

CURRENT ISSUES IN WIND ENERGY LAW 2010

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Lubbock, Texas
Texas Tech University School of Law
May 20-21, 2010**

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CURRENT ISSUES IN TEXAS WIND ENERGY LAW 2009

By Roderick E. Wetsel and H. Alan Carmichael

INTRODUCTION

The landscape of West Texas has changed significantly in the past decade. The exponential growth of the wind industry in the area has evoked vivid memories of the oil booms during the 1950's and early 1980's. Soon after the millennium, small towns throughout the region became hives of activity as landmen descended in droves, presenting unprepared landowners with voluminous leases and the promise of riches rivaling those of the speculators who first brought big oil to this part of the country nearly a century before.

Like any other boom, speculation was rampant. Wind companies soon began to outnumber rattlesnakes. Landowners faced, as many still do, a difficult decision as to whom to trust with their land. While development initially focused in far West Texas, around the McCamey area, developers quickly migrated east into Sweetwater, focusing their attention on the good wind capacity and available transmission lines in Nolan and Taylor Counties. The area was attractive because it not only provided the three main ingredients for development of a wind farm: (1) adequate wind capacity, (2) proximity to existing high voltage transmission lines, and (3) plenty of wide open spaces, but also was closest to the metropolitan load centers, such as Dallas/Ft. Worth, for sale of the electricity. In the years between 2002 and 2006 Sweetwater evolved from being known as the home of the world's largest rattlesnake roundup to being the wind energy capital of the world with two of the world's largest wind farms.¹

The expansive development in Nolan and Taylor Counties helped drive Texas to the national forefront of renewable energy generation. In 2006 Texas surpassed California as the nation's leading producer of wind generated electricity. This feat is made all the more astounding when one considers that the first commercial scale wind energy development occurred in California over a quarter of a century ago, while the first wind turbines did not appear on the Texas skyline until 1995. As of the end of 2009, Texas had an installed capacity of 9,410 megawatts with projects scattered throughout the rural landscape.²

With the spread of the wind boom across the state, it has become ever more essential for landowners to comprehend the fundamental principles of the wind lease and the complexities of developing a wind farm. Many of the attractive project areas are now gone and landowners are faced with increasingly long option commitments and greater uncertainty as to the ability of developers to acquire or construct the infrastructure necessary to successfully produce and sell electricity to the load centers which are often hundreds of miles away. This paper addresses these questions and other current issues in Texas wind energy law which should be of interest to Texas attorneys and landowners. The topics of discussion are as follows:

Chapter One:

The Wind Energy Lease - Before a wind farm can be constructed, a wind option and lease must be obtained from the landowner. This chapter describes the major elements commonly found in wind energy leases and, where possible, offers forms and suggested modifications.

Chapter Two:

Texas Wind Law - "Who owns the wind?" is still a troubling question for many scholars. This chapter briefly discusses the legal ramifications concerning wind rights in Texas as well as examples of laws in other states. It also gives an overview of developing litigation and case law surrounding the wind industry in the state.

Chapter Three:

Tax Abatement Issues - Chapter 3 discusses, in detail, the law and procedure regarding tax abatements in Texas for wind projects.

Chapter 4:

Challenges facing the industry - This chapter outlines past, current, and future developments regarding the transmission of electricity in Texas.

* * *

CHAPTER ONE

I. WIND ENERGY LEASE

There are currently numerous wind energy lease forms in use in Texas and other states. 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.³ 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 1-B, Exhibit "B" for a sample lease form (hereinafter referred to as "the Lease").

A. The Wind Energy Lease Option

With few exceptions, almost every wind lease in use today is predicated upon an exclusive option granted by the landowner for a given term.⁴ While early option terms ranged from two to five years, it has become increasingly more common to see option terms of five to seven years, with some as long as ten years in the Panhandle. The increase in option term length has been caused in large part by the decrease in readily available transmission lines for distribution of the power generated and the uncertainty as to when the problem will finally be alleviated. The option may be contained within the terms of the wind lease or the subject of a separate agreement. See Appendix 1-B 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. \$1.00 to \$5.00 per acre) often 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 the expenses of other tests and studies conducted during the option term.⁵ Additionally, they maintain that during the term of the option 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 reasonable notice has been given to the landowner, with approval by the landowner of routes of access to and upon the property;
2. that the optionee's activities on the property not unreasonably interfere with the landowner's farming, ranching, and recreational 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.

