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Henry McC. Ingram
Rose, Schmidt, Dixon & Hasley

John H. Lawrence Jr.
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CONTRACT MINING AGREEMENTS— THE CONTRACT MINER'S PERSPECTIVE

HENRY MCC. INGRAM*

and

JOHN H. LAWRENCE, JR.

I. INTRODUCTION

This Article focuses on legal issues which will arise in the contract mining relationship and offers suggestions to the contract miner and his advisors concerning areas of additional inquiry before the mining agreement is executed.¹ Obviously, the parties will be interested in assigning the risks, shifting the burdens and determining the liabilities of the proposed operation.

Various business considerations favor the use of a contract mining arrangement, which may provide a viable alternative when the underlying lease restricts assignment and subletting. It offers an opportunity to shift certain burdens of the proposed operation to another party. It affords the owner the opportunity to control reserves and coal sales without the burden of operational responsibilities and capital investments.

As in any business transaction, the objectives of the contracting parties and the relative strengths which they bring to the negotiations will determine the form and substance of a contract mining agreement. It is, of course, one thing to suggest that the miner seek an indemnification provision in the agreement for liabilities which he may incur—it is quite another to negotiate successfully the inclusion of such a clause in the agreement. The contract miner should also realize that if the owner² insists that the proposed mining operation be conducted with union employees or that the miner secure and maintain all necessary permits, the ultimate arrangement will undoubtedly contain those elements. The miner, however, should be familiar with the problems which may arise in such circumstances and should attempt to protect his interests to the maximum extent possible in negotiations for the agreement.

Having made the decision to use the contract mining arrangement, the parties may encounter difficulty in drafting the agreement because of their

* Henry Ingram received his B.A. degree from Allegheny College in 1961 and his LL.B. from University of Michigan in 1964. John Lawrence received his B.S. degree from Washington and Lee University in 1978 and his J.D. from the University of Virginia in 1975. Messrs. Ingram and Lawrence are partners in the law firm of Rose, Schmidt, Dixon & Hasley, Pittsburgh, Pennsylvania. The authors gratefully acknowledge the substantial research and related efforts of David Onuscheck and Bruce A. Bartolotta in the preparation of this Article.

¹ This Article is written as a companion to the accompanying article, Gage, *Drafting a Contract Mining Agreement—The Owner's Perspective*, 86 W. VA. L. REV. 821 (1984), which describes the contract mining relationship from the owner's perspective.

² Throughout the Article we refer to the person having the right to mine the coal as the "owner" even though he may not actually own the coal in fee but may be a lessee or perhaps another contract miner.

desire to assign various risks, liabilities and costs in a way that may be inconsistent with an independent contractor relationship. Care must be taken to avoid converting the independent contractor relationship into some other relationship.

The primary purposes of this Article are to survey the applicable law, suggest how an assessment of the risks, burdens and liabilities can be made from the contract miner's perspective, and suggest specific clauses for the contract mining agreement. Specific consideration has been given to the laws of Kentucky, Ohio, Pennsylvania, Virginia and West Virginia.

II. BASIC CONSIDERATIONS

One of the first considerations in establishing the structure of the mining relationship is the nature of the owner's interest in the coal. Where the owner is a lessee under a lease which prohibits assignment or subleasing, the lessee must obtain the consent of the lessor to assign the lease or enter into a sublease. However, the lessee may be unwilling to ask for a consent to an assignment or sublease since such a request is often met with a counter request by the lessor to increase the lease royalty or make other concessions. Under these circumstances, a properly structured contract mining agreement should avoid a violation of the nonassignment clause. In order to avoid characterization as an assignment of the lease or as a sublease, the agreement should avoid any implication that the contract miner has the exclusive right to possession of the premises or owns the coal either before or after severance. Although neither party will want the contract mining agreement to constitute a breach of the nonassignment clause in the underlying lease, the contract miner's interests will be better protected if the agreement gives him more than a bare license which is terminable at will.³ Depending upon the jurisdiction, the miner's interest will be better protected by creating an easement or license coupled with an interest.⁴

If the contract miner is willing to perform his services for a price related to the market price of the coal, the contract mining agreement may be structured so that the contract miner receives a percentage of the gross or net proceeds from the sale of the coal. This would allow the contract miner to claim a depletion deduction against its income from the property.⁵ In this situation, care should be taken that the arrangement does not constitute a partnership or violate any restrictions on assignment or subleasing.

The other principal terms of the contract mining agreement involve the responsibilities of each party with respect to the operation of the mine, en-

³ A bare license does not entitle the licensee to protection against interference with his use by the licensor or third parties. 3 AMERICAN LAW OF MINING § 14.2, n.19 (1981).

⁴ See 4 COAL LAW AND REGULATION § 83.03[5] (D. Vish & P. McGinley ed. 1983).

⁵ See *supra* notes 8 through 32 and accompanying text.

vironmental and other compliance matters and the respective liabilities of the parties. The specimen contract mining agreement in the accompanying article (the "Specimen Contract") exemplifies a contract mining agreement protective of the owner's interests.⁶ Typically, the agreement will be drafted so that the contract miner is an independent contractor, thus minimizing the liability of the owner for injuries to employees of the contract miner, other tort claimants, and for environmental and other regulatory requirements.

