

# What You Should Know About Wind Farms

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**Are they just a lot of hot air? No, and there are some very important points to keep in mind about their leases.**

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**DRIVE ACROSS** parts of Illinois, Kansas, Louisiana, Texas and California and you will see (as they are much too large to miss) wind turbines. They increasingly pepper the landscape of open areas within the United States that have sustained wind flow levels, most commonly in agrarian and coastal areas. Some would say they capture a certain beauty with their spinning rotors and the promise of alternative energy; all would say they are large. There is no denying that they seem to be more prevalent in some parts of the country and in the news than ever before. Certainly California is not new to the concept of the wind farm, but for the first time in our practice, clients in our Chicago office are seeking assistance on such matters.

**WHAT IS A WIND FARM?** • A wind farm is intended to provide an alternative source of electricity, either for on-site use or for sale as a commodity. It collects and then converts wind energy into electricity, which is then transmitted. In connection with this collection, conversion and transmission process, wind turbines, transmission lines and related equipment and facilities are constructed by a developer on the subject land. The developer leases the subject land from a landowner pursuant to a lease, which

provides for the developer tenant's use of the land for such construction and wind energy conversion, as well as exploration of the feasibility of the site for such use. Certainly the most attractive advantage to a landowner is the ability to still farm or otherwise utilize its land despite the presence of the lease. The projects are heavily financed, as the cost of the development of a wind farm is substantial. As the following provisions of this article will attempt to demonstrate, there are specific provisions that practitioners will encounter in a wind farm lease. This article will explain such provisions and offer alternatives to proposed provisions.

**THE LEASE** • As mentioned above, the lease agreement is the operative document governing the relationship between the developer tenant and the landowner landlord. These are frequently heavily negotiated documents, as the interests of the landlord and those of the tenant (as in most lease situations) frequently are not aligned.

### **What Is Being Leased?**

The lease will typically state that the landowner is granting the developer the exclusive right and easement on, over, and across the landowner's land for the unobstructed flow of wind, along with the right to develop, use, capture, and convert such wind into electrical energy. Such rights will include the ability to develop and construct improvements and facilities on the land in order to capture and convert the wind power. Such improvements usually include generating units required to convert the wind, transmission lines, and related facilities to transport the electrical energy to central power grids, meteorological towers for wind assessments, roads and bridges for access, as well as the installation of fences and gates for protection of the very expensive (and potentially hazardous) wind turbines. The landowner will retain the right to utilize its land for such activities as farming, ranching, hunting, conservation and, possibly, mineral explo-

ration, and to enter into leases and grant easements in furtherance of such activities, though developers will desire that such other uses not include the development of wind energy and, in any event, not interfere with the developer's rights under the lease.

### **The Premises**

One of the more contentious provisions negotiated by the landlord and the tenant in the lease can be the definition of the premises. The tenant will want, even require, that the defined space be as large as possible, thereby maximizing the potential to develop its wind energy project. The landlord, however, will desire as small an area as possible given that the lease will also prohibit the landlord's interference with the project (through the development of structures that could potentially interfere with wind flow), and thus, the landlord will seek to limit the restrictions on its ability to use the land for other purposes. Provided that the landowner is able to continue to use its land as it intends, and the developer is able to lease sufficient land to justify the project, a happy medium is attainable.

### **The Term**

The initial term of the lease is typically designed to be an investigative period for the tenant, where the tenant will conduct wind studies, perform surveys and perform such other tests to determine whether the land will lend itself to the developer's project. This initial term can range from three to 10 years. While developers will, understandably, negotiate broad access and use rights during this due diligence period, one limitation that a landowner should insist upon is a prohibition against conducting any invasive environmental testing without the landowner's consent. Provided that the developer determines that the project is feasible on such land, the developer will then exercise an extension option, which can range from 30 to 50 years or more. The extension term begins when the project com-

mences commercial operations of the wind farm, which, as discussed below, triggers a substantial increase in rental payments.

