

**CURRENT ISSUES IN TEXAS WIND ENERGY LAW 2008**

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## CURRENT ISSUES IN TEXAS WIND ENERGY LAW 2008

By Roderick E. Wetsel and H. Alan Carmichael

### INTRODUCTION

The Texas wind energy boom continues. The exponential growth of Texas wind development now rivals the booms seen in the oil and gas industry in the 1950s and early 1980s. In 2006, Texas surpassed California and now ranks first in the nation for wind energy development (i.e., installed and planned megawatt ("MW") capacity.<sup>1</sup> This accomplishment is even more momentous when you consider that California's first commercial scale wind installation was completed in 1981 and the first commercial scale wind farm in Texas went on line in 1995.

Thus far, development in Texas has been concentrated in two primary areas. The first was in West Texas (the McCamey area) and the most recent in West Central Texas (the Sweetwater area). In both places, growth and change came with amazing speed. Indeed, in as few as six years, the Sweetwater area proceeded from having no turbines to being home to three of the world's largest wind farms. The reason for such intense interest in the Sweetwater area is that it provides three primary ingredients for wind development: (1) optimum wind capacity, (2) proximity to existing high voltage transmission lines, and (3) plenty of wide open spaces in a sparsely populated rural landscape.

By 2006 and throughout 2007, the boom spread throughout the state. Developers moved north toward the Texas Panhandle and south through the "heart of Texas counties" (including McCullough, Concho and Schleicher Counties), southwest to Edwards and Val Verde Counties near the border with Mexico, and further south to the Texas Gulf Coast in counties such as Brooks, Jim Hogg and Willacy, east through Callahan and Shackelford Counties as far as Erath County (Stephenville), and west to counties such as Crockett, Martin, Andrews and Ector. Farmers and ranchers who at first rejected the idea of wind development began to actively seek turbines for their lands. Local cafes and courthouses buzzed with landowner stories of fortunes made overnight. The Horse Hollow Project in Taylor and Nolan Counties, which extends over 38 miles and is over 7 miles wide, is now the largest wind farm in the world, with 735 megawatts. The world's second largest wind farm is the Sweetwater Wind Project near Maryneal, Texas in Nolan County, with 512 megawatts. A new project begun in 2007 by Airtricity near Roscoe, Texas in Nolan County is planned to exceed 1000 megawatts (a "gigawatt").

Over the last several years, landowners in many counties farmed wind associations and selected "steering committees" to hire attorneys to attract wind developers and negotiate wind leases. Promoters began putting together packages of leases in order to "flip" deals to interested wind companies. The West Texas Wind Consortium, which was formed in 2003, now claims a large membership and regularly holds meetings at Texas State Technical College in Sweetwater to educate landowners and organize political support for wind development in Texas.

On July 20, 2007, after many months of public hearings and prolonged studies, the Texas Public Utility Commission ("PUC") voted to designate eight Competitive Renewable Energy Zones ("CREZ") in West Central Texas, West Texas and the Texas Panhandle, out of twenty-five areas

which were nominated. This event and the many hearings and publicity which preceded it, set off a further rush by developers to the Texas Panhandle. By the late summer and fall of 2007, landmen descended like Biblical locusts on such Panhandle towns as Pampa, Miami, Mobeetie, Floydada, Childress and Silverton. Even before this decision by the PUC, Texas billionaire T. Boone Pickens announced plans for a 4,000 MW project in four Panhandle counties (Gray, Roberts, Hemphill and Wheeler)—five times larger than the Sweetwater project (the world's largest). (See Appendix 1.) By Thanksgiving of 2007, Pickens' company (Mesa Power) had leased thousands of acres for this new project.

Installations of wind power in the United States in the last quarter of 2007 alone surpassed the amount installed in all of 2006. It is expected that wind capacity installed in 2008 will equal or exceed 2007.

However, as with all booms, there has been some backlash. Some areas have formed anti-wind groups to oppose current or future development and have held town meetings and rallies to gain support for their cause. Wind opponents (including some disaffected landowners without leases on their land) have filed lawsuits in three Texas counties against wind companies, developers, and in one instance, neighboring landowners. One of these suits was tried before a jury in Taylor County during the last part of December, 2006.<sup>2</sup> Even more ominously, by the end of 2007, the U. S. Congress had failed to extend the Federal Production Tax Credit, which is set to expire on December 31, 2008. (See Chapter I B below.)

Despite all of this activity and interest, wind energy law in Texas still remains in its formative stages. As yet, there is little or no statutory regulation of the industry. Although there is some litigation and an appeal pending, as shown in Chapter 3, there is no case law on the books. Likewise, the rapid growth of the Texas wind market has created new challenges for Texas energy lawyers, who by this point have likely encountered their first wind lease or option agreement.

Given these developments, this paper addresses four current issues in Texas wind energy law which should be of interest to Texas attorneys and landowners:

(1) The wind energy lease. Before a wind farm can be constructed, a wind lease and often a wind energy lease option must be obtained from the landowner. Chapter One describes the major elements commonly found in wind energy leases and, where possible, offers forms and suggested modifications;

(2) Ownership of wind rights. The question: "Who owns the wind?" - is still a troubling one for many scholars. Chapter Two discusses the various theories projected for the ownership of wind rights, as well as the landowner's ability to reserve and/or convey such rights.

(3) Litigation. Lawsuits have been filed in Taylor, Cooke and Jack Counties between the owners of land adjacent to current or proposed wind farms, as plaintiffs, and the wind company, developers, and (in Taylor County) neighboring landowners with wind leases, as defendants. The Taylor County case resulted in a verdict for the wind company and has been appealed. Chapter Three discusses the various claims made by the parties in these suits.



(4) Current and future developments. Recent decisions by the Texas Public Utility Commission have supported the further growth of the wind industry in Texas. Chapter Four discusses current and future CREZ and transmission issues under consideration.

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## CHAPTER ONE

### I. WIND ENERGY LEASE

There are currently numerous wind energy lease forms in use in Texas. Although there is some variation, these leases are identical in that their provisions are concerned with protecting the lessee's future investment in the property. In this respect, the wind leases in use today can be compared to the printed form oil and gas leases in use fifty years ago. As opposed to oil and gas leases now in use, wind energy leases may easily be 30 to 40 pages in length, exclusive of the land description. They contain many additional provisions, often ignored by parties to an oil and gas lease, which reflect the very different nature of the wind energy lease. It is a lease of the surface only of the land (i.e. a tenancy for years) as opposed to a conveyance of a fee simple determinable as in the case of an oil and gas lease. Of necessity, therefore, the wind energy lease contains provisions often found in other long term surface leases.

