Are Wind Rights A New Stick in the Bundle?

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Energy

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Although Texas has been one of the epicenters of wind development, the state has not passed any laws recognizing or rejecting the ability to sever a "wind estate." Investors have been hopeful that Texas courts will lead the charge in recognizing or creating wind rights for three major reasons: (1) Texas has more wind power capacity than any other state, so Texas's actions are immensely significant for the industry, (2) Texas has created and maintained the highest level of jurisprudence relating to the creation and development of mineral rights (the potential corollary to wind rights), and (3) Texas courts are well known for fiercely protecting the rights of individual landowners to develop and divest land in the manner that they best see fit. The risk surrounding whether Texas courts would recognize the severability of a wind estate dissipated in May 2023 when a judge confirmed the right to sever wind rights and a jury awarded damages for the first time under state law. Unfortunately, a plethora of uncertainty remains.

Ridge Renewables, LLC v. Hale County Wind Farm, LLC et al.

On Aug. 24, 2010, Glendale King, who owned 256 acres of land in fee simple absolute, signed a wind lease with Hale County Wind Farm LLC. The lease expired on Aug. 24, 2017. On Jan. 12, 2011, King conveyed certain ownership interests in his property to Kelly and Ronna Smalley. In connection with the conveyance to the Smalleys, King reserved a life estate in all royalties derived from the production of wind energy and all rights to lease the property for wind energy production purposes.

On Oct. 30, 2017, two months after the termination of the 2010 wind lease, Hale induced the Smalleys to execute an amendment to the expired lease which extended the termination date from Aug. 24, 2017, to Aug. 24, 2020. King, who had sole authority over the wind rights at the time of the amendment, had no involvement in the extension. Without the knowledge or consent of King, Hale constructed two wind turbines on the property and generated and sold electrical energy, receiving revenue from the trespassing wind turbines.

On Sept. 22, 2020, King conveyed to Ridge Renewables LLC all title and interest owned by him in the land, including all wind rights and causes of action accruing or accrued with respect to the wind rights in the property. In a motion for partial summary judgment on bad-faith trespass, Ridge argued it exclusively owns the rights to develop, lease and receive revenues from wind energy production on the property. The judge granted Ridge's motion, signifying the first time any Texas court has recognized the legitimate severability of wind rights under state law. However, lack of guidance from the court has left many unanswered questions for Texas landowners and wind developers.

The Impact of Regulatory Uncertainty on a Renewable Power Project ("RNP") Rights Acquisition

Recently (anecdotally, around five years ago), the number of wind and solar projects producing and in development appeared to reach a scale sufficient to spawn investor interest in the landowner side of a Renewable Power Projects lease (an "RNP lease"), especially the revenue stream associated with future payments (royalty, periodic minimums, etc.) due to be paid by the project developer to the landowner under the RNP lease for an RNP project that is in production or that has otherwise reached full development stage (an "LRS"). The "bones" of a deal where a financial investor acquires an LRS (and certain other rights, as discussed below) from a landowner in exchange for a lump-sum payment are fairly straightforward, consisting of the main conveyance documentation pursuant to which landowner sells the right to receive the LRS and related rights to the investor in exchange for the lump sum cash payment, which may be broken up into a purchase and sale agreement and a recordable assignment, and will typically also include a customary array of ancillary consents and releases.

a. Benefits and Risks of RNP Rights Acquisition

To help illustrate the impact of regulatory uncertainty, we set out the main commercial and legal outcomes for stakeholders involved in LRS assignment below. These stakeholders include: the landowner (grantor under the LRS rights conveyance and lessor-assignor under the RNP lease), the investor (grantee under the LRS rights conveyance and assignee-lessor under the RNP lease), and the developer (lessee under the RNP lease).

b. Maintenance of LRS Assignment

The investor's primary goal is to obtain and maintain each LRS it acquires until it is fully paid, enabling the investor to recover the amount of its original investment, plus an expected return. The investor's business plan likely includes optionality to monetize tranches of the LRS via securitization or repackaging and reselling to secondary investors, requiring a minimum level of payment stability to achieve a desired credit rating. Therefore, the investor's primary concerns are mirror images of the investor's goals. Regulatory certainty surrounding RNP rights grants would give investors comfort that future bankruptcy courts would not permit a landowner to reject the conveyance and the rights assigned thereunder as an executory contract. Lack of certainty as to this proposition likely results in lower offers to landowners or RNP rights transactions being priced so low that they become non-viable.