### **The Rent**

Given that the developer must lease large tracts of land for the development of its wind project, and given the expense in developing the project, the developer will have underwritten the amount to be paid to each landowner in order for the project to be economically feasible. This amount will likely be determined prior to the developer approaching the landowner. This may translate to little wiggle room for negotiation. What is important is that the landowner be paid market rent, with the “market” constituting the neighboring property owners with whom the developer is also negotiating. A landowner would be wise to attempt to negotiate some assurance that what the developer is paying them is consistent with all other landowners in the developer’s project. This is one way to keep a check on the developer. This can get tricky, however, as a particular landowner’s property may not be as valuable to the developer as another landowner’s property. Nevertheless, there is an argument to be made that adjacent landowners should be paid comparable rents. The base rent during the initial lease term is generally a per acre amount and can vary depending upon location of the proposed wind project and the perceived value of the land. The base rent during the extended term can vary from a per acre amount, to a per megawatt of generating power on the property, to “royalty” payments, i.e., a percentage of gross revenues received by the developer (though the developer will include an acknowledgement by the landowner that the developer has made no representation that the facilities will be profitable or will even be constructed). The landowner should insist that the tenant pay the landowner the greatest of these amounts, and perhaps increase in accordance with some metric, such as a CPI index. Developers frequently also pay

landowners additional amounts if generating units and/or overhead transmission lines are installed on the land, or if the developer constructs an access corridor on the land, which may contain roads or underground facilities. Additional rent can also be payable in the event the tenant installs temporary storage yards or construction staging areas (though landowners should seek to keep these areas well-defined and perhaps, depending upon the landowner’s plans for the property, fairly contained), if meteorological towers or substations are installed, or even if overhead transmissions exceed a certain voltage. As with the base rent discussed above, the landowner would be wise to insist that the developer pay the landowner the same amounts paid to adjacent landowners.

### **The Guaranty**

Given that the developer will likely desire that the tenant entity be a single purpose entity, the landowner will have concerns about who is standing behind the tenant’s obligations. Given the extent of the development and the amount of the improvements that the developer will undertake, the landowner is justified in being concerned about performance and, perhaps more importantly, restoration upon the expiration of the term of the lease. Requesting a guaranty of payment and performance is one mechanism for giving the landowner comfort in this regard, though most developers will very likely be hesitant to provide such security. In a recent wind farm lease negotiated by the authors, the developer’s suggested alternative to providing a guaranty was the following mechanism: if after the 10th year of a 40-year lease term the landowner determines that the developer’s obligations under the lease exceed the salvage property of the facilities, or if the facilities are nearing the end of their useful life, then the landowner may require that the developer post security sufficient to ensure the developer’s restoration obligations. This may or may not satisfy the typical landowner, whose tolerance

for risk will depend upon the size of the project and the rent payable under the lease, as well as the comfort level the landowner has with the developer.

### **The Termination Right**

If the developer determines that the project on the land will not be as productive and/or profitable as it had originally intended or hoped it would be through its investigations during the initial lease term, the developer will want to have a unilateral termination right. The landowner should seek reimbursement of its costs incurred in connection with the lease, in addition to some additional termination payment. The developer will seek to set such fee at a nominal amount, such as \$100, while the landowner may have another amount in mind as to what constitutes fair compensation. Provided that legal fees are reimbursed, the landowner may be satisfied with such a nominal amount.

### **Tenant Covenants**

The typical wind farm lease will contain many tenant covenants. The following are a few that are noteworthy.

#### ***Reimbursement For Damage***

The lease should contain a provision whereby landowners are reimbursed for, and indemnified against, any losses or damage caused to the land, or generally arising out of the developer's use of the land. This should include reimbursement for the destruction of livestock, crops, and any improvements or structures on the property. In addition, the landowner should consider whether there is any other special use of the land that warrants protection. For example, all or a portion of the land may be subject to a U.S. Department of Agriculture's Conservation Reserve Program contract, whereby native grasses and plants are required to be planted and maintained on the land. The reimbursement provision of the lease should give the landowner protection in the event the developer causes any

damage to such plants and grasses, thereby subjecting the landowner to liability for breach of that contract.

### ***Restoration***

Of vital importance to a landowner is the developer's restoration obligation at the end of the term of the lease. Not only should the lease contain an obligation to restore, but to do so within a finite period of time of both the completion of the construction of the project and the lease expiration. For instance, within a reasonable period of time after the completion of construction (three to six months is reasonable), the landowner should require that all surface portions of the property be restored to substantially the same condition that existed before the commencement of such construction. In addition, within a reasonable period of time (again, three to six months is reasonable, but developers will look to make this period 12 months or longer) after the expiration of the lease, the developer should be required to remove all of the wind power facilities installed on the property, along with surface restoration. In addition, there should be a requirement that footings and foundations also be removed, though developers will push to limit such removal obligations to a certain depth, e.g., four feet.

### ***Insurance***

The developer must carry sufficient insurance. Each project is different, depending upon the scale and the size of the developer, but there should be a substantial commercial general liability policy with an umbrella policy. The developer should not be allowed to self-insure.