A large part of the increased length of the wind lease may be attributed to the fact that wind farms are capital intensive projects involving tens and sometimes hundreds of millions of dollars. For this reason, every wind lease is drafted in recognition of the lessee's plans to finance its development and operation. Concerns about lending requirements often cause the wind company to be very resistant to changes in the printed form of the lease. The landowner, on the other hand, may wish to change some provisions and add others in order to preserve and protect the land and his or her right to use the same for competing uses such as farming, ranching, oil and gas exploration, hunting and recreation. The farmer or rancher will seek to maximize his income from the land from all sources, in addition to wind lease payments. Wind farms may extend over a very large area and thus have a broad area of influence, but actually occupy only a small part of the land. The "footprint" or amount of land actually taken up by a turbine is generally very small and the remaining acreage can be used for other compatible land uses, such as grazing or farming.<sup>3</sup> As will be shown, however, hunting may be a more difficult issue. These concerns and the accommodation of competing uses of the land often require extensive negotiation and compromise in order to reach an agreement satisfactory to both parties. See Appendix 2-A, Exhibit "B" for a sample lease form (hereinafter referred to as "the Lease").

#### A. The Wind Energy Lease Option

With few exceptions,<sup>4</sup> almost every wind lease in use in Texas today is predicated upon an exclusive option granted by the landowner for a given term ranging from two to seven years, which may be extended (e.g. such as a two-year option with a two-year extension). The option may be contained within the terms of the wind lease or the subject of a separate agreement. See Appendix 2 for an example of a separate option agreement.

The purpose of the option is to allow the wind company time to conduct a wind study to determine whether the potential site is suitable for wind development. Typically, the option grants to the optionee/lessee the exclusive right of ingress and egress over and across the land for the purposes of (a) installing, maintaining, operating, inspecting and removing one or more wind monitoring devices (i.e. meteorological towers), including the performance of all tests and studies associated therewith; (b) surveying the land; and (c) performing such other tests and studies as the wind company may desire in connection with the option, including environmental, avian and cultural resource assessments, and geotechnical, foundation and soil tests.

The consideration for the option is usually a flat fee paid to the landowner at the time it is executed, or an annual fee paid during the term. The fee is often calculated on a price per acre basis for each acre of land covered by the option (e.g. \$2.00 to \$10.00 per acre) with a minimum base amount paid for small tracts. The amount of the consideration is quite nominal in light of the cost of development of a wind farm and is much lower than the amount typically received as bonus for an oil and gas lease. However, wind companies argue that such relatively low option fees are justified by the significant cost of the wind measurement, as well as other tests and studies conducted during the option term.<sup>5</sup> As well, they maintain that while the option is in effect there is only minimal disruption of surface use.

In addition to the term, consideration, and permitted activities, the option also includes provisions with regard to termination, assignment, notice, and the rights and responsibilities of the parties during the option term. The landowner may also wish to include provisions such as the following:

1. that the activities of the optionee be conducted only after a minimum amount of notice has been given to the landowner, with approval by the landowner of routes of access to and upon the property, as well as with minimum disruption of the surface estate;
2. that the optionee's activities on the property not unreasonably interfere with the landowner's farming and ranching activities;
3. that at no time shall the optionee or any authorized agent of optionee bring firearms or unauthorized persons onto the land; and
4. that the landowner be allowed to hunt and lease the land for hunting purposes during the option period, provided that reasonable and necessary precautions are taken by both parties for the protection of the optionee's personnel and property.

In almost every case, the exercise of the option by the wind company makes the lease effective and immediately binding upon the parties. As a result, it is necessary for the wind company and landowner to negotiate all of the terms and provisions of the wind energy lease in advance. Considering the many detailed provisions contained in the lease, this procedure can be very time consuming and expensive. Thus, if the option is not exercised, the attorney's fees and costs paid by each party for drafting the lease will be for naught. One exception is an option agreement which includes a "term sheet" that outlines the basic terms and conditions of the proposed wind energy

lease and provides that, upon exercise of the option, the landowner and optionee "shall use commercially reasonable efforts to negotiate in good faith to agree upon a comprehensive Wind Energy Lease acceptable to each party and with the language typically required by optionee's lenders and title company, as well as language typically required by landowners, within one hundred twenty (120) days of the negotiations being initiated by optionee..." It provides that the wind energy lease shall contain the same economic terms and provisions as contained within the "term sheet."<sup>6</sup>

## **B. The Wind Farm**

Rarely, if ever, will a wind lease on a given property contain enough acreage to constitute a wind farm. Instead, as will be seen, separate wind leases are taken from landowners owning contiguous tracts to form a wind project. Most wind farms in West Texas range from 2,000 acres to over 100,000 acres, depending upon the topography, number of turbines installed, and other such factors.<sup>7</sup>

Although there are many smaller turbines still in use, the size of the turbines installed today usually ranges from one megawatt to three megawatts. Until recently, in central West Texas, the most popular machine has been the 1.5 megawatt turbine manufactured by General Electric. This turbine rises to a height of 80 meters (264 feet) at its hub and has a rotor radius of approximately 38 meters (125 feet). In 2006 and 2007, developers of the Horse Hollow II, Sweetwater Wind and Airtricity wind farms in Nolan County included 2.3 MW turbines, which are even larger (80 meters to the hub with a rotor radius in excess of 40 meters). In the summer and fall of 2007, Enel North America, Inc. completed construction of twenty-one 3 MW turbines at its Project Snyder in Scurry County.

Spacing of turbines is determined by a variety of factors, including terrain, wind speed, wind direction, turbine size and access to an electric grid. As a general rule, the optimum spacing of turbines is in an east to west direction and north to south rows with approximately 1,000 feet between each turbine and 3,000 feet between rows. There are, as yet, no spacing regulations for wind turbines.

The wind turbines actually occupy only a small part (between three to eight percent) of a wind farm. The wind company utilizes the remaining acreage for access roads, installation of underground (and sometimes above-ground) transmission lines, substations, and related facilities. The most attractive area for a wind farm is one which has a steady wind speed that averages at least 13 miles per hour and/or a wind capacity factor of 35 to 45 percent.<sup>8</sup>

Calculation of the landowner's income from each turbine is a highly useful number and is of great importance to landowners. The arithmetic needed to arrive at this number is not difficult if a few definitions are understood. First, turbine size is expressed in megawatts (MW), where 1000 watts is equal to one kilowatt (kW), and 1000 kW is equal to one MW. Electricity production is expressed as kW produced over time, or in kWh (kilowatt hours). Three calculations are required to arrive at landowner income (i.e., royalty. See, for example, [www.windenergy.org/index.htm](http://www.windenergy.org/index.htm)):

(1) Total electricity produced in a year by one turbine: 1.5 MW (1500 kW) turbine x capacity factor (efficiency factor) of 40% (0.4) x 8760 (number of hours in a year) = 5,256,000 kWh of electricity per year.

(2) Total income per turbine in a year: If the electricity is sold for 3.5¢/kwh, then multiplication times the total electricity produced per year yields the income received per year by the wind power company:  $\$0.035/\text{kwh} \times 5,256,000 \text{ kwh of electricity} = \$183,960$  total income received by the company on each 1.5 MW turbine.

