time to negotiate an agreement that the landowner can survive with over the many years of the agreement.

III. Background Information

- A. Wind Developer will construct turbines, internal transmission lines, and possibly external transmission lines, as well as substation to convert the wind-powered electricity to proper form.
- B. The **energy** generated by Wind is measured in **mega watts** and **kilowatts**:
 - 1000 kilowatts (KW) equals 1 mega watt (MW)
- C. Wind Developer is paid for amount of Mega Watts generated, minus transmission costs and/or wheeling charges (cost to use transmission lines to get electricity to market).
 - 1 MW turbine (most turbines are 1 MW to 2 MW) x 8760 hours per year x the wind site capacity factor .39 x \$55 per MW (could be \$30 -- \$55) = \$187,902 per year per 1 MW turbine.
- D. Also, there are large tax credits for wind development:
 - \$19 per MW tax credit to developer equals \$63,251 per year per MW of nameplate capacity (depreciation and tax credits are at least one half of project).
- E. Economies of scale dictate that a wind project needs to be at least 100 MW – 300 MW in order for a wind project to be somewhat economically feasible. Not feasible without tax credits at this point in time.
- F. Rule of thumb: Point of Reference.
 - One 1 MW turbine is at least \$2 million so 300 MW project x \$ 2 million per turbine = \$600 million just for turbines, no transmission, construction, etc.
 - Wind project usually pays for itself by year 12-15.
 - Turbines will need repowering at year 25-30 (nobody knows for sure).

IV. Due Diligence – Analysis of Wind Development

- A. Montana was in the speculative phase of the market for wind energy, but this may be changing.
- B. Miscellaneous companies have been developed to lease land and develop wind projects in Montana. These companies may sell the project to a developer rather than develop the project themselves.
- C. Some wind developers have utilized a different model in the Midwest where a large company that needs the tax credits helps develop the project and then at year 10-15 the project is transferred to the land owners: community wind development.
- D. The steps taken by a wind company to determine whether or not to build a project:
 - Economic modeling;
 - Collect Anemometer data;
 - Determine capacity factors;
 - Transmission study;
 - Interconnection studies;
 - Environmental assessment;
 - Permitting; and,
 - Negotiating sales agreements (PPA).
- E. Analysis of a wind company:
 - The financial strength of the company.
 - ❖ A wind developer has to have significant financial strength to fund its own projects (most do not self fund).
 - ❖ There has been a shortage of wind turbines, which means that the larger, more established companies are first in line to get available turbines.
 - ❖ Wind project development is a very complicated, complex and an expensive business, which means that it is less risky to associate with a company with a track record rather than a start-up company
 - Whether the company has developed wind projects in the United State or elsewhere.

- ❖ Development of wind projects in the United States is different than in other countries due to different regulations and other issues that are particular to the United States.
- Any bad press about the company/the reputation of the company.
 - ❖ If you enter into an agreement with a company, your business relationship may last for more than 50 years. It is important that the company has a record of good relationships with landowners.
- Understand the motivations and abilities of the company.
 - ❖ Does the company intend on selling the project? If so, this would mean that you would not be negotiating the long-term deal with the company, which may result in the land being tied up for 50 years or more.
 - ❖ How does the company prioritize the project in relationship to its other projects?
 - ❖ Does the company have other projects in Montana?
 - ❖ Has the company developed other projects in the U.S.?
 - ❖ What percentage of projects that the company has started leasing land have actually been developed?
- Find out the target project size:
 - ❖ Total acres to be leased;
 - ❖ Anticipated number of megawatts; and
 - ❖ Amount of property to be encumbered.
- Barriers to building a large scale project include:
 - ❖ Access to capital
 - ❖ Cash flow
 - ❖ Access to equipment, like Turbines (see above)
 - ❖ Knowledge of the industry (especially transmission)
 - ❖ Long timelines for the project
 - ❖ Trend toward big companies getting bigger, and smaller companies going away.