With the increased length of option periods and the greater uncertainty of transmission many landowners have begun to include milestones within the option period to ensure that the developer will make a good faith effort in constructing the project. Milestones often set out specific time periods in which the developer must install meteorological towers, sign an interconnection agreement, perform required studies, obtain necessary government approvals and provide the landowner with maps and site plans. Typically, however, wind companies agree to such milestones only with the largest and most essential landowners in a wind project.

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."⁶

B. The Wind Farm

Rarely 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.⁷

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). From 2006 through 2008, developers of the Horse Hollow II, Sweetwater Wind and Eon 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.⁸

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):

(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/kwh x 5,256,000 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 x 4% (0.04) 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/MW.⁹

The Federal Production Tax Credit (FPTC) provides approximately a 2 cent per kilowatt hour tax benefit for the first ten years of the operation of a wind farm. From 1999 to 2008, the FPTC has expired on three separate occasions, each time causing a dramatic slowdown in the wind energy industry and contributing to the boom/bust cycle which has historically plagued the industry. The FPTC was set to expire on December 31, 2008 and despite bipartisan support, the U.S. Congress failed to pass several bills throughout 2007 and 2008. These failures sent a shudder through the wind energy industry which hoped for a multi-year extension to ensure certainty and stability for further development. On several occasions the FPTC failed to pass due to political posturing. During the summer of 2008, as oil prices continued to rise, the FPTC was burdened with oil related issues which hampered its bipartisan support. It was not until October 3, 2008, as part of the Emergency Economic Stabilization Act of 2008, that the FPTC finally did get new life. Unfortunately the FPTC did not receive the multi-year renewal sought by the industry and was only extended to December 31, 2009. Then, on February 17, 2009, the American Recovery and Reinvestment Act of 2009 again extended the FPTC through December 31, 2012. This law also provided for an equivalent financial grant in an amount of up to 30% of the applicant's tax basis in the "specified energy property."

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 2. 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 construction 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. The lessee may be very resistant to such changes, since at the outset it may not be known whether substations and other facilities will be placed on the leased property.

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 the life of the wind turbines installed (i.e. 20 to 25 years) as well as 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 fifty (50) years, commencing on the effective date and expiring on [__ date __], or
2. an initial term which may be as short as one to three 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.¹⁰

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 today is usually 50 years, including the time required in construction of the project, although wind companies sometimes propose even longer lease terms.

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 3a.
- b. an amount paid on the lease commencement date calculated by multiplying a dollar figure (e.g. \$5,000.00) 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. \$4,500.00) 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 such as \$75-\$100 per rod or a set annual fee 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,¹¹ and depending upon whether the electricity is sold by merchant plant or long term power purchase agreement.¹² 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 2009, the "standard" royalty is likely to remain at 4% to 4.5%, 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% 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. \$4,500) per megawatt or \$7,500.00 per turbine per year installed on the land; or (b) \$[_____] (an amount usually figured on a per acreage basis, e.g., \$20.00 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 3(c)(iii) 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.¹³

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 larger 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. \$25,000.00) 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. Over the last several years, suits were filed in Taylor, Cooke and Jack Counties although to date only the Taylor and Jack County cases included landowners as defendants. See Chapter Two.

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 1-B.

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 4. 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 5.

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 6.

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

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:

- A. 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;
- B. The landowner must give notice to the wind lessee of any lease, grant or conveyance involving the land or any part thereof; and
- C. 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

Texas Wind Law

I. OWNERSHIP, RESERVATIONS AND CONVEYANCES OF "WIND RIGHTS"

In the early years of wind development in Texas, the issue regarding landowner rights in wind seemed rather far-fetched.¹⁴ Given the developments of the past decade and the proliferation of wind generated energy across Texas, not to mention the explosion of wind royalty owners and lessors in the state, the question is no longer just academic. It is now relatively common for landowners to transfer or withhold their "wind rights" in much the same way landowners have been conveying and reserving mineral interests for over a century. The real question is: "Can they?"

Some of the first writers on the subject relied upon established common law doctrine for guidance. Like wild animals or percolating water, wind does not have quantifiable value until it has been reduced to possession.¹⁵ In Texas, an individual does not own a wild animal so long as the animal remains wild and unconfined.¹⁶ Until the animal is captured and confined, ownership of the animal remains in the state.¹⁷ Of course, wind is easily distinguishable from wild animals. Percolating water may be slightly more analogous. Under Texas law, absent malice or waste, a surface owner has the

right to take all the percolating water he can capture from beneath his land.¹⁸ Unlike wild animals, which are owned by the state, percolating water is owned by the surface owner. In “The Severance of Wind Rights in Texas,” Austin attorney Lisa Chavarria points out that under Texas common law the right to the wind which flows across the land belongs to the surface owner.¹⁹ She cites the Latin dictum, “*Cujus est solum, ejus est usque ad coelum et ad inferos*,” which roughly translates as, “to whomever the soil belongs, it is theirs up to the sky and down to the depths.”²⁰ Under these theories it may be argued that the wind belongs, at least initially, to the owner of the surface estate.