c. Enforceability of RNP Lease

The investor must be able to enforce its lessor rights to receive and require the developer to pay the LRS payments; however, the investor must also have a mechanism to encourage the landowner to continue to perform and comply with all of the Lessor's obligations under the RNP lease so as to avoid any breach of the lease that would cause the developer to stop paying the LRS. Many of the Lessor's obligations under the RNP lease relate to access and land use. These obligations may include positive covenants, but the most important obligations will typically be negative covenants, such as not occupying certain sites or conducting activities that thwart the developer's intended use. Because the landowner continues to enjoy daily use of the land for all purposes other than those rights assigned under the RNP rights grant, it is the landowner that must perform the applicable obligations and avoid performing the prohibited actions.

Enforcement of the terms of the RNP lease is also likely to be the developer's main concern with respect to an RNP rights acquisition. The developer will be interested in the investor's ability to enforce the lessor's access and use obligations when the investor is not occupying the land on a day-to-day basis. The developer will also be concerned that any future dispute that arises between the investor and the landowner over the terms of the RNP conveyance may involve the developer or cause collateral damage impacting the viability of the project. The developer will face other difficulties in the event of a financing or refinancing with regard to estoppel agreements, which now presumably must be obtained from the investor and the landowner. Because a developer receives no benefit from an RNP rights acquisition, it may look upon these potential risks in a negative light, causing significant issues in cases where the developer has a consent right over any assignment under the RNP lease.

A landowner will typically remain obligated to comply with the obligations under the RNP lease on a joint and several basis with the investor. However, because the landowner has already received 100% of the consideration it expects to receive, it will no longer be incentivized to comply with the ongoing lessor obligations under the RNP lease. This concern only worsens over time—for example, if an original landowner sells its interest in the land to a successor, that successor, who did not receive payment from the investor, is even less incentivized to comply.

Although the landowner's primary goal under the RNP rights acquisition is accomplished at closing, the landowner may also be concerned with the enforcement of certain covenants under the RNP lease during the remaining term, especially if the landowner assigns its enforcement rights to the investor. The investor lacks incentive to strongly enforce covenants on behalf of the landowner where the investor risks losing LRS payments by pursuing action against the developer. More regulatory clarity regarding the interactions between stakeholders could help ease the concerns of each party and make transacting much easier.

d. Nature and Enforceability of RNP "Tail Rights"

Another investor benefit arises when the investor negotiates the right to acquire 100% of the landowner's 'wind rights' into perpetuity, including "tail rights" to develop or re-lease the land for the development of new wind energy projects after the current RNP lease terminates. However, given the significant unknowns surrounding the future monetization of RNP tail rights, investors will likely attribute little value to them. The investor's concerns relate to enforceability of the rights when exercised 20-30 years later—i.e., how amenable the current landowner will be to a new wind development project on their land where (i) the landowner will probably receive little or no bonus or royalty payments, (ii) the landowner will have to provide unknown access and use rights, and (iii) the landowner will probably not be a party to any new RNP lease.

Landowners tend to be more concerned about the nature of RNP Tail Rights than the administration of the RNP rights grant during the remaining term of the RNP lease. Presumably, this is in part because the RNP lease sets out detailed rights and obligations of the parties with respect to access and land use, whereas the description of RNP Tail Rights tends to be necessarily vague and broad. The landowner's concerns mirror the investor's concerns over RNP Tail Rights—i.e., the scope of potential future development, the lack of input that the landowner has over the development and the potential negative impact on the value of their land. This uncertainty can be a major impediment and result in lengthy provisions trying to emulate years of common law developments that apply to grants of mineral interests—i.e., dominant estate theory, accommodation doctrine, etc.—in each case modified to fit the nature of a renewable power project.

The Impact of *Ridge Renewables*

The decision in *Ridge Renewables* is a significant first step towards more regulatory certainty around LRS and RNP leases for renewable power projects in Texas. In *Ridge Renewables*, the court supported the basic concept of the severance of wind rights under an RNP rights acquisition and, perhaps more importantly, may have signaled the direction that Texas courts are likely to head with respect to this area of law—i.e., toward recognizing and supporting the rights of a landowner to enter into these transactions. As we discussed above, there is a significant amount of work to do to fill in the details of how an RNP rights acquisition works. That said, Texas courts took decades to fill in the details around mineral rights acquisitions and severances, so they have time.

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