### ***Taxes***

The developer should be obligated to pay all taxes relative to the project and its leasehold interest, in addition to any increase in the landowner's

real and/or personal property taxes resulting from the project.

### ***Liens***

The lease should contain a covenant against the creation of liens (or the allowance thereof). Given the amount of construction that will occur on the site, this is a real risk for the landowner.

### ***Compliance With Law***

The developer should be obligated to comply with law. This covenant should include an obligation to comply and perform in accordance with all applicable environmental laws in connection with the development and use of the project, and the developer should have an obligation to remediate any contamination caused by it or its activities on the land.

### ***Indemnification***

Perhaps the most important tenant obligation is the indemnity. As in other lease scenarios, the landowner landlord should be no worse off due to the developer tenant's activities. To that extent, the landowner should insist upon the broadest form of indemnity possible, including protection from and against any damage to property or persons, destruction of crops and livestock, and from any presence (or perhaps just violation) of any environmental laws.

### ***Landlord Covenants***

Developers will insist that the lease contain a number of landowner covenants. Following are examples of a few typical landlord covenants.

### ***Grant Of Easements***

The developer will insist that the landowner agree to grant all easements necessary during the lease term for the construction and operation of the wind farm facilities, including for such items as access and transmission line installation. Land-

owners should ask for reasonable compensation in exchange for such grant, as well as require that such easements expire at the end of the lease term. In addition, landowners may consider requiring a developer to record a release at the expiration or termination of the lease evidencing termination of such easements.

### ***No Interference***

Developers will look to the landowner to ensure that the landowner not interfere with the flow of wind on the land, or otherwise engage in any activity that could decrease the production capabilities of the wind power facilities, and will (similar to other lease scenarios) require a covenant of quiet enjoyment. However, in no event should landowners represent that the wind flow on the premises is sufficient for the developer's project. In addition, landowners should limit the non-interference covenant only to instances of any "knowing" interference by the landowner or its agents and agree to protect the developer only from and against anyone acting by, through or under the landowner. If the developer will not agree to the "knowing" interference, the parties may agree to some standard as to what constitutes "interference." For instance, the construction by the landowner of more than a certain number of structures that are more than a pre-determined size could constitute interference. The landowner must decide whether this limitation will affect any plan for development of its land. The developer may wish to prohibit hunting on the property given safety concerns surrounding the use of firearms near the facilities. Depending upon the landowner's plans for its property, the landowner may be amenable to this.

### ***Cooperation***

Developers will request that landowners agree to cooperate with the project. This will include the landowner agreeing to cooperate in the developer's permitting and entitlement process, as well as seek-

ing zoning variances, if necessary, and may include the right to contest taxes. Developers will seek to pursue these matters in their own name, as well as in the name of the landowner. Landowners should insist that, at a minimum, prior notice be given and that the landowners have approval rights over any changes that affect the land. In addition, landowners should request that they receive compensation for all such cooperation or reimbursement of costs incurred.

### ***Additional Encumbrances***

Developers will desire the right to seek non-disturbance agreements from any mortgagees of the landowner. Landowners may wish to limit any obligation to obtain this protection on behalf of the developer to such instances that would likely result in a delay to or interference with the facilities or any financing of the project, and in any event, the landowner should solely be obligated to utilize reasonable efforts to so obtain such an agreement. As with landowners' cooperation, developers should compensate landowners for all efforts in obtaining any such agreement from the landowners' mortgagees.

### ***Ownership Of Facilities***

The developer will seek an acknowledgment from the landowner that the facilities remain the property of the developer and not of the landowner, and that in no event will the facilities constitute fixtures.

### ***Indemnification***

Developers will typically look for an indemnity from the landowner protecting them from damages arising in connection with the presence of hazardous materials or the violation of any environmental law. As with most landowner provisions, the landowner would be wise to attempt to minimize its exposure as much as the developer will tolerate.

