Implied Duty to Mine in Georgia

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THE IMPLIED DUTY TO MINE IN GEORGIA

by James C. Rebberg and James B. McLaughlin, Jr.

The recent case of Higginbottom v. Thiele Kaolin Company,1 refused to recognize an implied duty to mine in a lease of kaolin rights, at least where the lease provided for a minimum annual rent or royalty. The opinion is interesting in two respects: first, in its refusal to recognize such an implied duty where there is such a minimum payment and, second, in its interpretation of the prior Georgia case law. This article will analyze the Higginbottom case and the prior Georgia cases relevant to the issue of implied obligations in leases. While it will deal primarily with implied obligations in mineral leases, it will mention other Georgia cases which deal with implied obligations in other types of leases. Some of these cases are relevant to the issue of whether a court should imply a duty to perform certain activities under a lease agreement. In the implied duty to mine cases issues of fraud, lack of mutuality and an inequality of bargaining power sometimes arise, but the scope of this article is limited to the issue of the implied duty to mine.

Higginbottom

The facts of the Higginbottom case undoubtedly parallel those of many mineral lease situations throughout middle Georgia. The leases in question were for an initial term of 50 years with an option to renew for an additional term of 49 years. The lessee was granted the right to mine, process, or manufacture all kaolin and bauxite on the properties which it deemed to be commercially profitable. The lease contained the normal provisions granting to the lessee the rights of ingress and egress necessary to carry out the contemplated activities under the lease. It provided that the lessee would pay a royalty of $.25 for each ton of refined clay and bauxite removed and, in addition, it required the lessee to pay one dollar per year per acre as a rental fee or minimum annual royalty. As is usual in such leases, it also provided that the one dollar per acre per year payments should be credited against any amounts due as royalties arising from mining within the year in question.

The lease was entered into in the early 1960's but the lessee, Thiele, never began mining operations under the lease. As a result of Thiele's failure to mine, the landowners-lessees filed suit against Thiele, seeking to rescind the leases for breach of an implied duty to mine within a reasonable time and for fraudulent inducement. The trial court granted Thiele's motion for summary judgment and the landowners appealed to the Supreme Court of Georgia. While the Supreme Court addressed both grounds of the lessor's appeal, this article is concerned only with the issue of the implied duty to mine. The Supreme Court affirmed the lower court's granting of the motion for summary judgment.

Previous Georgia Mineral Lease Cases

In deciding the issue of whether there is an implied duty to mine in such a mineral lease the Georgia Supreme Court looked primarily at two earlier Georgia cases. They are Hodges v. Georgia Kaolin Company2 and Palmer Brick Company v. Woodward.3 While it is true that both of these cases addressed the implied duty to mine issue, their facts appear distinguishable from the facts of Higginbottom. While the court, in Palmer Brick, recognized that there may be an implied duty to mine under certain circumstances, it refused to find any such implied duty in that case. That decision appears to be correct in that the minimum annual rental which was being paid by the lessee was substantial. In fact, the minimum annual rental being paid in Palmer Brick exceeded the royalties actually earned. In addition, the lessee was in actual occupation of the property, which made it impossible for the true owner to make any use of the property.

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property. Such facts distinguish the Palmer Brick case from Higginbottom.

The Hodges case is also easily distinguished from Higginbottom. In Hodges, the court found that the lessee was under an implied duty to mine within a reasonable time after the inception of the lease, but only because the lessee had entered upon the property, had begun preparation to mine and had then abandoned such preparatory efforts. The Hodges court actually held that once the lessee had cleared the land a duty to exercise reasonable diligence in continuing these activities arose. Notions of good faith and fairness demanded the imposition of a duty to mine upon the exercise of the right to clear and possess the lessor’s property and thus to render the land useless to the true owner. Therefore, Hodges is also factually distinguishable from Higginbottom.

