

TAX AND LEGAL ISSUES FOR REAL ESTATE PROFESSIONALS

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Part I

- Issues With Easements



Other Interests in land

- **Easements**
 - An easement carries no possessory right, but is merely a right to use or take something from another's land
 - Right-of-way
 - Flowage
 - Lateral and subjacent support



Easement in Gross

- **An easement that serves the holder personally instead of in connection with the holder's ownership or use of a specific parcel of land**
 - Utility company easements
 - Street easements
 - Railroad easements
- **A nonassignable personal right that terminates upon death, liquidation or bankruptcy of holder**



Appurtenant Easement

- **An easement benefiting a particular tract of land. It becomes a right in the particular parcel and passes with the title upon subsequent conveyance of the land**
 - Walkways
 - Driveways
 - Utility lines for a particular parcel
 - Water rights (at least in some western states)



Distinguishing Between Easements In Gross and Appurtenant Easements

- **Facts and circumstances test**
- **Preference of courts is for appurtenant easements - passes with title**
 - Runs with the land
 - What about water rights?
 - What about rights to wind-flow?

 **Affirmative Easement**

- Entitles the holder to conduct certain activities upon the land subject to the easement
- The majority of easements are affirmative

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 **Negative Easement**

- Gives the holder a right to require the landowner to do or not do certain things concerning the land
- Synonymous with covenantal land restrictions and similar to “natural rights” that are incidents of land ownership
 - Riparian rights
 - Lateral and subjacent support rights
 - Right to be free from nuisances
 - See *Bormann v. Kossuth County Board of Supervisors*, 584 N.W.2d 309 (Iowa 1998)

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 **Negative Easement**

- American law generally does not recognize negative easements for light, air & view unless interference is malicious

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 ***Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.*, 114 So.2d 357 (Fla. App. 1959)**

- **Facts:** The Eden Roc Hotel sought to enjoin Fontainebleau from constructing a 14-story addition, alleging that the construction would interfere with the light and air on its beach and cast a shadow on the beach making it unfit for the use and enjoyment of its guests. The Eden Roc was built approximately one year after the Fontainebleau. The trial court granted a temporary injunction.

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 ***Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.*, 114 So. 2d 357 (Fla. App. 1959)**

- **Issue:** Is the Eden Roc entitled to an injunction on the basis that it has an easement for air and light, or on any other grounds?

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 ***Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.*, 114 So.2d 357 (Fla. App. 1959)**

- **Conclusion:** No, American common law does not recognize an easement for light and air. It is irrelevant that the addition may have been erected partly for spite. Adjoining landowners can build to the line of their respective tracts. Amending the zoning law is the proper manner to resolve this type of dispute.

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Coty v. Ramsey Associates, Inc., 149 Vt. 451, 546 A.2d 196 (1988)

- **Facts:** Plaintiffs sought an injunction against defendant for establishing a pig farm on an adjacent parcel of land in retaliation for plaintiff's opposition to a motel that defendants had planned to build on the adjacent parcel. The trial court determined that the farm was a nuisance and enjoined further operation of the farm not in accordance with good husbandry practices. The trial court awarded almost \$600,000 in compensatory and punitive damages.

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Coty v. Ramsey Associates, Inc. (Vermont 1988)

- **Issue:** Was the pig farm a nuisance? Is there a recognizable exception to the general rule that no negative easement exists for light, air and view?

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Coty v. Ramsey Associates, Inc., 149 Vt. 451, 546 A.2d 196 (1988)

- **Conclusion:** Yes. The farm constituted a nuisance by being both unreasonable and substantial and was established solely out of malice. The trial court's decision is affirmed in all respects.

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Other Interests in Land

- **Profit**
 - A profit allows the holder to remove some substance from another's land, and is typically accompanied by a license
 - A license is a permissive land use that is terminable at will of licensor
 - A license is not an interest in land and need not be in writing
 - Distinction between profit and easement
 - An easement is a use right, but a profit is a right of severance

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Other Interests in Land

- **Profit**
 - Example: A woodlot owner could grant another person a right to enter the woodlot to cut and remove timber
 - Right of severance leading to possession
 - Exists for a fixed period of time or perpetually
 - A profit like an easement, is an interest in land and must be in writing to be enforceable

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Other Interests in Land

- **License**
 - Covers broader range of permissive land uses
 - A hunter who is on the premises with permission is a licensee
 - A license can be terminated at any time by the licensor
 - Without permission, the land use is a trespass
 - A license is *not* an interest in land, but is only a privilege
 - Can be granted orally

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Types of Easements

- **Implied easements**

- May arise from prior use, by necessity or by prescription
 - Easement arising from prior use
 - **Example:**
 - » Severance of a large tract into two smaller tracts and a utility line now crosses two tracts instead of only one.

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Types of Easements

- **Implied easements**

- “Easement by necessity”
 - Arises when a parcel is severed, resulting in a landlocked parcel. No prior use is necessary.

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Types of Easements

- **Easement by prescription**

- Analogous to acquiring property by adverse possession (open and notorious, adverse, under a claim of right, continuous and uninterrupted, or use made with acquiescence, for the statutory period)
- Permission eliminates the possibility of acquiring an easement by prescription, but *acquiescence* does not

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Prescriptive Easement/Adverse Possession

- **Cannot be asserted against the government**
- **Can the government acquire title via adverse possession?**
 - If so, avoids constitutional requirement to pay for property that is “taken”
 - See *Chesbro v. Douglas County*

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Boundary by Acquiescence

- **Can arise when adjoining owners are mistaken about true boundary and treat a particular fence or line as the boundary for the statutory period**

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Rafanelli v. Dale, 924 P.2d 242 (Mont. 1996)

- **Facts:** Dale owned a landlocked parcel and had used three access routes across Rafanelli’s property at various times. Dale claimed an easement by prescription for Route B. Rafanelli claimed that Dale’s use was permissive or on the basis of neighborly accommodation.
- **Issue:** Did Dale have a prescriptive easement over Route B?

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Rafanelli v. Dale, 924 P.2d 242 (Mont. 1996)

- **Conclusion: Yes. The Dale's continuous use of route B, their ignoring two requests that they obtain permission to use the road, and the Rafanelli's failure to obstruct or interrupt the Dale's use, are evidence of hostile and adverse use for the required 5-year period.**

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State Adverse Possession Statutes

- See Table 1

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Easements

- **What type of use is permissible?**
 - Specific terms of easement control
 - If instrument is silent, presumption is that easement lasts forever and allows normal development
 - *Read instruments carefully*

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Termination of Easements

- **Merger**
 - Unity of ownership
 - A owns Blackacre and B owns adjoining Whiteacre. B grants A an easement across Whiteacre so that A can acquire access to Blackacre. Two years later, A buys Whiteacre in fee simple. The easement is terminated.
- **Release**
 - If the easement is for more than one year, the release must be in writing and comply with all the formalities of a deed

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Termination of Easements

- **Estoppel - Reasonable reliance by owner of burdened estate who changes position based on easement holder's statements or conduct**
 - **Example:** A tells B that A is going to release the easement over B's property. As a result, A doesn't use the easement for a long time. B then builds a machine shed over A's easement. A could not reassert the existence of the easement after the machine shed has been built.