### **Financing Provisions**

Given the amount of financing that wind farm projects require, of utmost importance to the developer is the freedom to mortgage the facilities. In connection with this, the developer will seek (because its lenders will require it) broad lender rights. The lease will likely allow the lender to acquire title to the facilities and operate thereon in accordance with the terms of the lease and perform, on behalf of the developer, any of the developer's obligations under the lease. Lenders will also desire to have copies of notices of default and the ability to cure such defaults. As with most leases, landowners should seek to limit such cure rights to some reasonable period of time (ideally, the same amount of time given the developer before the occurrence of an event of default), though developers will seek, on behalf of their lenders, for this period to be as long as possible provided the lender has commenced the cure and is diligently pursuing the remedy. The lease may also likely provide that in the event the lease is rejected in bankruptcy, the landowner will enter into a direct lease with such lender on the same terms and conditions as contained in the lease. Lenders will likely also wish to restrict the landowner from agreeing to a modification of the lease without the consent of the lender. Landowners should seek to restrict this right by adding qualifying language thereto (e.g., the landowner will not enter into a modification if it is reasonably expected to materially reduce the rights or remedies of a lender or reduce the security of the lender's lien in the facilities). In addition, the landowner should insist that the developer provide the landowner with evidence of such consent before the landowner's execution of any modification that would otherwise require the consent of the lender.

**LEGAL ISSUES AND CASES** • The law of wind, particularly in the context of adjudicated matters, remains in its infancy, and with respect to wind farm leases is virtually nonexistent. With the

ever-increasing appeal of wind energy as a viable alternative to non-renewable sources of electricity, lawyers and legislators alike must inevitably confront a host of legal issues raised by wind farms and wind farm leases.

### **Property Rights In Wind**

As noted above, the primary vehicle used to establish a wind farm is a wind energy lease. At its most fundamental level, and similar to the question posed with mineral leases, the validity of the lease is dependent upon a recognized, severable property right in wind (or in a mineral lease, the underlying resource). But exactly what estate, if any, does a landowner possess in the wind that flows over his property? A number of common law principles can be asserted for the recognition of wind rights. First and foremost is the old adage that a landowner's property extends from the center of the earth to the sky. However, given the multitude of regulations on air space imposed by the FAA, local zoning boards and other governmental entities, blind reliance on this principle to establish wind rights is dubious. Another school of thought likens wind rights to the law of wild animals, which generally states that a person obtains possession of a wild animal only upon reducing it to possession. Thus, a landowner or wind lessee would obtain ownership to wind by using wind turbines to capture and convert it into electricity. The most popular (and convincing for these authors and most in the field) argument for wind rights lies in an analogy to mineral and oil rights law. It is well-established that rights to subsurface minerals and oils can be severed from the surface estate and separately leased, sold, and conveyed. Although wind is not identical in nature to minerals and oil, the recognition of wind as a severable resource does not require a stretch of the imagination.

To date, only one case, *Contra Costa Water Dist. v. Vaquero Farms, Inc.*, 68 Cal. Rptr.2d 272 (Cal. Ct. App. 1997), has expressly recognized the existence

of a severable property right in wind. The California Court of Appeals reasoned both that "windpower rights are substantial rights capable of being bought and sold in the marketplace" and that the 30-year wind farm lease on the property stood as "irrefutable evidence that one may have a right to use windpower rights without owning any interest in the land."

The lack of litigation relating to wind property rights reflects either a general acceptance of such rights as another stick in a landowner's "bundle of rights" or the relative infancy of the windpower industry. Rather than leave the issue of winds rights to the courts, South Dakota has enacted legislation expressly setting forth the type of wind rights that may be created. Section 43-13-19 of the South Dakota statutes provides:

"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."

Although the statute's recognition of wind property rights represents a step in the right direction, the South Dakota statute is a prime example of overlegislating. Given the significant up-front capital costs required for a wind project, both the five-year development deadline and the 50-year term limit discourage development of large commercial wind projects in a state with one of the best wind energy-producing potentials in the nation. Further, the requirement of annual rental payments is overly intrusive to the rights of parties. Although the aim of the statute is to protect unsophisticated landown-

ers from overzealous wind developers, these terms are best left to mutual agreement between landlord and tenant to promote flexibility.

### **Nuisance And Tort Liability Claims**

By far, the most prevalent objections raised by wind farm opponents are nuisance claims, which involve a fact intensive, case-by-case analysis. The most common bases asserted for wind farm nuisance include: aesthetic objections to wind turbines; adverse effects on adjacent property values; excess noise produced by the turbines; and safety issues, including ice thrown from the turbine blades. Although wind turbine nuisance claims are difficult to prove and depend upon the degree of harm suffered by the plaintiff, some courts have ruled in favor of the plaintiffs. The most commonly cited case is *Rose v. Chaikin*, 453 A.2d 1378 (N.J. Super. Ct. Ch. Div. 1982), in which the court held that the constant, excessive noise produced by the landowner's single wind turbine outweighed the social utility of wind energy production. The turbine was located 10 feet from the neighbor's property line in a residential neighborhood. In *In re Halnon*, 811 A.2d 161 (Vt. 2002), the Supreme Court of Vermont upheld the denial of a wind turbine application based on its perceived negative aesthetic impact. The plaintiff successfully argued that the turbine would adversely impact the "scenic and natural beauty" of the predominantly wooded area and would obscure its view of the nearby Green Mountains. The court was also persuaded by the possible availability of alternate sites for the turbine.

