

ANATOMY OF A SOLAR LEASE: THE LANDOWNER PERSPECTIVE

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I. Preface & Introduction

(by: Roderick E. Wetsel)

As recently as 1999, most Texas attorneys, including myself, had never seen a wind-energy lease. However, by the end of that year, with wind developers arriving in droves to the windy areas around Sweetwater, landowners perplexed by lengthy and complex company forms began seeking legal counsel. So it was by a twist of fate, I became one of the first “wind lawyers.” Not long thereafter, I received a call from the State Bar Oil and Gas Section asking if I would agree to write and present a paper on “these new wind leases” at the 2003 Advanced Oil, Gas & Energy Law Course in Houston. After a long pause (*in what was to become a life changing moment*), I agreed. Knowing that I would need some help, I called my old friend and law school classmate, Mike McElroy, to see if there was anyone in his firm that might be interested in co-authoring the paper. He referred me to one of his associates, Lisa Chavarria, and the rest is history. From there, I went on to co-author a textbook on wind law and to land an adjunct professorship at The University of Texas Law School, and Lisa became a partner in a leading renewable energy firm in Austin.

Now, over thirteen years after publication of “Anatomy of a Wind Lease,” the University of Texas has approached us to write an article for a presentation on solar leases. Once again, I sought help. This time, I turned to my partner, Jeffrey L. Allen, who has over nine years of experience in renewable energy, and Jacob R. Lederle, an associate with my firm (*and one of my former top students at the University of Texas Law School*).

Therefore, just as “Anatomy of a Wind Lease” introduced attorneys and landowners to the major elements of a wind lease, this paper, as well as a separate paper written by Lisa Chavarria, will introduce attorneys (as well as landowners and industry counsel) to the major elements of a solar-energy lease.

II. Major Elements of the Solar Energy Lease

The following is a brief review of the major elements of solar energy leases now seen in the Texas market.

A. Purpose Clause, Permitted Uses, & Additional Developer Rights

Over the last several years, rapid technological advances coupled with dramatic reductions in costs as well as the Investment Tax Credit (“ITC”) have provided the catalyst for a veritable “solar boom,” especially in Texas. Unsurprisingly, this boom has saturated the solar market with lease forms—each slightly different than the next. Despite this situation, however, each lease form will have some variation of a purpose clause (*but if the lease does not, one should certainly be added*), which as the name implies defines the purpose of the lease. Although this probably sounds rather straightforward—the purpose of the lease is quite obviously to build a solar farm—the clause is of extreme importance for both the developer and the landowner as it frequently will also set out what can and cannot be done on the property.¹

The typical purpose clause might recite something along the lines of: “this lease is for solar energy purposes and Operator shall have the exclusive right to use the Property for such purpose.” When dealing with such a clause, your first step should be to check the definition of “solar energy purposes” or whatever phrase the lease may use as generally the definition will set out the permitted uses of the property. Obviously, the broader the definition the more favorable it is to the developer and the more restricted the definition the more favorable it is to the landowner; however, a standard definition might recite something along the lines of: “solar energy purposes means collecting, converting, transmitting, and distributing electrical energy converted from solar energy.” As you might surmise, it is advisable to further define and refine

¹ Depending on the developer and the lease form they are using, occasionally there will be a separate clause that sets out the permitted uses.

the language to reach a point where the lease clearly sets out what the developer can use the property for and to avoid as much ambiguity as possible.

Depending on the structure of the lease, frequently the lease will either grant additional rights or easements for (i) ingress to and egress from the project, including the right to construct roads; (ii) for the construction of the project, including transmission facilities to distribute the energy converted; and (iii) other rights that may be necessary to fully operate the project. If, as part of the lease, the company is seeking easements, the landowner will want to ensure that the easements will not survive the expiration or termination of the solar lease. Likewise, landowners should also insert a clause that the property cannot be used for any other purpose and does not grant any additional rights other than what is listed in the lease—which should help avoid the situation where a company attempts to use the property in a manner not contemplated by the lease.