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Termination of Easements

- **Abandonment - easement holder takes some sort of physical action indicating an intent to permanently abandon the easement**
 - Mere words are inadequate to constitute abandonment
- **Prescription - easement holder now becomes rightful owner**

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Ownership and Use of Abandoned Railways

- **What happens when a railroad abandons a line?**
 - Pre- 1983: If railroad granted an easement -
 - Abandonment terminates railroad’s interest with reversion to adjacent fee simple owners
 - State law controls after abandonment
 - If state law specifies that abandoned lines revert to adjacent landowners, compensation is due
 - » 11/21/02 Fed. Ct. of Claims opinion involving Katy Trail in Missouri - \$410,000 awarded to 13 adjacent landowners

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Ownership and Use of Abandoned Railways

- **1976 RRRRA**
 - Designed to promote conversion of abandoned lines to trails
 - ICC authorized to delay disposition of railroad property for up to six months after order of abandonment
 - Exception if property offered for sale for public purposes

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Ownership and Use of Abandoned Railways

- **National Trails System Act (1983 amendments)**
 - ICC authorized to preserve abandoned lines for future use and allow interim use as recreational trails
 - Concept known as “railbanking”
 - Abandonment procedure

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Ownership and Use of Abandoned Railways

- **National Trails System Act (1983 amendments)**
 - **Abandonment procedure**
 - Railroad obtains STB’s permission for discontinuance
 - Granted based on possible future public convenience and whether qualified person wants to operate a trail line
 - Trail operator must agree to manage trail, be responsible for trail and pay taxes on trail
 - Railroad files application with STB and gives notice of planned abandonment
 - Application states whether line is suitable for recreational purposes

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Ownership and Use of Abandoned Railways

- **National Trails System Act (1983 amendments)**
 - Abandonment procedure
 - Trail group submits map and agreement to assume financial responsibility
 - If railroad intends to negotiate trail agreement, STB issues “CITU”
 - 180 days to reach agreement

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Ownership and Use of Abandoned Railways

- **Legal issues**
 - Pre-1983
 - Clear that easement interest of adjacent fee owners reverted upon abandonment
 - *Consolidated Rail Corp. Inc. v. Lewellen*, 682 N.W.2d 779 (Ind. 1997)
 - *Glosemeyer v. United States*, 45 Fed. Cl. 771 (2000)
 - Post-1983
 - When does abandonment occur?
 - State property law may control (*Fritsch v. Interstate Commerce Commission*, 59 F.3d 248 (D.C. Cir. 1995), cert. denied sub. nom. *CSX Transportation v. Fritsch*, 516 U.S. 1171 (1996) (D.C. Cir. 1995)

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Ownership and Use of Abandoned Railways

• Legal issues

– Post-1983

• 5th Amendment concerns

- 1983 Act upheld as constitutional - (no abandonment occurs under 1983 Act & ICC retains jurisdiction)
- But, may be possible to sue for a “taking” in Court of Federal Claims
 - » Compensable taking found in *Preseault v. United States*, 52 Fed. Cl. 667 (2002)

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Ownership and Use of Abandoned Railways

• Legal issues

– Recent developments

- Proposed legislation (local control & protection of reversionary interests)
- Nationwide class action lawsuit filed on behalf of adjacent landowners in Kansas federal district court in late 1998
 - Trail group later conceded the matter based on Kansas law (abandoned line reverts to adjacent owners of the fee interest)
- 2014 U.S. Supreme Court decision

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Part II

• Tax Issues Associated With Easement Payments

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Overview

- **Landowners get payments from utility companies, oil pipeline companies, wind energy companies and other for right-of-way easements**
 - Rights acquired
 - Right to lay pipeline
 - Aerogenerators and road access
 - Electric lines
 - Other access rights
 - Negative easement payments

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Nature of the Transaction

• Perpetual/permanent easement

- If no retained beneficial rights, it’s treated as a sale of the underlying tract
 - Deprivation of all beneficial interest except for retention of legal title
 - Treat as a sale of the land itself under Secs. 1221 or 1231
- If beneficial rights retained, it’s a sale of an easement
 - Example would be retained rights to plant crops on the surface of the easement property
- Note:
 - If a lease is involved (rather than sale) ordinary income will be the result with no basis offset

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Easement Payments

- **Only basis of the land allocable to the portion subject to the easement is reduced with excess treated as capital gain**
 - Two tax issues involved when allocating basis
 - Allocate between portion impacted and balance of property
 - Allocate between rights created by easement and rights in property
 - Equitable apportionment – not based on acreage
- **Does the easement impact the taxpayer’s entire property? Maybe can allocate entire basis**
 - Example and cases - p. A161
 - Examine the terms of the particular easement
 - Example 3 on page A161

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Severance Damage Payments

- **Does the easement bisect the taxpayer's property?**
 - If so, is the rest of the property usable?
 - If not, then apply easement proceeds against basis in entire property
 - Watch for this particularly with commercial property and ag land that has developmental potential
 - Might be able to use Sec. 1033 rules (involuntary conversion)
 - Use the severance damages to restore the property or invest the damages in other qualified property



Temporary Easement Payments

- **For space**
 - Access, storage, etc.
- **Separately designated**
 - Generates rental income for the allocated amount
- **Suggestion:**
 - Include the temporary space in the perpetual easement which is then reduced after a stated amount of time
 - May get some basis offset
 - May be able to classify as damage payments



Damage Payments

- **If for present damage, may be able to be offset by basis in the affected property (FSA 200228005)**
 - Environmental contamination
 - Soil compaction
- **If payment is for damage to growing crops**
 - Treat as sale of the crop
- **Payments for future damage are treated as rental payments (release language)**
 - No basis offset



Lease Payments

- **If for present damage, may be able to be offset by basis in the affected property (FSA 200228005)**
 - Environmental contamination
 - Soil compaction
- **If payment is for damage to growing crops**
 - Treat as sale of the crop
- **Payments for future damage are treated as rental payments (release language)**
 - No basis offset



What is a Lease That Generates Ordinary Income?

- **Easements for a definite term**
- **Easement for "as long as oil and gas is produced in paying quantities"**
- **If reversionary rights retained**
 - But, if the transaction involves a contingent reversion in case the easement is not used or abandoned constitutes a sale of an easement



Negative Easement Payments

- **It's rental income in the recipient's hands**
 - F.S.A. 20152102F (Feb. 25, 2015)
 - Based on *Morehouse*
 - Could have application to situations involving the government's use of a taxpayer's property to enhance wildlife and conservation

Eminent Domain

- **Condemnation award**
 - IRS views it as solely for the property taken and is treated as a sale for tax purposes
 - If it exceeds the FMV of the property taken the taxpayer might be able to allocate the award to various types of damages.
 - Preserve evidence!!
 - If personal residence is involved in the condemnation, the taxable amount of the reward is decreased by the gain excluded under Sec. 121

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Eminent Domain – Deferral of Gain

- **Sec. 1033 (applies to condemnations and sales under threat of condemnation)**
 - Reinvest in like-kind property
 - 3 years
 - Can include severance damages if used to restore the property
 - A sale of the remaining property can also qualify for 1033 treatment if the remaining use is not practical and the property is sold

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How to Defer Gain Under Sec. 1033

- **Just don't report the condemnation gain realized on the return for the year the award is received**
- **In the year the gain is realized, taxpayer must disclose details concerning the replacement property**
- **Example**

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Other Points on Condemnation Awards and Sec. 1033

- **3 years to reinvest**
 - From close of first tax year in which the taxpayer realizes any part of the gain
 - It's the earlier of the date of disposition or the date that condemnation is threatened, and ends 3 years after the close of the first tax year in which any part of the gain is realized.
- **Severance damages may also qualify for deferral under Sec. 1033**
- **Must allocate basis between land and improvements (Rev. Rul. 79-402)**
- **Must allocate amount realized on condemnation between various classes of property involved**

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Expenses Incurred During Condemnation

- **Treat as capital expenditures**
 - Add to basis in the property subject to the easement
 - Reduces gain on condemnation
- **If made to substantiate and recover severance damages, capitalize as part of basis of property that is not condemned**

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Estate Tax Implications

- **Long-term leases can have an impact on estate tax value**
 - Estate of *Mitchell v. Comr.*
 - Long-term lease enhanced value
- **When did death occur?**
 - Still during development phase?
 - Probably no value enhancement
- **What about Sec. 2032A?**
 - Grant of an easement could be a disposition triggering recapture tax

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 Part III

- **Legal Issues to Consider When Negotiating Wind Energy Leases**

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 Topics For Discussion

- **General comments**
- **Liability concerns**
- **Legal issues involving the agreement**
- **Creating an equitable agreement**

 Key Question – Is Your Property a Potential Target for a Wind Farm?