Because the first commercial scale development of wind energy in Texas did not occur until 1995 and the proliferation of turbine installation did not follow until 2003 or after, Texas has not given much direction to landowners or practitioners as to whether landowners can sever wind rights. The first issue is how to define “wind rights.” When the wind starts to produce income on a piece of land, or has the potential to produce income, there are two main concerns. First, is the right to convey the landowner’s right to payment under a wind lease. This is the most common conveyance to date with regard to wind leases. The conveyance of payments often takes the form of a recorded stipulation agreement or even a simple payment directive to the wind company. The main concern with the method of conveying a right to payment is the intended longevity of the payment right. Does the landowner wish to permanently grant a payment interest in the transferee and create an ownership similar to a non-participating royalty interest owner, or does the landowner wish to convey a right to payment only under this particular lease? This distinction can have far reaching implications as many wind leases are ephemeral documents which come and go with the expiration of their option periods (or the failure of a poorly funded developer).

The second and more controversial issue refers to a true severance of rights, in which the “wind estate” is separated from the surface in the same way that the mineral estate is severed. This procedure includes severing the executive rights into a third party other than from the owner of the surface estate. It creates a new set of conflicts and issues which have yet to be litigated. To date there is no Texas case law or legislation on the issue.

There is some precedent outside of Texas. California has produced at least one significant decision with regard to severance of wind rights. In *Contra Costa Water District v. Vaquero Farms, Inc.*²¹ the Contra Costa Water District argued that the landowners had a right to sever wind rights from the surface estate of the property.²² The water district had condemned property of Vaquero Farms in an area of existing wind energy development.²³ A dispute arose regarding valuation of the property. Vaquero wanted the value of the wind included with the condemnation payment while the water district sought to exclude it,²⁴ which caused great disparity in the appraisal value of the property. Under California law a condemning authority cannot be required to take more severable rights than it needs for public use. In this case, since the water district intended to use only the surface it did not want to take the wind.²⁵ The court looked to established precedent, including the severance of oil, gas and mineral rights in condemnation actions, for guidance.²⁶ It held that because the landowner had the ability to lease the property and make a profit from the wind, it had a “substantial right” in the wind. It ruled: “The lease stands as irrefutable evidence that one may have a right to use windpower rights without owning any interest in the land.”²⁷

Therefore, under California law, a condemning authority cannot be required to take more severable rights in property than what is needed for the public use. The Court held that the wind could be severed from the surface and owned separately.²⁸ Comparing wind to oil and gas, the court went on to state that, “The right to generate electricity from windmills harnessing the wind, and the right to sell the power so generated is no different, either in law or common sense, from the right to pump and sell subsurface oil or subsurface natural gas by means of wells and pumps.”²⁹

The rule in California could and probably should become the law in Texas. However, the case is fact specific because it only deals with eminent domain. The larger issue in Texas will be whether or not an individual in a private land transaction can sever the wind from the surface. This is a subject upon which there is contrary authority in some other states. The legislature in South Dakota recently enacted Section 43-13-19 of the South Dakota Codified Law which reads:

“No interest in any resource located on a tract of land and associated with the production or potential production of energy from wind power on the tract of land may be severed from the surface estate as defined in § 45-5A-3, 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 wind power has occurred on the land within five years after the lease began. The payment of any such lease shall be on an annual basis.”

North Dakota also has a similar statute.³⁰ It is probable that other states will likewise adopt comprehensive statutory schemes regarding wind in the near future.

A Federal Court decision in the New Mexico district is the most recent decision building precedent for the conveyance of wind rights. In *Romero v. Bernell* the Court was faced with a challenge to the partition of land which held great wind energy potential but was yet to be developed.³¹ The Respondent argued that wind should be analogous to minerals in situ, stating that the land should be partitioned in with consideration given to its potential value.³² Citing an earlier edition of this paper, the Court held that under New Mexico law the right to harvest wind energy is an inchoate interest in land and does not become vested until reduced to possession, therefore, because the land was undeveloped for wind energy purposes, the Court did not take into account the potential value of any “wind estate” with regard to partition.³³

Given the developing nature of the law concerning the conveyance of wind, any conveyance or reservation of wind rights should be accompanied by a disclosure of the uncertainty and risks involved in doing so. Practitioners may also want to consider incorporation of 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 to be conveyed or reserved. For an excellent discussion of this subject, see the article by Lisa Chavarria referenced above.

