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Mining Leases in the United States: The Case for Diligent Development

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Summary

Introduction

In all of American law, the coal mining lease may be the most unique legal instrument. Part contract, part conveyance instrument, scoping in landlord-tenant law and carrying with it the old soil of dozens of implied covenants in common law, the coal mining lease can be a legal minefield (pun intended) for the uninitiated. In this article, the authors will analyse certain key commercial terms in the context of recent litigation in American courts surrounding them, and focus on the duty of the coal mining lessee to mine and develop the premises in their possession.

In brief, a coal mining lease is an agreement between the owner of the land – or lessor – and a mining operator: the lessee. The agreement has been characterised as both a conveyance and a contract. Although denominated a lease, the instrument is in substance both a grant of a mineral estate and a bilateral contract for its development and exploitation. A coal lease conveys to the lessee a property interest in the coal in place, yet remains contractual in nature to the extent that it binds the lessee to perform certain covenants.

The most important commercial covenant imposed on the lessee is the covenant to develop the property and generate a mining royalty. At the end of the day, the lessor wants the stream of cash it bargained for in letting the property to the lessee.

Legal obligations on mine lessees: show me the money

A lease of minerals 'is both a conveyance and a contract'. 'It is designed to accomplish the main purpose of the owner of the land and of the lessee (or its assignee) as operator.'[1] Unlike a more traditional landlord–tenant relationship for buildings or houses, the lessee in a mining lease is typically either impliedly or explicitly required to actually mine the property and pay the landowner a royalty. In exchange, the mining operator is granted corporeal rights to occupy property and use it for mining-related purposes, to the exclusion of all others. In other words, the mineral owner wants their subterranean assets converted into cash through a royalty stream, and the operator wants the legal right to accomplish its essential business purpose: to mine, process and sell the coal.

In a recent case in West Virginia, *The Bruce McDonald Holding Co v. Addington, Inc*, the parties tried, to the best of their ability, to express their intent right on the first page of a 40-year mining lease. They wrote:

> It is the mutual intent of all parties hereto that the Lessee herein shall systematically mine such property by multi-level deep, strip and auger mining in such manner as to ensure that all the merchantable and mineable coal in all of the seams hereby leased, as provided in Article X of this Lease is mined and that all such coal so mined will be prepared, marketed, and sold by such means and methods as will ensure the highest available sales prices therefor.

In Article X of the Lease, incorporated in the recital set forth above, the parties agreed that the Lessee: 'will diligently prosecute its operations on the premises hereby leased so that all the merchantable and mineable coal herein provided to be mined shall be mined and royalties therefor paid to Lessor'.

And, for any coal that is mined, the parties agreed upon a per-ton royalty of 10 per cent of the gross selling price, or US$2.00 per ton, whichever is greater.

In Article XIII of the same Lease, the parties agreed that the Lessee would pay an annual minimum royalty measured by 250,000 tons times 'the average selling price at which the same quality of coal was sold by Lessee . . . from the same preparation plant from which Lessor's coal, hereby Leased, was sold.'

Unfortunately, the Lease contained major problems. First, it did not contain language that indicated payment of the minimum was in lieu of or fully discharged upon the Lessee's obligation to develop the property. Second, nor did the minimum royalty provision in the document supply a price or fee in the event that the Lessee did not mine or sell *any* coal from the Leased Premises.

Approaching the end of the 40-year term, the Lessee had not even *begun* mining under the Lease. But it had paid a minimum royalty under Article XIII during the duration of the Lease. The Lessee measured the minimum royalty payment by the floor royalty of US$2.00 per ton, which for many, many years was well below what 10 per cent of the gross selling price of the coal would be, if it had been sold. (The coal is primarily a high-vol A product, selling for over US$200 per ton at times.) The Lessor accepted a payment of US$500,000 (250,000 tons times US$2.00 per ton) for many of the 40 years of Lease history, without ever objecting to the calculation method, before it turned around and sued the Lessee for breach of the contract.

The Lessor alleged the Lessee had breached the promises in the Lease to diligently mine the coal so that all the merchantable and mineable coal was mined and sold at the highest possible prices. Alternatively, the Lessor claimed that the minimum royalty was intended to float along with the market price, and Lessee's '$2.00 per ton' calculation on the minimum royalty was insufficiently low when judged by that intent.

The slack in the deal was two-fold:

1. how does the payment of the minimum royalty square with the expressed intent of the parties that the Lessee would diligently prosecute operations so that all the coal was mined and sold at the highest possible selling price; and
2. how do you measure the royalty payment when no coal was sold from the Leased Premises?

This case was heard in the Business Court Division of the West Virginia circuit courts. At the motion to dismiss stage, the court agreed with the Lessor that the minimum royalty and the duty to mine were separate, enforceable obligations of the Lessee, and it allowed the case to proceed through discovery. At the summary judgment stage, the Business Court reversed its previous ruling, holding that the lease imposed *no duty* upon the Lessee to ever mine the property, only to pay the minimum royalty.