- **Constant 11-13 mph wind speed**
- **Proximity to existing transmission lines**
- **No endangered species, high bird activity, or highly valued aesthetics**
 - Might be possible to mitigate bird problems
- **Local community and political support**

 Recent Data

- **Wind energy production generates only 5.5% of total U.S. power production**
- **But, the Joint Committee on Taxation estimates that the total cost to taxpayers of the wind production tax credit between 2016 and 2020 will be \$23.7 billion**

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 Wind Energy Development

- **Site selection is the key to development and the avoidance of legal problems in the future:**
 - Windy (based on windy days and velocity)
 - Near transmission lines
 - Access to roads
 - Few environmental concerns
 - Community support – zoning, use permits, etc.

 General Comment

- **Always evaluate the agreement with an eye toward the risk you might face**
 - Environmental concerns
 - Issues that could be raised by neighbors
 - Zoning issues; set-back requirements
 - Land use restrictions
 - Farm program eligibility
 - Economics



Wind Energy Development

• Primary Issues

- Landowner must stay abreast of liability issues
 - Trespassers
 - Third party usage
 - Environmental/aesthetic issues
 - Nuisance



Liability Concerns

- **Tort liability may be assessed in cases where harm results from a party's conduct with respect to the construction or maintenance of wind turbines**



Pre-Construction Contracts

- **Tort liability can arise where harm results of a party's negligence with respect to the construction or maintenance of wind aerogenerators**
 - Duty
 - Breach
 - Causation
 - Damages



Legal Issues During the Development Phase

- **Lawsuits and claims related to developer's actions**
 - This becomes a contractual issue
 - Independent contractor/employee analysis
 - Control issue



Limiting Liability Exposure

- **Dealing with potential liability via the contract – the development phase**
 - A landowner must be careful to expressly limit their potential tort liability
 - Written provision- not liable for negligence of others with respect to the wind generation operation
- **Insurance**
 - Landowner should ensure that liability insurance is in place



Tort Liability

- **Nuisance**
 - Private nuisance - Substantial and unreasonable
 - Public nuisance – unreasonable interference with a right that is common to the general public's health, safety, comfort or convenience, or is illegal
- **Negligence**
- **Trespass**



Tort Issues to Address in the Agreement

- **Damages to adjacent property**
 - Alteration of flow of surface water
- **Aesthetic damages**
- **Damages/injury caused by ice throws**
- **Stray voltage**



Tort Issues to Address in the Agreement

- **Interference with electromagnetic fields**
- **Fire caused by malfunction or lightning**
 - Include an inspection clause
- **Interference with TV and radio signals**
- **Death of protected birds**
- **Adverse health impacts**



Industrial Wind Farms

- **The next generation of nuisance lawsuits?**
 - Nuisance defined – an unreasonable interference with another person’s use and enjoyment of their property
 - Private – must be substantial and unreasonable
 - Public – involves an interference with public health, safety, comfort, convenience, or is illegal



Recent Case Law

- ***Burch v. Nedpower Mount Storm, LLC, 320 W. Va. 443, 647 S.E.2d 879 (2007)***
 - Wind farm with 200 wind turbines in close proximity to residential property could constitute a nuisance
 - Homeowners had sued to permanently enjoin construction and operation
 - Noise, eyesore, flicker and strobe effect of light reflecting from blades, potential danger from broken blades, ice throws, reduced property values



Burch v. Nedpower Mount Storm, LLC

- **Additional findings of the Court:**
 - Even though State Public Service Commission approved the facility, such approval did not abrogate the common law of nuisance
 - Wind farm not a nuisance per se, but could become a nuisance
 - Thus, plaintiffs’ claims were sufficient to prospectively enjoin a nuisance
 - Plaintiffs can adduce sufficient evidence to prove their allegations in an effort to abate the nuisance



Recent Case Law

- **November 2007- VT Board of Civil Authority ruled that a wind turbine reduced the value of adjacent property by 10 percent**
 - Evidence showed turbine within 300 feet of petitioner’s home
 - Noise, blinking lights, glare from blades, vibrations

Setback Requirements

- **Supreme Court NY:**
 - Approved minimum setback requirements for wind turbine placement away from residences, public roads, and other properties not containing wind turbines
 - Court says that the setback requirement was not a de facto unconstitutional taking under NY Constitution
 - There was an appropriate rationale including environmental concerns

Setback Requirements

- *Flat Rock Wind v. Rush County Area Board of Zoning Appeals, No. 70A01-1606-PL-1382, 2017 Ind. App. LEXIS 60 (Ind. Ct. App. Feb. 14, 2017).*
 - Facts:
 - The plaintiff sought to build a wind generation facility on more than 29,000 acres in two counties in Indiana containing 95 aerogenerators.
 - In 2015, the plaintiff filed an application with the defendant (county zoning board of appeals) for the approval of a special exception from the applicable zoning ordinance to build a portion of the facility in the defendant's county.
 - The county zoning ordinance required a minimum setback distance of 1,000 feet from residential dwellings. Concerned landowners in the designated area raised concerns about harmful side effects of the project including noise, stress, sleep disruption, vibration, flicker, and other annoyances that would impact them personally and lower their property values.
 - The plaintiff then amended its application to have a 1,400-foot setback from landowners that didn't enter into leases with the plaintiff. A member of the defendant proposed a 2,300-foot setback from the property lines of landowners not entering into lease agreements with the plaintiff and the measure passed on a majority vote of the defendant.
 - The plaintiff filed for judicial review of the increased setback requirement.

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Setback Requirements

- *Flat Rock Wind v. Rush County Area Board of Zoning Appeals, No. 70A01-1606-PL-1382, 2017 Ind. App. LEXIS 60 (Ind. Ct. App. Feb. 14, 2017).*
 - Trial court:
 - The trial court upheld the enhanced setback requirement based on the explicit language of the county zoning ordinance at issue that specified a "minimum" 1,000-foot setback as merely a guideline.
 - The trial court also allowed the disaffected landowners to participate in the lawsuit.

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Setback Requirements

- *Flat Rock Wind v. Rush County Area Board of Zoning Appeals, No. 70A01-1606-PL-1382, 2017 Ind. App. LEXIS 60 (Ind. Ct. App. Feb. 14, 2017).*
 - Appellate court:
 - On appeal, the appellate court affirmed. The appellate court held that, as a guideline, the setback was subject to a "reasonable restrictions" to preserve the public's health and safety.
 - On the landowners' motion to intervene, the appellate court also upheld the trial court on the basis that IN Trial Rule 24(A)(2) was satisfied – the landowners showed an interest in the subject of the action; disposition of the action could impede the protection of the landowners' interest; and representation of the interest by the plaintiff and defendant would inadequately represent the landowners' interest if the defendants' decision were modified or reversed.
 - The court pointed to the negative impact on land values and health impacts if the setback distance were reduced.