(3) Royalty income per year to landowner at 4% royalty:  $\$189,960 \times 4\% (0.04) \text{ royalty} = \$7,358$  per 1.5 MW turbine per year. Income per MW is  $\$7,358$  divided by 1.5 MW is equal to  $\$4906/\text{MW}$ .<sup>9</sup>

The Federal Production Tax Credit (FPTC), which provides a 1.9 cent per kilowatt hour tax benefit for the first ten years of the operation of a wind farm, is set to expire on December 31, 2008. Despite bipartisan support, the U. S. Congress failed to extend the FPTC within the 2007 energy bill. This omission sent a shudder through the wind energy industry which had sought a five-year extension to ensure certainty and stability for further development. From 1999 to 2007, the FPTC has expired on three separate occasions, each time causing a dramatic slow down in the wind energy industry and contributing to the boom/bust cycle which has historically plagued the industry. Hopefully, in 2008 Congress will enact legislation extending the FPTC before any slow down in manufacturing and development occurs.

## II MAJOR ELEMENTS OF THE WIND ENERGY LEASE

### A. Purpose Clause

The clause or clauses describing the purpose or permitted uses of the surface in the wind energy lease generally allow the lessee to undertake any activity the lessee determines is necessary, helpful, appropriate or convenient in connection with, or incidental to, the accomplishment of the construction and maintenance of the wind farm. See Appendix 3. It is important to note that the permitted uses include not only the assembly and installation of wind turbines, but also of transmission and gathering lines, both overhead and underground, substations, energy storage facilities, telecommunication equipment, roads, pipelines, control, maintenance and administration buildings, utility installations, lay down areas, maintenance yards, water wells, fences, as well as other improvements, facilities, appliances, machinery and equipment in any way related to or associated with the permitted uses. Many of the above described uses are only engaged in during the building phase of the wind farm. Thereafter, surface use is generally limited to normal maintenance and upkeep of the project. The lease may also contain a clause that allows the lessee to conduct site tours for the public.

As will be seen, if the landowner wishes to restrict uses of the surface of the land by the lessee, additional provisions must be added to the lease. For example, if the landowner does not wish for a substation or for an "O and M building" (i.e., Operations and Maintenance building) to be placed upon the land, the landowner must delete these provisions from the permitted uses or add a provision prohibiting these uses without his or her consent. Since at the outset the lessee may not know whether substations and other facilities will be placed on the leased property, it may be very resistant to such changes.

## **B. Term**

The term of a wind energy lease can range from 30 to 50 years, or more. The length of the term may be affected by:

1. the life of the wind turbines installed (i.e. 20 to 25 years); and/or
2. the minimum amount of time the lessee needs to recoup its investment and make a reasonable profit.

Although there are many variations, the term may be either:

1. a single term, such as thirty (30) years, commencing on the effective date and expiring on [\_\_date\_\_], or
2. an initial term which may be as short as one to two years (i.e. the construction period) or as long as twenty to twenty-five years, with an extended term or successive terms of ten to fifteen years each.<sup>10</sup>

In negotiating the length of the lease term, the parties must balance their competing concerns:

1. that the landowner is negotiating a lease that may well extend beyond his or her lifetime and which will affect future uses of the land; and
2. that the wind company is seeking to recover its costs and maximize profits while taking advantage of future innovations in the industry.

Given these concerns, the average term of a wind energy lease is often about 35 years, including the time required in construction of the project, although lease terms totaling as long as 50-80 years are now not uncommon.

## **C. Rent/Royalty**

The primary source of compensation to the landowner in a wind energy lease is found in the rental and/or royalty clause. However, most leases also provide for additional compensation by way of bonus payments before commencement of construction, installation payments, and minimum royalty. An analysis of these clauses in the order of their appearance in the lease form is as follows:

1. Bonus Payments Before Commencement of Construction (Pre-Construction Payments).

Bonus payments are usually either of the following:

- a. monthly payments beginning on the effective date of the lease, prorated for partial

months, until the commencement of construction (e.g. monthly rental payments of \$2,000.00 paid in advance). See Appendix 4a.

- b. an amount paid on the lease commencement date calculated by multiplying a dollar figure (e.g. \$4,500.00) by the number of turbines to be located on the lease land, but not less than \$\_\_\_\_\_, plus \$\_\_\_\_\_ per rod, multiplied by the number of rods included in each access and transmission easement upon the premises. An additional amount may also be paid for the location of a substation or other facilities upon the land. See Appendix 3b. For a further discussion of substation payments, see paragraph D.4. below regarding surface damages.

## 2. Installation Fees

Installation fees (surface damages) may be payable in conjunction with bonus payments, or in lieu thereof. This clause provides that the lessee shall pay to the lessor a sum equal to \$[\_\_\_\_\_] (e.g. \$3,500.00) per megawatt of installed capacity upon the land in advance or, alternatively, in two equal installments, with the first installment being due and payable within sixty (60) days of the commencement of construction, and the remaining installment being due and payable within sixty (60) days of the first day of production of wind generated electric power on the premises.

The purpose of this clause is to compensate the landowner for all surface and other damages incurred during the construction phase of the project. It is based upon the assumption that the more megawatts of capacity (i.e. turbines) placed upon the land, the greater the surface damages. See Paragraph 3a of the Lease. Separate sums such as \$15.00-\$20.00 per rod are usually also paid at the time of construction as surface damages for the construction of roads and underground transmission lines. Greater sums are often demanded for the installation of overhead transmission lines.

## 3. Royalty

Royalty, which is also referred to as rent, operating fees and/or monthly production payments, is described as a percentage of the gross revenues, as that term is defined in the lease. It is usually paid quarterly. There is no standard definition of gross revenues, and the term is variously described from lease to lease as to the items which are to be included and excluded. A definition favorable to the landowner is found in Paragraph 3b of the Lease and in Appendix 3d.

Royalty may be paid on a semi-fixed basis, such as 4% of the gross revenues for the first 10 years and 5% or 6% thereafter, or on a graduated scale, such as 4% of the gross revenues for the first 5 to 10 years, increasing by 1/2% every 5 to 10 years thereafter during the term, or any extended term. Royalty schedules may also vary, depending upon whether the electricity generated by the project is sold into the ERCOT or SPP grid,<sup>11</sup> and depending upon whether the electricity is sold by merchant plant<sup>12</sup> or long term power purchase agreement.<sup>13</sup> Occasionally, landowners are able to negotiate an escalation clause effective for the extended term (i.e., years 30 and beyond), which raises the royalty, minimum royalty and other landowner payments to the then prevailing rates.

As in oil and gas leases, the amount of royalty in the lease will depend on the bargaining power of

the lessor and the willingness of the wind company to increase its standard offer. In 2007, the "standard" royalty is 4%, although beginning royalties of 5% to 6% are not uncommon. Likewise, the amount of money a landowner may expect to receive as royalty during any given year of the lease term depends on many additional factors such as:

- a. the number of megawatts (i.e. turbines) installed on the property, which will be dictated by the size of the turbines used;
- b. the wind capacity of the area, with 40 to 45 percent being considered to be the optimum range;
- c. the hours of operation of the turbines on an annual basis;
- d. the availability of a transmission line with sufficient capacity; and
- e. the price, usually figured on a per kWh basis with one MW = 1,000 kW, as shown above.