B. Lease Term

Perhaps one of the most important provisions in a solar lease from the landowner's perspective is the term of the lease, i.e., how long the lease is for. Not unlike a wind-energy lease the majority of solar leases will be divided into a "development term" and an "operations term" and also not infrequently a separate "construction term," during all of which if certain requirements are not met the lease will terminate.

The various terms in a solar lease should be very familiar to those who have seen or dealt with a wind-energy lease as the two are nearly identical in purpose—during the development term the company will conduct feasibility studies, complete any due diligence activities, and construct the project; however, if the lease has a separate construction term then once the company starts construction the lease will enter the construction term and then upon completion

of construction the lease will enter the operations term, which is the period during which energy is actually being produced and sold.

While the purpose of each separate term might be identical to a typical wind lease there are a few marked differences between wind and solar lease terms. One of the most obvious is the overall length of the term. For example: A typical wind lease generally has a 40 to 50-year operations term with a 5 to 7-year development term. Conversely, a solar lease generally has a much shorter operations term (usually in the range of 30 to 35 years).

C. Lease Compensation

Again, one familiar with a wind lease will recognize the basic terminology and structure of the solar lease payment scheme. Like a wind lease, a solar lease is based around a guaranteed minimum payment, commonly referred to as “minimum rent” or simply, depending on the structure of the lease, “rent.” Whereas wind lease minimum royalty payments are commonly based on a payment per megawatt of nameplate capacity, the solar lease compensation is, generally, calculated as a simple surface lease, i.e. a fixed sum per acre of leased land. The payment amount varies based upon the underlying value of the land itself and can range anywhere from \$200 per acre for remote, dry land in far West Texas to over \$1000 for exurban land that bear substantial potential for future non-agricultural development. The payments are made annually and are adjusted either by a fixed schedule, an agreed percentage, or, less commonly, by an inflation adjuster.

The acreage payment is characterized as “minimum” rent. Buffeted by over a century of oil and gas development and a decade and a half of wind development, most landowners require and receive a royalty as true rent, retaining the acreage payment as minimum annual compensation. Absent a royalty payment, the landowner is asked to forego the potential benefit

of increasing profits for the sale of electricity, locking in the rent today at a time of historically low electricity prices.

The royalty payment is again familiar to those acquainted with the modern wind lease, albeit a little lower. Royalties tend to start at around 3% of gross revenues. Like a wind lease, “gross revenues” are defined to include all or most of the following: (i) revenues received from the sale of electricity generated on the property, (ii) revenues from the sale of renewable energy credits, pollution credits or other associated credits; (iii) monies received as settlement or judgment amounts in any take or pay contracts, (iv) proceeds from any lump sum payment or payments to cancel or modify any obligation under any energy or electricity or capacity purchase contract or other contract related to the Project, and (v) payments made by an insurer which are made specifically in lieu of revenues received. Royalty payments are generally made quarterly, with the minimum rent payment made within thirty to forty-five days of the end of each calendar year. The minimum rent payment is made in the event that the prior year royalty payment did not exceed the product of the minimum payment amount times the total number of acres in the project.

Another landowner payment issue carried over from prior experience in wind and oil and gas is payment of surface damages. A repeated refrain throughout this paper has been the realization that a solar lease consumes the surface of the occupied area (a concept which is discussed in more detail below). Regardless, it is typical to receive payments for buried collection, transmission and distribution lines, as well as for overhead lines which carry electricity out of the “occupied area.” For portions of the property outside the occupied area, the lease should include payments for roads, transmission, collection and distribution lines, and

substations. Payment of surface damages are generally paid within thirty days of the commencement of construction.