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Note on Setback Requirements

- Many wind turbine manufacturers recommend a safety zone with a radius of at least 1,300 feet from wind turbine

Interference with Airport Radar

- *Clark County v. FAA, 522 F.3d 437 (D. D.C. 2008)*
 - Evidence showed that turbines would interfere with airport's radar



Aesthetics and Nuisance

- ***Rankin, et al. v. FPL Energy, LLC, et al., No. 11-07-00074, 2008 Tex. App. LEXIS 6398 (Tex. Ct. App. Aug. 21, 2008)***
 - 421-turbine wind farm sued for damage to “visual impact” (blinking lights, flickering shadows and noise)
 - Court noted that TX common-law doctrine of nuisance did not recognize nuisance claims based on aesthetical impact



The Development Phase

- **Contract with a developer**
 - Right to enter the premises
 - Evaluate the property for potential wind energy development
 - Exclusivity
 - 2-5 years
 - Could contain an option
 - Annual payments ranging \$2/acre to \$10/acre



The Development Phase

- **A shorter term is generally preferred (3 years as opposed to 5 or 6 years)**
 - Include a release provision after the first three years whereby operator releases landowner from the exclusivity provision if a similar or better offer comes along
 - Note: Allowing the operator to “sit” on the property for 6 years with no commitment to develop the wind resource could be used as a blocking maneuver with the landowner paying the price



Crafting an Equitable Agreement

- **What are the developer’s intentions concerning the use of the land?**
 - Construction clause should limit construction phase to 2 years (with compensation to landowner for loss of property usage during this time)
 - Note: The necessary construction time is shortening with developments in technology. As such, the construction clause could be shortened.



Second Part of Agreement

- **Contract for development and operation of aerogenerators on the property**
 - Longer term (20 to 50 years)
 - Option or options to extend the agreement
 - Landowner compensation
 - Number of turbines
 - Per megawatt of energy generated
 - Royalty-based
 - Make sure the compensation is adjusted for inflation



Key Points

- **Probably best to have the two parts separated out and put in different agreements**
- **Always have legal counsel review the agreements**



Length of Term

- **Think about what happens when a generator wears out**
 - Are funds set aside for the inevitable decommissioning costs associated with removing aging, worn-out generators?
 - Not required in TX, for example
 - Life span is less than 20 years
 - Tear-down cost is approximately \$200,000 per generator
 - Landowners are typically on the hook for the removal of non-functional generators

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Scope Questions

- **How much of the land will be subject to the agreement?**
- **How long will the land subject to the agreement be affected?**
- **Is compensation adequate for the rights given up?**



Estate Planning Issues

- **Is it planned for the farming operation to expand in the future?**
- **Have the on-farm heirs been consulted?**



Valuation Issues

- **For federal estate tax purposes, key valuation date is date of death. So, what's the impact of a wind energy contract on valuation?**
 - If signed shortly before death, little-to-no impact
 - If death occurs after contract has been in place for several years, and production has been ongoing, IRS could argue for valuation enhancement
 - Offsetting factors – (1) drag on real estate values; (2) increased nuisance potential; (3) payments are replacement income for rights given up



Federal Estate Tax

- **Impact of wind turbines on special use valuation election**
 - Pre-death development: use precise legal description in wind energy agreement to delineate specific areas that wind energy company has rights to (make the election only as to the other areas)
 - Post-death recapture: use of precise legal description in wind energy agreement will minimize impact of recapture to only those land areas impacted by turbines



Crafting an Equitable Agreement

- **What is the amount of compensation to be paid?**
 - How is "gross revenue" defined?
 - Is it a flat amount annually, an annual payment per tower, a percent of gross proceeds, based on KW hours generated annually, selling price of MW per year?
 - Is an inflationary factor built in?
- **What is the compensation structure?**
 - Payment timing
 - Payment frequency
 - Payment for loss of crop cultivation
 - Take care in defining "crop" and "cultivation"



What Are The Developer's Rights

- **Examine the agreement to determine the developer's rights granted by the agreement**



Assignment Issues

- **Does the developer intend to assign the agreement?**
 - If so, who are the potential assignees?
 - Will the original developer remain liable if there is a subsequent default?
 - In the event of assignment, it is not acceptable for the landowner to have no recourse against either the parent company or the developer where the landowner has no right to object to the assignment



The Development Phase

- **Does the developer want to develop the land or simply use a portion of the surface for a term of years?**
- **Is a set number of turbines guaranteed to be constructed by a certain date**
 - If not, will developer guarantee a minimum amount of payments?
 - What about a CPI adjustment?



Developer's Rights

- **What events trigger the developer's rights to terminate the contract?**
 - At any time without cause?
 - How are payments due to be handled?



Cost Questions

- **Is gating, fencing or limiting access required?**
- **Potential for environmental contamination?**
- **Compliance with governmental regulations?**
- **Cost to be an additional insured?**
- **Potential cost of construction liens?**



Cost Questions

- **Compensation for damage to drainage tile?**
- **What about change in flow of water?**
- **Access roads**
 - Limit the constructions of roads and lanes
- **Property taxes**
- **What if a neighbor sues?**

Crafting an Equitable Agreement

- **Insert clause language requiring removal of all improvements the developer makes upon termination of the agreement**
- **On a related note:**
 - May need a “good faith” negotiation clause with respect to the location on the property where the facilities will be placed so as to minimize the impact on existing farming operations

Legal Issues for Landowners

- **What events allow the developer to terminate the agreement?**
 - Anytime without cause?
 - Can I go to court? Binding arbitration?
 - Do I have any termination rights? If so, how do I exercise those rights?
 - What happens to the structures upon termination?
 - Who pays for removal?
 - How soon do they have to be removed?
 - How are payments due under the agreement to be handled?

What are the Landowner's Rights?

- **Make sure adequate compensation is paid for the rights given up**
- **What are the landowner's termination rights?**
 - How are they exercised?
 - They are usually severely limited

Crafting an Equitable Agreement

- **Is the proposed contract a lease or an easement?**
- **Does the developer have a right of renewal?**
- **Any lease should not be perpetual**
- **If it's an easement, what is included?**
- **Is a sale of the land contemplated?**
- **Setback requirements?**

Crafting an Equitable Agreement

- **Amount of compensation**
- **Revenue computation**
- **Inflationary factor?**
- **Unneeded land covered?**
- **Tax consequences of an up-front lump-sum payment**
- **Developer's intent on usage of the land**
- **Mortgage?**

Crafting an Equitable Agreement

- **Indemnification clause?**
- **Landowner's usage of the property?**
- **Treated as favorably as neighbors?**
- **Removal clause**
- **Agreement recorded?**
- **Confidentiality clause?**
- **Review by insurance agent**
- **Violation of USDA land use restrictions**

Crafting an Equitable Agreement

- **What about the impact on aerial crop dusting activities**
- **Can the landowner sell the property, or portions thereof?**
- **What's the risk to the landowner?**
- **What happens if the company filed bankruptcy?**

Environmental Concerns

- **Aesthetics**
 - Viewscape, viewshed, scenic byways
 - Flicker from blades
 - Usually not a problem over ½ mile away
 - FAA lighting requirements (blinking light)
 - FAA restrictions if located close to airport
 - Noise issues (usually not objectionable)
 - For residences over ½ mile away, noise is usually not a problem
 - County zoning, conditional use permits
 - **Note:** Wabaunsee Co. Kansas has banned large-scale wind farm development (the ban has been upheld judicially)

Wind Farming – Concluding Thoughts

- **Each project should comply with local level review and a cost/benefit analysis that is required of other industrial-scale development**
- **A site-specific assessment is necessary if the area is environmentally sensitive**
- **Reliability of wind energy is problematic, and it is not competitive with fossil fuels without subsidy**

State-Level Policy Issues

- **Should state legislatures enact statutory measures?**
 - Should there be a maximum length of easement/lease terms before renegotiation?
 - Should there be a limit on the number of turbines per township?
 - Should the state specify a procedure for valuing wind rights?
 - Should there be a state decommissioning fund to assure payment of costs for removal of obsolete facilities?