It is worth noting that the cases cited above (and the majority of nuisance litigation over wind turbines) have involved single turbines used for on-site electricity generation. This is due to the fact that single wind turbines are more likely to be located in primarily residential areas, drawing the ire of neighbors and the sympathy of courts. However, the probability of successful nuisance claims against large-scale commercial wind farms is much

lower. Commercial wind farms often are located in rural, open spaces with large distances between neighbors. In addition, advances in wind turbine technology have substantially reduced noise emissions and improved safety features. Moreover, given the large production capacities of commercial wind farms, courts are likely to give great weight to their social utility.

Nonetheless, landowners should insist that wind developers implement all available and cost-effective measures to avoid nuisance claims. Although wind farms can never be made completely nuisance-proof, available mitigation techniques include establishing setbacks from residences and public rights-of-way, requiring visual uniformity of turbines, painting turbine towers a color which camouflages with the surrounding landscape, building fences around tower bases, and installing motion-detector night lights. In addition, as noted earlier in this article, wind farm leases should require the developer to carry sufficient insurance against potential nuisance and liability claims, which name the landowner as an additional insured, and indemnify the landowner against any claims made by a third party arising from the developer's activities or the location of the turbines. Landowners should hesitate to allow developers to "self-insure" unless sufficient evidence of the financial health and capability of the developer is presented.

### **Environmental Impacts**

While the environmental benefits of wind energy technology are touted, wind farms are not immune from environmental concerns. Apart from the obvious ramifications of placing wind farms in undisturbed areas or habitats of endangered species, citizens' groups and other opponents of wind farms have challenged the adverse effects of commercial wind farms on migratory birds and bats. Scientific research provides evidence for the increased rate of mortality among birds and bats caused by wind turbines, but the extent of such in-

crease is debated and highly dependent upon the site location. Recent studies suggest that the mortality effect of wind turbines is more pronounced for bats than for birds.

Judicial challenges to commercial wind farms based on harm to migratory birds and bats have been unsuccessful. (*See Kerncrest Audubon Soc’y v. City of Los Angeles Dep’t of Water and Power*, 2007 WL 2208806 (Cal. Ct. App. Aug. 2, 2007) for a detailed discussion and analysis of avian fatalities and studies). However, as a condition for issuing permits for wind farms, many zoning bodies require developers to provide environmental and avian impact studies showing a negligible or otherwise acceptable level of impact on birds and bats. These studies at times are required for durations of up to one year. In addition, wind farm permits may include ongoing avian impact monitoring requirements.

### **Implied Covenants In Wind Leases**

As discussed above, many wind farm leases provide that the landowner will receive a percentage of the revenues received from the sale of the electricity generated by the wind turbines on the leased property. If a wind lease contains such a “royalty” provision, important questions are raised. Will courts be inclined to imply a duty on the developer to: continuously operate the wind turbines for the duration of the lease term; install and operate the maximum amount of turbines as is permitted by applicable law or commercially reasonable given the property landscape and market conditions; and/or use the most advanced technology to maximize energy production? As discussed by noted wind energy scholar Ernest E. Smith, the rationale behind these implied covenants is straightforward: Because the landlord’s receipt of full rent is dependent upon the performance of the tenant’s operations on the property, the tenant has the obligation to conduct operations with reasonable care and diligence in order to maximize results. In essence,

the developer is acting not simply for himself, but also for the interests of the landlord.

Given that an implied covenant of continuous operation have been recognized by some courts for oil and gas leases, agricultural leases, and percentage rent leases, commentators on wind farm leases believe it would not be far-fetched for a court to imply such a covenant to wind farm leases with “royalty” rent provisions. That being said, developers are encouraged to avoid any such implied covenants by expressly handling these issues in the wind farm lease. For instance, Ernest Smith suggests a court may be less likely to imply a continuous operations covenant when the lease includes payment of periodic fixed rentals in addition to “royalty” payments. In addition, the wind lease can specifically state the number or types of turbines that will be installed.