III. TAX ISSUES RELATED TO CONTRACT MINING

In structuring a contract mining agreement, it is essential that all tax aspects of the transaction be evaluated so that the desired tax treatment is obtained. Before agreeing upon the method of compensating the contract miner, the parties should consider the factors governing who is entitled to claim depletion. The parties should also agree on responsibility for all other tax matters, such as the federal reclamation fee, the black lung benefits excise tax and the various state taxes, including *ad valorem* real estate taxes.

A. Depletion

Section 611 of the Internal Revenue Code⁷ provides that in the case of mining concerns "there shall be allowed a deduction in computing taxable income a reasonable allowance for depletion."⁸ Depletion allowance is calculated by one of two methods, percentage depletion or cost depletion. Percentage depletion is allowed under section 613 of the Internal Revenue Code⁹ for mines, wells and various enumerated natural deposits. The annual allowance for percentage depletion applicable to coal is ten percent of the gross income from the property (which excludes amounts paid for rents or royalties with respect to the property on which the mining is taking place), but not more than fifty percent of the income from the property computed without regard to the depletion allowance. Percentage depletion is not limited to the taxpayer's basis in the property, and thus the taxpayer is entitled to the depletion allowance, even after its basis in the property is reduced to zero. Cost depletion, which is provided for under section 612 of the Internal Revenue Code,¹⁰ is calculated by deducting an appropriate portion of the taxpayer's basis in the property for each ton of coal mined and sold.¹¹ A separate depletion calculation is required for each property.¹² For any taxable year, the

⁶ See Gage *supra* note 1 at 841.

⁷ I.R.C. § 611 (1976).

⁸ For an excellent discussion on coal depletion allowance, see McMahon, *Coal Depletion Allowance*, 85 W. VA. L. REV. 581 (1983).

⁹ I.R.C. § 613 (1976 & Supp. IV 1980).

¹⁰ I.R.C. § 612 (1976).

¹¹ Treas. Reg. § 1.611-2(a)(1) (1983).

¹² "Property" is defined in I.R.C. § 614 (1976 & Supp. IV 1980).

allowable depletion deduction for a property depends upon whether cost or percentage depletion is greater. The taxpayer is required to utilize the method which results in the greater deduction.¹³

Percentage depletion was long characterized, like cost depletion, as a method of recouping the owner's capital investment in the minerals, free of tax.¹⁴ More recently, however, the depletion allowance has more realistically been viewed as a special incentive for engaging in the business of exploring and developing mineral reserves.¹⁵

A taxpayer is entitled to depletion only if he has an economic interest in the coal in place.¹⁶ This criterion was first enunciated by the United States Supreme Court in *Palmer v. Bender*,¹⁷ and later codified in Treasury Regulation section 1.611-1(b)(1).¹⁸

Treasury Regulation section 1.611-1(b)(1) attempts the difficult task of drawing a distinction between an economic interest and an economic advantage. Under that section, if the contract miner has made no investment in the coal, it will be deemed to have merely an economic advantage, not a depletable economic interest. Generally, the depletion cases involving contract miners attempt to define the difference between an economic interest and an economic advantage.

The Supreme Court held in *Parsons v. Smith*¹⁹ and *Paragon Jewel Coal Company v. Commissioner*²⁰ that a contract miner who is paid a fixed price per ton or a price per ton that is not directly related to the market price does not have the requisite economic interest and thus is not entitled to a deple-

¹³ I.R.C. § 613(a) (1976); Treas. Reg. § 1.611-1(a) (1983).

¹⁴ *Commissioner v. Southwest Exploration Co.*, 350 U.S. 308, 312 (1956).

¹⁵ *United States v. Swank*, 451 U.S. 571, 576 (1981).

¹⁶ See generally McMahon, *Defining The "Economic Interest" In Minerals After United States v. Swank*, 70 Ky. L. J. 23, 36 (1982).

¹⁷ 287 U.S. 551 (1933).

¹⁸ Treas. Reg. § 1.611-1(b)(1) (1983) provides in relevant part:

Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place . . . and secures, by any form of legal relationship, income derived from the extraction of the mineral . . . to which he must look for a return of his capital. . . . A person who has no capital investment in the mineral deposit . . . does not possess an economic interest merely because through a contractual relation he possesses a mere economic or pecuniary advantage derived from production. For example, an agreement between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction . . . does not convey a depletable economic interest.

¹⁹ 359 U.S. 215 (1959).

²⁰ 380 U.S. 624 (1965).

tion allowance. In *Parsons v. Smith*, the Court cited seven factors in distinguishing an "economic interest" from an "economic advantage."²¹ Additionally, the Court held that a contract miner was not entitled to depletion where he received a fixed fee per ton of coal delivered and was not authorized to keep or sell any of the coal but was required to deliver all that was mined to the owner.²²

These seven factors were reviewed by the Court in *Paragon Jewel Coal Company*, which held that a contract miner was not entitled to depletion where the contract miner's fee, although not fixed, was not directly related to the sales price of the coal and was payable regardless of whether the owner was able to sell the coal in the market.²³ The owner bore the risk of a decline in the market and the benefit of any rise in the market. Although the miner's fee in the *Paragon Jewel* case was not fixed, it was adjusted periodically to reflect general trends in the market. The fact that the contract in that case was held to be terminable did not seem to affect the Court's view as to the relative market risk of the parties.