State-Level Policy Issues

- **Should the state create a permanent fund for capturing some of the value of harvesting the wind with payment of a “dividend” to the public?**
- **Should the state specify certain minimum standards that all easements/leases should satisfy? (i.e., crop loss, compaction, road and line easements, etc).**

State-Level Policy Issues

- **Should developers be able to sell easements/leases without a landowner's consent?**
- **Should a landowner be entitled to void an agreement if the developer has not erected any turbines within a certain period of time?**



State-Level Policy Issues

- **Should counties be required to adopt a permitting process, the effect of which would be to assure that developers' actions would be public?**
- **Should landowners be able to cancel easements if the final location of a turbine unreasonably interferes with the owner's intended use of the land?**

WASHBURN LAW 110



Part IV

- **Kansas Fence Law**



General Rules

- **Partition fences and location issues**
 - To be placed on the line between tracts of land owned by different persons
 - Can be located entirely on one side of the boundary
 - Can become the actual boundary regardless of what a survey reveals

WASHBURN LAW 111



Determining Property Boundary

- **Adverse Possession**
 - Open and notorious use for 15 years
 - Adjacent owners know the fence between their properties is not on the boundary
 - Adjacent owners know where the actual boundary is
 - One party is benefited by the misplaced fence
 - Other party takes no action to remedy the problem within 15 years


WASHBURN LAW 112



Determining Property Boundary

- **Doctrine of Practical Location**
 - Adjacent owners know that the fence is not on the boundary
 - Adjacent owners don't know where the actual boundary is located
 - One party has a good faith belief of ownership
 - After 15 years of usage the fence can be the actual boundary between the tracts

WASHBURN LAW 113



Partition Fences – Building and Maintenance Issues

- **General rule:**
 - Owners of adjoining lands must build and maintain in good repair in equal shares, unless they agree otherwise
 - Can enter onto adjoining land at reasonable times and in reasonable manner to maintain the fence

WASHBURN LAW 114



“Right-Hand” Rule

- **Build to the right from mid-point**
- **Kansas law**
 - “Equal shares” rather than in halves
- **Can have a written fence agreement**
 - Recorded and becomes part of the land records
 - Binds subsequent owners

WASHBURN LAW 115



“Fence-In”

- **Livestock owners must keep their animals fenced-in**
- **What if adjacent non-livestock owner shares a partition fence?**
 - If non-livestock owner does not maintain their share and injury results to them because of the defective fence, they can’t recover for damages caused by adjacent owner’s animals
 - Also liable to others

WASHBURN LAW 116



“Fence-In”

- **What if a non-livestock owner doesn’t want their land enclosed?**
 - Cannot be forced to build or pay for an equal share of a partition fence
 - Adjoining tracts must be used in common (same purposes)
 - So, a landowner is only relieved from responsibility for sharing equally the cost of building and maintaining partition fences when the land is used in common and the complaining party does not want the fence

WASHBURN LAW 117



Procedure for Handling Fence Disputes

- **Can reach an agreement on building a maintenance between the landowners**
 - Record in county Register of Deeds office in county where fence is located
- **If no agreement reached...**
 - Fence viewers should be called
 - County commissioners (or their designees)
 - For fences on county lines...
 - Chairmen of county commissioners of the counties serves as the fence viewers (can select a third person)
 - Majority vote controls

WASHBURN LAW 118



The Fence Viewers

- **Can act collectively as a Board, or any two of them may be appointed to serve as the fence viewers**
 - Handle disputes concerning the building or maintenance of partition fences
 - They cannot order a fence to be moved
- **Will view the fence in controversy and then assign to each party, in writing, an equal share or part of the fence to build, maintain or repair**
- **Decision is recorded at Register of Deeds office in county where fence is located**

WASHBURN LAW 119



Fence Viewers

- **If commissioners are acting as “fence viewers”, their decision is final, conclusive, non-appealable, and binding on the parties and all succeeding occupants of the land**
- **If they do not appoint “any two of them” to serve as the viewers, then the decision is a board opinion that is appealable.**
 - Notice of appeal served on board’s clerk within 30 days after board make’s decision
 - Appealing party must post bond and pay costs

WASHBURN LAW 120



Decision of Fence Viewers

- If ignored, then other party can fix the fence and charge the other party for their share of the cost, plus interest (1%/month) and attorney fees (if necessary)
- Fence viewers must be called to not only make an initial review, but also to view the fence whenever there is any subsequent argument between adjacent landowners
 - So, if one party disregards the initial ruling, the other party can't build the non-performing party's portion of the fence or make necessary repairs until the viewers have made a second view and determine that the fence in question needs to be built or repaired.
 - Can't send bill until a third view has been made to certify the work and the amount claimed due

WASHBURN LAW 121



What Type of Fence Can be Required?

- Whatever is legal in the county
- Can't require a higher-quality fence
- Legal fences
 - 3-wire barbed wire
 - 4-foot high fences
 - Post and rails
 - Post and palings
 - Post and planks
 - Palisades
 - Stone
 - Posts and wires
 - Turf

WASHBURN LAW 122



Other Types of Legal Fences

- Rail fence
 - 4.5 feet high to the top of the riders
- Stone fences
 - 18 inches wide at the bottom and 12 inches wide at the top
- Turf fences
- Hedge fences
- Post and wire
 - Posts set in ground at least 2 feet deep and not more than 12 feet apart; 4 strands of fence wire not smaller than No. 9
- Brook, river, creek, ditch, etc.

WASHBURN LAW 123



Barbed Wire Fences

- County can set more stringent requirements, but here are the state provisions
 - At least 3 wires
 - Third wire from ground not less than 44 inches nor more than 48 inches from the ground
 - Bottom wire between 18 and 24 inches from ground
 - Center wire equidistant between upper and lower wires
 - All wires well stretched and barbed

WASHBURN LAW 124



Barbed Wire Fences

- Barbs average not more than 9 inches apart
- Two wires not smaller than No. 11 or one wire no smaller than No. 9, or be wires having not less than 950 pounds of breaking strength
- All wires securely fastened to posts
- Posts not more than two rods apart and not less than 20 inches in the ground
- Posts not more than 48 feet apart, slats placed perpendicularly, not more than 12 feet apart and fastened to wires by staples, or with holes in the slats

WASHBURN LAW 125



Electric Fences

- At least one 14-gauge wire (or equivalent) not more than 48 inches from ground
- County commissioners could elect to declare that an electric wire fence is not a legal fence in the county

WASHBURN LAW 126



Liability for Trespassing Animals

- **Owner generally not liable if fence is in good shape**
 - Must be a showing of negligence
 - Note – dogs and cats can run at large
 - Note – peacocks can't run at large, but Sheriff can't take them into custody

WASHBURN LAW 127



What is Evidence of Negligence?