#### 4. Minimum Royalty

The Minimum Royalty clause in a wind lease is an annual guaranteed income payment whereby the landowner receives a minimum amount of money even if the turbines located on the property are temporarily not generating electricity or are generating very little electricity. Because Minimum Royalty payments are costly, in the event no turbines are located on the leased property, it is likely that the wind company will exercise its right to terminate the lease. If the company installs no turbines, but wishes to continue to hold the lease, provisions should be added for a base minimum annual amount to be paid as part of the Minimum Royalty.

A Minimum Royalty clause is frequently drafted as the greater of: (a) \$[\_\_\_\_\_] (e.g. \$2,500) per megawatt or \$4,500.00 per turbine per year installed on the land; or (b) \$[\_\_\_\_\_] (an amount usually figured on a per acreage basis, e.g., \$15.00 per acre); provided, that said sum is prorated for partial years and is due and payable only to the extent that the royalty payments do not exceed the minimum royalty during any calendar year.

Often language is added to this provision which provides that the minimum royalty shall escalate over time during the term and any extended term of the lease. A sample minimum royalty clause is set out in Paragraph 3ciii of the Lease.

#### **D. Uses Reserved by the Landowner; Protection of the Surface**

Due to the fact that the wind energy lease is given for such a long term, the landowner will often be concerned as to how his or her other uses of the land will be affected now and in the future. Normally, the wind lease simply states that the landowner expressly reserves the right to use the land for all other purposes not granted to the lessee under the lease so long as said uses do not interfere in any way with the lessee's operations. By way of elaboration, the attorney representing the

landowner may wish to negotiate additional lease provisions which preserve specific landowner uses and expressly identify the rights and responsibilities of the lessee in the maintenance, protection and restoration of the surface.

### 1. Ranching and Agricultural Use

As in an oil and gas lease, the landowner whose ranch is covered by a wind lease will seek to include specific details regarding ingress and egress to the land, as well as provisions for maintenance of roads, locking of gates, fixing of fences, fencing of dangerous machinery, distance requirements from houses, barns, corrals and water tanks, and other such provisions in order to protect his or her livestock and property. The landowner/farmer will also wish to include provisions for the maintenance and replacement of terraces, avoidance of CRP (Crop Rotation Program) lands, placement of roads and overhead power lines, and similar terms so that his or her farming operations are not unduly hindered by the wind operation.

### 2. Oil and Gas Exploration

A landowner who also owns all or an undivided interest in the mineral estate will wish to preserve his or her right to explore and develop the land for oil and gas. Given that the mineral estate is dominant to the surface, making the wind lease subservient to the surface rights of a mineral owner and his oil and gas lessee, the wind company will also be interested in protecting its operations from interference. If there is no outstanding oil and gas lease on the land and the lessor's involvement in a subsequent oil and gas lease is important to the future development of the property, express language that allows the landowner to lease the land for oil and gas exploration and development, but protects the location of the wind turbines and other installations from interference by the oil company and its assigns is essential. If the land is already subject to an oil and gas lease, drafting can be more difficult, but a wind lessee might at least expect to receive the benefit of the accommodation doctrine, which requires an oil and gas lessee to accommodate existing surface uses where such accommodation is reasonably possible, consistent with industry practice, and practicable within the confines of the premises. *Getty Oil Co. v. Jones*, 470 S.W.2d 618 (Tex. 1971); *Tarrant County Water Control and Improvement District No. 1 v. Haupt, Inc.*, 854 S.W.2d 909 (Tex. 1993); *Sun Oil Co. v. Whittaker*, 483 S.W.2d 808 (Tex. 1972).<sup>14</sup>

### 3. Hunting and Other Recreational Uses

As every rancher knows, hunting is big business in Texas. In many areas, hunting has supplanted cattle raising as the primary source of income from the land. A landowner with an existing (or chances of a future) hunting lease will want to structure the wind lease so that he or she can continue to receive income from hunting. The wind energy company, on the other hand, has grave concerns about liability issues, not only for its own employees and property, but also for those of its business invitees, independent contractors and others who must come on the land to build and maintain the project. In the past, these conflicting positions have frequently lead to serious disagreement between the parties. As a result, almost all wind leases include a "Hunter's Waiver and Release Agreement" as an exhibit to the lease. All persons hunting on any part of the land covered by the wind lease, or entering upon the land for recreational purposes, are required to execute the waiver and release prior



to entry. Most companies insist that there be no hunting at all during the construction phase; however, they do customarily reimburse the landowner for his lost revenue up to an agreed amount. Additionally, some companies also require hunters not only to sign a release, but also to notify the wind company on entering and leaving the land.

In negotiating these clauses, it is important to remember that rifle hunting season exists only for about two months of the year (i.e., November and December), whereas shotgun hunting (i.e., bird hunting) exists from September until late Spring (i.e., dove, quail and turkey season). The most concern is really with rifle hunting, since a rifle bullet can travel as far as a mile or more, but a shotgun's effective range is not over 50 yards. As shown in Paragraph 5b of the Lease, common sense and reasonable precautions may be all that is necessary to protect each of the parties' interests. Some wind companies, however, take the position that this clause is non-negotiable. In such instances, the landowner will have to evaluate which activity will generate the most income.

#### 4 Surface Damages, Maintenance, and Restoration

##### a. Surface Damages

Unlike most current oil and gas leases, the wind energy lease often does not contain provisions for the payment of specific surface damages. As shown in paragraph C.2. above, the wind company may take the position that the bonus payments and/or installation payments paid to the lessor at the beginning of the lease cover all surface damages incurred in the initial construction of the project. Substations are usually an exception to this rule. If a substation is to be located upon the lease, the lease usually provides for the payment to lessor of a flat fee (i.e. \$5,000.00) at the time of construction or a stated dollar figure paid annually during the term of the lease (such as \$1,500-\$3,000 per year), or both. Surface damages incurred after the initial construction phase are the subject of an "Additional Disturbance" clause. See Paragraph 6g of the Lease. Under this clause, surface damages are paid only if such damages are not in connection with the installation of any additional turbines on the land. The presumption is that the installation of additional turbines will increase the landowner's royalty, thereby compensating the landowner for any additional surface damages.

Some wind leases also contain provisions regarding the use of water and the excavation and use of caliche. The wind company may negotiate for use of water from surface tanks or existing water wells. If there are no existing water wells, the wind company may seek an option to drill a water well or may simply truck the water from another location. A wind facility generally uses little water, except during construction, when water is used to clean the turbine blades prior to installation, mix concrete, and water down roads during dusty conditions.

As in modern oil and gas leases, the landowner will seek to negotiate the highest possible price for his or her water and caliche and will likely also seek to restrict the use of water by the lessee, as it is an extremely valuable resource.