II. Litigation

Perhaps the most well publicized litigation concerning a wind farm in Texas is the case of *Rankin v. FPL Energy LLC*. This litigation involved a suit by disgruntled neighboring landowners who sued both the Lessee and the landowners in the Horse Hollow Wind farm in Taylor County, Texas.³⁴ The plaintiffs sought injunctive relief against the defendants in order to prohibit the placement of “monster wind turbines” near their land. They asked for compensatory damages for their loss of property value as well as the “destruction of their homes and lifestyle.”³⁵ In voluminous pleadings, the plaintiffs also brought claims of both public and private nuisance as well as trespass, arguing that the nearby turbines were unsightly, created noise, reduced property values, and ruined the aesthetic value of the land.

At the beginning of the *Rankin* case the trial court denied preliminary injunctive relief to the plaintiffs and granted defense summary judgment motions, which limited the suit to a noise based nuisance claim. The case was originally tried before a jury in Taylor County in December 2006 after the landowner defendants were non-suited by the plaintiffs. The defense presented its case with a bit of theatrics by comparing the noise level in the court room after hours to that on the wind farm at the distance which the plaintiffs were complaining. The court room turned out to be slightly louder. Theatrics aside, following a two week court battle, the jury determined that the turbines were not a nuisance and judgment was entered for the wind company. In its instruction the trial judge told the jury, “Under the laws of the State of Texas, a condition that causes aesthetic changes to the view, scenery, landscape, or beauty of an area is not a nuisance.”³⁶

The Eastland Court of Appeals agreed with the trial court.³⁷ In its decision, the Court referred to the century old case of *Shamburger v. Scheurrer*,³⁸ “. . . (The) law will not declare a thing a nuisance because it is unsightly or disfigured, because it is not in a proper or suitable condition, or because it is unpleasant to the eye and a violation of the rules of propriety and good taste. . . .”³⁹ The Court also did not accept arguments by the plaintiffs that the negative emotional response caused by the erection of the turbines was adequate cause for relief.⁴⁰ Review of the Eastland Court’s *Rankin* decision was denied by the Texas Supreme Court.

In summary, the Court of Appeals held that the installation of wind turbines in a rural area was not a nuisance. It pointed out that Texas case law recognizes very few restrictions on a landowners use of his or her own property.⁴¹ To allow neighboring landowners to bring a nuisance action against lawful conduct based on aesthetic concerns, the Court reasoned, would be to allow neighbors to effectively zone the surrounding property.⁴² It chose not to interfere with long standing precedent and upheld the trial court’s ruling.

In 2006, suits similar to the *Rankin* case were filed in Cooke County and in Jack County.⁴³ Both lawsuits were based on complaints similar to those in Taylor County. In the Jack County lawsuit, however, the landowners brought counter claims against the plaintiffs regarding tortious interference with their contractual relationship with the wind company. The Cooke County case was settled in 2007. The Jack County case was also settled with the entry of an agreed judgment of dismissal on July 8, 2008. At this time, no additional neighboring landowner suits have been filed in Texas, although such could happen as the industry moves into the Texas Hill Country, an area which has opposed wind development.

In 2008, some of the plaintiffs in the original Taylor County lawsuit filed a new suit against the Taylor County commissioners and the county judge to set aside tax abatements previously granted in the county to wind companies.⁴⁴ This suit was based upon Attorney General Opinion GA-0600, which is discussed in more detail in Chapter Three. The plaintiffs filed a non-suit in July 2008 and the case has not yet been refiled.

Other litigation regarding wind in Texas concerned the environmental impact of wind development. In December 2007, a nine-member environmental group, which included the King Ranch in South Texas, filed suit in federal court in Austin against developers of wind farms in Kenedy County and sought an injunction against the Texas Land Commissioner Jerry Patterson and the Public Utility Commission of Texas.⁴⁵ The suit claimed the wind companies had not sufficiently studied the impact of wind farms on wetlands, habitat, endangered species and migratory birds. On August 4, 2008, U.S. District Judge Lee Yeakal dismissed the lawsuit. A written order in the case and possible appeal are pending.

Although litigation involving wind energy has been sparse, future lawsuits may be expected between wind developers and oil and gas operators, as well as the owners of “wind rights” and mineral owners, regarding the conveyance and reservation of “wind rights.”

CHAPTER THREE

CURRENT AND FUTURE DEVELOPMENTS

As of the last quarter of 2010 there were 9,410 MW of installed wind generation capacity in ERCOT.⁴⁶ In the summer of 2008, the Texas Public Utilities Commission voted to allow 18,000 MW of wind capacity into ERCOT. Applications for over 100,000 MW of wind generation are currently under review at ERCOT,⁴⁷ making development, and probable over-development, certain in Texas over the next few years.