- **Gates left open**
- **Fence improperly constructed or maintained**
- **Knowledge that animals were in heat and needed a stronger enclosure or a closer watch**
- **Knowledge that the animals are out and no attempt made to return them**

WASHBURN LAW 128



Distraint

- **If animals stray onto land that is lawfully enclosed, adjoining owner may have a right to distraint the animals**
 - Can recover damages (costs)
 - Livestock owner must be notified within 24 hours of distraint being utilized
 - If owner can't be found, then notify Sheriff
 - Animals can be held for five days without bringing legal action against owner to recover damages
 - Alternatively, Sheriff can retrieve the livestock and hold them
 - Notice within 24 hours after receiving livestock
 - Owner has 10 days to claim and pay costs
 - Then, livestock sold at public auction

WASHBURN LAW 129



Railroad Fences

- **Railroads are responsible for damages caused to animals that are hit by a train regardless of whether they were negligent or not**
 - Livestock owners do not have to establish that the railroad was negligent
- **Railroad avoids liability by enclosing tracts with a lawful fence**

WASHBURN LAW 130



Public Roads Through Private Pastures

- **Can be authorized by county commissioners**
 - Can permit a gate and fence to be placed over and across certain public roads
 - Can't authorize the locking of a gate that would prohibit general public access to the road
 - Road can be either auto-gated or cattle-guarded
 - If gate is used and is left open when it is to remain closed, it is a misdemeanor subject to a \$100 fine

WASHBURN LAW 131



Responsibility for Highway Fences

- **State has common law duty to keep highways in reasonably safe condition**
 - That means maintaining highway fences

WASHBURN LAW 132

Criminal Penalties

- **It is a crime to willfully leave a gate open or willfully cut wires, mutilate or tear down a fence**

WASHBURN LAW 133

Part V

- **Kansas Ag Lease Law**

WASHBURN LAW 134

Agricultural Leases as Estates in Land

- A lease is an estate in land for a definite period of time that is fixed in advance
- Oral agriculture leases are presumed to be tenancies from year to year that automatically renew if no notice of termination is given
 - State law governs termination of oral agricultural leases

13
5

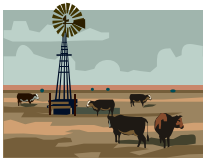
Agricultural Lease Provisions - Common Law Concerns

- **Various Issues**
 - Removable fixtures
 - Permanent improvements
 - Landlord's right of entry
 - Lease termination
 - Liability for rent in event of natural disaster
 - Right of tenant to harvest crop after lease expiration
 - "Doctrine of emblements"

13
6

The Importance of Leasing to Agriculture

- **Permits farmers and ranchers to operate larger farm businesses with the same amount of capital**
 - Assists beginning farmers and ranchers in establishing a farming or ranching business



13
7

Types of Agricultural Leases

- **Cash lease**
 - Periodic payment of a rental amount that is either a fixed number of \$/acre or fixed amount for the entire farm
- **Flexible cash lease**
 - Specifies that the amount of cash rent fluctuates with production conditions and/or crop or livestock prices

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8

Types of Agricultural Leases

- **Hybrid cash lease**
 - Specifies that the rental amount is to be determined by multiplying a set number of bushels by a price determined according to terms of the lease, but at a later date
 - Tenant markets the entire crop, the landlord benefits from price increases, and the tenant does not bear the entire risk from low commodity prices

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9

Types of Agricultural Leases

- **Guaranteed bushel lease (hybrid-cash lease)**
 - Tenant delivers a set amount of a certain type of grain to a buyer by a specified date; the landlord determines when to sell the grain
- **Minimum cash or crop share lease**
 - Guaranteed cash minimum; with landlord having the opportunity to share in crop production from a good year without incurring out-of-pocket costs; tenant retains production risks
 - Rent is paid in a certain proportion of the crops

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0

Types of Agricultural Leases

- **Crop share lease**
 - Rent paid on basis of proportion of crops
 - Expenses shared by agreement
- **Livestock share lease**
 - Share of livestock, livestock products and crops paid as rent
 - Landlord usually shares expenses
- **Irrigation crop-share leases**
 - Rent certain proportion of crops produced
 - Landlord shares expenses

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1

Other Points Concerning Leases

- **Estate planning implications**
 - Material participation and social security benefits
 - Material participation and post-mortem estate planning techniques
 - Post-death cash leasing
- **Farm program benefits**
 - “Active engagement” test

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2

FSA Regulations

- **When is a cash lease a cash lease?**
 - Notice DCP-172 (Apr. 2, 2007)
 - If any portion of rental payment is based on gross revenue, the lease is a share lease
 - If rent is tied to set amount of production based on future market value that is not associated with the farm's specific production, it's a cash lease

14
3

FSA Regulations

- Beginning with 2009 crop year, tenants and their landlords may reach any agreement desired concerning flexing the cash rent payment and lease will still be deemed to be a share-rent arrangement

14
4



Leases and Allocation of Risk

- ***K & M Enterprises v. Pennington, 764 So. 2d 1089 (La. Ct. App. 2000)***
 - **Facts:** The plaintiff leased ground from the defendant and planted 406 acres to corn. The growing crop was consumed by deer, and the tenant sued to recover the lost crop.
 - **Issue:** Whether the tenant bears the risk of loss of the corn crop

14
5



Leases and Allocation of Risk

- ***K & M Enterprises v. Pennington, 764 So. 2d 1089 (La. Ct. App. 2000)***
 - **Holding:** Tenant bears the risk
 - Contract language clear and unambiguous
 - “Acts of God” among the “risks” assumed by the tenant
 - Tenant’s right to put up electrical fence not included in landlord’s responsibility to convey “peaceable possession” to tenant

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6



Other Farming Arrangements

- Custom cutters
 - Usually treated as independent contractors
- Croppers
 - Not treated as tenants if landlord supplies land *and* inputs, controls operation of the farm and pays portion of crop to the person raising and harvesting the crop
 - No legally enforceable interest in crop
 - Only has contract right to compensation in-kind for labor
 - No interest in real property to be terminated
 - A “cropper” is an employee (i.e., a wage earner) that is hired to produce a crop.
 - *Henney v. Lambert, 237 Iowa 146, 21 N.W.2d 301 (1946)*

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7



Custom Cutters and Croppers

- **Questions concerning status of parties**
 - **Courts look to intent of parties based on facts and circumstances**
 - **Terms of agreement (written or oral)**
 - **Actions of parties**
 - **Type of farming operation**
 - **Has exclusive possession been given?**
 - *See Hoffman v. Estate of Siler*

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8



Statute of Frauds and Agricultural Leases - Non UCC Issues

- ▶ **A lease is both a contract and a conveyance of an interest in real estate**
 - Written terms control
 - Oral leases are subject to state statutes
 - Because real estate is involved, the statute of frauds must be satisfied
 - ▶ Oral leases for one year or less are enforceable

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AG Leases and the Statute of Frauds

- ▶ **Part performance**
 - Part performance (i.e. planting a crop) can remove the lease from the statute of frauds requirements
 - ▶ *Stuber v. Sowder (Kan. 1935)*
- ▶ **Promissory estoppel/detrimental reliance**
 - Possession by tenant may remove statute of frauds requirement
 - ▶ *Kolkman v. Roth (Iowa 2003)*
 - ▶ *Rhodes v. Sigler (Illinois 1975)*

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Notice of Termination of Oral Ag Leases

- ▶ **State law controls**
- ▶ **State lease law is quite different from state to state**
 - Types of crops
 - Cropping seasons
 - Pasture lease rules may be different from crop lease rules

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Statute of Frauds and Agricultural Leases - Non UCC Issues

- ▶ **Agricultural leases as personal service contracts**
 - What happens if either the tenant or the landlord dies during the term of the lease?
 - ▶ If landlord dies, heirs assume the lease
 - *Giltner v. Estate of Giltner* (Iowa 2008)
 - ▶ What if tenant dies?

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Ames v. Saylor, 267 Ill. App. 3d 672, 642 N.E. 2d 1340 (1994)

- ▶ **Facts:** Parties entered into an oral lease of farmland. After 20 years, the tenant died.
- ▶ **Issue:** May the tenant's heirs assume the lease?

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Statute of Frauds and Agricultural Leases - Non UCC Issues

- ***Ames v. Saylor, 267 Ill. App. 3d 672, 642 N.E. 2d 1340 (1994)***
 - **Conclusion:** The lease dies with the tenant. A farm tenant's heirs are not entitled to continue to lease the property after the tenant's death until receiving statutory notice of termination.
 - The landlord contracted for the deceased tenant's services only. The lease is a personal services contract.