D. Reserved Uses

As discussed elsewhere in this paper, the developer has the exclusive right to use the property to operate a solar-energy farm and for no other purpose. Accordingly, all other uses of the property (e.g., hunting, agriculture, oil and gas activity, etc.) are reserved onto the landowner. It is important to realize, however, that unlike wind energy development and oil and gas development, solar energy development has a substantial surface footprint. For example, whereas wind energy development utilizes thousands of acres (e.g., in some cases over 200,000 acres) for the most part other activities can continue on the property. On the other hand, while solar-energy development utilizes fewer acres (approximately 5 to 7 acres per megawatt or roughly 1,000 to 1,500 for a 200-megawatt project) that acre is rendered almost completely unusable for any other purpose as nearly every inch of the property will be covered with solar arrays and supporting infrastructure. As a result of this dichotomy, it is necessary to understand the concepts of what constitutes an “occupied area” and an “non-occupied area,” in solar leasing.

Generally speaking, the “occupied area” of a solar lease refers to the portion of the leased property upon which the solar arrays are installed. It is an area (typically fenced off) exclusively used by the solar developer where the landowner waives its right of ingress and egress, as well as the right to use any portion of that particular tract for any other purpose. The “occupied area” concept is useful in drafting and negotiating solar energy leases on large tracts of land which may only be partially used for the development of solar energy. For example, a company may want to lease more property than they will actually use. As a result, only a portion of the property will be utilized for solar-energy development (i.e., the occupied area). However, the developer

will likely need to maintain the right of ingress and egress across all of the property for the purpose of maintaining the solar project as well as for the development and installation of transmission facilities and support facilities. As a result, on those areas outside the occupied area the landowner will reserve the right to use the property for any purpose and in any manner that does not interfere with the company's use of the occupied area.

Probably the most important issue that deserves special attention in the context of solar-energy is oil and gas exploration. However, with that being said, what follows will only be a cursory review of the problems associated with competing solar and oil and gas development.² As anyone who has been in Texas for more than a day can attest, oil and gas is king and the laws of Texas have been crafted to afford mineral owners and oil and gas operators with substantial rights of surface use. In a nutshell, once the minerals beneath a particular tract are severed from the surface, a separate fee simple estate is created in the minerals. However, for this estate to be fully enjoyed the owners of the mineral estate must have access to the surface estate.³ Thus, Texas courts have held that there is an implied easement, in favor of the mineral estate, to use the surface in any manner reasonably necessary to explore for, develop, and produce the minerals. This concept is known as the Dominant Estate Doctrine. As a result of this implied easement, most companies will seek a waiver of surface rights (either in the lease or by separate agreement) from the landowner that ensures the landowner will not disrupt the project by enforcing its implied easement to utilize the surface. However, if the landowner does not own any of the minerals beneath his or her property or only owns a portion the company will need to obtain additional waivers to ensure that their project is not disrupted.

² For a more detailed examination of the issue, we direct you to Ernest E. Smith, Jacob R. Lederle, & W. Jared Berg, *Everything Under the Sun: A Guide to Siting Solar in the Lone Star State*, 12.1 TEX. J. OIL, GAS & ENERGY L. 42 (Fall 2016).

³ See *Harris v. Currie*, 176 S.W.2d 302, 142 Tex. 93 (Tex. 1943).

Along the same lines, if there are nonexecutive mineral owners (those without the ability to lease their interest or those with a mere royalty) then the landowner faces significant liability if he or she waives the right to use the surface to develop minerals. One of the most recognized attributes of the mineral estate is the executive right (i.e., the right to lease the minerals); however, like the minerals themselves the executive right can be severed from mineral ownership. For example, a landowner can convey half of the minerals beneath his or her property to someone else but also stipulate that the conveyance does not include the right to lease the minerals (i.e., the landowner has conveyed a nonexecutive fee simple mineral interest). Likewise, the landowner could simply convey the right to receive a portion of the royalty generated by producing the minerals (a royalty by definition does not include the right to lease the minerals). In such a scenario, whoever retains the right to lease the minerals also owes nonexecutive mineral owners and royalty owners a duty of utmost good faith and fair dealing.⁴ It is highly likely, that leasing the property for solar energy development and waiving the right to utilize the surface would result in a violation of this duty. Thus, an attorney representing a landowner who owns some but not all of the minerals need to be cognizant that not adequately dealing with the above scenarios is likely to create significant liability for their clients. One method, that most companies are open to, is to demand that certain areas be set aside that will allow mineral owners to access their minerals.⁵