Eighty-five percent of the electricity consumed in Texas is in the ERCOT region, whose rates for transmission service and wholesale power are exempt from FERC regulations.⁴⁸ However, most of the Panhandle falls under the reliability council of the Southwest Power Pool (SPP).⁴⁹ The SPP region covers eight states: Arkansas, Kansas, Louisiana, Mississippi, Missouri, New Mexico, Oklahoma, and Texas.⁵⁰ At the present, it has applications for 4,470 MW in potential wind projects, 1,113 MW of which are in the Texas Panhandle alone.⁵¹

I. BACKGROUND

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 so 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, which was 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 exceeded the limited ability of the transmission infrastructure to reliably export power from the region. Despite the “open access” provisions adopted in Senate Bill 373 and passed in 1995, developers were now characterized as “piling on” to the grid and were 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.

The curtailment of the McCamey area projects was a prime example of how siting and development of wind projects could occur much more rapidly than transmission expansion.

In Senate Bill 20 of the First Called Session of 2005, the 79th Texas Legislature expanded the Renewable Portfolio Standard (“RPS”) to 5000 MW by the year 2015 with a target of 10,000 MW by 2025. As of November 19, 2008, capacity of existing projects in Texas was 6,297 MW with an additional 2,469 MW under construction. Recognizing that the goal of 10,000 MW would require upgrades to the transmission grid in order to service existing resource areas as well the resource rich areas of the Panhandle, the Texas Legislature required the Public Utility Commission of Texas (PUC) to designate Competitive Renewable Energy Zones (CREZ).

II. DESIGNATION OF CREZ

The PUC required ERCOT to evaluate Texas renewable energy resources 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 included a map with a summary of the best regions having development potential of at least 1000 MW each. The PUC later increased the MW goal to 4000 MW.

In December of 2006, the Commission adopted rules implementing the CREZ process. (P.U.C. Subst. R. 25.174). The rules contemplated that the Commission would issue a final order designating CREZ by July 5, 2007.

On June 15, 2007, Chairman Paul Hudson issued an order extending the time for issuance of a final order and requested briefing on threshold legal and 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 a final order in PUC Docket 33672.

On October 2, 2007, the PUC issued an interim order designating five areas of Texas as “CREZ” areas, 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.

By Interim Order in Docket 33672, the PUC ordered ERCOT, along with its stakeholders, to design transmission plans for four specified scenarios of wind generation development in the areas defined by the PUC. Over 276 individuals and vendors participated in the study. The ERCOT System Planning staff and stakeholders submitted into the PUC CREZ Docket (33672) on November 11, 2007 (document 984), a list of issues, which included proposed and existing levels of wind generation. It proposed four levels or tiers, as follows:

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Crez Wind Capacity	5,150	11,553	17,956	17,516
Base Case Wind	6,903	6,903	6,903	6,903
Total Wind	12,053	18,456	24,859	24,419

On July 17, 2008, the PUC chose Scenario 2 with a threshold of 18,456 MW. The resulting ERCOT transmission layout is depicted in Appendix 16-2, and a time line for construction is shown in Appendix 16-3.

III. RECENT DEVELOPMENTS

A. Production Tax Credit

The growth of the wind energy industry can also be attributed to the utilization by developers of the Production Tax Credit (PTC) created under the Energy Policy Act of 1992.⁵² The PTC provides an income tax credit for the production of electricity from qualified wind and other sources of renewable energy with the current value being two cents per kilowatt-hour of electricity produced.⁵³ Although Congress has extended the PTC for one or two year extensions at a time, it has also allowed it to lapse in the years 2000, 2002 and 2004.⁵⁴ The surge of the industry in the past three years stems from the uninterrupted PTC which has given the industry a steady base for expansion.⁵⁵

When the PTC was set to expire on December 31, 2008, the industry feared a slow-down in growth which threatened 116,000 jobs and \$19 billion in investments.⁵⁶ Wind companies worried that a short term extension of the PTC would create a “boom-and-bust” cycle, making planning tricky and stability within the industry uncertain.⁵⁷

On April 10, 2008, the United States Senate approved the addition of the Cantwell-Ensign amendment providing for a one year extension of the PTC to the Housing Stimulus Bill.⁵⁸ This bill

continued the two cents per kilowatt hour incentive to facilities that produced electricity from renewable resources and provided that credit could be claimed for 10 years.⁵⁹ The bill did not pass the House of Representatives. However, on October 3, 2008, the House of Representatives did pass the Emergency Economic Stabilization Act of 2008 by a vote of 263 to 17. As part of a \$700 billion bail out package for the financial industry, the PTC was extended and signed into law by President George W. Bush the same day.⁶⁰ Then, on February 17, 2009, newly elected President Barack Obama signed into law the American Recovery and Reinvestment Act, which extended the Federal Production Tax Credit through December 31, 2012, and provided that wind facilities are now eligible for a 30% Investment Tax Credit. It also provided for a Federal Grant Program through the Department of Treasury that issues grants for up to 30% of the cost of a new wind energy facility.

