

(Speech by Bernard E. Nordling, SWKROA Assistant Executive Secretary, at the 55th annual meeting of the Southwest Kansas Royalty Owners Association in Hugoton, Kansas, on April 26, 2003)

GUIDELINES FOR LANDOWNERS IN NEGOTIATING WIND ENERGY LEASES

INTRODUCTION

You may wonder why wind energy should be a topic for discussion at the annual meeting of the Southwest Kansas Royalty Owners Association but the answer is easy. Many of our members are landowners as well as being mineral owners and with the weakened farm economy, there is a tremendous amount of interest among landowners in wind power development as a potential source of income.

In a recent article appearing in the Electricity Forum News, the American Wind Energy Association is predicting that wind may be the next cash crop harvested by some American farmers. Currently, wind generates less than one per cent of the nation's power but with big improvements in wind power technology, with the need to produce environmentally clean power, and with financial incentives offered by both federal and state governments, wind is becoming the fastest-growing power source. The Wind Energy Association predicts six per cent of America's power will come from the wind by the year 2020.

The big wind turbines require large areas of land with strong, steady winds. **The top five states for wind energy potential are North Dakota, Texas, Kansas, South Dakota and Montana in that order.** According to the Wind Energy Association, the potential for wind power is enormous. It estimates that the wind could produce over ten billion kilowatts annually, **three times the amount of power the United States now uses.**

The federal government has provided several incentives to encourage wind energy development, including the Farm Security and Rural Investment Act of 2002 and the Wind Energy Production Tax Credit which is a per kilowatt-hour tax credit for wind-generated electricity which is available during the first 10 years of operation. There is also the Renewable Energy Production Incentive providing financial incentive payments for electricity produced and sold by new qualifying renewable energy generation facilities. Double-declining balance, five-year depreciation is also available. www.windustry.org.

Numerous states are providing incentives as well. As noted above, Kansas is the state with the nation's third largest wind energy potential. According to the U.S. Energy Information Administration, Kansas is one of the four states with the most land near existing transmission lines suitable for wind energy development, making it a leading candidate for utility-scale wind energy development. **As a tax incentive, Kansas offers K.S.A. 79-201 which exempts renewable energy property from the state property tax.**

NO PERSONAL EXPOSURE TO WIND ENERGY LEASES UNTIL TWO YEARS AGO

Personally, since my retirement in 1993 I have had no occasion to be interested in wind energy development in Kansas until in recent months. My first exposure to wind energy was as a member of the Agricultural and Mineral Committee of the Kansas University Endowment Association in the spring of 2001. The Association, which owns a quarter section in Gray County adjacent to the Montezuma wind farm, **was asked by the Florida Power & Light Energy's Gray County Wind Energy, LLC, to execute a wind non-obstruction, noise, shadow and overhang easement.** A decision was made by the committee not to recommend the execution of the easement at the time. My personal observation of the proposed easement was that it was pretty one-sided and overreaching. In my mind, there were numerous objectionable provisions. **One particular provision coming to mind was that it was a perpetual easement running with the land so long as the wind farm existed and the easement could not be terminated by the Owner under any circumstances.**

My next exposure came several months later when in the fall of 2001 I innocently told a close friend in Lawrence that I would be glad to look over a wind farm lease she and her family were being asked to execute on some 5,600 acres of land they owned in Texas. I was sort of curious about what one of those wind energy leases looked like and I volunteered to look at it for her without charging anything. **BIG MISTAKE!** The lease she brought over to the house was 31 pages long, plus a three page memorandum of lease!

I started going through the lease and the more I read, the more upset I became! It turned out to be the most one-sided, unconscionable, over reaching contract I had ever examined in my entire fifty-four years of law practice! Literally, by the time I reached Page 15 and 16, I started crossing out whole pages which were so far over reaching, one-sided and unfair, it was disgusting!

My first advice to my friend was that she needed to hire an attorney in Texas to protect her interests and try to negotiate better lease terms. They were eventually able to negotiate somewhat better terms but there are still many objectionable provisions in the lease and they were basically told "take-it-or-leave-it."