E. Payment of Taxes

While it is certainly not a universal truth, considering the ever-expanding development of small scale exurban solar projects, the majority of solar development occurs on relatively remote

⁴ See *Lesley v. Veterans Land Board*, 352 S.W.3d 479 (Tex. 2011); See also *KCM Financial LLC v. Bradshaw*, 457 S.W.3d 70 (Tex. 2015).

⁵ Naturally, the mineral issues discussed do not apply if the landowner does not own any minerals or does not own the executive right. In that scenario, the burden is on the developer to ensure that adequate waivers and agreements are reached with the actual mineral owners.

agricultural land and, as Texans are acutely aware, the state has found it necessary to tax land. However, to help offset the relatively high property taxes imposed, Texas offers some benevolence in the form of what is colloquially referred to as an “ag exemption.” The ag exemption is, in fact, not an exemption *per se*, but a set of modified appraisal methods which are authorized by our wonderfully succinct constitution and described particularly in Section 23 of the Tax Code. While a detailed description of the Tax Code’s treatment of agricultural land is beyond the scope of this paper, suffice it to say that there are two basic appraisal methods: (i) the Agricultural Use Appraisal, and (ii) the Open-Space Appraisal. Fundamentally, the former is designed to assist full-time farmers and includes occupation requirements for the applicant. The latter bears a lower bar and focuses primarily on the land itself.

The issue of ad valorem taxes was first breached during the wind development boom in the middle part of the last decade. As wind development increased in rural West Texas, appraisal districts discovered a new-found source of revenue. Drought stricken land written off as the habitation of rattlesnakes and a few hearty goats, was rediscovered as income producing land; suddenly with a real and ascertainable value. Unlike minerals which are separately assessed when producing, no separate “estate” existed (nor exists now) for wind, thus the increased value is attributed solely to the surface. Additionally, land that was once pasture or farm lands, now bear giant wind towers. Those changes of circumstance raised two questions: (1) How is this going to affect my bottom line? (2) What about my ag exemption?

With wind, the ag exemption question generally faded. One familiar with the West Texas landscape can see that wind development cooperates well with other uses. The wind turbine occupies a little less than once acre, physically, causing little, if any, impact to the ranching operations, and only relatively minor modifications to farming which are addressed in the lease.

That left the more general question of the landowner's bottom line. It is perfectly reasonable to see that land producing a constant royalty is worth more than land lacking the same. Appraisal districts increased the underlying value of the land accordingly, which caused some "sticker shock." In order to soften the blow, the wind lease evolved to include a clause which provides that the lessee is responsible for any increase in the landowner's ad valorem taxes resulting from the lessee's development of the land. A caveat usually follows stating increases in the appraised value resulting from landowner improvements is excluded.

The weary landowner, aware of the State's unique appraisal methods, next looked to the lessee for protection against loss exemption as well. As referenced, the loss of eligibility for specialized appraisal methods has been generally an afterthought on wind leases, but not for solar agreements. As described in more detail elsewhere in this paper, solar energy development necessarily precludes the use of the land's surface for any activity other than solar energy development. As a consequence, it is quite likely, and nearly inevitable, that solar land will no longer be eligible for the Agricultural-Use Appraisal or the Open-Space Appraisal. As a result, the landowner may then not only lose its prospective tax savings, but will become liable to pay the assessor the tax savings for the previous three years on the Ag-Use Appraisal and five years on the Open-Space Appraisal, both of which are accompanied with interest and a tax lien. This exemption loss is commonly referred to as the tax "roll back".

