

LAW OF BIOFUELS
—Real Estate Issues—

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The form of ownership of the property on which a biofuel facility will be constructed—and the related legal rights—are fundamental issues to consider. Ownership options for a developer include direct ownership of the real property, an option to purchase the real property from the owner or a ground lease between the developer and the owner. In addition, easements and licenses may be necessary in connection with the construction or operation of the facility.

Direct Ownership and Options. The simplest form of ownership of the real property on which the facility will be constructed is for the developer to purchase the property. In this case, the developer will enter into a purchase and sale agreement. A purchase and sale agreement should include the purchase price, closing date, closing contingencies and deliveries, representations and warranties, indemnification, and other material terms of the purchase.

Rather than an immediate purchase of the real property on which the facility will be constructed, the developer may acquire an option to purchase the property at a future date. An option may be contained in a stand-alone document or incorporated in a ground lease (discussed below), and should be recorded in the appropriate county real property records. In addition, an option may be structured as either a simple option to purchase or a right of first refusal.

In a simple option to purchase, the developer acquires the right to purchase the real property from the owner for a specified price during a defined term. Typically, an option “premium” or fee will be paid by the developer at the time the option is entered into. The option agreement should define, in as much specificity as possible, the term of the option, the manner in which the option may be exercised, the purchase price and the method for paying the purchase price. If the purchase price is not fixed at the time the option is entered into, it is advisable to have the purchase price be based on the fair market value of the property, as determined by an independent appraisal. As an alternative, the purchase price may be a fixed amount that is adjusted based on a yearly consumer price index.

Rather than a simple option to purchase, the developer may be granted a right of first refusal to purchase the real property in the event the owner receives an offer to purchase from a third party. A right of first refusal should require the owner to deliver notice to the developer within a specified time after receiving the third party offer. This notice will describe the specific terms and conditions of the third party offer, including the purchase price, method of paying the purchase price, closing date and closing contingencies. The developer will then have the right to purchase the property, on those same terms and conditions, for a specified period of time.

Ground Leases. If the developer does not purchase the real property on which the facility will be constructed, the developer typically will enter into a ground lease with the owner. In cases in which the property has already been developed, demolition of the current improvements may be necessary. This section provides a brief description of issues that the developer should consider in negotiating a ground lease for the construction of the facility.

Term. A ground lease frequently will have a relatively lengthy term (e.g., 20-50 years). In negotiating the term of a ground lease, the developer should consider including options to extend the term of the lease or to use other real property adjacent to the facility (if such use becomes necessary and such property is available).

Use. The “permitted use” for the property should be broad enough to allow the developer to construct, maintain and operate the facility in a practical and flexible manner. The owner frequently will propose that

certain activities not be conducted on the premises, such as illegal or hazardous activities. Any proposed restrictions should be reviewed to ensure they do not restrict the developer from constructing and operating the facility or carrying out any future plans.

Access and Interference by the owner. A ground lease frequently will permit the owner to enter onto and inspect the premises. The developer should consider limiting the owner's access to the premises, however, because it may be dangerous for the owner to enter onto the premises unexpectedly. Accordingly, the owner's access rights should be limited to defined times and purposes and should require prior notice to the developer.

Rent. Rent under a ground lease may be payable monthly, yearly or in other intervals. Rent may be a fixed amount or variable (e.g., based upon a percentage of the developer's sales or gross revenues). The developer should determine which schedule and method for determining the amount of rent is appropriate. In addition to basic rent, the developer will be responsible for all construction, maintenance and insurance costs associated with the facility and all utilities and real estate taxes. If the facility is constructed on property where there are common areas shared with other tenants, common area charges may also be included in the rent.

Construction. A ground lease frequently will contain construction criteria and standards, and will provide the owner with the right to approve various stages of the construction. The ground lease should provide the developer with the maximum amount of flexibility in constructing the facility and should limit, to the extent possible, the owner's right to approve the construction of the facility. After the construction of the facility is complete, the developer should also have the ability to maintain, alter or modify the facility at its discretion without the consent of the owner.