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Distinguishing *Ames v. Saylor*

- ***Wilson v. Fieldgrove (Neb. 2010)***
 - Oral cash lease and death of tenant
 - No statutory notice requirement
 - Common law – 6 months
 - Sharecrop leases are generally personal service contracts
 - Cash leases do not die with the tenant
 - Tenant's services not involved

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Agricultural Lease Provisions - Common Law Concerns

- ▶ **Various Issues**
 - Removable fixtures
 - Permanent improvements
 - Landlord's right of entry
 - Lease termination
 - Lease assignment
 - Control of weeds
 - Liability for rent in event of natural disaster
 - Right of tenant to harvest crop if land is sold or tenant dies
 - ▶ "Doctrine of emblements"
 - Right to crop that is growing when lease terminates
 - ▶ "Away-going" crop

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Doctrine of Emblements

► *Taggart v. Battaglia*, 140 Or. Ct. App. 585, 915 P.2d 1001 (1996)

- **Facts:** Defendant was a Christmas tree farmer that operated a leased Christmas tree farm. Defendant failed to make lease payments, but landlord did not terminate the lease. Plaintiff purchased the farm from the landlord's estate and defendant executed a quit claim deed giving up all interest in the land. During the next Christmas season, defendant reentered the premises and harvested nearly 200 trees.
- **Issue:** Does the doctrine of emblements allow the defendant to harvest the trees?

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Doctrine of Emblements

► *Taggart v. Battaglia*, 140 Or. Ct. App. 585, 915 P.2d 1001 (1996)

- **Conclusion:** No. Defendant terminated the lease by executing a quitclaim deed. Doctrine of emblements does not apply when the tenant terminates the lease. The execution of the deed also conveyed the growing crop to the buyer.

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Doctrine of Emblements

► **Death of the landlord with a growing crop in the field**

- Landlord owns a fee simple
 - Landlord's heirs succeed to landlord's share of the crop
- Landlord owns a life estate
 - Growing crops generally held to be personal property – landlord's crop share becomes personal property of landlord's estate
 - Note: Colorado and Oregon courts have held otherwise

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Agricultural Lease Provisions - Common Law Concerns

- **Crop and livestock lease provisions**
- **Oil and gas lease provisions**

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Oil and Gas Leases

• **Conveyance of the mineral interest by sale of the lease**

- Oil and gas, while in the ground, are considered part of the realty
 - Rights can be conveyed by deed
 - Mineral interests may be severed from the surface
 - Upon sale of land, if no reservation made, presumption is that no severance has occurred
 - Many landowners prefer to retain ownership of surface and lease the mineral rights

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Oil and Gas Leases

► **Power to sell or lease**

- Majority owners of mineral interests protected if one or more of holders of minority interests becomes unknown
 - District court appoints a receiver who can negotiate for sale or lease of the interest
- Owners of less than fee interests must usually join in executing an oil and gas lease

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Oil and Gas Leases

► What if surface leased for crop production?

- Crop tenant could recover damages from landlord for damage to tenant's crops or for interference with tenant's use of the surface by the oil and gas operator
 - Landlord could reserve right to lease for oil and gas or could have oil and gas lease made subordinate to surface for drilling
 - If ag lease granted first, subsurface tenant may need to get ag lease tenant's permission before drilling can commence

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Oil and Gas Leases

► Contractual provisions

- Use of surface
 - Lessee typically has right to enter land and explore for minerals (drill) and begin production if discovered
 - Includes implied right to use as much of surface as is reasonably necessary to exercise development rights (i.e., laying pipelines, building roads, constructing buildings)
 - May need additional contract language to restrict location of wells and/or structures
 - May want provision requiring lessor's approval concerning location of wells, structures and roads

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Oil and Gas Leases

► Contractual provisions

- Water use clauses tend to be broad
 - Landowner may want to limit use of water by operator
 - Reserve all fresh water or limit operator's use to such amounts as will not interfere with landowner's usage
 - Limit usage to primary production activities
 - No interference with landowner's use or intended use for irrigation purposes
 - Drilling operations not to interfere with irrigation practices during irrigation seasons and until crops harvested

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Oil and Gas Leases

• Contractual provisions

- Surface damage clauses
 - Protects landowner against damage to the surface (without the clause, lessee has no liability except for excessive use or negligence)
 - Landowner may want clause requiring lessee to restore surface to original condition
 - Note: State law may require lessee to remove all equipment and structures and to leave land in original condition upon abandonment of an oil or gas well
 - Additional concern may be location of pipelines that might interfere with farming activities

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Oil and Gas Leases – Surface Damage Clauses

• *Trotter v. Wells Petroleum Corp., 11 Kan. App.2d 679, 732 P.2d 797 (1987)*

- **Facts:** The plaintiff purchased land with oil production and leased the land to the defendant. The defendant buried a pipeline under the plaintiff's pasture and in the process damaged the pasture grass. The lease contract stated: "Lessee shall bury his pipe below plow depth and promptly cover and level all pits" and "Lessee shall pay all damages caused by its operations to growing crops...."
- **Issue:** Is the plaintiff's pasture a "growing crop" that is subject to the damage provisions of the lease?

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Oil and Gas Leases – Surface Damage Clauses

► *Trotter v. Wells Petroleum Corp., 11 Kan. App.2d 679, 732 P.2d 797 (1987)*

- **Conclusion:** No. No evidence was offered to indicate the defendant in any way cultivated or worked the pasture so as to alter its natural growth. A reference to "plow depth" in connection with "growing crops" only covers crops resulting from planting, cultivation and labor.

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 Oil and Gas Leases**► Common contract clauses**

- Term usually for a definite term of 2 to 10 years, and so long thereafter as oil and gas is produced in paying quantities
- “Delay rental” clauses
 - Tenant must either start drilling within a fixed time (usually a year) or pay a stipulated amount for the privilege of extending the lease for an additional period
- “Unless clause”
 - Lease terminates unless operator either begins drilling or pays the delay rental
- Some leases require written notice of termination

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 Oil and Gas Leases**► Common contract clauses**

- Pooling clause
 - Pooling –putting together tracts or parts of tracts to form a drilling unit
 - Pooling clauses may not be required under state law (but may be entered into voluntarily)
 - Typical acreage unit for gas is 640 acres
 - Lease likely to remain in force if lessee operating either land covered by lease or other land pooled with it

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 Oil and Gas Leases**► Common contract clauses**

- Unitization clause
 - Bringing together producing properties over a producing reservoir so a single operator can maximize production from that reservoir
 - Note: State law may establish a procedure whereby unitization may be ordered by a state agency in limited circumstances involving secondary recovery activities

171

 Oil and Gas Leases**• Common contract clauses**

- Royalty provision
 - Landowner’s share is usually 1/8 to 3/16 of gross production
 - Operator usually pays all expenses of exploring and producing oil and gas from operator’s share (“working interest”)
 - For oil, royalty usually paid “in kind” and lessee purchases landowner’s share based on market value
 - For gas, royalty usually paid under long-term contract

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 Oil and Gas Leases**• Common contract clauses**

- Storage provision
 - Payment may be made to owner for storage, even in absence of drilling
 - Payment may be low in light of possible interference with surface use
 - Lease may contain clause allowing lease to remain in effect so long as gas storage continues
 - » Complete flexibility to lessee in continuation of lease, but no compensation to landlord for use in gas storage
 - » May want to negotiate a separate agreement

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 Oil and Gas Leases**► Common contract clauses**

- Surrender clause
 - Provides a means of relieving lessee of any obligations once it is apparent that lease is no longer profitable
 - Forfeiture could occur simply on failure to drill or failure to pay delay rental
 - Typically gives lessee right to remove machinery and other structures
 - Should be in writing and filed with Register of Deeds so that title to premises will be unencumbered in the future

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Wind Energy Leases (Suggested Provisions)

- ▶ **What part of the land is subject to the agreement?**
- ▶ **What events trigger early termination?**
- ▶ **Automatic renewal clause?**
- ▶ **When must construction commence?**
- ▶ **Compensation for land use restrictions?**
- ▶ **Landowner's rights to use the property?**
- ▶ **USDA farm program complications?**
- ▶ **Liability for actions of third parties**

175



Hunting Leases

- ▶ **Key consideration**
 - Potential liability sustained or caused by hunters on the property
 - ▶ Recreational use statutes vary from state to state

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Hunting Lease

- ▶ **Not really a lease, but a license to use the property for hunting purposes**
 - Contract right to use defined by the parties
 - Get it in writing
 - ▶ Identify parties
 - ▶ Property description
 - ▶ Types of hunting allowed and when allowed
 - ▶ Termination provision
 - ▶ Renewals?
 - ▶ Liability waiver and indemnification
 - ▶ Payment terms

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Part VI

- **Top Ten Ag Law Developments of 2016**

WASHBURN LAW 178



What Was Big In 2016?