The *Parsons* and *Paragon Jewel* cases, which involved payment of mining fees unrelated to the market price, should be distinguished from the cases of *Ruston v. Commissioner*²⁴ and *Brown v. Commissioner*²⁵ in which the contract miner was paid a fixed percentage of the net selling price or net profits

²¹ The seven factors were:

(1) The contract miner's investment was in his equipment, all of which was movable—not in the coal in place;

(2) The contract miner's investment in equipment was recoverable through depreciation—not depletion;

(3) The mining contract was terminable without cause on short notice;

(4) The landowners did not agree to surrender to the contract miner and did not actually surrender any capital interest in the coal in place;

(5) The coal, at all times, even after it was mined, belonged entirely to the landowners, the contract miner could not sell or keep any of it and was required to deliver all that he mined to the landowners;

(6) The contract miner did not share in the proceeds from the sale of the coal, but was paid a fixed sum for each ton of coal mined and delivered which fee was full compensation for the performance of the contract miner's work and for the furnishing of all labor and equipment required for the work; and

(7) The contract miner agreed to look only to the landowner for all sums to become due it under the mining contract which did not grant the contract miner an interest in the coal in place.

359 U.S. at 225.

²² For other cases in which contract miners earning fixed fees per ton of minerals mined have been denied depletion deductions, see *Costantino v. Commissioner*, 445 F.2d 405 (3d Cir. 1971); *McCall v. Commissioner*, 312 F.2d 699 (4th Cir. 1963); *United States v. Stallard*, 273 F.2d 847 (4th Cir. 1959); *Adkins v. Commissioner*, 51 T.C. 957 (1969); and *Denise Coal Co. v. Commissioner*, 29 T.C. 528 (1957), *aff'd in part, rev'd in part*, 271 F.2d 930 (3d Cir. 1959).

²³ 380 U.S. at 635.

²⁴ 19 T.C. 284 (1952).

²⁵ 22 T.C. 58 (1954).

realized from the sale of the coal. In the latter cases, the contract miner was found to be entitled to claim depletion. This is consistent with the Supreme Court's focus on which party bears the market risk.

In *Ruston* the lessee entered into a contract which gave the contract miner the exclusive right to mine the coal, but the lessee retained title to the coal both before and after extraction and retained the sole right to market the coal. The contract provided that the contract miner was to receive eighty-three percent of the net profits from the sale of the coal as compensation for his services. The Tax Court, taking note that the contract miner looked solely to the sale of the coal for its income, held that the contract miner had an economic interest in the coal.²⁶

Similarly, in *Brown* a contract miner was engaged to mine coal for a percentage of the net profits from the sale of the coal. The Tax Court held that the contract miner had an economic interest in the coal because the miner's compensation was directly related to the sales price of the coal and it had an exclusive right to mine the coal.²⁷ In addition, a contract miner which receives a percentage of the net proceeds from the sale of the coal has an economic interest even though it does not have an exclusive right to mine the property.²⁸

In the recent case of *United States v. Swank*,²⁹ the Supreme Court held that a contract miner has an economic interest in coal in place notwithstanding the fact that the mining agreement was terminable on only thirty days' notice.³⁰ Therefore, even though *Swank* involved a lease, a contract miner operating under a contract terminable without cause with at least thirty days' notice may not be disqualified from claiming depletion for that reason alone.

In summary, a contract miner should have a depletable economic interest in the coal if his fee is based upon the market price for the coal. The taxpayer need not have a property interest in the coal, either before or after mining, nor have the right to sell it, so long as payment is due only upon sale of the coal and is based on the market price at the date of sale.³¹ A contract mining

²⁶ 19 T.C. at 295.

²⁷ 22 T.C. at 61. It should also be noted that the contract mining agreement in the *Brown* case was not terminable without cause.

²⁸ Compare *Holbrook v. Commissioner*, 65 T.C. 415 (1975) with *Oil City Sand & Gravel Co. v. Commissioner*, 32 T.C. 31 (1959); *Victory Sand & Gravel Co. v. Commissioner*, 61 T.C. 407 (1974); and *Weaver v. Commissioner*, 72 T.C. 594 (1979). In the latter three cases, licensees who did not have an exclusive right to extract minerals, but had the right to sell the minerals in question, were found to have an economic interest.

²⁹ 451 U.S. 571 (1981).

³⁰ 451 U.S. at 585.

