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## The Bioenergy Farm Lease, Part 1: Long-Term Leasing Provisions

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As the bioenergy industry in the United States expands to meet increased demands for transportation fuel under the Renewable Fuel Standard and electrical power under state Renewable Portfolio Standards, farmers will seek the ability to grow dedicated, high yielding energy crops of a perennial nature on leased property. This is the first in a series of short articles intended to address a range of legal issues raised in a bioenergy farm lease. In this article we address the necessity of long-term leasing provisions, flexible rental payments, and early termination clauses. In our second and third articles, we will address, respectively, lease provisions related to potential invasiveness concerns associated with some bioenergy crops and the possibility for rhizome reclamation as an added element of perennial biomass production.

### Introduction

A variety of state and federal renewable energy mandates and incentives,<sup>1</sup> along with various sustainability/low carbon standards,<sup>2</sup> are driving interest in production of perennial energy crops such as Miscanthus or switchgrass. Federal incentive programs, such as the Biomass Crop Assistance Program (commonly referred to a BCAP), include these crops, and they are considered to have significant environmental and economic benefits.<sup>3</sup> In addition to requiring fewer mechanical and chemical inputs than traditional grain or oil seed production,<sup>4</sup> their extensive root systems make them resilient and capable of growing on highly erodible land, thereby potentially reducing soil erosion and improving water quality.<sup>5</sup> These features, along with a high yield potential, have propelled Miscanthus and switchgrass to the center of many bioenergy discussions in the Midwest.<sup>6</sup>

Perennial energy crops such as Miscanthus and switchgrass, however, require a substantial initial investment and long establishment periods<sup>7</sup>—characteristics which suggest that leases for land intended for their production must be multiyear agreements. On the other hand, as we discuss below, current default interpretations of farm leasing arrangements in the United States have not yet evolved to protect the interests of the parties. Accordingly, both prospective tenant farmers and landowners need to develop specific contract provisions to protect their respective interests.

### The Statute of Frauds

The statute of frauds and the statutory protections created pursuant to it are illustrative of the manner in which the law currently fails to protect tenant farmers engaged in perennial energy crop production. The statute of frauds<sup>8</sup>, a set of rules relating to the enforceability of contracts, requires written confirmation of any agreement that cannot be performed in one year. In other words, under the statute of frauds, multiyear farmland lease agreements must be immortalized in some manner of writing in order to be enforced by a court.<sup>9</sup> As perennial energy crops require a significant initial investment and establishment period, farmers are likely to grow such crops only under multiyear lease agreements. If the contract is not put in writing, as the statute of frauds requires, a court may not enforce the lease, thereby allowing the landowner to terminate the tenant farmer's access to the bioenergy crops.

A number of states have rules in place intended to protect tenant farmers and landowners from unfair treatment under the statute of frauds. For example, in Illinois a tenant farmer operating without a written lease usually is viewed as a tenant from year-to-year<sup>10</sup> and is given some protection by a minimum notice period, imposed by statute, which prevents the farm tenancy from being immediately terminated.<sup>11</sup>

However, these minimal statutory protections, while affording tenants a small amount of contractual security in the annual production and harvest of traditional row crops, are inadequate to protect farmers who wish to grow perennial energy crops. For example, in Illinois, a farmer must receive at least four months' notice prior to the end of the lease in order for a year-to-year lease to be terminated.<sup>12</sup> Four months' minimum notice would be cold comfort to a farmer who had sunk substantial financial interest in establishing perennial biomass crops. Accordingly, multiyear, written lease agreements are an essential element of perennial bioenergy crop production.

### **Easing Concerns**

Fortunately, developing written, multiyear lease agreements, in addition to being necessary to protect the interests of tenant farmers, also functions to alleviate particular concerns both tenant farmers and landowners may harbor with regard to growing perennial energy crops. A recent focus group conducted by researchers at the University of Illinois illustrated some of these underlying trepidations.

For example, one issue raised by several participants of the study related to the contingency of cropping decisions and the necessity of obtaining the landowner's pre-approval to plant energy grasses.<sup>13</sup> The process of contracting for multiyear leases partially assuages this concern—such a process creates an opportunity for farmers to discuss explicitly the potential profitability of dedicated energy crops with landowners, thus making the landowner's approval more likely.

Study participants also noted (somewhat unexpectedly to these authors) that, although landowners might be amenable to planting energy grasses on uncultivated land, taking farmland out of corn and soybean production to plant dedicated bioenergy crops goes against the grain, so to speak, of established farming practices and might place the owner in the position of being considered too "progressive."<sup>14</sup> The process of developing lease agreements speaks to this concern—the creation of a multiyear lease suggests to the community the landowner's engagement in a long-term commercial venture, rather than an experiment.

In addition to the relatively minor issues of prior approval and community perception, the primary reservations for landowners contemplating a long-term lease arrangement most likely is the inability to adjust the rent on a yearly basis to account for market conditions (market risk) and the "tying-up" of the land to single producer (marketability risk).<sup>15</sup> Changes in the price of commodities and land values over time may result in rental payments substantially below alternative land production values.<sup>16</sup> In other words, a landowner may reason that the opportunity cost of such an arrangement is too high.