### **Conflicts Between Wind Farm Tenants And Mineral Rights Owners**

Mineral right reservations and leases pose substantial obstacles for wind farm tenants. The general rule of thumb is that mineral estates are dominant to surface estates, and the mineral rights owner is awarded an implied right to enter upon and use the surface estate in a manner reasonably necessary to conduct mineral extraction operations. Naturally, wind power rights are part of the surface estate. The commencement of extraction operations would prove troublesome for a wind farm business, particularly if the location of the wind turbines, transmission lines, or access roads hinders the extraction process. In the event of a dispute between the wind farm tenant and the mineral rights owner, the extent of the wind farm tenant’s rights (and even ability to operate a wind energy facility) is likely to be a hotly litigated issue in the future, particularly when the wind farm lease precedes creation of the mineral estate.

Although a dispute with a potentially unknown mineral rights owner may be worrisome to a wind

farm tenant, the developer is not helpless. If possible, the developer should select sites that are not subject to mineral leases or reservations. To be safe, the developer should perform a title search of the property and request that the landowner represent that the land is not subject to any mineral estate. Further, the wind farm lease should expressly preclude the landowner from severing the mineral estate or entering into a mineral or oil lease. In the event that the property is subject to a pre-existing mineral lease and no suitable alternative parcel is available, the wind lessee should request that the mineral estate owner covenant to use commercially reasonable effects to prevent interference with wind farm operations.

**INCENTIVE PROGRAMS** • Although commercial wind energy production continues to grow, wind energy continues to be much more expensive than competing forms of electricity generation. Moreover, the current economic and financial meltdown has eroded available financing for wind energy and put projects on hold. Accordingly, wind energy developers remain heavily dependent on federal and state incentives in order to remain profitable.

### **Federal Incentives And Programs**

Despite the forefront in national politics of our country's dependence on foreign oil, the federal government surprisingly plays second fiddle to the states in terms of wind energy incentive programs. Nevertheless, the federal government does provide some important wind energy incentives.

#### ***Federal Production Tax Credit (26 U.S.C. §45)***

The principal federal incentive for wind energy is a per-kilowatt-hour production tax credit (PTC) against corporate income. The PTC is only available to the owner/developer of a "qualified facility", which the act defines as a wind facility located in the United States and placed in service after

December 31, 1993 and before January 1, 2013. Under the act, the taxpayer is entitled to receive an income tax credit in the amount of 1.5 cents multiplied by the kilowatt hours of wind electricity produced and sold by the taxpayer to an unrelated third party during the taxable year. The 1.5 cents base amount is subject to adjustment for inflation each year. Currently, the inflation-adjusted PTC amount is approximately 2.1 cents per kilowatt hour. The PTC may be claimed only for electricity produced and sold during the 10-year period beginning on the date the wind facility was first placed into service, but is subject to reduction for certain grants, tax-exempt bonds, subsidized energy financing and other credits received by the taxpayer to offset the construction of the wind facility. The credit is taken by completing IRS Forms 8835 (Renewable Electricity Production Credit) and 3800 (General Business Credit).

As noted above, the PTC is not available to any wind facility placed into service after January 1, 2013. Congress has allowed the PTC to expire in the past on a number of occasions, only to then renew it for a limited number of years. The PTC's "on-off" status is primarily responsible for the phenomena of boom-bust cycles found in the wind energy industry, demonstrating how closely wind energy development is tied to the PTC. The PTC acts as a subsidy that pays the taxpayer for wind-generated electricity in addition to the market price at which the taxpayer sells the electricity.

The PTC underwent some important changes as a result of the economic stimulus package signed into law by President Obama on February 17, 2009 as The American Recovery and Reinvestment Act of 2009 (the "2009 Stimulus Act"). Subject to certain limitations, the 2009 Stimulus Act allows wind energy facilities that qualify for the PTC to, in lieu of the PTC, elect to take either (i) the federal business investment tax credit (ITC) under 26 U.S.C. §48 or (ii) a cash grant from the U.S. Treasury Department under section 1603 of the 2009 Stimu-

lus Act to reimburse the developer for a portion of new wind project start-up costs. The ITC and cash grant options generally can total up to 30 percent of eligible project costs.