- **The “not quite Top Ten”**
 - HRA relief for small business
 - Small employer can offer an HRA without triggering the \$100/day penalty
 - Veterinary Feed Directive Rule
 - Veterinarians must provide a “directive” to livestock owners seeking to use or obtain animal feed products containing medically important antimicrobials as additives.
 - Final Drone Rules
 - Greater commercial use of drones weighing less than 55 pounds allowed

WASHBURN LAW 179



What Was Big in 2016

- **The “not quite Top Ten”**
 - County bans on GMO crops struck down
 - Either HI had regulated them at the state level to remove county authority, or federal law preempted the county rules
 - Insecticide-coated seeds exempt from EPA regulation under FIFRA
 - No need for separate registration before usage

WASHBURN LAW 180



What Was Big in 2016?

- **The “not quite Top Ten”**
 - Appellate court will decide (maybe) WOTUS final rule fate
 - U.S. Supreme Court considering where jurisdiction rests
 - CA proposition involving egg production safe from challenge
 - Plaintiffs lacked standing
 - NRCS properly determined wetland status of farmland
 - Determination made based on “color tone” differences, photographs, and wetland signatures on a comparison site 40 miles away
 - FLPs and the business purpose requirement
 - Retained ownership issues



The “Top Ten” of 2016

- **No. 10**
 - Elimination of rational basis test eliminates ag exemption from Workers’ Compensation in New Mexico
 - *Rodriguez, et al. v. Brand West Dairy, et al.*
 - Court looked at primary job duties of employees and not the business of the employer to find the distinction between ag and non-ag irrational and without any rational purpose
 - » Violation of “equal protection”
 - Court in other states have upheld the ag exemption from equal protection challenges
 - » Cost savings
 - » Administrative convenience
 - » Controls costs for farms and ranches
 - » 29% of NM farms and ranches had elected coverage
 - » Additional cost imposed was \$10.5 million annually on NM farms and ranches
 - » Avg. claim \$16,876 while net farm income was \$19,373



The “Top Ten” of 2016

- **No. 9**
 - COE jurisdictional determinations subject to court review. *United States Army Corps of Engineers v. Hawkes, Co. (Sup Ct.)*
 - Once a J.D. is made the landowner has three options:
 - Quit
 - Seek a federal permit
 - Proceed and risk fines of up to \$75,000/day and/or criminal sanctions
 - The inability to challenge the determination is constitutionally defective
 - A J.D. is a “final agency action” that is immediately appealable



The “Top Ten” of 2016

- **No. 8**
 - Proposed Regulations under I.R.C. §2704
 - The possible elimination of the ability to generate minority interest/lack of marketability discounts
 - Hearing in early Dec. 2016
 - Not finalized before President Trump took office
 - May not become finalized
 - Treasury officials are saying (unofficially) that the regs. don’t take discounts away



The “Top Ten” of 2016

- **No. 7**
 - Capitalization and plants with a pre-productive period of more than two years
 - *Wasco Real Properties, I, LLC, et al. v. Comr. (Tax Court)*
 - Must capitalize real property taxes and interest during the pre-productive period



The “Top Ten” of 2016

- **No. 6**
 - No recapture of pre-paid expenses. *Estate of Backemeyer v. Comr. (Tax Court)*
 - Pre-paid expenses claimed in year 1 can be claimed again as farm expenses in year 2 by the surviving spouse
 - Basis step-up
 - Surviving spouse has separate farming operation
 - It’s not a double-deduction



The “Top Ten” of 2016

- **No 5**
 - Pasture chiseling is the discharge of a “pollutant” that violated the CWA. *Duarte Nursery, Inc. v. United States Army Corps of Engineers* (E.D. Cal.)
 - To prepare ground for planting wheat, farmer tilled the pasture 4-6 inches deep, taking care to avoid the areas delineated as wetland
 - Old delineation used
 - Intent doesn't matter
 - Hydrological connection to a creek that was a tributary of the Sacramento River
 - Farming equipment was also a “point source” pollutant
 - “Established farming operation” exemption didn't apply because land had been grazed since 1988

WASHBURN LAW 187



The “Top Ten” of 2016

- **No. 4**
 - Prison sentence for egg company executives even though no knowledge of problems. *United States v. Decoster* (8th Cir.)
 - Introduction of eggs into commerce that were contaminated with salmonella
 - Facilities in poor condition, etc.
 - Corporate officer can be held liable even without knowledge for negligent failure to prevent salmonella outbreak
 - \$100,000 fine (each) and 3 months in prison (each)
 - “Public welfare” offense
 - Liable for negligently failing to prevent salmonella outbreak
 - No violation of Due Process
 - Strong dissent

WASHBURN LAW 188



The “Top Ten” of 2016

- **No. 3**
 - The IRS and self-employment tax
 - Repair regs – what happens when you use the de minimis safe harbor on breeding stock (that are held for productive use) and then sell them?
 - Amounts that would normally be capitalized can be deducted (\$2,500)
 - Report sale income as ordinary income on Sch. F?
 - But, no S.E. tax if property is stock in trade or includible in inventory, or property is held for sale to customers in ordinary course of business
 - » IRS says to report gain on Part II of Form 4797 (based on facts)
 - No S.E. tax!
 - No challenge on non-farmer's CRP payments

WASHBURN LAW 189



The “Top Ten” of 2016

- **No. 2**
 - TMDLS and the regulation of ag runoff
 - Courts denied attempts by environmental groups to force EPA to create additional federal regulations involving TMDLs
 - *Conservation Law Foundation v. US EPA* (D. R.I.)
 - » There is no need for an NPDES permit for stormwater discharges to a WOTUS for which a TMDL has been established.
 - Only if further controls on stormwater discharges are necessary after a TMDL has been established.
 - *Gulf Restoration Network v. Jackson* (E.D. La.)
 - » EPA need not make a “necessity” determination on fertilizer runoff
 - No Supreme Court review of Chesapeake Bay case involving TMDLs on nonpoint pollution

WASHBURN LAW 190



The “Top Ten” of 2016

- **No 1**
 - The election of Donald J. Trump as President
 - Ag policy
 - Bi-lateral trade agreements
 - What about less efficient forms of energy?
 - Next Farm Bill focus?
 - » Livestock disease and biosecurity
 - » Cottonseed as an eligible commodity for ARC and PLC
 - » Reference prices going up?
 - Tax policy
 - AMT eliminated?
 - Obamacare taxes gone?
 - Corporate tax rate cut?
 - Federal estate tax gone?
 - » What about income tax basis step-up?
 - Permanency of provisions?

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THANK YOU!

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