UNFAVORABLE LEASE TERMS

I won't bore you with the gory details of the contract, but just to give you an idea of some of the sad terms of that agreement, the lease is actually perpetual with no termination rights on the part of the landowner without going to court. The Texas lease provided for a construction period not to exceed five years with only a nominal payment and then the initial lease term begins and extends for a period of twenty years once construction is completed.

The lessee has the option to renew the lease for like periods of ten years each, plus an indefinite number of other ten year extensions if producing electricity in paying quantities. The lease can be terminated at any time by the lessee by giving thirty days notice of termination to the landowner. No such rights to terminate were given to the landowner without filing suit.

Other objectionable provisions of the Texas wind energy lease, not necessarily in order of importance, were:

1. **The lease covered 5,600 acres but not all of the land would necessarily be used for wind energy development.** The tenant was given the exclusive use of the land for wind development and allied purposes. The tenant had the right to use the property for one project or could divide it into multiple separate projects. Also, once the lease was signed, the Owner has to give sixty days written prior notice to Tenant for any use of the land other than for hunting, ranching and agricultural purposes. **The way I read that provision, the landowner must get written permission to build a home or to lease the land for oil and gas purposes.**
2. **It was almost impossible from the fine print of the lease to determine the exact amount to be paid for rent.** There were provisions for payment of three percent of the gross proceeds from the sale of electricity but it took two to three pages to define what was included and excluded from determining gross proceeds. There was also a minimum annual rental payment of \$10,000 per year. **Initially, the compensation was to be \$2,000 per tower but I am happy to report, my friend and her family were able to negotiate more favorable terms of a minimum rent of \$10,000 per year, or \$3,000 per tower per year, or \$0.001 per kilowatt hour for all electricity generated per year, or the sale price of 2,000 megawatts per year, or 4% of gross revenue of electricity produced and sold per year, whichever was greater each year.**
3. **There was initially no inflationary factor built into the lease.**
4. **There were no provisions to protect the landowner from wind or soil erosion or for the landowner to designate the location of roads.**
5. **The tenant had the right to assign the lease without written consent from the landowner.**
6. **The landowner had to agree to any mortgage to the property as well as agree to any assignment of the mortgage.** Four pages of the lease deal with the duties of the landowner with respect to mortgagees or assignees of mortgagees, including the requirement to execute a new lease upon written notice.
7. The lease requires landowner to execute additional documents, without additional consideration, in order to evidence Owner's grant of easement to the Tenant without spelling out the terms of such easements.
8. The lease contains provisions where the landowner is required to indemnify the tenant without similar provisions to protect the landowner.

9. **Many of the lease provisions are too broad for the purpose granted.**
10. **The landowner is required to execute a Memorandum of Lease so the full lease document does not have to be placed of record.**

CONCERNS OVER FAILURE TO RECORD FULL WIND ENERGY LEASE OR EASEMENT

It was this concern I had in examining the Texas wind energy lease that caused me to become involved on behalf of the Southwest Kansas Royalty Owners Association in a bill pending in the last Kansas legislative session dealing with the recording of wind energy leases.

Kansas State Senator Stan Clark, R-Oakley, Chairman of the Senate Committee on Utilities, during the past legislative session, sent to any interested party, the weekly agenda on bills pending before his committee. **I noticed in the agenda for the week of March 10th, the Committee had scheduled a hearing on HB2280 requiring the recording of leases pertaining to wind energy. The bill, as originally drafted, required the filing of record any lease involving wind resources and technologies to produce and generate electricity. However, by action of the House Committee on Utilities, the bill was amended to permit the filing only of a memorandum of lease or easement and not the full lease agreement or easement.**

I immediately alerted SWKROA President John Crump and Executive Secretary Erick Nordling to the problem and secured permission to file a statement on behalf of the Association and on behalf of Kansas landowners to recommend to the Senate Committee on Utilities that the full document needed to be filed of record. **I pointed out that it was absolutely essential that any prospective purchaser or mortgagee of lands covered by a wind energy lease or agreement be fully aware of the rights and obligations of the parties with respect to the agreement.**