### ***Renewable Energy Production Incentive (REPI) (42 U.S.C. §13317)***

The REPI is the non-taxpaying entities' version of the PTC. Under the REPI, wind energy facilities owned by non-for profit electric cooperatives, public utilities and local and state governmental entities are entitled to receive incentive payments for electricity produced and sold in the amount of 1.5 cents per kilowatt hour (subject to inflation-adjusted increases) for the first ten-year period of the facilities operation. The REPI incentive payments are available only for electricity generated by a wind facility first used before October 1, 2016 and authorizes appropriations only through September 30, 2026. The REPI incentive payments are subject to yearly appropriations by Congress, making the REPI less reliable than the PTC.

### ***Accelerated Depreciation (26 U.S.C. §68)***

Under federal law, wind facilities are granted an accelerated capital cost depreciation schedule of five years. In addition, subject to the satisfaction of certain criteria, the Economic Stimulus Act of 2008, as modified by the 2009 Stimulus Act, includes a 50 percent bonus depreciation for eligible renewable-energy systems acquired and initially operated in 2008 or 2009.

### **State Incentives And Programs**

The states provide a variety of different options and incentives to promote wind energy development. The most prevalent of these programs is the "renewable portfolio standard" (RPS). An RPS mandates that certain investor-owned utilities or other retail electrical providers within a state supply a specified amount (usually between four and 30 percent) of their electricity from renewable en-

ergy sources, such as wind. The RPS often provides timetables for scheduled incremental increases in the required percentage. Depending on the state, utilities generally are allowed to meet their requirements through a combination of self-producing energy from renewable energy facilities, purchasing energy from third-party renewable energy providers, installing sufficient generating capacity from renewable energy technologies, or purchasing tradable renewable energy credits (REC). An REC is a tradable right to claim the environmental attributes of a certain amount of energy (usually one megawatt hour) produced from a renewable source. RECs are acquired from parties (such as other utilities) who have produced excess amounts of electricity generated from renewable sources. As it relates to wind, an RPS creates a market demand for wind energy and is the primary driver for wind energy development at the state level. As of February 2009, 28 states and the District of Columbia have enacted some form of mandatory RPS, while another five states have passed voluntary RPS goals.

In addition to the RPS, many states offer wind energy incentives including forms of property tax exemptions. *See, e.g.*, Kan. Stat. Ann. §79-201, Tex. Tax Code Ann. §11.27 and Wis. Stat. §70.111(18). Other incentives include property tax assessment reductions, grant programs for wind facility construction, and net metering laws (i.e., laws which entitle wind energy producers to deduct electricity produced from wind energy from their electric bills in a one-to-one ratio). A review of Illinois law provides a good case study of some examples of available state wind energy incentives.

### ***Renewable Portfolio Standard (20 Ill. Comp. Stat. §3855/1-1 et seq.)***

Illinois is one of the 28 states to enact a mandatory RPS, which includes a number of the features found in a typical RPS. Under its act, a newly created state agency is required to develop renewable

energy procurement plans for electric utilities supplying over 100,000 customers as of December 31, 2005. Subject to certain cost-protection provisions, the act initially required these utilities to supply at least two percent of their electricity from renewable energy resources by June 1, 2008, with annual increases resulting in a benchmark of 25 percent by June 1, 2025. Under the act, at least 75 percent of the produced renewable energy must come from wind power. The Illinois act allows renewable energy to be procured through the purchase of tradable renewable energy credits and requires the renewable energy to be produced within Illinois through June 1, 2011, to the extent cost-effective renewable energy resources are available.

***Property Tax Assessment Reduction  
(35 Ill. Comp. Stat. §200/10-600 et seq.)***

Before 2007, commercial wind energy facilities in Illinois were assessed differently for property tax purposes from county to county. This program created burdens on wind projects that crossed county lines. In the fall of 2007, Illinois passed a law establishing consistent assessment valuation procedures for certain commercial wind farm facilities. For assessment years 2007 through 2011, wind energy devices with a capacity of at least 0.5 megawatts and generating electricity for commercial sale are valued at \$360,000 per megawatt of capacity, adjusted annually for inflation. The law also provides for reduction of the valuation for physical depreciation, but the depreciation may not reduce the valuation amount by more than 30 percent, absent special exceptions.

***Renewable Energy Business Development Grant Program (authorized by 20 Ill. Comp. Stat. §687/6-1 et seq.)***

In prior years, Illinois has provided grant programs to encourage the development of electricity from renewable resources, including wind power. In 2009, the State of Illinois, through its Renewable

Energy Business Development Grant Program, will provide an award of up to \$1 million (subject to waiver in appropriate circumstances) to a qualified applicant for the development of renewable energy businesses, including wind projects. The grant program is limited to projects located within Illinois and is open to individuals, private companies, not-for-profit entities, schools, and state and local governmental entities that are customers within the service area of an investor-owned utility or municipal utility that imposes an “assistance charge” under Illinois law. The use of the grant money is limited to the development of business plans, engineering drawings, market studies, and financial analyses, equipment purchases, and other business development activities.