- ❖ Neighbors: potential problems (local zoning; height limits).
- No Development Guarantee
- ***Not necessarily a question of a “good” or “bad” company, but more a question of a “good” or “bad” agreement.***

V. What Comprises a Wind Lease? Exclusive and broad rights to evaluate, to construct infrastructure, to finance, to operate, to transmit power:

- A. Not like water rights or mineral rights (most likely cannot convey wind rights separate from the land).
- B. Contract to use the surface of the land for a term of years for a specific purpose: Lease.
 - Options or development term: up to 12 years.
 - Lease: up to 70 years, at least 35 years (usually a short form recorded).
 - Easements: roads, transmission lines, substation.
- C. Compensation:
 - Possible signing bonus
 - Possible attorney fee/reimbursement for review and negotiation
 - Per acre fee during development phase
 - Commencement of construction payment
 - % of gross revenue
 - ❖ May not include RECs curtailment payments, warranty or insurance payments
 - ❖ May carve out certain costs of delivery power
 - Guaranteed minimum
 - Substation payment
 - Met tower payments
 - The annual adjustment attached to CPI or up 3% annually.
 - Payment per mile or rod for transmission lines.
 - Payment for any gravel or construction material used.
 - Personal wind turbine
 - Other Considerations:
 - ❖ Construction Impact Fee
 - ❖ Repowering Fee for turbines

❖ Payment for use of water

D. Operational Terms in a Lease: (more important than compensation terms because dictates the use of the land for 3-9 decades)

- Grant of Rights

- ✓ What is the purpose of the agreement?
- ✓ Does the agreement grant access rights?
- ✓ Does the agreement grant easements?
- ✓ What rights are reserved to the landowner?
- ✓ Does the agreement grant mineral rights?
- ✓ Does the agreement grant water rights?
- ✓ Does the agreement impact hunting rights?
- ✓ Does the landowner have a right to audit the developer's books to determine whether compensation is accurate?
- ✓ Does the agreement grant the developer a right to build a substation and own the underlying property fee simple?
- ✓ Is the landowner prohibited from building new buildings?
- ✓ Is the landowner prohibited from using certain areas of the property?
- ✓ Is the landowner prohibited from certain uses on the property?
- ✓ Can the landowner sell the property?
- ✓ Can the landowner mortgage the property?
- ✓ Does the landowner have site approval rights?
- ✓ If there are easements granted in the agreement, are these easements strictly limited to the purposes and scope of the wind farm project?
- ✓ Could the landowner end up with only transmission on his property and no compensation because of no turbines being built on his property?
- ✓ Can the landowner continue ranching, farming, and utilizing the property for recreational purposes as he did prior to the agreement?
- ✓ Can the landowner lease the property for other purposes besides wind development during the time of the agreement?
- ✓ Can the landowner develop mineral rights during the agreement?
- ✓ Does the agreement prohibit the placement of turbines next to home sites?

- Road Construction and Maintenance

- ✓ Does the agreement grant the right to build roads anywhere without any standards?
 - ✓ Does the agreement provide that the developer will pay for the use of any gravel or road coverings?
 - ✓ Does the agreement require the developer to stockpile topsoil for reuse?
 - ✓ Who has to pay for maintenance of the roads?
 - ✓ Who can use the new roads?
- Taxes
 - ✓ Does the developer have a duty to pay taxes for the project?
 - ✓ What happens if the developer goes bankrupt and cannot pay its taxes?
- Construction Liens
 - ✓ If the developer does not pay its construction costs, can the contractors place a lien on the underlying real property?
- Gates and Fences
 - ✓ Does the agreement require the developer to pay for relocation of fences, cattle guards, electric gates, other gates, or anything else that needs to be fixed due to the project to keep livestock from straying?
 - ✓ Does the agreement provide compensation for injured or dead livestock if caused by construction or developer leaving gates open?
- Weeds and Erosion
 - ✓ Does the agreement provide that the developer will be responsible for weed and erosion control during the full time of the agreement?
- Baseline Condition
 - ✓ Does the agreement require the developer to pay for a rangeland or other expert to prepare a baseline analysis of the condition of the land prior to any construction?
- Prohibited Activities

- ✓ Does the agreement prohibit developer's employees, agents, contractors, etc. from smoking on the property?
 - ✓ Does the agreement prohibit developer's employees, agents, contractors, etc. from camping or living on the property?
 - ✓ Does the agreement prohibit developer's employees, agents, contractors, etc. from hunting on the property?
 - ✓ Does the agreement prohibit developer's employees, agents, contractors, etc. from bringing pets or other animals on the property?
 - ✓ Does the agreement prohibit developer's employees, agents, contractors, etc. from using illegal drugs on the property?
 - ✓ Does the agreement prohibit developer's employees, agents, contractors, etc. from driving too fast on the roads to the property?
 - ✓ Does the agreement require the developer to keep the property free from trash, garbage, etc?
- Insurance
 - ✓ Does the agreement require the developer to have insurance?
 - ✓ Does the agreement require the landowner to have insurance?
- Hazardous Materials
 - ✓ Does the agreement require the developer to be responsible for its hazardous waste?
- Indemnification
 - ✓ Does the agreement require indemnification in an amount that could bankrupt the landowner?
 - ✓ Does the agreement require the developer to indemnify the landowner for any fires that damage the landowner's or neighboring property?
 - ✓ Does the agreement limit the landowner's indemnity to the landowner's insurance coverage?
- Default