I pointed out further the difficulties faced by that prospective purchaser or mortgagee in determining who might have a copy of the full document available for examination if it is not placed of record. **I also pointed out that a wind energy lease is no different than an oil and gas lease and that the full terms of an oil and gas lease must be placed of record.**

President Crump also filed a statement on behalf of the Association expressing his opinion that all energy companies should be treated the same. Since oil and gas leases are required to be filed of record, to do less with wind energy companies would be setting an unfavorable precedent. He also pointed out that farmers are required to file of record water rights and changes in water rights and wind energy leases should be no different.

Philip Ridenour, a Cimarron attorney who has represented landowners in negotiating wind energy leases covering the Montezuma Wind Farm in Gray County, and landowners on wind energy projects in Kiowa, Butler and Hamilton counties, also filed a statement on our behalf requiring the recording of the full document.

Phil's statement was an eye-opener in that he pointed out to the committee it had been his experience that once the wind farm leases are proposed and submitted to the farmers, the companies absolutely refuse to negotiate any changes in the lease terms. This results, in essence, Phil said, in a "take-it-or-leave-it lease, confirming pretty much what I experienced in the Texas situation. Phil further testified that in the leases he had examined, the farmer agrees that if people are on the property with his permission and damage is done to the wind farm installation, the farmer agrees to indemnify and reimburse the wind farm lessee. As an example, if the farmer contracts a custom cutter and a bearing falls off the custom cutter's combine setting the wheat field on fire which results in the heat warping the rotors, the farmer is liable for damages.

The most discouraging provisions in the leases Ridenour has examined is that, without exception, the lessee is a shell corporation created for liability purposes. He stated, as an example, the wind farm in Gray County is widely thought to have been installed by a major utility but in reality, the lease runs to some sort of wholly owned subsidiary or shell which has a minuscule net worth compared to the large public utility.

The Association was represented at the Senate hearing on the bill by our lobbyists, John Pinegar and Doug Smith. During the discussion on the bill, the question arose as to whether oil and gas leases needed to be recorded and the Committee requested that I issue a legal opinion on that question. Since I'm retired and living in Lawrence, I don't have access to any law books at home, and if anyone would have asked me ten years ago to do research under those circumstances, I would have been completely befuddled. But thanks to modern technology and with the help of Erick and his law associate, Shelley Kurt, I was able to do my research on my trusty computer and came up with a six-page opinion answering the question in the affirmative.

It was actually a trick question since the recording statute provides that "every instrument in writing that conveys real estate, any estate or interest created by an oil and gas lease.....**may be recorded in the office of register of deeds of the county in which such real estate is situated.....**" Two sections later though, it provides that "**no such instrument in writing shall be valid, except between the parties thereto,.....until the same shall be deposited with the register of deeds.**" By wild coincidence, the ironic thing was that in researching the subject of the necessity to record an oil and gas lease, I discovered in one of the very first footnotes under the recording statute, **I had written an article in 1955 for the Kansas Law Review dealing with this very subject and pointing out that the 1953 Kansas Legislature had amended the recording statutes to specifically include "any estate or interest created by an oil and gas lease."**

My recommendation to the Senate Committee on Utilities was to let HB 2280 die a natural death and then next legislative session amend the recording statute to specifically include wind energy leases and easements in the same manner as the 1953 legislature did to include oil and gas leases. Fortunately, the Committee followed my recommendation and hopefully the 2004 Kansas Legislature will go along with my recommendation.