Additionally, the Business Court held that the alternative claim – for an increased minimum royalty based upon market price of the same quality of coal – likewise failed to have a basis in the language of the Lease. The court ruled that by the plain language of the Lease, the resetting of the minimum royalty payment could only be accomplished through mining and selling of the coal by the Lessee itself under the Lease. Thus, the Lessor could not prove the 'average selling price of the same quality of coal' by using comparable sales from adjacent properties. Therefore, the US$2.00 per ton times 250,000 calculation prevailed.

United States courts want lessees to mine the land in their charge

The Business Court's order finding the lessee's US$2.00 per ton calculation was acceptable strikes a marked difference from not only long-standing West Virginia opinion in *Hamrick v. Nutter*, but from the common law of the mineral producing states in the entire Central Appalachian Basin (including the states of West Virginia, Virginia, Kentucky and Tennessee), which collectively and currently mines approximately 20 per cent of the coal in the United States. The area is historically known for bituminous coal with high energy content and low sulphur, making it prized for metallurgical and power-generation use.

Indeed, the region was the heart of US underground coal mining for much of the twentieth century, so legal precedents arising from these jurisdictions have always been closely followed and adhered to when it comes to United States mining litigation.

In *Hamrick*, the West Virginia Supreme Court set out the following holding in a syllabus point: 'The lessor in a coal mining lease may maintain an action of assumpsit for breach of the lessee's covenant to properly and diligently develop the mine property.'[2] *Hamrick* so held even though the lease at issue in that case also contained a minimum royalty payment.

In surrounding states, the law agrees with *Hamrick.* Applying Kentucky law, *North Star Co. v. Howard,* reached the same result:

> Star argues that the Howards are not entitled to recover damages against Star because of Star's failure to diligently mine the Howards' coal, but are limited to the minimum royalty specified in the Howards' lease. The lease contains not only a provision for the payment of minimum royalty but also a covenant requiring Star to diligently mine the Howards' coal. The parties to the lease obviously did not intend the minimum royalty provision as a limitation on the specific covenant requiring Star to mine diligently. Any other interpretation would render the requirement of diligence meaningless.[3]

Virginia law agrees: '[T]he leases involved herein provided for both a minimum royalty and diligent development of the mines. Therefore, the payment of minimum royalties does not satisfy the duty of diligent development'[4] (applying Virginia law). Ohio law also agrees: 'The fact that the lessees have continued to make annual payments for a period of over eighteen years does not alter their responsibility to develop the land within a reasonable time. The questions of working diligently and of paying rent or royalties are entirely separate matters.'[5] And, Pennsylvania law agrees: 'Even if the [lessee] paid royalties (including the monthly minimums) . . . still it was the [lessee's] duty to mine and remove the coal during the term of the lease.'[6]

This *Addington* case is a case of irrational exuberance. The lease was negotiated and signed in the midst of a great upswing in the market for coal in the mid-1970s. Oil embargoes were driving fossil fuel prices through the roof, and thus, operators rushed in to snap up more coal reserves, often bidding against each other. Lessors had leverage. In this case, the parties were so certain that the market circumstances would continue, they did not even contemplate that the coal would never be mined, let alone specifically address the situation when no mining occurred in the minimum royalty provision. This loophole in the document led the mine operator to wholly resist ever commencing operations, for fear of closing its potential escape hatch.

On appeal, the West Virginia Supreme Court of Appeals affirmed the Business Court's decision. The high court found that, as a matter of law, the Lessors waived their right to contest their Lessee's lack of diligence by accepting – without objection – a minimum royalty payment over a period of over 20 years. See *Bruce McDonald Holding Company v. Addington, Inc*.[7] The court so held even though the lease contained a strict anti-waiver clause. In the end, the West Virginia Supreme Court took an off-ramp from deciding the precise substantive issue in the case by finding that the Lessors had waived their rights under the coal mining lease.

Conclusion

Thus, two lessons appear from this case: (1) the failure to address a complete refusal by the lessee to perform its promises led to a state of inertia between the parties; and (2) inertia is bad in a commercial context. The impact that the *Addington* case may have on other mining litigation in the United States is not yet clear, but the fact that a court opened up the door to accepting that lessees can effectively squat on valuable land that lessors would otherwise be making money from is something to keep an eye on.

Endnotes

1 *Bryan v. Big Two Mile Gas Co*, 213 W. Va. 110, 117, 577 S.E.2d 258, 265 (2001). ^ Back to section

2 Syl. pt. 1, *Hamrick v. Nutter*, 93 W.Va. 115 (1923). ^ Back to section

3 *N. Star Co v. Howard*, 341 S.W.2d 251, 254 (Ky. 1960). ^ Back to section

4 *Coal Res, Inc v. Gulf & Western Indus, Inc*, 865 F.2d 761, 766 (6th Cir. 1989). ^ Back to section

5 *Ionno v. Glen-Gery Corp*, 2 Ohio St. 3d 131, 134, 443 N.E.2d 504, 508 (1983). ^ Back to section

6 *Boron v. Smith*, 380 Pa. 98, 103–04, 110 A.2d 169, 171 (1955). ^ Back to section

7 825 S.E.2d 779 (W. Va. 2019). ^ Back to section

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