##### b. Maintenance

The wind lease usually contains general terms regarding the obligation of the lessee to maintain the surface of the land. The landowner may wish to add provisions that specify in detail the lessee's responsibilities.

**c. Restoration and Removal Bond**

As in most current oil and gas leases, many wind energy leases contain a provision which provides that within a stated period of time after the termination or expiration of the lease, the lessee shall, upon the written request of the landowner, remove all of its improvements from the land, and restore the land to its approximate original condition as it existed before the lessee constructed its improvements, all at the lessee's sole cost and expense. Normally, the removal operation includes any subsurface improvements located within three to five feet of the surface of the land. The landowner will seek to add a provision to the lease requiring the lessee to post a bond or other security after a stated period of time in order to ensure that funds are available at the end of the lease term to remove the wind facilities and clean up the lease. Typically, such a clause requires this bond or other security to be posted after 10 to 15 years of operation, at which time it may be assumed that the salvage value of the turbines will be less than the cost of restoration. See Paragraph 18 of the Lease.

**E. Taxes**

The wind lease usually includes or should include a clause which provides that the lessee shall be responsible for any annual increase in the landowner's *ad valorem* taxes levied as a result of the wind energy project, thus making the landowner responsible only for ad valorem taxes attributable to his or her ownership of the land and any improvements he or she installs thereon.

**F. Insurance and Construction Liens**

The wind lease provides that the lessee shall, at its expense, maintain a broad form comprehensive coverage policy of general commercial liability insurance. Some forms also require the landowner to purchase a similar policy. Most wind leases require that the lessee keep the land free of mechanic's and materialman's liens for labor and materials provided to the project.

**G. Assignment**

Like the oil and gas lease, the wind lease may be assigned at the lessee's sole discretion. The landowner may wish to condition this right upon the creditworthiness of the assignee (i.e., that the assignee be at least as creditworthy as the lessee).

**H. Termination**

As in oil and gas leases, the lessee in a wind lease has the right, at any time, to surrender or terminate all or any portion of its right, title and interest in the lease. The landowner, on the other hand, has no corresponding right to terminate the lease, except in the case of a payment default. See paragraph J below. The landowner may wish to add a clause providing that if the wind company terminates

the lease after operations commence (i.e., construction), the lessee will pay liquidated damages to the landowner equal to the minimum royalty payable under the lease for three to five years prior to termination.

#### **I. Indemnity**

Indemnity clauses are standard in a wind energy lease and may be extremely broad. Like the service company in an oil field service contract, the landowner will need to pay careful attention to this clause and seek to modify the same in order to restrict his or her liability. Also, the landowner should seek indemnity from the wind company regarding suits by neighboring or area landowners involving the construction or operation of the wind project. Such suits have been filed in Taylor, Cooke and Jack Counties, although to date only the Taylor County case included landowners as defendants. See Chapter Three.

#### **J. Default and Remedies**

Provisions regarding default and remedies in the wind lease are similar to other surface leases. Typically, the only way the landowner can terminate the lease upon default by the lessee is for non-payment, and then only after the lessee has been notified of the same and given an opportunity to cure. The lessee's breach of any other term of the agreement only affords the landowner a "cause of action under applicable law."

Given the huge capital investment made by the lessee and its investors in a wind project, the landowner will probably find it extremely difficult, if not impossible, to include a provision in the lease allowing the landowner to terminate the lease for anything other than a payment default.

#### **K. Disputes; Venue and/or Arbitration**

Due to the fact that wind leases are almost exclusively found in the rural areas of the state, the wind company may seek to include an arbitration clause or alternate venue site for the resolution of any disputes regarding the lease or its terms. Like other companies operating in rural areas, the wind company may be concerned about being "home-towned" by a local judge and/or jury. The landowner, on the other hand, may not wish to resolve his or her disputes under the lease by an unfamiliar process (like arbitration) in a far away city, such as Dallas or Houston, and will seek to establish venue in the county where the land is located. Consequently, the landowner and wind company have valid competing concerns over venue and the best method to resolve disputes.

#### **L. Confidentiality**

Every wind lease contains a confidentiality clause which provides that the terms of the lease are proprietary and must be kept confidential. As a result, the lease itself is never recorded. Instead, as in many oil and gas leases today, a Memorandum of Lease is executed by the parties and filed of record in the county where the land is located.

#### **M. Force Majeure**

The wind lease usually contains a broad *force majeure* clause similar to an oil and gas lease. The landowner should seek to modify this clause to provide that the lessee shall be required to fulfill all monetary obligations under the lease, including payment of the minimum rent, even if there is an event of *force majeure*.

#### **N. Subordinated Lien**

The landowner may wish to add a clause providing for a subordinated lien on the wind project facilities upon the land to secure the lessee's obligations to remove and restore the property at the end of the lease and to pay all rent and other monetary obligations in the lease.

#### **O. "Favored Nations"**

Although usually resisted by wind companies, this is a clause which provides that if the wind lessee enters into another lease within a specified distance and time from the current lease containing more favorable terms, those terms will also be granted to the landowner.

#### **P. Reimbursement of Attorney's Fees**

It is now customary for the lessee to reimburse the landowner for his or her attorney's fees incurred in the negotiation of the lease. The landowner may wish to add a clause specifically requiring the lessee to pay these fees.

#### **Q. Build Out Clause or MW Guarantee**

If possible, the landowner should seek to add a clause providing that the wind company will maximize the number of turbines installed on the land or will guarantee the installation of a stated number of megawatts.

#### **R. Miscellaneous Provisions**

There are numerous additional provisions in a wind energy lease including representations and warranties of the lessor and the lessee, title, mortgages, subordination, hazardous materials, condemnation, and non-obstruction easements, among others. To address all of these clauses would be far beyond the scope of this article. Examples of many of these clauses are contained within the printed lease form in Appendix 2.

### **III. ADDITIONAL DRAFTING CONSIDERATIONS**

#### **A. Separate Leases or Unitization?**

In almost all cases, a separate wind energy lease is prepared for each tract of land included in the wind power project, so that the landowner receives royalty only from the turbines located on his or her land. Some wind companies have suggested unitization as an alternative, but pooling of wind leases on a surface acreage basis, as in oil and gas leases, is rarely, if ever, seen.

For obvious reasons, unitization is not favored by the large landowners in a wind energy project, as they desire to receive all of the royalty from the turbines located on their land. In the future, unitization might be utilized in the situation where a project involves multiple small acreage tracts, none of which can accommodate many turbines.