ARTICLES ON WIND ENERGY IN THE MID-WESTERN STATES

This leads us to the point of why I am here today to discuss with you suggested guidelines to you as landowners in negotiating wind energy leases. In doing research on the subject, I was amazed at how much information is available through the internet. **Interestingly enough, many of the articles I encountered on the subject came from the northern tier of mid-western states: Minnesota, Wisconsin, North Dakota, South Dakota, and Kansas.**

In an article datelined August, 1994, by John Bailey, Institute for Local Self-Reliance, entitled, “Will Minnesota Farmers Benefit from Wind Power?” Mr. Bailey points out that speculators are going door-to-door buying up wind rights from most uninformed and inexperienced landowners. He cautions that Minnesota farmers must quickly learn the new math of windpower or they will end up like their brethren in Texas, West Virginia and Kentucky did in the dawn of the coal and oil era. “At the dawn of the renewable energy era Minnesotans need to learn that the value of their above-soil wealth is the crucial factor.” He cautions his readers to know the basic economics of wind power. www.me3org/issues/wind/windoped.html.

The North Dakota Farm Bureau, in its website, www.fb.com/ndfb.archives59.html, It urges prudence regarding wind contracts. “Harvesting Dakota Wind” is an organization being formed by Farm Bureau groups in the Dakotas with intentions to create an internet-accessible database that landowners can use to make their own informed decisions regarding wind energy contracts. The organization will be asking developers to support a “Dakota Standard” that specifies a minimal lease amount in flat annual payments or royalty or a combination, along with adhering to specified contract provisions.

Joe Richardson, North Dakota Farm Bureau energy project consultant, states in the undated article, entitled, “Archives,” that he has been offered \$5,000 per turbine per year if the wind blowing across his land, on an annual average basis, is 15.6 mph hour or better. He indicates that landowners need to consider both price and percentage in relation to turbine size. The article contains other worthwhile information in negotiating wind energy leases.

In an AP article datelined December 11, 2000, from Rio Creek, Wisconsin, entitled, “Growing number of wind generators popping up around Wisconsin,” an official with Wisconsin Public Service Corporation is quoted as saying **that wind energy leases in Washington and Iowa counties provide annual payments ranging from \$3,000 to \$7,000 per tower.** www.jasonline.com/WI/121100/wi-windpower1211000328.asp.

An excellent source of information about wind energy for Kansans can be found at the website of the Kansas Energy Information Network provided as a service of the Kansas Corporation Commission’s Energy Program and the University of Kansas Energy Research Center. www.kansasenergy.org. **At its Kansas Wind Energy site, it is revealed there are at least eleven wind developers interested in Kansas.** The site gives brief information about current Kansas wind projects. The one with which we are most familiar is the Gray County Wind Farm.

Gray County Wind Farm

The Gray County Wind Farm, the largest wind farm in Kansas, was built in 2001 by FPL Energy, a Florida-based company. Spread over an area of 12,000 acres, the farm has 170 turbines with a generating capacity of 110 megawatts, enough to power 33,000 homes. The towers are 212 feet high with a blade span of 77 feet. Landowners are paid \$2,000 per tower for 20 years. According to information about the wind farm, a computer turns the blades to face the wind. They start to rotate at 7 miles per hour. At 9 mph, the blades turn at 14 rpm and start to generate electricity. When the wind reaches 13 mph, the blades increase their rpm to 22, the maximum speed. At 33 mph the turbine generates its maximum power and at 56 mph, the computer automatically turns the blades sideways to the wind. Towers and turbines are built to withstand wind at up to 134 miles per hour.

Other Kansas Wind Projects

According to Kansas Wind Energy, there are three proposed wind projects in the Flint Hills in Butler County. The proposed sites are meeting with opposition by farmers in the area and by environmentalists because of the threat to the tallgrass ecosystem and what the projects might do to prairie chickens and other grassland birds. **Last month, Sunflower Electric Power Corp. (Sunflower) announced it was teaming up with Renewable Energy Systems (RES) to construct between 65 and 70 wind turbines on 6,000 acres near Leoti in Wichita County.**

Numerous other projects are being considered in several other Kansas counties..