³¹ Rev. Rul. 73-470, 1973-2 C.B. 88; Private Letter Ruling 8216007.

agreement intended to confer an economic interest in the coal on the contract miner may inadvertently create a joint venture or partnership, and thus particular attention should be paid to the consequences of such an arrangement.³²

B. Surface Mining Reclamation Fees

The Surface Mining Control and Reclamation Act³³ (SMCRA) imposes a reclamation fee on "operators" for each ton of coal produced in the United States. This fee is paid into the Abandoned Mine Reclamation Fund administered by the Secretary of the Interior for the purpose of reclaiming mined areas. All "operators of coal mining operations" are subject to SMCRA³⁴ and are required to pay a reclamation fee equal to the lesser of \$.35 per ton or 10% of the value of the coal produced by surface coal mining, and the lesser of \$.15 per ton or 10% of the value of the coal produced by underground mining.³⁵ The value of the coal is determined at the time of the "initial bona fide sale, transfer of ownership or use by the operator" immediately after it is severed.³⁶

Under SMCRA an "operator" is "any person, partnership or corporation engaged in coal mining who removes or intends to remove more than 250 tons of coal from the earth by coal mining within twelve consecutive calendar months in any one location."³⁷ Neither SMCRA nor the regulations contain any further guidance with respect to whether the contract miner or the owner or lessee of the coal will be liable for the reclamation fee. The preamble to the enactment of the regulations, however, states that "Congress intended the burden of fee payment to fall upon the person who stands to benefit directly from the sale, transfer, or use of the coal," and that the "identification of operators will be made in light of the realities of the business world and will not turn solely on a literal interpretation of the word 'removes.'"³⁸

³² 4 COAL LAW AND REGULATION § 83.08[2][b] (D. Vish & P. McGinley ed. 1983).

³³ 30 U.S.C. §§ 1201-1328 (Supp. V 1981).

³⁴ All underground and surface coal mining operations are subject to the Act unless: (1) the extraction of coal is made by a landowner (or lessee) for his own noncommercial use; (2) the extraction of coal is for commercial purposes but will be accomplished through surface mining operations which will affect two acres or less during the life of the mine; (3) the extraction of the coal is incident to state or federal highway or other construction; (4) the extraction of coal is incidental to the extraction of other minerals where the coal does not exceed 16-2/3 percent of the mineral tonnage removed for commercial use or sale within any 12 consecutive month period; or (5) the coal extracted amounts to less than 250 tons of coal within a 12 consecutive month period. 30 C.F.R. § 870.11 (1982).

³⁵ 30 U.S.C. § 1232(a) (Supp. V 1981). This section also provides that the reclamation fee for lignite coal shall be at a rate of 2% of the value of the coal at the mine or \$.10 per ton, whichever is less.

³⁶ 30 C.F.R. § 870.12(d)(1) (1982).

³⁷ 30 U.S.C. § 1291(13) (Supp. V 1981).

³⁸ 42 Fed. Reg. 62,713 (1977).

The Office of Surface Mining (OSM) has issued a proposed rule which would further define the party responsible for the reclamation fee.³⁹ Under the proposed rule, the burden would fall on the person or entity that owns the coal under state law immediately after it is severed, extracted or removed. Thus, in the typical contract mining situation in which the contract miner has no ownership interest in the coal, the owner will be liable for the fee.⁴⁰ If, on the other hand, the contract mining agreement provides that the contract miner has the right to extract and sell the coal and retain the principle portion of the sales proceeds, the contract miner will be liable for the fee.⁴¹ Liability for payment of the reclamation fee should be specifically covered in the agreement.

C. *Black Lung Benefits Excise Tax*

The Black Lung Benefits Act of 1977⁴² imposes an excise tax on the sale of coal to finance benefits for persons suffering from black lung disease. This tax is imposed on coal sold or used by the "producer" at the lower of \$.50 per ton or 2% of the sales price for coal from underground mines, or the lower of \$.25 per ton or 2% of the sales price for coal from surface mines located in the United States.⁴³

Payment of the tax is the responsibility of the producer of the coal. The term "producer" is defined as the person in whom ownership of the coal is vested under state law immediately after the coal is severed from the ground, without regard to the existence of any contractual arrangement for the sale or other disposition of the coal or the payment of any royalties between the producer and any third party.⁴⁴ For example, if the owner of the coal leases the coal and the lessee extracts the coal and sells it, paying the owner a fixed royalty, the lessee will be liable for the tax if, under state law, the lessee is the owner of the coal immediately after the coal is severed from the ground.⁴⁵ On the other hand, if the owner contracts with a miner who is to extract the coal for a set price per ton, the owner will be responsible for the tax, since under state law he remains the owner of the coal immediately after severance.⁴⁶ Thus, a contract miner which has a sufficient interest in the coal to constitute an economic interest for purposes of the depletion allowance may also be considered a "producer" and, therefore, be responsible for the payment the Black Lung Benefits Excise Tax.

³⁹ 48 Fed. Reg. 54,190 (1983).

⁴⁰ 48 Fed. Reg. 54,191, Example (1) (1983).

⁴¹ 48 Fed. Reg. 54,191, Example (2) (1983).

⁴² 30 U.S.C. §§ 901-945 (Supp. V 1981).

⁴³ Treas. Reg. § 48.4121-1(b)(1) (1983).

⁴⁴ Treas. Reg. § 48.4121-1(a)(1) (1983).

⁴⁵ Treas. Reg. § 48.4121-1(a)(2), Example (2) (1983).

⁴⁶ Treas. Reg. § 48.4121-1(a)(2), Example (1) (1983).