The real question which arises from a reading of Higginbottom is whether the provision in a lease which requires a lessee to make a minimum annual rental payment answers the question as to whether there is an implied duty to mine on the part of the lessee. The court held that there was no duty to mine within a reasonable period of time after the inception of the lease, giving two primary reasons. First, the court felt that it was significant that the lessee had not interfered with the lessor’s possession or profitable use of the property, relying primarily on Hodges for this proposition. Second, the court found that since the lessee was required to pay a minimum annual rental, which was to be credited toward any royalties due as a result of any mining during that particular twelve-month period, this indicated the parties did not contemplate any duty on the part of the lessee actually to mine the property. The court felt that this minimum annual rental provision indicated that the parties contemplated that the lessee might not mine during the term of the lease (a possible 99-year period) and therefore negotiated this minimum right to cover that possibility.

Higginbottom also cited Sewell v. Aggregate Supply Company5 and Smith v. Aggregate Supply Company6 for the proposition that if a minimum annual rental is paid and is credited only to royalties due for the year in which it is paid there is no implied duty to mine. Again, this is based upon the assumption that inclusion of such an annual rental is an indication that they knew that mining might not occur under the lease. It is questionable that such assumption is valid in a case like Higginbottom.

Other Georgia Lease Cases

An interesting observation is that in other types of leases the Georgia courts have not made such an assumption as to the intent of the parties just because a minimum rental payment is provided for in the lease. For example, in the case of Sinclair Refining Company v. Davis7 the lessee of premises for use as a service station had agreed to pay a minimum rental of $10 per month plus additional rent based upon a per gallon of gasoline sold upon the premises during the term of the lease. The Georgia court found an implied duty on the part of the lessee to operate a service station for the sale of gasoline because it was clearly within the contemplation of the parties. Since that was the purpose of the parties’ entering into the lease, the lessee’s failure to operate a service station upon the premises was found to be a breach of the lease in a manner so substantial and fundamental as to defeat the object of the lease. The lessor was allowed to rescind, even though the lease provided for a minimum rent of ten dollars per month. The basic premise of Sinclair is that a breach of a contract as to a matter which is substantial and fundamental as to defeat the object of the lease. The lessee would mine minerals. Nevertheless, Higginbottom states that the parties contemplated that the lessee might never mine minerals from the property of the lessor.

An approximate analogy is the percentage payment clause found in so many commercial leases. In Fifth Avenue Shopping Inc. v. The Grand Union Company,8 the United States District Court for the Northern District of Georgia held that, under Georgia law, if parties to a lease contemplate that the amount of rent to be generated by a percentage payment clause will be substantially greater than the minimum rental specified in the lease, it is reasonable to imply a covenant that the lessee will operate his business on the leased premises throughout the term of the lease. Fifth Avenue is distinguishable from Higginbottom in that the lessee in Fifth Avenue was in actual possession of the property and the lessor therefore could not itself use the property. However, a close reading of Fifth Avenue makes it clear that this is not the basis of the decision. In short, the obvious differences between the lease of a service station (or of shopping center
space) and a mining lease are not alone a valid basis for reaching a different result in the latter. This is made clear by Fifth Avenue, where the landlord could not use the premises at all, but the court still based the decision on the fact that the minimum monthly rent was substantial and therefore the landlord had no right to complain or enforce any implied duty on behalf of the lessee to use the premises for certain purposes. The key was that the lessee was required to pay a substantial minimum monthly rent. The key was not that the landlord could not use the property for any purposes.

The fact that the lessee was paying a substantial minimum monthly payment raises the question of what is to be considered substantial. Fifth Avenue correctly looked to the intent of the parties at the time they entered into the lease. The fact is that, in a case such as Fifth Avenue, the minimum monthly rent closely corresponds to what the parties could expect the lessee to pay even if the lessee fully operated a business on the premises. In other words, the retail sales which would be generated by the lessee would not substantially, perhaps not at all, increase the amount of rent that was to be paid.

Fifth Avenue relied upon Kroger Company v. Bonny Corp. On the question of what constitutes a substantial minimum the court quoted Kroger as follows:

The [Sinclair] cases indicate that the minimum [rental payment] was substantially below contemplated performance, and was therefore not 'substantial'.

This raises the obvious question of what is the contemplated performance in a mining lease. Palmer Brick indicates that it is mining of the premises.