LEGAL ISSUES FOR LANDOWNERS TO CONSIDER IN NEGOTIATING WIND ENERGY AGREEMENTS

There is an excellent article appearing at www.windustry.org/opportunities/easements.htm, entitled , “Wind Energy Easements - Legal Issues,” prepared by Robert R. Nardi and John H. Daniels, Jr., with the Minneapolis, Minnesota law firm of Willeke & Daniels. I visited with Mr. Nardi last week and learned their firm has represented numerous landowners in the Midwest in negotiating wind energy agreements.

The article outlines issues relating to provisions contained in wind energy agreements and offers suggestions on what a landowner should consider in negotiating the terms of the easements. The authors point out that a wind energy agreement will have a long term effect on your land and it will not only affect you but future generations as well. **They urge you not to execute any such agreement without seeking the advice of your attorney.** Some of the questions they suggest you should ask yourself and your developer are:

- 1. How much of my land will be tied up and for how long?**
- 2. How much will I be paid and how will I receive payments?**

3. **Are the proposed payments adequate now and will they be adequate in the future based on what I am giving away?**
4. **If a lump sum payment is being offered for long-term rights, am I really being adequately compensated?**
5. **Does the proposed method of payment or the easement itself present any adverse tax consequences to me?**
6. **Are there firm plans to develop my land, or is the developer just trying to tie it up?**
7. **Is the developer willing to guarantee that a specific number of wind energy turbines will be built on my land by a certain date or at least will it be willing to guarantee me certain minimum payments?**
8. **If payments are to be based on revenues generated by the wind energy turbines, how much information is the developer willing to disclose concerning how the owner's revenue will be determined?**
9. **What easement rights is the developer able to later sell or transfer without my consent, and how might such transfer or sale affect me? Will the original developer still be liable to me if the new developer or owner of the easement rights does not pay me or otherwise defaults?**
10. **What are the developer's termination rights? Can the developer simply terminate the easement at any time, and if so, how does that affect future payments?**
11. **What are my termination rights and are they easily exercised?**
12. **If the easement is terminated either voluntarily or involuntarily, what happens to the wind energy structures and related facilities located on my land? Is the developer required to remove everything, including cables and foundations, and if so, how soon and at whose cost?**

The article goes on to dissect and discuss various provisions of wind energy option agreements and wind energy easements themselves. If you are ever approached by a wind developer to execute an option agreement or wind energy easement, you will find it most helpful for you and your attorney in your negotiations to review the comments and suggestions of Nardi and Daniels. As I mentioned above, I found the article at www.windustry.org/opportunities/easements.htm. The article may also be found at www.kansasenergy.org/wind.htm.

Another excellent source of information available for landowners in negotiating wind energy

agreements is a 49-page publication entitled, “**Landowner’s Guide to Wind Energy in the Upper Midwest,**” made available through the Isaac Walton League of America, a national conservation organization established in 1922 to protect America’s air, land, water and wildlife. **The Guide discusses how landowners can evaluate their wind resources, how then can evaluate the economics of wind power under a variety of development scenarios, and the contractual issues a landowner should consider when approached by a wind developer.** The cost is \$5.00 and you may order copies from the League at the following address:

**Isaak Walton League of America
1619 Dayton Avenue, Suite #202
St. Paul, MN 55104
Phone: (651) 649-1446
Fax: (651) 649-1494
billgrant@iwia.org**

RECOMMENDATIONS ON NEGOTIATING WIND ENERGY LEASE TERMS

In negotiating a wind energy lease on behalf of landowners, I would make several recommendations and I will list them, not necessarily in the order of importance. In fairness to both parties to the wind energy agreement, most provisions of the lease should be negotiable.