In order to protect the landowner, it is imperative that the tax section of the solar lease not be limited only to increases in ad valorem taxes, but to also cover any penalties on roll back taxes. In effect, at least as to the "occupied area," the solar company should assume payment of all ad valorem taxes. Thus, roll back taxes and increases notwithstanding, it is an ever-growing trend in solar to deviate from the wind lease norm of limiting increases in ad valorem taxes to

eliminating taxes for the landowners all together. As referenced herein repeatedly, a solar lease is emotionally and functionally akin to selling the land. The landowner retains little to no right to use or control the land. As such, it is appropriate to be released of the tax burden. As a practical matter, given the general requirement that the lessee protect against increases, and further given the relatively low value of much of the land developed for solar use, the gesture of paying all the ad valorem taxes by the lessee is far from fiscally catastrophic. A common lease addressing this point may say: “Tenant shall pay all real and personal property taxes assessed against the Property occupied by Tenant’s Solar Facilities after the Commercial Operations Date.”

It is, ultimately, the goal of the lease to limit the landowner’s ad valorem tax burden to be equal to that of similarly situated land that is not encompassed by a solar lease. Care should be taken to ensure the same.

F. Removal Bond

A common feature, nearly ubiquitous to renewable energy leases negotiated over the last decade, is a security for the removal of improvements upon expiration or termination of the agreement. The concept of removal security was developed to address landowner concerns for the restoration of their property following the decommissioning of the project or upon the termination of a lease. To achieve that end, the removal security sets aside a bond, letter of credit, or guarantee from a creditworthy entity in an amount equal to the reasonable estimate of the cost to remove the facilities from the property and to restore the property pursuant to the restoration clause of the lease. A full removal cost bond is preferable; however, it is not uncommon for the bond to be in an amount equal to the removal cost net of the salvage value of the improvements. A typical removal security will include a provision to settle good faith disputes as to the cost of removal as well as the salvage value as applicable. In that regard, the

lease will often provide that the parties acquire a disinterested third party engineer who may be, if the parties cannot agree, appointed by the district or county judge with jurisdiction in the county where the land is located. The lease will also provide for a date for placement of the bond. This is generally between the tenth and twentieth anniversary of the lease effective date, though leases do sometimes require an earlier posting date.

G. Indemnity

Indemnity clauses are standard fare in renewable energy leases and this is no less true for solar leases. In fact, there is unlikely to be very much difference between a clause found in a wind lease or one found in a solar lease. Essentially, they both seek to assure the landowner that the company will indemnify and hold harmless the landowner from all lawsuits arising out of or from the companies use of the land. Unlike a wind lease, an attorney representing a solar landowner will want to ensure that the indemnity clause in a solar lease covers suits by minerals owners. As discussed in the section on reserved uses, the nature of solar development creates the possibility for significant liability if the mineral estate is not adequately addressed; therefore, as an extra step to protect landowners, it is advisable to include suits by mineral owners as a suit covered by the indemnity clause.

H. Choice of Law, and Venue

A clause that is often overlooked in standard contracts are the ones dealing with what law will apply and where disputes will be resolved. Frequently, the companies seeking to lease a landowner's property are not from Texas, which creates the possibility that absent an express clause to the contrary, another state's law may apply to a Texas solar farm. Obviously, no landowner (or his or her attorney) wants to litigate a dispute by having to rely on New York, or Florida, or California law. Therefore, it is critical that any choice of law clause be reviewed to

ensure Texas law will apply in the event of a dispute and that all disputes will be heard in the state courts of the county where the land is located (as opposed to arbitration which is a process normally unfamiliar to Texas landowners).

III. Conclusion

Based on the volume and variety of solar leases we have seen in different areas of Texas in just the last year, it appears that solar energy is now on the same trajectory that wind energy was in 2003. If such is the case (and we believe it to be so), it is likely that solar leases in the coming years will become less diverse and more landowner friendly. We hope that this article will serve as a catalyst in this process.