B. PUC and Transmission

On June 19, 2008, the PUC adopted rules and criteria for transmission service providers with the ability to build the transmission projects identified in the final CREZ order. The requirements sought to enable and promote competition in the construction of the transmission projects and were a change from the old way of building transmission, in which only a utility was allowed to build transmission within its service territory.⁶¹ Interim Order in Docket No 33672 designated the areas of Texas where transmission would be built to encourage the development of wind generation.⁶² As the most beneficial and cost effective goal for consumers, the order provided for transmission development to all of the designated CREZ areas with a threshold of 18,000 MW of wind generation for use in the ERCOT grid.⁶³

This order by the PUC encouraged wind generation and development to the extent that the Texas Panhandle soon became a hotbed of competition for wind energy developers. It also caused other developers, such as Mesa Power, fearing overload of the public transmission lines, to make plans to build their own private transmission lines.

The PUC also dealt with the issue of how to manage excess wind development and to effectuate dispatch priority. In its order in Docket 33672, the PUC did not entirely seal the fate of non-CREZ wind energy projects by denying access to public transmission lines, but did state that, "Developers within a CREZ that submit evidence of financial commitment in a dispatch priority proceeding would likely fare better than other developers."⁶⁴

Dispatch priority rules are urgently needed to eliminate the uncertainty and risk held by developers and investors. PUC Substantive Rule 25.1749(c)(6) requires that within 45 days of an application for a Certificate of Convenience (CCN) for transmission improvements filed pursuant to the order designating the zone a CREZ, each developer for that CREZ shall post a letter of credit or other collateral in an amount equal to 10% of the developer's pro rata share of the estimated capital cost of the transmission improvements. If the developer fails to deposit the funds, the Commission may take appropriate action, including reconsideration of the CREZ designation, dismissal of the CCN application, or allowing another developer to make the deposits instead. Under this Rule a typical wind project of 400 MW, at an estimated cost of approximately \$25,000 per MW, would require a deposit of approximately \$10 Million.

Today, with the current adverse economic conditions and PTC uncertainty, the PUC is working with wind industry stakeholders and financial participants to establish policy guidelines to mitigate inherent risk. PUC Project Number 34577 established the Proceeding to Develop Policy Relating to Excess Development in Competitive Renewable Energy Zones. It held its first workshop on September 17, 2008. Workshop participants responded to ERCOT staff questions filed previously in August, 2008. The group outlined issues regarding dispatch priority as well as classes of investors or developers based on financial commitment.

C. National Issues

Transmission is an issue of national concern. The problem in dealing with transmission for the entire country is, as in Texas, one of getting wind power from the mostly rural windy areas to the metropolitan load centers that need the electricity the most.⁶⁵ Since the nation's highest wind potential is in the middle of the country, from Texas north to the Dakotas, building transmission lines to the east and west coast areas will be expensive and controversial.⁶⁶

Recently, Senate Majority Leader Harry Reid (S.B. 2076) and Representative Jay Inslee (H.R. 4059) introduced legislation to establish National Renewable Energy Zones (NREZ's).⁶⁷ This bill seeks to overcome current transmission constraints by removing obstacles for the construction of transmission in areas with potentially great sources of renewable energy.⁶⁸ Also, in February 2007, the Federal Energy Regulatory Commission entered an order allowing greater access to transmission lines for power generators of all types, including renewable energy projects.⁶⁹

* * *

CONCLUSION

Over the past several years, the wind energy industry in Texas has come of age. As noted earlier, 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 very little case law to act as precedent in guiding practitioners. Similarly, there are no legal canons regarding wind ownership in Texas, and the art of conveying and reserving wind rights remains to be developed.

