

Frac Sand: U.S. District Court Addresses Whether Quarry Operation Commenced Within the Terms of the Mining Lease



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A United States District Court addressed in an August 15th opinion a dispute between parties to a mining lease involving frac sand. See *Pronschinske Trust v. Kaw Valley Companies, Inc. and KC Proppants, LLC*, 2017 WL 3498712 (W.D. Wisconsin).

The primary issue was whether “mining” and “quarry” had commenced as these terms are defined in the mining lease, triggering certain payment obligations.

Ivan and Beverly Pronschinske (“Pronschinske”) entered into a Mining Lease Agreement (“Lease”) through their trust with KAW Valley Companies, Inc. (“KAW”). KAW entered into the Lease to mine frac sand from Pronschinske’s property in Wisconsin. It provided KAW the exclusive right to “quarry, process, crush, manufacture, wash, remove, and sell all sand, gravel, stone and other rock products (it mined or quarried) from the Pronschinske property.

KAW is described as having “walked away without removing any sand.” Regardless, Pronschinske argued KAW’s activities on the property constituted commencement of mine and quarry operations triggering an obligation for KAW to make certain payments.

KAW responded that payments were not triggered until materials had actually been mined or quarried. As a result, the company argued there was no payment obligation.

Pronschinske filed an action in United States District Court arguing the failure to pay was a breach of the Lease.

Both parties agreed that the Lease terms were unambiguous. Therefore, the Court determined the issue could be decided solely on the basis of the terms of the Lease.

Two of the three Lease payment obligations included triggers for a “Commencement Royalty Credit” and “Minimum Production Royalty.” Therefore, the Court identified the primary issue as whether KAW owed the Commencement Royalty Credit or the Minimum Production Royalty.

Paragraph 5 of the Lease establishes the “Commencement Royalty Credit”:

Upon Lessee’s commencement of mine or quarry operations as determined by Lessee in its reasonable discretion, Lessee agrees to pay to Lessor the sum of Forty Five Thousand Dollars (\$45,000.00) (the “Commencement Royalty Credit”). The Commencement Royalty Credit shall be nonrefundable, but shall be used to offset any future amounts and royalties due Lessor from Lessee.

The phrase “mine or quarry” was defined in paragraph 1 of the Lease to mean “to quarry, process, crush, manufacture, wash, remove and sell ... all sand, gravel, stone and other rock products[.]”

Paragraph 6 of the Lease provides for the payment of weight-based royalties once Products are “mined from the Property;” these royalties are referred to as “Production Royalties.” This paragraph reads in full:

Lessee shall pay Lessor a royalty of \$1.50/ton (2,000 lbs.) for the first 65,000 ton of sand, stone and rock products mined from the Property in satisfaction of the offset requirements for the Initial Royalty Credit and Commencement Royalty Credit. Thereafter Lessee shall pay Lessor a royalty of \$2.50/ton (2,000 lbs.) for sand, stone and rock products mined from the Property (all such royalties are hereinafter referred to as “Production Royalties”) for the sand, stone and rock products mined from the Property weekly (measured from the Effective Date). Lessee shall make such payments to Lessor no later than the Friday following the week in which products are mined from the Property. Notwithstanding anything to the contrary contained herein, Lessee shall pay to Lessor an annual minimum Production Royalty of \$75,000 (the “Minimum Production Royalty”). In the event that, as of the month containing the anniversary date of the Effective Date, the monthly Production Royalties (as such may be prorated) fail to meet or exceed the Minimum Production Royalty, Lessee shall pay to Lessor the difference between the actual amount paid to Lessor during the year and the Minimum Production Royalty for such year. This catch-up payment will be made with the next monthly payment due hereunder.

Paragraph 9 states in part:

The royalties payable under paragraph 6 and paragraph 7 shall be payable based on the removal from (or transportation across) the Property. All sand, gravel, stone and other rock products mined from the Property shall be weighed at the time of removal from the Property and the royalties shall be based on the actual weight as reflected in weight tickets.