- ✓ Does the agreement allow the landowner to default the developer for anything besides nonpayment after a long period of providing notice?
- Protection of Lenders
 - ✓ Does the agreement provide sufficient protection for lenders to the developer?
- Termination
 - ✓ How much time and for what reasons can the developer terminate the agreement?
 - ✓ Does the landowner have any termination rights besides for nonpayment?
- Restoration
 - ✓ Does the developer have explicit standards for restoration, such a return to baseline condition?
 - ✓ Does the developer have a requirement to bond to safeguard restoration?
- Meetings with Federal, State and County Agencies
 - ✓ Does the landowner have a right to notice and to attend the developer's meeting with federal, state or county agencies?
- Most Favored Nations Clause
 - ✓ If the developer enters into an agreement with the neighbors after the agreement is completed, does the agreement require the developer to pay the same terms to this landowner?

VI. Montana's Wind Energy Easement Statute:

- Mont. Code Ann. § 70-17-303 provides that a Wind Energy Easement is "an easement obtained for the purpose of insuring the undisturbed flow of wind across real property of another must be created in writing and is subject to the same conveyancing and instrument recording requirements as other easements on real property."
- I have seen it in one lease, so far.

VII. Can Wind Rights be Severed from the Underlying Property:

- New Mexico federal case determined that an inchoate interest in wind power rights did not prevent partition. *Romero v. Bernell*, 603 F.Supp.2d 1333 (D. New Mexico 2009). The petitioners were owners as tenants in common on property that had a wind farm. One of the parties argued that the property could not be equitably partitioned because the principal value of the property was the wind farm development. This party's underlying premise was that wind power rights were like mineral rights and were not capable of being portioned. The Court stated:

The right to "harvest" wind energy is, then, an inchoate interest in the land which does not become "vested" until reduced to "possession" by employing it for a useful purpose. Only after it is reduced to actual wind power can wind energy be severed and/or quantified. See, e.g., *Contra Costa Water Dist. v. Vaquero Farms* (1997), 58 Cal.App. 4th 883.

Next, the Court likened the wind to water rights and reasoned that individual rights to water can only be acquired by appropriation and application of the water to beneficial use. "Respondents, then have no legal objection to partition on the ground that the future 'principal value of the Property appears to be for wind farm development.'"

- California state case, See, e.g., *Contra Costa Water Dist. v. Vaquero Farms* (1997), 58 Cal.App. 4th 883, determined that wind power rights were capable of segregation in California. The case was an eminent domain proceeding in which the Water District was acquiring a rancher's property for a reservoir and diversion facilities. Some of the ranchers' property was developed and had approximately 260 turbines on it. The Water District determined that it would be easier to just condemn the fee interest and to sever the windpower rights.

The Court stated the "question before us may be stated as follows: When a public entity acquires property through eminent domain, are the windpower rights capable of segregation or are they so affixed to the underlying land that they must be acquired by the condemning authority?"

The rancher argued that its wind rights were dependent upon the control of the surface. The Court reasoned that "after the condemnation proceeding *Vaquero* will own all windpower rights in each of the affected parcels, together with an easement for ingress and egress and such other access rights as may be required for the maintenance and development of these windpower rights," and that wind generation was fully compatible with the Water District's public uses for the land taken. Therefore, based on well-established California law "that a

condemnation of property for public use need not be unqualified, total, and unconditional.”

In Montana, I have seen the following language in a Warranty Deed:

➤ Wind Energy: The Grantor reserves unto itself, its successors and assigns for a limited term of 25 years after the date of closing (until December 31, 2033) the right to market, develop, and operate wind energy resources upon the above-described property, together with the executory right to issue wind power leases upon the above-described lands for a term not to exceed December 31, 2033. In any wind power lease issued by the Grantor:

- i. The Grantor shall receive one hundred percent (100%) of the royalties and lease payments for the first five year period of the lease.
- ii. The Grantor shall receive fifty percent (50%) and the Grantee shall receive fifty percent (50%) of the royalties and lease payments beginning on the sixth year of any wind energy lease issued by the Grantor.
- iii. The Grantee shall receive 100% of the royalties and lease payments beginning January 1, 2034 when the Grantor's interest in wind power from these lands automatically terminates. Thereafter, all wind energy marketing, developing and operating rights upon these lands shall be owned exclusively by Grantee.