To date, wind energy companies have invested hundreds of millions of dollars in Texas and have plans to continue to make Texas the most popular site for wind development in the United States. Although the current economic situation has caused development to slow down, the Texas Public Utility Commission has supported and encouraged further growth. The implementation of the CREZ process should facilitate development of the rich wind resources in the Texas Panhandle. Indeed, the land rush to the Panhandle has already begun. As early as 2005, landmen moved into towns such as Pampa, Miami, Mobeetie, Floydada, Childress and Silverton. In 2007, 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) and by the end of that year his company had leased over one hundred thousand acres. In 2008, Pickens placed the largest turbine order in history (667 turbines at a cost of two billion dollars) for this new project. By the summer of 2009, the Texas Public Utility Commission had selected the contractors for the construction of new transmission lines. Work is expected to begin as early as the fall of 2009.

Despite national economic woes, the wind keeps blowing. It should play a vital role in the energy development in this country for years to come, creating exciting new opportunities for lawyers and landowners alike.

* * *

This paper is a revision of a former article prepared by Roderick E. Wetsel, H. Alan Carmichael and Lisa Chavarria entitled "Emerging Issues in Texas Wind Energy Law: Leases, Tax Abatements, and Ownership of Wind Rights," published in Vol. 28, No. 3 of the March 2004 issue of the State Bar of Texas Oil, Gas and Energy Resources Section Report, as well as other papers prepared by the same authors. The authors of this paper wish to recognize the contribution by Lisa Chavarria, who is now with the firm of Stahl, Bernal & Davies, L.L.P. in Austin, Texas, in the research and preparation of the original article as well as Frank Horak of Astek Wind Energy, Austin, Texas in the preparation of Chapter 4 of the original paper..

The authors also gratefully acknowledge the assistance of Jeffrey L. Allen and Faith E. Feaster of the firm of Wetsel & Carmichael, L.L.P. for the 2009 revision. Jeff is a 2003 graduate of Texas A&M University with a B.A. degree in history and received both MBA and JD degrees from Texas Tech University in 2007. He was admitted to the Texas bar in 2007 and the state bar of New Mexico in 2008. Faith is a 2005 graduate of Hardin-Simmons University with a Bachelor of Music in Piano Performance and received her JD degree from Texas Tech University in 2008. She was admitted to the Texas bar in 2008.

* * *

END NOTES

1. Horse Hollow Wind Energy Center in Nolan County is currently the world's largest with 735.5 installed megawatts. It covers 120,000 acres and includes 421 turbines capable of generating enough electricity to power more than 220,600 homes. The Sweetwater Wind Farm has 585 installed megawatts and is the second largest in Texas and covers over 60,000 acres. The Roscoe Wind Farm, also located partially in Nolan County, is planned to be the world's largest, surpassing the Horse Hollow project, with 781.5 megawatts. It includes a total of 627 wind turbines and produces enough electricity to power of 260,000 homes. Construction of this project is continuing in 2009.

2. American Wind Energy Association, U.S. Wind Energy Projects (Year End 2009 Market Report, January 2010) at <http://www.awea.org/projects/>.

3. AWEA, Wind Energy and Economic Development: Building Sustainable Jobs and Communities (undated), at 2, available at 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...")

4. 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.

5. 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.

6. 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.

7. The Sweetwater Wind Power project in Nolan County covers over 60,000 acres and consists of 585 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 735.5 MW and covers over 120,000 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 (now Eon) wind project near Roscoe, Texas which has been under construction since 2007 utilized both 2.3 MW and 1.5 MW turbines. Additionally, the AES SeaWest Wind Power Buffalo Gap II Project near Nolan, Texas, totals over 120 MW.

8. 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.

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

10. Ernest E. Smith, Wind Energy in Texas, supra, at p. 6.

11. 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.

12. 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.

13. *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).

14. In a 2002 paper entitled "Wind Energy Leases, Propsects and Issues," Professor Ernest E. Smith of the University of Texas School of Law stated, "At first blush, the issue of landowner rights in wind appears at best academic, at worst rather silly. Ernest E. Smith, "Wind Energy Leases: Propsects and Issues" Advanced Real Estate Law Course, State Bar of Texas, 2002, p 5.

15. *Id.*

16. *Jones v. State*, 45 S.W.2d 612, 613-14 (Tex. 1931).