Upon executing the Lease Kaw undertook a number of steps in preparation to mine or quarry which included:

1. survey the property
2. conduct well checks
3. taking soil borings
4. agreement to upgrade a highway
5. paid for widening pond

The Lease is stated to clearly provide that KAW was “not obligated to extract any materials or sell any products by virtue of the Lease” and it was in their “reasonable discretion” when and whether “to commence. . . mine or quarry operations,” and that the Lease is “predicated on the property being properly zoned for the contemplated quarry operations and immediately and continually available for Lessee’s contemplated use.”

Paragraph 14 further provides:

Should Lessee be prevented from conducting its anticipated normal business operations because of a lack of zoning, access, or any necessary governmental permit or approval, or because of any other condition (including without limitation, depletion or inadequacy of reserves) which in Lessee’s opinion renders or threatens to render Lessee’s contemplated operations commercially infeasible or impracticable, then (A) Lessee shall have the right, but not the obligation, to undertake such efforts as it deems reasonable and necessary, in its sole discretion, to secure necessary zoning classification, permit, approval, or access, or to remove any such condition, and Lessor agrees to cooperate fully with Lessee in this regard, including but not limited to, execution of any documents and attendance of any hearings which Lessee reasonably deems necessary, or (B) with or without exercise of Lessee’s rights under clause (A), Lessee shall be entitled to cancel this Lease, as to all or any portion of the Property, upon ten (10) days’ prior written notice to Lessor

A Conditional Use Permit was granted. Nevertheless, KAW determined it was commercially infeasible or impractical to engage in mining activities on the property. KAW subsequently terminated the lease.

The phrase “mine or quarry operations” was addressed by the parties from their different perspectives.

KAW argued that the definitions of “mine” or “quarry” means to quarry, process, crush, manufacture, wash, remove and sell . . . all sand, gravel, stone and other rock products. . . . They concluded that until any of these activities occurred, there was no “mine or quarry operations.” The Court stated it was undisputed that KAW never engaged in any such activities.

Pronschinske countered that KAW’s view would render the term “operations” meaningless. They argued that adding the word “operations” after “mine or quarry” broadened the scope of activities covered by the definition in Paragraph 1. The term was stated to include the steps taken by KAW to secure the Conditional Use Permit and to prepare to mine or quarry. A dictionary definition was cited for the word “operations” which is defined to mean:

. . . a usually military action, mission, or maneuver including its planning and execution.

Pronschinske stated that such an interpretation would raise the question as to which action would not be deemed to be part of the planning stages for mining or quarrying (noting that everything the parties said and did was part of the plan to undertake mining or quarrying). It was further argued that various sections of the lease indicate “a sequence of events that clearly anticipates that mining or quarrying operations will commence on some future date, but only if certain conditions are met and only if defendants choose to commence, which they are not obliged to do.” The Court rejected Pronschinske’s argument. It stated that consistent with the primary definition of “operation,” ordinary people reading Paragraph 5 would understand the phrase “commencement of mine or quarry operations” indicated mine or quarry activity by actually mining or quarrying sand (i.e., ordinary people would not understand the phrase to encompass preparatory activity that occurring before mining or quarrying actually began).

The Court concludes that the commencement royalty did not become due until KAW actually commenced mining or quarrying. This was deemed to be the result if the contract was given a plain and ordinary reading.

As to the “Minimum Production Royalty,” Pronschinske referenced Paragraph 6’s “Notwithstanding” clause, arguing that this provision was triggered regardless of whether any products were ever mined. The Court dismissed this argument stating that Paragraph 6 relates exclusively to the payment of Production Royalties; the \$75,000 payment itself is described as a Minimum Production Royalty.

The Court states that an ordinary and plain read of Paragraph 6 makes it clear that the Minimum Production Royalty, like the Production Royalties, is not owed until products are “mined from the property.” The Court also states that if the parties had actually contemplated a lease guaranteeing Pronschinske an annual payment of \$75,000 (regardless of whether any products were mined) they could have so stated.

As a result, the Court rejected the claim that KAW owes Minimum Production Royalties in the amount of \$75,000 per year for five years.

[A copy of the opinion can be downloaded here.](#)