A more nuanced approach can alleviate these market concerns by allowing for yearly adjustments to rental payments over the life of the lease. For instance, the parties could agree to renegotiate the rent each year (perhaps also subject to annual percentage change limitations), or they could agree to allow a neutral third party to determine the rent.<sup>17</sup> The parties could also agree to a flex lease arrangement. These are cash leases tailored to automatically adjust to changing price scenarios.<sup>18</sup> Many potential measures of price and yield could be used in flex lease arrangements, including the price of a selected crop or multiple crops.<sup>19</sup> Use of a flexible lease would allow landowners to feel more comfortable in a long-term arrangement, as they could hedge their risk of declining rental payments against the various opportunity costs associated with leasing to farmers of more traditional annual row crops.

As noted above, landowners may also be concerned that the marketability of the farm is at risk when they enter into a long-term lease agreement, as once entered and properly recorded, a long-term lease subjects any purchasers of the land to the terms of the underlying lease agreement.<sup>20</sup> However, pre-negotiated early termination clauses (with associated fees) incorporated into the lease agreement can

alleviate this issue.<sup>21</sup> Incorporating a plan for potential early termination provides needed flexibility for both the landowner and tenant.

## Conclusion

Perennial energy crops such as Miscanthus and switchgrass require a large initial investment and long establishment periods, characteristics which suggest that leases for land intended for their production must extend across multiple growing seasons. Although the statutory and common law system has not yet incorporated specific provisions for this new type of farming arrangement, the standard written agricultural lease can be modified to protect the interests of both landowner and tenant. Early termination clauses with pre-negotiated fees and variable cash rent provisions can alleviate many of the initial concerns raised by landowners in their reluctance to engage in long-term agricultural leases.

## References

<sup>1</sup> See, e.g., Energy Policy Act of 2005, Pub. L. No. 109-58, § 1501 119 Stat. 594, 1067 (2005) (originally codified at 42 U.S.C. § 7545(o)); Database of State Incentives for Renewables and Efficiency, Renewables Portfolio Standards for Renewable Energy (2010), available at <http://www.dsireusa.org/>.

<sup>2</sup> See e.g., Jody M. Endres, *Legitimacy, Innovation, and Harmonization: Precursors to Operationalizing Biofuels Sustainability Standards*, 37 S. Ill. Univ. L. R. 1 (2012).

<sup>3</sup> Emily A. Heaton, Frank G. Dohleman & Stephen P. Long, *Meeting US Biofuel Goals with Less Land: The Potential of Miscanthus*, 14 Global Change Biology 2000 (2008).

<sup>4</sup> Kimberly Jensen, Christopher D. Clark, Pamela Ellis, Burton English, Jamey Menard, Marie Walsh & Daniel de la Torre Ugarte, *Farmer Willingness to Grow Switchgrass for Energy Production*, 31 Biomass and Bioenergy 773 (2007).

<sup>5</sup> *Id.*

<sup>6</sup> Heaton, *supra* note 3.

<sup>7</sup> Feng Song, Jinhua Zhao & Scott M. Swinton, *Switching to Perennial Energy Crops Under Uncertainty and Costly Irreversibility*, 93 Am. J. Agric. Econ. 768 (2011).

<sup>8</sup> See, e.g., 740 ILCS 80/2.

<sup>9</sup> See *id.* (“No action shall be brought to charge any person upon contract for sale of lands, tenements or hereditaments or any interest in or concerning them, for a longer term than one year, unless such contract or some memorandum or note thereof shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized in writing, signed by such party.”).

<sup>10</sup> See *Rhodes v. Sigler*, 27 Ill. App. 3d 1 (3rd Dist. 1975) (finding that oral agreements for year-to-year tenancies do not violate the statute of frauds because an oral agreement for a year-to-year tenancy can be completely performed within the year period).

<sup>11</sup> 735 ILCS 5/9-206.

<sup>12</sup> *Id.*

<sup>13</sup> Miriam A. Cope, Sara McLafferty & Bruce L. Rhoads, *Farmer Attitudes Toward Production of Perennial Energy Grasses in East Central Illinois: Implications for Community-Based Decision Making*, 101 Annals of the Ass'n of Am. Geographers 852 (2011).

<sup>14</sup> *Id.*

<sup>15</sup> Edward Cox, *A Lease-Based Approach to Sustainable Farming, Part II: Farm Tenancy Trends and the Outlook for Sustainability on Rented Land*, 16 Drake J. Agric. L. 5 (2011).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> Donald L. Uchtmann and A. Bryan Endres, *Illinois Farm Leases: One Variable Cash Rent Option*, available at [http://www.farmdoc.illinois.edu/legal/articles/ALTBS/ALTB\\_08-03/ALTB\\_08-03.pdf](http://www.farmdoc.illinois.edu/legal/articles/ALTBS/ALTB_08-03/ALTB_08-03.pdf).

<sup>19</sup> *Id.*

<sup>20</sup> Cox, *supra* note 15.

<sup>21</sup> *Id.*

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