17. *State v. Bartree*. 894 S.W.2d 34 (Tex. App. – San Antonio 1994, no pet.).
18. *Sipriano v. Great Spring Water of America, Inc*, 1 S.W.3d 75 (Tex. 1999).
19. Lisa Chavarria, “The Severance of Wind Rights in Texas”, State Bar of Texas Oil, Gas and Energy Resource Law Section Report, Volume 32 Number 2, December 2007.
20. *Id.*
21. *Contra Costa Water Dist. V. Vaquero Farms, Inc*. 68 Cal.Rpter2d 272 (Cal. Ct. App. 1997).
22. *Id.* at 275.
23. *Id.*
24. *Id.* at 273
25. *Id.*
26. *Id.*
27. *Id.* at 277.
28. *Id.* at 278
29. *Id.*
30. North Dakota Century Code 17-04-04
31. *Romero v. Bernell*, 603 F.Supp.2d 1333 (D. N. M. 2009)
32. *Id.* at 1334.
33. *Id.* at 1335.
34. Plaintiff’s Eighth Amended Petition and Request for Injunctive Relief at 21, *Rankin v. FPL Energy, LLC*. (Cause No. 46138-A, 42nd Judicial District, Taylor County, Texas).
35. *Id.*
36. *Rankin v. FPL Energy LLC*, 266 S.W.3d 506, 508 (Tex App. -- Eastland 2008, pet. denied).
37. *Id.* At 513.
38. *Shamburger v. Scheurrer*, 198 S.W. 1069, 1071-72 (Tex. Civ. App. – Fort Worth 1917, no writ).
39. *Rankin*, 266 SW3d at 510.
40. *Id.*

41. *Id.* at 512.

42. *Id.*

43. *Joe O'Dell, et al. vs. FPL Energy, LLC, et al.*, Cause No. 06-502 in the 235th 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 271st Judicial District Court of Jack County, Texas.

44. *Dale Rankin, et al. vs. Commissioners Court of Taylor, County, Texas, et al.*, Cause No. 8387-D in the 350th Judicial District Court of Taylor County, Texas.

45. *Coastal Habitat Alliance vs. Jerry Patterson, Commissioner of the Texas General Land Office, et al.*, Civil Action No. A07CA 985LY, in the United States District Court for the Western District of Texas, Austin Division.

46. American Wind Energy Association, U.S. Wind Energy Projects (Year End 2009 Market Report, January 2010) at <http://www.awea.org/projects/>.

47. *Id.*

48. *Electricity in Texas*, Michaels, Robert J., Texas Public Policy Foundation, (Feb. 2007) at 3.

49. *Id.*

50. Southwest Power Pool Electric Energy Network, *About SPP*, at <http://www.spp.org/section.asp?pageID=1> (last visited April 24, 2008).

51. Walker, Rick, *Wind Energy Development in the Southwest Power Pool Region*, The Wind Coalition..

52. American Wind Energy Association, *Production Tax Credit Extension*, at <http://www.awea.org/legislative/> (last visited April 3, 2008).

53. *Id.*

54. *Id.*

55. *Id.*

56. American Wind Energy Association, *Support an immediate full value, long-term extension of the PTC*, <http://www.awea.org/legislative/pdf/PTC%20Fact%20Sheet.pdf> (last visited April 3, 2008).

57. *Id.*

58. American Wind Energy Association Statement on Addition of Cantwell-Ensign Amendment to Senate Housing Stimulus Bill, http://www.awea.org/newsroom/releases/Cantwell_Ensign_Amendment_041008.html (last visited December 29, 2008).

59.*Id.*

60. *Wind, Solar Tax Credits Extended in \$700 Billion Bail-Out*, Environment News Service, <http://www.ens-newswire.com/ens/oct2008/2008-10-03-02.asp>, (last visited December 12, 2008).

61. Barry T. Smitherman, Public Utility Commission of Texas Senate Business and Commerce Committee, October 6, 2008, http://www.puc.state.tx.us/about/commissioners/smitherman/present/pp/Sen_Fraser_CREZ_100308.pdf, (last visited December 12, 2008).

62.*Id.*

63.*Id.*

64.*Id.*

65. *Move Over, Oil, There's Money in Texas Wind*, New York Times, February 23, 2008, at http://www.nytimes.com/2008/02/23/business/23wind.html?_r=4&pagewanted=2&ref=business&oref=slogin (last visited on December 30, 2008).

66.*Id.*

67. American Wind Energy Association, *Support Legislation to Create National Renewable Energy Zones*, http://www.awea.org/policy/documents/Transmission_Fact_Sheet.pdf (last visited on December 29, 2008).

68.*Id.*

69. Federal Energy Regulatory Commission, *Preventing Undue Discrimination and Preference in Transmission Service*, 18 C.F.R. 35 and 37, (Issued Feb. 16, 2007, <http://www.ferc.gov/whats-new/comm-meet/2007/021507/E-1.pdf> (last visited December 30, 2008).

APPENDICES

FORMS AND INSTRUCTIONS

The following forms are either used with permission or have been developed by the authors for this paper.

As with all forms, these forms are included for illustrative purposes only and should not be used unless independent analysis and consideration is given by a licensed attorney as to their applicability to a given fact situation.