Fifth Avenue concluded that the law in Georgia is that if the parties contemplate that the amount of rent to be generated by a percentage payment clause will be substantially greater than the minimum rental specified in the contract, there is an implied covenant that the lessee will operate his business on the leased premises throughout the term of the lease. The logical conclusion in a mineral lease situation would be that if the minimum annual rental payments, in Higginbottom one dollar per acre per year, are to defeat the implied duty to mine, they must be substantial. In order to be substantial they must be reasonably related to the amount of rent, or royalties, which would be generated by the lessee's operating his business on the leased premises; i.e. conducting mining operations on the premises.

Therefore, if the royalties which would reasonably be generated from the mining of clay from the property of a landowner can reasonably be assumed to be much greater than one dollar per acre per year, the one dollar per acre per year is not a substantial payment and, therefore, should not defeat the implied duty to mine.

Tennessee Valley Kaolin Corp. v. Perry. was cited in the Higginbottom opinion, but the opinion does not mention that the lease in Tennessee Valley had a specific provision which stated:

. . . agreed . . . that the failure of Spinks to prosecute mining . . . shall cause a forfeiture unless Spinks shall pay the minimum annual payments. (emphasis added)

The real basis of Tennessee Valley, then, is that this specific provision prevented a forfeiture of the lease for failure of the lessee to mine because it stated the obligation of the lessee in the alternative; i.e. prosecute mining . . . or pay the minimum annual payments. The court found that this lessee had in fact paid the annual payments; therefore, there was no forfeiture.

It is important to realize that the Tennessee Valley court did not hold that there was no implied duty to mine solely because of the provision for minimum payments. It went on, instead, to hold that the parties expressed their intention that the minimum annual payment was a sufficient alternative to royalties paid from actual mining.

This is significantly different from the question of whether a minimum annual payment is sufficient to eliminate the implied duty to mine.

One of the soundest, from an analytical point of view, of the cases dealing with the implied duty to mine is a quite recent case from Ohio. It stressed that an insubstantial minimum royalty is not intended by the parties as the real consideration for a mineral lease and, therefore, should not preclude the implication of a duty to mine. It stressed, also, the interest of the public in such leases. It said:

"It [failure to imply the duty to mine] would allow a lessee to encumber a lessor's property in perpetuity merely by paying an annual sum. Such long-term leases under which there is no development impede the mining of mineral lands and are thus against public policy."

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Conclusion

It appears that the Georgia courts have not stressed sufficiently the intent of the parties and the public policy considerations. It could be argued, and undoubtedly has been argued, that the real reason why kaolin leases do not expressly require prompt exploitation of the mineral resource is to enable the kaolin companies to tie up large reserves of kaolin. This, perhaps, may be wise from a business point of view, notwithstanding its definite anti-competitive effect. However, in light of the fact that the lease agreements in question are normally drafted by attorneys for the kaolin companies, any ambiguity in such agreements should be construed against the kaolin companies. Such a reading would suggest that the parties contemplated exploitation of the mines which, in turn, would result in reasonable royalty payments to landowners.

Footnotes

7. 251 Ga. 148, 304 S.E.2d 365 (1983) at 367: where such an annual rental is provided for, it indicates that they knew that mining might not occur for some time...
10. 491 F. Supp. 77 at 80.
11. Id.
13. Id. at 490.
14. Jonno v. Glen-Gery Corp., 443 N.E.2d 504 (Oh. 1983), reversed on the issue of whether forfeiture or an award of damages would be the appropriate remedy for the breach of the implied covenant to mine.
15. Space limitations prevent discussion of other relevant decisions from other states. See Dublin v. West, 528 P.2d 411 (Colo. 1974), holding that where the minimum rental is minuscule in relation to the reasonably contemplated royalties the lease may be terminated; Deerfield Rock Corp. v. McClellan, 121 So.2d 822 (Fla. 1960), holding that the presence of other consideration is insufficient alone to eliminate the implied duty to mine; and McDonald v. The Grande Corp., 214 So.2d 795 (La. 1960), holding that the real object of a mining lease is to generate a profit for both lessor and lessee.

Uncontested.

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