### **B. Overhang Provision**

As with the drainage provisions in an oil and gas lease, the landowner in a wind lease may well be concerned about a turbine or turbines which either overhang or are located a short distance from his land. A sample overhang provision is found in Appendix 5. Under this provision, the landowner receives additional royalty for the "taking" of wind from his or her land. Wind companies, on the other hand, prefer not to deal with the revenue sharing required by an overhang provision. If necessary, the wind company would rather make a one-time payment (or perhaps annual payments) to the landowner as compensation for the "drainage," similar to compensatory royalty. Moreover, the wind company usually seeks to avoid this issue by including a setback waiver in the lease or by obtaining an overhang easement from the landowner. The setback waiver provision provides that if the landowner now or in the future owns or leases any land adjacent to the leased land and the lessee holds a lease on said adjacent property and has installed or constructed or desires to install or construct wind power facilities on said land near the common boundary between the two properties, the landowner waives any and all setbacks and setback requirements, whether imposed by applicable law or by any person or entity. The provision further provides that the landowner shall, without demanding additional consideration, execute any setback waiver, setback elimination or other document reasonably requested by the lessee in this regard. Likewise, the overhang easement, which may be contained in a separate document, provides that the landowner grants unto the lessee an irrevocable, exclusive easement appurtenant to the land for the right and privilege to permit the wind facilities located on adjacent properties to overhang the landowner's land. See Appendix 6.

### **C. Retained Acreage Clause**

Wind leases, like oil and gas leases, at the outset of a project often cover far more land than will ultimately be used in the construction of the wind farm. Although the wind company, as a matter of practice, will probably release any unused acreage, this clause will insure that it will do so. A sample retained acreage clause is set out in Appendix 7.

## **IV EFFECT OF THE WIND ENERGY LEASE ON CONVEYANCING OR LEASING OF LAND**

### **A. Conveying or Leasing Land Subject to a Wind Lease**

Every wind lease provides that the lease shall burden and shall run with and against the land, and shall be binding upon and against the landowner, as well as his or her heirs, successors, grantees, assigns, permittees, licensees, lessees, employees and agents, and all persons claiming under them. The lease also often provides:

4. The landowner will not sell, transfer, assign or encumber the land or grant any license, easement, lease or other right with respect to the land which could interfere with the wind lessee's operations;
5. The landowner must give notice to the wind lessee of any lease, grant or conveyance involving the land or any part thereof; and
6. The landowner must execute agreements subordinating any lease or grant of the land to the wind lease and must use his or her "best efforts" to have the tenant or grantee execute similar agreements within a short, specified period of time.

\* \* \*

## CHAPTER TWO

### OWNERSHIP, RESERVATIONS AND CONVEYANCES OF "WIND RIGHTS"

The development of wind technology in Texas has created a new and profitable use for rural real property. As well, it has produced a previously unforeseen aspect of surface ownership. Landowners now recognize that "wind rights" are a valuable property right. However, legal scholars are troubled by the issue of wind ownership and by the fact that no legal canons regarding such ownership yet exist.

In a paper entitled "Wind Energy Leases, Prospects and Issues," delivered by Professor Ernest E. Smith of the University of Texas School of Law to the 2002 Advanced Real Estate Law Course, Professor Smith states:

"At first blush, the issue of landowner rights in wind appears at best academic, at worst rather silly."<sup>15</sup>

However, Professor Smith goes on to point out that practitioners may look to the law governing wild animals and percolating waters for guidance. [For an excellent discussion of these two theories see Terry E. Hogwood "Against the Wind" Oil, Gas and Energy Law Section Report 6, 11 (Dec. 2001).] Like wild animals or percolating water, wind does not have a quantifiable value until it has been reduced to possession. *Id.* In Texas, an individual does not own a wild animal so long as the animal remains wild and unconfined. *Jones v. State*, 119 Tex.Crim. 126, 45 S.W.2d 612, 613-14 (1931). Until the animal is captured and confined, ownership of the animal remains with the State. *State v. Bartree*, 894 S.W.2d 34 Tex.App.-San Antonio 1994 no pet.). Under Texas law, absent malice or waste, a surface owner has the right to take all of the percolating water he can capture from beneath his land. *Sipriano v. Great Spring Water of America, Inc.*, 1 S.W.3d 75 (Tex.1999). It should be noted that the significant difference between the two theories is that ownership of a wild animal resides with the State until capture, and percolating waters are at all times owned by the surface owner. The State has classified water as a natural resource, thereby allowing its regulation by the legislature. Likewise, if wind is classified as a natural resource, the legislature would be authorized to pass laws regulating its use.

Over the last several years, one of the most frequently asked questions has concerned the severance of wind rights. To date, there are no Texas cases that provide guidance on this issue. Indeed, according to the research conducted by Terry Hogwood for his paper, there is only one case in the United States that addresses the question. The 1997 California condemnation case of *Contra Costa Water Dist. V. Vaquero Farms, Inc.*, 68 Cal Rptr. 2d 272, held that wind rights are a distinct and severable right. There apparently are no other reported cases, but there is a proposed South Dakota statute that provides that:

“No interest associated with the production or potential production of energy from wind power may be severed from the surface estate...except that such rights may be leased for a period not to exceed fifty years. Any such lease is void if no development of the potential to produce energy from which wind power has occurred on the land within five years after the lease began.”

[Proposed South Dakota Title Standards 9-06, Wind Energy Rights - Limitation on Severance]

Texas presently has no case law or statutory authority addressing the severability of wind rights from the surface estate. Although the authors and many commentators on the subject feel that the severance of wind rights from the surface will ultimately be upheld in Texas, any conveyance or reservation of wind rights should be accompanied by disclosure of the uncertainty and risks involved in doing so. Practitioners may also want to consider incorporation a special warranty into any conveyance of wind rights, and are well advised to specifically define the nature and extent of the rights which are either conveyed or reserved. For an excellent discussion of this subject, see Lisa Chavarria's article in the State Bar of Texas Oil, Gas and Energy Resources Law Section Report, Volume 32, Number 2, December 2007.

A reservation clause as well as a sample conveyance are set out in Appendix 8 and Appendix 9.

\* \* \*

## CHAPTER THREE

### LITIGATION

Nearly all wind projects are constructed in rural settings, well outside the reach of zoning or building codes. As in any developing industry, it will not be long before breach of contract, lease interpretation and other contract claims find their way into Texas courts. Soon to follow could be contract and warranty claims brought by project owners against the manufacturers of the turbines and their component parts.

Potential areas of new litigation unique to the wind energy arena may involve overhang and setback disputes between neighbors or between project owners on adjoining lands.

The first litigation involving neighbor vs. neighbor was filed in Taylor County in 2005. In that case, homeowners near a wind farm sued the wind developer and neighboring landowners with wind leases.

The plaintiffs in the Taylor County litigation sought redress under the legal theories of nuisance, public nuisance and trespass on the grounds that the nearby wind turbines were unsightly, created noise, reduced property values and ruined the aesthetic value of the land. The trial court denied preliminary injunctive relief to the plaintiffs in 2005 and granted defense summary judgment motions, thereby limiting the plaintiffs to a noise-based nuisance claim. The case was tried to a jury in December, 2006. At the beginning of the trial, the plaintiffs filed a non-suit as to all of the landowner defendants. After a two-week court battle, the jury determined that the turbines were not a nuisance, and judgment was entered for the wind company defendants. The verdict is on appeal to the Eleventh Court of Appeals at Eastland, Texas.<sup>16</sup>

In 2006, similar suits were filed in Cooke County and in Jack County.<sup>17</sup> The Cooke County case was settled in 2007, and the Jack County case has not yet proceeded to trial.