D. State Taxes

Other taxes that should be considered before drafting a contract mining agreement are the various state severance or business occupation taxes that may be incurred by the contract miner. These taxes are in addition to each state's income, property, workman's compensation and unemployment insurance taxes.

1. Kentucky

Kentucky imposes a severance tax of 4.5% on the gross value of coal mined in the state, with a minimum of \$.50 per ton for each ton.⁴⁷ The tax is imposed on all coal "severed" and/or "processed" within Kentucky. The "taxpayer" is "any individual, partnership, joint venture, association, or corporation engaged in severing and/or processing coal" in Kentucky.⁴⁸ The statute further provides that where a party contracts to sever and/or process coal, but does not obtain title to that coal or does not have an economic interest therein, the party who owns the coal or has an economic interest is the taxpayer.⁴⁹ This economic interest requirement is similar to the concept used in determining entitlement to depletion for federal income tax purposes.⁵⁰

Therefore, if the contract miner has an economic interest in the coal and is thus entitled to claim depletion, it will be subject to the Kentucky severance tax. If the contract miner is merely an independent contractor earning a fixed fee per ton of coal mined or delivered, it will not be responsible for the tax.

The Kentucky Department of Revenue will not recognize a contractual delegation of the duty to pay this tax. If a contract miner pays the tax pursuant to his obligations under a contract mining agreement, the Department of Revenue will refund the payment by the contract miner and assess the tax against the owner of the coal. In order to delegate this obligation effectively, the contract miner must waive any right to the refund and assign it to the owner.⁵¹

2. Ohio

In addition to various income and corporate taxes, and unemployment insurance and workman's compensation taxes, Ohio imposes a severance tax upon the "severer" of minerals.⁵² The severance tax is imposed on coal at a

⁴⁷ KY. REV. STAT. § 143.020 (1983).

⁴⁸ KY. REV. STAT. § 143.010(5) (1983).

⁴⁹ *Id.*

⁵⁰ KY. REV. STAT. § 143.010(10) (1983).

⁵¹ Vish, *Tax Consequences and Responsibilities*, Eastern Mineral Law Foundation, Special Institute on Contract Mining 30 (Sept. 14, 1982) (available from Eastern Mineral Law Foundation).

⁵² OHIO REV. CODE ANN. § 5749.02 (Baldwin 1982).

rate of \$.04 per ton mined in the state. In addition, a tax of \$.01 per ton of coal mined is imposed for a state reclamation fund. For purposes of the severance tax, the "severer" is "any person who actually removes the natural resources from the soil or water" in Ohio.⁵³ Even though the definition of "severer" would appear on its face to include contract miners, it has been held that where the contract miner is merely an independent contractor earning a set fee per ton of coal mined, the owner of the coal will be liable for the severance tax.⁵⁴

No "person" may sever or sell a natural resource in Ohio without first obtaining a license or permit therefor.⁵⁵ Unless such person has obtained a license or permit from another department in the state, the fee for such permit is \$50.⁵⁶

3. West Virginia

West Virginia imposes a Business and Occupation Tax on "every person exercising the privilege of engaging . . . in the business of severing, extracting, reducing to possession and producing for sale, profit or commercial use any natural resource products."⁵⁷ In the case of coal, the tax is assessed against the "producer" of the coal at a rate of 3.5% of the gross sales proceeds.⁵⁸ In addition, West Virginia imposes a tax of 0.35% of the value of the coal produced in the state (based on the gross sales proceeds) for the purpose of creating special municipal and county funds.⁵⁹ The burden of this additional tax also falls on the "producer" of the coal.⁶⁰

In West Virginia, the "producer" is any person who engages in the "severing, extracting, mining, quarrying, reducing to possession and producing for sale, profit or commercial use" any coal either directly or by contracting with others for the necessary labor or mechanical services.⁶¹ Moreover, the producer is the person having an "economic interest" in the coal rather than one with a mere "economic advantage."⁶² This is the same criterion used for federal depletion. Indeed, the regulations cite several factors that will be considered in determining which party is the "producer," including which party

⁵³ OHIO REV. CODE ANN. § 5749.01 (Baldwin 1982).

⁵⁴ *N&G Construction, Inc. v. Lindley*, 56 O.S.2d 415, 10 O.O.3d 521, 384 N.E.2d 704 (1978); and *Ohio ex rel. La Boiteaux Co. v. Court of Common Pleas, Hamilton County*, 61 O.S.2d 60, 399 N.E.2d 90 (1980).

⁵⁵ OHIO REV. CODE ANN. § 5749.04 (Baldwin 1982).

⁵⁶ *Id.*

⁵⁷ W. VA. CODE § 11-13-2a (1983).

⁵⁸ W. VA. CODE § 11-13-2a (1983).

⁵⁹ W. VA. CODE § 11-13-2 (1983).

⁶⁰ W. VA. CODE § 11-13-2a (1983).

⁶¹ W. VA. REG. B.O.T. § 1.2(a).A (1975).

⁶² W. VA. REG. B.O.T. § 1.2(a).C (1975).

is entitled to the federal depletion allowance.⁶³ Other factors which will be considered are whether the party has the exclusive right to mine the coal or is obligated to pay royalties to another and whether there is an exclusive and mandatory sales/purchase agreement between the parties.⁶⁴ Accordingly, a contract miner that is entitled to claim depletion will be subject to the West Virginia Business and Occupation Tax as a producer.