Condemnation. It is always possible that a governmental entity with the power of eminent domain could condemn the real property on which the facility is being constructed. Upon condemnation, the owner will be awarded the fair market value of the real property, including the value of any improvements. The developer should insist that the ground lease specify that the portion of the condemnation award related to the facility or other improvements will be paid to the developer. In addition, the developer should be compensated for the value of the remaining term of the ground lease.

Security. If the owner is to provide a secure premises for the construction of the facility, the ground lease should specify the owner's duties in this regard. The developer should also consider including the right to build a fence around the facility and to monitor access by the owner or third parties.

Insurance. The ground lease will require the developer to maintain general liability insurance as well as all-risk property insurance for the full replacement value of the facility. The amount of this required insurance should be reviewed with the developer's insurance company. If the facility is constructed on property where there are common areas shared with other tenants, the ground lease should specify that the owner will be responsible for maintaining the requisite insurance for the common areas.

Assignment and Subletting. A ground lease frequently will restrict the developer from assigning or subletting the facility without the consent of the owner. The developer should consider negotiating exceptions, such as permitting an assignment or sublease to a financially sound tenant. In addition, if a corporate restructuring of the developer is a realistic possibility, the developer should have the right to assign the ground lease to an affiliate of the developer without the consent of the owner. As a general rule, an assignment or sublease will not relieve the developer of its obligations to the owner under the terms of the ground lease.

Financing the Facility. If the developer will require financing from a commercial bank or other third party to finance the construction of the facility, the right to mortgage or otherwise encumber the leasehold interest must be included in the ground lease.

Environmental Issues. The ground lease should include representations by the owner that there are no environmental liabilities existing on the real property. The ground lease will require the developer to agree that it will not violate environmental laws or use hazardous substances in a manner that is inconsistent with environmental laws. The ground lease should not, however, completely prohibit the use of hazardous substances on the property (provided such use does not violate environmental laws or regulations).

Title. The ground lease should require the owner to deliver a title insurance policy insuring the leasehold interest in the property. Title to the facility, and all other improvements constructed on the property, should remain vested in the developer throughout the term of the ground lease. At the end of the lease term, the developer should have the right to remove the facility, and all other improvements, from the property. In the alternative, the developer may have the right to deconstruct or demolish the facility at the end of the lease term.

Indemnification. The ground lease will require the developer to indemnify the owner for any loss or injury suffered by the owner in connection with the developer's use of the property. The ground lease also should require the owner to indemnify the developer for any injury or loss suffered by the developer in connection with the owner's entry onto the property.

Easements to Use Adjacent Property. The developer frequently will require an easement to use real property adjacent to the real property on which the facility is constructed. For example, the developer may require an "access" or "right-of-way easement" for purposes of building a road to the facility that crosses over a neighboring parcel of property. Because easements may be essential for the construction of the facility, easements should be obtained early in the planning process.

An easement is a right granted by the owner of real property to a third party to use the property for a specific purpose, which creates a separate interest in the property. Easements can be drafted to be "appurtenant" (i.e., a right that attaches to the property itself) or "in gross" (i.e., a right that resides only in the holder of the easement). Unless expressly limited, an appurtenant easement will have a perpetual duration. An easement should be granted by a conveyance, be specific as to the permitted use and be recorded in the appropriate county real property records.

Licenses to Use Property on Which the Facility Is Constructed. In certain situations, the developer will grant a third party a license that represents a limited right to use the real property on which the facility is constructed. For example, the developer may wish to permit a third party to construct and maintain a CO₂ liquidification or dry ice plant on the property, and will grant the owner of that plant a license to construct and operate the plant on the property.

A license is a right granted by the owner of real property that permits a third party to undertake certain actions on the property. Unlike the holder of an easement or a lease, a licensee does not have an interest in the real property itself. In addition, a license is revocable at any time by the owner of the real property. A license of this nature frequently will contain many of the provisions discussed above with respect to ground leases.