In the opinion of the authors, it is doubtful that the existence of these lawsuits will seriously inhibit wind development in Texas. This is particularly true in light of the 2006 verdict in Taylor County. These cases and the mere existence of anti-wind organizations, however, will be a continuing concern to the wind industry. See Appendix 10 for a sample “anti-wind” publication from a recent newspaper article in Cooke County.

\* \* \*

## CHAPTER FOUR

### CURRENT AND FUTURE DEVELOPMENTS

#### I. BACKGROUND

With an installed wind capacity of over 4,356 megawatts (MW) as of the end of 2007, wind development in Texas is expanding rapidly. More than 15,000 MW of wind is in ERCOT’s interconnection queue, and according to the American Wind Energy Association (AWEA), two-thirds of predicted wind generation is expected to occur in Texas in the coming years.

As part of the Texas electricity industry restructuring legislation in 1999 (Senate Bill 7), wind development was mandated as one of several qualifying renewable energy sources to generate 2,000 MW by 2009. It quickly outpaced the development of other renewables such as solar, geothermal and biomass, but also created the first of several challenges of integrating wind energy into the State’s electricity grid. One of the basic functions of the ERCOT independent organization, as specified in Senate Bill 7, was to ensure access to the transmission and distribution system for all buyers and sellers of electricity on nondiscriminatory terms. That meant that any qualifying generator that wished to interconnect to the transmission grid and sell power at wholesale prices could do so.



By 2000, 755 MW of wind generation had been developed in the McCamey area of Texas—an attractive wind resource area of Texas characterized by high bluffs, willing landowners and appealing access to transmission interconnect points. In under two years, developers had begun to exceed the limited ability of the transmission infrastructure to reliably export power from the region. Despite “open access” provisions adopted in Senate Bill 373 and passed in 1995, developers were now characterized as “piling on” to the grid and were being curtailed by ERCOT. Even though developers arguably were losing revenue due to the business risk of over development, ERCOT stakeholders and the Board of Directors passed Protocol Revision Request (“PRR”) 333 and awarded the wind operators compensatory losses based on each company’s share of total retail sales.

As evidenced in the McCamey area in 2000 and 2001, the siting and development of generator facilities can occur much more rapidly than transmission expansion. The Legislature had to address this “chicken and egg” dilemma.

In Senate Bill 20 of the First Called Session of 2005, the 79<sup>th</sup> Texas Legislature expanded the Renewable Portfolio Standard (“RPS”) by an additional 3000 MW to 5000 MW by the year 2015. Recognizing that meeting this goal would require upgrading the transmission grid to service existing resource areas as well as extending the ERCOT transmission footprint to resource rich areas of the Panhandle, the Texas Legislature required the Public Utility Commission of Texas (PUCT) to designate Competitive Renewable Energy Zones (CREZ).

## **II. DESIGNATION OF CREZ**

ERCOT was tasked with evaluating Texas renewable energy resources and providing this information to the PUCT by December 1, 2006. The ERCOT study was to take into account input from stakeholders in the region, including developers, landowners, utilities and consultants. The study was to include a map with a summary of the best regions housing development potential of at least 1000 MW each and was later expanded to 4000 MW. See Appendix 11, Crez Areas of Interest..

In December of 2006, the Commission adopted rules implementing the CREZ process. (P.U.C. Subst. R. 25.174). See Appendix 12. The PUCT CREZ Rule, in summary, is as follows:

- Conducted as a contested case
- Parties nominate CREZs
- Suitable land areas and renewable resources
- Must support at least 1000 MW of new renewable capacity
- Developers must demonstrate financial commitment
- PUCT designates one or more CREZs and major transmission elements
- CREZ order due in 180 days
- Selected TSPs have one year to submit CCN applications after CREZ designation
- CCN applications processed on accelerated timeline (180 days)
- CREZ developers collectively post 10% collateral for CREZ transmission
- CREZ process is iterative

The Commission held contested case proceedings in the first half of 2007 to designate the CREZs (by Order). In determining whether to designate one of the nominated CREZs, the Commission will consider three criteria:

- The production capability of the region,
- The level of financial commitment by generators (developers) in the region, and
- Other factors, including the cost of transmission and the benefits of renewable energy in the candidate zone.

For each new CREZ it orders, the commission shall specify:

- the geographic extent of the CREZ
- major transmission improvements necessary to deliver to customers the energy generated by renewable resources in the CREZ and a general description of where any new lines will interconnect to the existing grid;
- an estimate of the maximum generating capacity that the commission expects the transmission ordered for the CREZ to accommodate; and
- any other requirement considered appropriate by the commission as provided by PURA.

To manage any “piling on” or latercomer issues within the CREZs, the commission may invoke disincentives:

- The commission may identify the developers whose projects may interconnect to the transmission system in the CREZ under special protection schemes.
- Priority in interconnecting to the transmission system may be based on a number of factors, including financial commitments of the developers in accordance with subsections (b) and (c) of this section. (25.174)

The rule contemplated that the Commission would issue a final order designating CREZs within six months—scheduled for July 5, 2007.

### **III. RECENT DEVELOPMENTS**

On June 15, 2007, Chairman Paul Hudson issued an order extending the time for issuance of a final order and requesting briefing on threshold legal/policy issues. Because of the volume of materials that had been filed, as well as the breadth of the issues presented during the hearing on the merits, the Commission found good cause to extend the deadline required by P.U.C. Subst. R. 25.174 for issuance of final order in PUC Docket 33672.

On October 2, 2007, the PUCT issued an interim order designating five areas of Texas, identified parties who demonstrated financial commitment to wind development, and tasked ERCOT to develop transmission plans for four different levels of installed wind resources in those zones. (See Appendix 12.)

The CREZ Transmission Optimization (CTO) Study was issued pursuant to PUCT Interim Order in Docket 33672. ERCOT, along with stakeholders, was ordered to design transmission plans for four specified scenarios of wind generation development in the areas defined by the PUCT. The CTO Study kickoff was August 24, 2007, as a Regional Planning Group subgroup (RPG-CREZ Task Force), meeting generally weekly. The study is expected to require 24 weeks to completion.

As of September 15, 2007, the amount of in-service wind generation had increased to 4101 MW and the additional signed interconnection agreements (IAs) had increased to 2802 MW, for a total of 6903 MW. As a result, ERCOT has increased the baseline used for the CTO Study to 6903 MW from the 4850 that had been included in the 2006 ERCOT CREZ study. In addition to the 6903 MW of wind generation in-service and with signed IAs, there are over 18,000 MW of wind generation currently in some phase of the interconnection study process which were not nominated in the CREZ docket. Whether any portion of this 18,000 MW of potential wind generation that is ultimately constructed requires transfer capability that is additive to the levels in the Table seen in Appendix 12 depends upon whether it participates in the CREZ solution pursuant to 25.174 and the outcome of Project No. 34577 regarding dispatch priority.