A contract miner who is not liable for the tax as a producer will be liable for the Business and Occupation Tax as a person engaging in a service business in the state.⁶⁵ This tax is imposed for the privilege of doing business in West Virginia and is levied upon the individual who performs the business or service at a rate of 1.15% of the gross income of such business.⁶⁶ This tax is not in addition to the tax imposed by West Virginia Code section 11-13-2. Therefore, if the contract miner is deemed to be a producer, he will not be subject to the 1.15% tax imposed by West Virginia Code section 11-13-26.

IV. LABOR CONSIDERATIONS

A. *Introduction*

Any person contemplating a contract mining arrangement should consider not only the impact of the arrangement on labor relations with his own employees, but also the potential impact of the owner's collective bargaining agreements and labor relations on his proposed operations. An important motive of the owner in a contract mining situation is to shift risks, burdens and liabilities of the mining operation to the contract miner. Labor contracts of owner or affiliated companies can have both direct and indirect consequences upon contract mining operations of an independent contract miner. Moreover, in the Appalachian coal fields, several unions including the United Mine Workers of America (UMWA), the Southern Labor Union, and the Operating Engineers are actively engaged in efforts to organize new and existing mining operations and to preserve bargaining and representation status in existing unionized operations.

Collective bargaining or wage agreements between owners and unions may impose obligations on owners with respect to mining operations or properties proposed to be operated under a contract mining agreement. Contract miners should be aware of specific labor law issues arising under owners' labor agreements so that appropriate protection can be secured in the mining contract. Contract miners should also be prepared to deal with picketing and other union concerted activity which may arise in situations where labor disputes arise under owners' labor agreements.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ W. VA. CODE § 11-13-2b (1981).

⁶⁶ *Id.*

B. *Maintaining Non-Union Status*

A good example of this type of problem exists in situations where the owner is a signatory to the National Bituminous Wage Agreement of 1981 (UMWA Agreement). A question arises as to whether an owner may enter into a contract mining operation where the contract miner is to operate non-union or with a different union.

Under the UMWA Agreement, two factors determine whether the owner must require a contract miner to hire employees who are members of the UMWA: whether the contract miner's operation is a new or existing operation and whether the owner lays off miners concurrently with the contract miner's hiring of non-UMWA miners.

The present UMWA Agreement does not require a signatory owner to require that a "new operation" employ members of the UMWA. There was some ambiguity as to this question under the 1978 and previous versions of the UMWA Agreement, but the Agreement was amended⁶⁷ in 1981 in accordance with the position taken by the UMWA in the cases of *Lone Star Steel Co. v. NLRB*⁶⁸ and *Amax Coal Co. v. NLRB*.⁶⁹ Article IA, section (f) now states that the UMWA Agreement does not apply to any new operation unless and until the UMWA is voluntarily recognized by the employer, certified by the National Labor Relations Board (NLRB), or otherwise properly obtains bargaining rights at the new operation.

The UMWA also took the position in *Amax*⁷⁰ that the "Successor Clause,"

⁶⁷ The applicable articles of the National Bituminous Wage Agreement of 1981 (UMWA Agreement), are Article I and Article IA, section (f). Article I now states in relevant part:

THIS AGREEMENT . . . covers all of the bituminous coal mines described in Article IA, Section (f) owned or operated by said first parties. . . .

This Agreement shall be binding upon all signatories hereto . . . and their successors and assigns. In consideration of the Union's execution of this Agreement, each Employer promises that its operations covered by this Agreement shall not be sold, conveyed, or otherwise transferred or assigned to any successor without first securing the agreement of the successor to assume the Employer's obligations under this Agreement. Article IA, section (f) states:

As part of the consideration for this Agreement, the Employers agree that this Agreement covers the operation of all the coal lands, coal producing and coal preparation facilities owned or held under lease by them, or any of them, or by any subsidiary or affiliate at the date of this Agreement, or acquired during its term which may hereafter (during the term of this Agreement) be put into production or use. This section will immediately apply to any new operations upon the Union's recognition, certification, or otherwise properly obtaining bargaining rights. Notwithstanding the foregoing, the terms of this Agreement shall be applied without evidence of Union representation of the Employees involved to any relocation of an operation already covered by the terms of this Agreement.

⁶⁸ 639 F.2d 545 (10th Cir. 1980), *cert. denied*, 450 U.S. 911 (1981).

⁶⁹ 614 F.2d 872 (3d Cir. 1980), *rev'd on other grounds*, 453 U.S. 322 (1981).

⁷⁰ *Id.*

the second paragraph of Article I,⁷¹ applies only to the sale or other permanent disposition of an existing mining operation employing UMWA members under the terms of the UMWA Agreement.

Article I, however, permits the UMWA to obtain bargaining rights at the contract miner's operation if the owner controls the labor decisions made there. The NLRB would likely view this type of relationship as an "accretion" to the existing bargaining unit instead of a "new" operation. To avoid this possibility, the contract miner should include in the contract and establish in his day-to-day operations that he will control the activities of his employees.