The grant program requires the applicant to begin operating the renewable energy project within nine months after the grant is awarded. As a requirement of receiving a grant, the developer will be required to agree to contribute a certain amount of funds to the project and to operate the project for a certain period of time. In addition, the applicant is subject to ongoing monitoring and reporting requirements of the State.

***Net Metering  
(220 Ill. Comp. Stat. §5/16-107.5)***

With respect to wind power, Illinois currently allows net metering on a one-to-one kilowatt hour credit basis only for entities that generate wind power electricity on their own premises for on-site use. Further, eligibility is limited to entities that own or operate a wind facility with a rated capacity of not more than 2,000 kilowatts. Thus, under its current format, net metering does not apply to entities which either generate wind power electricity off-site or sell the electricity to third parties. Although legislation was introduced in the Illinois General Assembly in 2008 to extend net metering to off-site generation of wind energy by school districts (see HB 6660), the Illinois net metering law in its

current iteration falls short of its full potential by excluding off-site wind energy generation.

**CONCLUSION** • Wind energy farms offer exciting opportunities for developers and landowners, as well as the public at large. The quest for alternative energy sources and the reduction of reliance on oil is likely to result in the continued growth in this field, particularly with the new administration. There are many considerations at play, from the

development of the land and the wind power facilities, to the documentation and agreement with the landowner, to the available incentives. This article has attempted to shed some light on these considerations and to offer some insight into these processes. Such considerations are likely to change and shift (dare we say?) with the wind, so it would behoove owners and developers alike to stay current on this topic and consult professionals as needed.

### **PRACTICE CHECKLIST FOR What You Should Know About Wind Farms**

- Wind farms are an increasingly familiar part of the American landscape and there is good reason to believe that they will become more familiar over the next several years, particularly given the current administration. Under a wind farm lease, a developer leases the subject land from a landowner for the purpose of developing wind power. The leases are frequently heavily negotiated documents, and each negotiation is unique. However, the following are typical points that the lease should include:

\_\_\_ What is being leased? The lease will typically state that the landowner landlord is granting the developer tenant the exclusive right and easement on, over, and across the landowner's land for the unobstructed flow of wind, along with the right to develop, use, capture, and convert such wind into electrical energy;

\_\_\_ The premises. The tenant will want, even require, that the defined space be as large as possible, thereby maximizing the potential to develop its wind energy project;

\_\_\_ The term. The initial term of the lease is typically designed to be an investigative period for the tenant, during which the tenant will conduct wind studies, perform surveys, and perform such other tests to determine the suitability of the land. This initial term can range from three to 10 years;

\_\_\_ The rent. What is important is that the landowner be paid market rent, with the "market" constituting the neighboring property owners with whom the developer is also negotiating. This can get tricky, however, as a particular landowner's property may not be as valuable to the developer as another landowner's property. Base rent during an extended term (which is typically when the project is up and running) can vary from a per acre amount, to a per megawatt of generating power on the property, to "royalty" payments, i.e., a percentage of gross revenues received by the developer (though the developer will include an acknowledgement by the landowner that the developer has made no representation that the facilities will be profitable or will even be constructed);

\_\_\_ The guaranty. The landowner will have concerns about who is standing behind the tenant's obligations. Requesting a guaranty of payment and performance is one mechanism for giving the landowner comfort in this regard, though most developers will very likely be hesitant to provide such security;

\_\_ The termination right. If the developer determines that the project on the land will not be as productive or profitable as it had originally intended or hoped it would be through its investigations during the initial lease term, the developer will want to have a unilateral termination right.

- The typical wind farm lease will contain many Tenant covenants, including:

- \_\_ Reimbursement for damage;
- \_\_ Restoration;
- \_\_ Insurance;
- \_\_ Taxes;
- \_\_ Liens;
- \_\_ Compliance with law;
- \_\_ Indemnification.

- The following are examples of a few typical landlord covenants:

- \_\_ Grant of easements;
- \_\_ No interference;
- \_\_ Cooperation;
- \_\_ Additional encumbrances;
- \_\_ Ownership of facilities;
- \_\_ Indemnification; and
- \_\_ Financing provisions.

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