- 1. The length of the lease is of primary importance. It should be long enough for the wind developer to recoup its investment and a length of 20 years should be sufficient for that purpose. There probably should be a right of renewal of one 10 year period at the option of the lessee. At that point, if another extension of the lease is desired by the parties, I feel the landowner should have the right to renegotiate any of the lease terms he feels have not been in his best interests.**
- 2. No wind energy lease should be perpetual. If it is, it could violate the rule against perpetuities. At some point, there should be a right to terminate the agreement on the part of the landowner for whatever reason.**
- 3. One of the most important provisions in a wind energy lease is the amount of compensation to be paid. The agreement should clearly spell out the amount of compensation to be paid each year whether it be a flat amount each year, an annual payment for each tower, a percentage of the gross proceeds, a payment of a certain amount of kilowatt hours generated per year, or an amount based on the sale price of so many megawatts per year, whichever figure is greater.**
- 4. There should be an inflationary factor built into the contract to keep up with inflation. A perfect example of the need for that is the compensation being paid to the landowners involved in the Gray County Wind Farm. As I understand the contractual**

arrangements there, the landowners are receiving an annual payment of \$2,000 per year for 20 years without any adjustment for inflation. It doesn't take a rocket scientist to realize that if you calculate the present value of a cash flow of \$2,000 per year over a 20 year period, discounting those cash flows at 5%, you actually get only the equivalent of \$1,731.79 five years from now, \$1,544.35 10 years from now, and \$1,246.22 twenty years from now. The annual payment would need to be at least \$3,612.20 twenty years from now to keep up with inflation.

5. **The lease should not cover any lands that will not be a part of the wind project. If the developer does not install towers on your land, there should be some method of determining the compensation you will receive to have your land tied up with a reasonable annual payment.**
6. **Do not accept a lump sum one-time payment for the use of your land for obvious reasons, besides possible tax consequences. You should get tax advice during the negotiation process and before signing any agreement.**
7. **Before you execute a wind energy agreement, determine the intentions of the developer in using your land and when compensation may be expected. Limit any construction period to not more than three or four years with adequate compensation in the meantime to compensate you for having the land tied up.**
8. **Make a determination of your willingness to permit the developer to assign the lease without your consent. If you permit this to be done, be sure that the original developer is liable to you if the new developer defaults on the lease terms.**
9. **Decide whether you are willing to consent to any mortgagee of the wind developer and if you do consent, limit the extent of your obligations to the mortgagee.**
10. **Require an indemnification agreement on the part of the lessee for any liability incurred as a result of its operations on your property.**
11. **Clearly spell out the rights of the lessee and your rights to use the property subject only to the rights of the developer for purpose of producing wind power.**
12. **Put in a favored nations clause in the agreement so that you will be treated as well as any of your neighbors signing similar agreements.**
13. **Require the removal of all improvements made by the wind developer upon termination of the lease.**
14. **Require the full document to be placed of record rather than a memorandum of lease to eliminate the necessity of having to locate a copy of the lease in the event of sale or**

mortgage of the property.

- 15. Do not agree to confidentiality provisions which prohibit you from disclosing information pertaining to terms and conditions of the easement. You may find it necessary to do so for your banker or a prospective purchaser and you will be unable to divulge the contents of the easement because of the confidentiality agreement.**
- 16. You should have your insurance agent review your insurance policies to determine what additional costs may be incurred to insure against any new or additional risks due to the wind project.**
- 17. If your land is in conservation reserve, you should determine whether the wind developer's use of your property will violate your conservation reserve contract. If there is a violation you should require the developer to indemnify you for any lost payments or penalties.**
- 18. You should consider how the developer's interest in the property and the type and schedule of payments due under the contract may affect future sales or transfers of the property.**

I have hurriedly put this paper together and I am sure there are things I have missed that I should be discussing with you in negotiating with the wind energy companies. Suffice it to say, I think wind energy has a definite future in Kansas and we should do all in our power to encourage its development. But, as Mr. Bailey pointed out in 1994 to Minnesota farmers, you need to quickly learn the new math of wind power and not have to live many years with unfair contracts. Speculators are able to get uninformed landowners to sign at the dawn of a new industry in Kansas.

Thank you for being such an attentive audience.

(Speech by Bernard E. Nordling, SWKROA Assistant Executive Secretary, at the 55th annual meeting of the Southwest Kansas Royalty Owners Association in Hugoton, Kansas, on April 26, 2003)