While Articles I and IA, section (f) do not compel an owner to require the contract miner to hire union employees, Article IA, section (h)⁷² of the present UMWA Agreement prohibits a signatory from licensing or leasing coal lands to a nonsignatory operator if layoffs result or are caused at the signatory's other operations. Thus, the contract miner must be familiar with the owner's other operations to determine what potential labor problems may arise in his proposed operation.

However, not all leasing or licensing of a signatory's coal lands to a non-signatory followed by layoffs at the signatory's operations necessarily constitute a violation of Article IA, section (h). The layoffs must be the result of the leasing or licensing before any violation can be demonstrated.

Two arbitration decisions⁷³ hold clearly that a company's leasing program did not violate Article IA, section (h). In *National Mines Corporation and UMWA, District 30, Local 1741*,⁷⁴ bad weather forced National Mines to reduce the work week at its operations shortly after it had subleased "thin seam" operations to independent operators. The arbitrator held that subleasing did not violate the UMWA Agreement because bad weather was the actual cause of the layoffs. In *Cannelton Industries, Inc. and UMWA, District 17, Local 1460*,⁷⁵ the arbitrator held that Cannelton's layoffs at its operations

⁷¹ UMWA Agreement, *supra* note 67.

⁷² Article IA, Section (h) states:

The Employers agree that they will not lease, sublease or license out any coal lands, coal producing or coal preparation facilities where the purpose thereof is to avoid the application of this Agreement or any section, paragraph or clause thereof. Licensing out of coal mining operations on coal lands owned or held under lease or sublease by any signatory operator hereto shall not be permitted unless the licensing out does not cause or result in the layoff of Employees of the Employer.

⁷³ Under the UMWA Agreement, mine workers file grievances if the mine worker believes that a signatory has violated the provisions of the UMWA Agreement. UMWA Agreement, Article XXIII. An arbitrator hears grievances if the mine workers and the employer cannot settle the dispute.

⁷⁴ ARB 30-77-241 (March 21, 1977 Goldberg, Arb.).

⁷⁵ ARB 82-17-KD-151 (Dec. 13, 1982 Parkinson Arb.). *See also* Black Diamond Coal Mining Co. and UMWA, District 20, Local 8460, ARB (not listed) (Dec. 1, 1982 Beckman, Arb.).

five years after it leased two coal tracts to independent contractors also did not violate Article IA, section (h).

On the other hand, several arbitration decisions have concluded that a coal company's leasing program violates Article IA, section (h). In *Union Carbide Corporation and UMWA, District 17, Local 6243*,⁷⁶ Union Carbide requested that the UMWA terminate the common seniority unit at its mines, and began to license its coal lands and lay off its employees when the UMWA refused. The arbitrator held that Union Carbide's actions violated Article IA, section (h) because of the close proximity between the UMWA's refusal to accede to Union Carbide's request and the subsequent licensing and layoffs. In *Big Bear Mining Company and UMWA, District 17, Local 7692*,⁷⁷ the arbitrator held that a signatory violated Article IA, section (h) by licensing one mine to an independent contractor, and subsequently laying off its employees at a neighboring mine when the independent contractor began to produce coal. However, none of those decisions emphasize or rely upon the important distinction between the language of the two separate paragraphs of Article IA, section (h).

The first paragraph deals with the leasing or licensing of coal lands and coal production equipment and facilities. That paragraph, which prohibits only those arrangements implemented for the purpose of avoiding the application of the terms of the UMWA Agreement, has undoubtedly lost much of its force with respect to coal lands as a result of the amendment to Article IA, section (f). It is now clear that the UMWA Agreement does not automatically apply to the signatory's coal lands, even after they are developed into a coal mining operation, and that the UMWA must first establish a right to recognition at the operation.

The second paragraph of Article IA, section (h) is limited to "coal mining operations" and supports the argument that an ongoing mining operation must be the subject of the licensing referred to in the second paragraph of Article IA, section (h). That distinction would seem to indicate that the layoffs at the signatory owner's operations are irrelevant unless the signatory subcontracted what had been an active mining operation.

This distinction was further developed in *Clinchfield Coal Company and UMWA, District 28, Local 1452*.⁷⁸ Clinchfield had licensed small pockets of coal to independent operators for over twenty years because it could not economically mine the coal using conventional methods. The UMWA filed a grievance after Clinchfield closed its Camp Branch No. 1 mine, claiming that the continuing existence of the independent operations caused the shutdown

⁷⁶ ARB 82-17-KD-171 (Dec. 17, 1982, Wren, Arb.).

⁷⁷ ARB 81-17-82-367 (Nov. 15, 1982, Segal, Arb.). See also *King Coal Co. and UMWA, District 20, Local 1865, ARB 20-1865-82-10* (Dec. 7, 1982, Phelan, Arb.).

⁷⁸ ARB 81-28-82-122 (Oct. 30, 1982, Ables, Arb.).

in violation of Article IA, section (h). The arbitrator held that a causal relationship existed between Clinchfield's traditional licensing policy and Clinchfield's laying off its employees.