\* \* \*

## CONCLUSION

Over the past several years, the wind energy industry in Texas has come of age. Texas leads the nation in wind development. Yet, as in the past, no form books for wind energy leases have emerged. Although there has been litigation, there is still no case law to act as precedent in guiding practitioners. Finally, there are no legal canons regarding wind ownership in Texas, and the art of conveying and reserving wind rights remains to be developed.

Despite these constraints, as well as the appearance of "anti-wind" forces, it does appear that the wind energy boom will continue and that the industry is here to stay. To date, wind energy companies have invested hundreds of millions of dollars in Texas wind and have plans to continue to make Texas the most popular site for wind development in the United States. Likewise, recent decisions by the Texas Public Utility Commission have supported and encouraged further growth. The rapid evolution of this new industry has created an exciting opportunity for energy lawyers to be on the cutting edge of a new era. It is hoped that this article will be helpful to those attorneys, as well as to the landowners involved.

## END NOTES

<sup>1</sup> According to the American Wind Energy Association, as of December 31, 2007, Texas had 4,356 MW installed and 1,238 MW under construction, whereas California had 2,439 MW installed and 45 MW under construction.

<sup>2</sup> One of these groups, known as the North Texas Wind Resistance Alliance, was formed in 2006 in Montague and Cooke Counties. See Chapter Three.

<sup>3</sup> AWEA, Wind Energy and Economic Development: Building Sustainable Jobs and Communities (undated), at 2, available at [www.awea.org/pubs/factsheets/EconDev.pdf](http://www.awea.org/pubs/factsheets/EconDev.pdf) ("Farmers can grow crops or raise cattle next to the towers. Wind farms may extend over a large geographical area, but their actual 'footprint' covers only a very small portion of the land...")

<sup>4</sup> In 2005, parts of Taylor and Nolan Counties were leased without options to facilitate immediate construction of the initial phase of wind farms in that area.

<sup>5</sup> The cost of a MET tower is approximately \$15,000-\$25,000 (not including the amount paid for interpretation of the raw data). Additional sums are also paid for an inter-connect study as well as environmental, avian (biological), and historical investigations. The total cost of all of these studies could easily exceed \$100,000 for a typical wind farm.

<sup>6</sup> This option, which is the subject of a separate agreement, contains a paragraph which reads as follows:

"Grant of Option to Optionee. Owner hereby grants to Optionee an option to lease all or portions of the Property in accordance with the terms and conditions of the term sheet ('Term Sheet'), which is attached hereto as Exhibit 'B,' and made a part hereof. Owner and Optionee agree that the Term terms and conditions relating to the lease and does not necessarily summarize all terms and conditions, covenants, and representations, warranties and other provisions which shall be contained in the definitive legal documentation for the lease contemplated by this Option Agreement (the 'Wind Energy Lease'). Owner and Optionee shall use commercially reasonable efforts to negotiate in good faith to agree upon a comprehensive Wind Energy Lease acceptable to each party and with the language typically required by Optionee's lenders and title company within one hundred twenty (120) days of the negotiations being initiated by Optionee, which negotiations may be initiated at Optionee's sole discretion. The Wind Energy Lease shall contain the same economic terms as described in Exhibit 'B.' Optionee shall have the right to exercise the Option Agreement at any time during the Term (as defined below) of the Option Agreement."

The dangers of this procedure are obvious. Despite commercially reasonable efforts by both parties, it may be that the parties will ultimately disagree as to the specific wording of the basic terms and

conditions contained within the "Term Sheet," or will disagree on terms not included within the "Term Sheet." On the other hand, the landowner may wish to balance the chance of a problem occurring in later drafting the lease against the up-front cost (which can be substantial) of preparing the lease in advance.

<sup>7</sup> The Sweetwater Wind Power project in Nolan County covers over 60,000 acres and consists of 512 MW, including 1.0 MW, 1.5 MW and 2.3 MW turbines. The Horse Hollow II wind project constructed by Florida Power & Light contains 735 MW and covers over 100,000 acres in an east/west distance of approximately 38 miles in Taylor and Nolan Counties. It consists of both GE 1.5 MW turbines and Siemens-Bonus 2.3 MW wind turbines. The Airtricity wind project near Roscoe, Texas was under construction at the end of 2007 and utilized 2.3 MW and 1.5 MW turbines. Additionally, AES SeaWest Wind Power is now in Phase 3 of its Buffalo Gap II Project near Nolan, Texas, which will total over 120 MW.

<sup>8</sup> Ernest E. Smith, Wind Energy Leases: Prospects and Issues (Advanced Real Estate Law Course, State Bar of Texas, 2002), p. 4. The average wind speed in southern Nolan County is approximately 22 miles per hour.

<sup>9</sup> These calculations are credited to Dr. Jimmy Neill, PhD. (landowner and wind expert, as well as retired Distinguished Professor, University of Alabama).

<sup>10</sup> Ernest E. Smith, Wind Energy in Texas, supra, at p. 6.

<sup>11</sup> The Energy Reliability Council of Texas, ERCOT, manages the electronic grid which serves the majority of Texas. The Southwestern Power Pool, "SPP," manages an electronic grid which includes the Panhandle region of Texas and extends into New Mexico, Oklahoma and other plains states. Traditionally, royalty, minimum royalty and other landowner payments are higher within the areas served by ERCOT. With the planned extension of ERCOT transmission into the Texas Panhandle (see Chapter Four), the authors recommend consideration be given to differing schedules which vary the package of landowner payments according to the grid connection.

<sup>12</sup> Merchant plant sales of electricity denote those sales made without benefit of a long term contract. Merchant plant sales are contracted either one hour or twenty-four hours in advance of delivery and reflect the current market value of electricity as it is hourly influenced by supply and demand. Such sales of electricity from a wind farm require substantial expertise due to the punitive price measures which are triggered by over- or under-delivery of contracted volumes. If successfully managed, merchant plant sales can yield greater revenues than those generated by traditional longer term power purchase agreements. Those higher revenues can justify a lower royalty schedule for a landowner contracting with an operator willing to undertake a merchant plant operation and require a higher royalty schedule from those operators who will sell electricity by the more traditional and popular power purchase agreement.

<sup>13</sup> Id.

<sup>14</sup> Ernest E. Smith, Wind Energy in Texas, supra, at p. 10.

<sup>15</sup> Ernest E. Smith, Wind Energy Leases: Prospects and Issues, *supra*, p. 5.

<sup>16</sup> Dale Rankin, et al. vs. FPL Energy, et al., Cause No. 46,138-A in the 42<sup>nd</sup> Judicial District Court of Taylor County, Texas.

<sup>17</sup> Joe O'Dell, et al. vs. FPL Energy, LLC, et al., Cause No. 06-502 in the 235<sup>th</sup> Judicial District Court of Cooke County, Texas; Terry M. Black, et al. vs. Gamesa Wind US, LLC, et al., Cause No. 06-0129 in the 271<sup>st</sup> Judicial District Court of Jack County, Texas.

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