On appeal, the United States District Court for the Western District of Virginia⁷⁹ reversed the arbitrator's decision in part because (1) the arbitrator ignored the "coal mining operations" distinction in the second paragraph because Clinchfield had licensed "lands" and not "coal mining operations"; and, (2) the layoffs were "caused" by the economic conditions in 1982 and not by contracting policies that predated the layoffs by more than twenty years.

The contract miner should attempt to determine if the owner plans to lay off his employees at his other operations simultaneously with the initiation of the contract miner's proposed operation. If so, the contract miner must be prepared to deal with labor problems which are likely to arise. If the owner's employees are laid off, they are likely to file a grievance, which they are likely to win, and the owner might be compelled to terminate his agreement with the contract miner or seek to require the contract miner to become a signatory of the UMWA Agreement.⁸⁰ The contract miner should address issues of this nature in negotiations and seek to cover them in the agreement.

C. *The Union Contract Miner*

In many situations, a unionized owner, because of specific provisions in a collective bargaining agreement or the owner's labor relations policy, will require contract miners to become signatories to the owner's union agreement. For example, although modifications to the UMWA Agreement in 1981 have altered the situation to some extent, this custom or practice is frequently followed in coal producing regions where the UMWA has organized most employees. A miner contemplating a contract mining arrangement where the owner imposes such a requirement must familiarize himself with the requirements of these agreements and the federal law regulating the employment relationship.

For contract miners who have previously operated non-union mines, adherence to a collective bargaining agreement may require significant modification of previous labor practices in the areas of work assignment, layoffs, incentives, discipline and work rules. Additionally, the wages and fringe benefits required by such contracts can dramatically increase labor costs and create other liabilities which are not apparent on the face of the agreement.

Under the UMWA Agreement, signatories are required to participate in

⁷⁹ 556 F. Supp. 522 (W.D. Va. 1983).

⁸⁰ Most contract mining contracts permit the owner to terminate the contract in a very short period of time after notice is given. The owner would likely invoke the termination clause if he lost a grievance over work jurisdiction.

and make contributions to the 1950 and 1974 UMWA pension plans.⁸¹ This requirement creates an inherent labor cost differential between UMWA produced coal and non-union coal. Obviously, the contracting parties are likely to have taken this differential into account in negotiations. However, contract miners should also assess the impacts of federal statutes such as the Employee Retirement Income Security Act (ERISA), as amended by the Multi-Employer Pension Plan Amendments Act (MPPAA),⁸² which has special impact on signatories to the UMWA Agreement. MPPAA imposes significant liabilities on signatories to the UMWA Agreement upon cessation or substantial curtailment of operations or upon withdrawal from participation in the 1950 and 1974 pension plans.⁸³

Care must be taken to assure that the possible economic incentives for a decision to execute an owner's collective bargaining agreement are not outweighed by hidden liabilities arising from the agreement itself or created by applicable law.

V. LIABILITIES RELATED TO THE CONTRACT MINING RELATIONSHIP

A. *Workmen's Compensation*

In the typical situation, a contract miner is an "employer"⁸⁴ and must comply with the workmen's compensation statute in his state.⁸⁵ Compliance with the statute will include the maintenance of workmen's compensation insurance to provide compensation for employees injured on the job.⁸⁶

An owner occasionally will hire an independent contractor to perform a specific duty, for example shaft sinking, trucking or mining a portion of a mining property, rather than operating the entire mine. The contract miner who performs a specific duty is generally the classic independent contractor. Even the contract miner who controls the entire mine site may be an independent contractor, depending on the contract terms.

A contract miner hired to perform a specific duty will be an "employer" within the meaning of the worker's compensation laws if the owner does not

⁸¹ National Bituminous Coal Wage Agreement of 1981, Article XX.

⁸² Multiemployer Pension Plan Amendments Act of 1980, Pub. L. No. 96-364, 94 Stat. 1208 (1980) (codified as amended in scattered sections of 29 U.S.C.).

⁸³ See, Gabler, *Minimizing the Impact of Withdrawal Liability under the Multiemployer Plan Amendments Act of 1980*, 85 W. VA. L. REV. 707 (1983).

⁸⁴ PA. STAT. ANN. tit. 77, §§ 21, 25 (Purdon 1952); W. VA. CODE § 23-2-1 (1981); OHIO REV. CODE ANN. § 4123.01 (Baldwin 1982); VA. CODE § 65.1-3 (1980); KY. REV. STAT. § 342.610(2) (1983).

⁸⁵ PA. STAT. ANN. tit. 77, §§ 1-1603 (Purdon 1952 & Supp. 1983); W. VA. CODE §§ 23-1-1 to -5-6 (1981 & Supp. 1983); OHIO REV. CODE ANN. §§ 4123.01-99 (Baldwin 1982); VA. CODE §§ 65.1-1 to -163 (1980); KY. REV. STAT. §§ 342.001-990 (1983).

⁸⁶ PA. STAT. ANN. tit. 77, § 501 (Purdon 1952 & Supp. 1983); W. VA. CODE § 23-2-5 (1981); OHIO REV. CODE ANN. § 4123.29 (Baldwin 1982); VA. CODE § 65.1-103 (1980); KY. REV. STAT. § 342.340 (1983).

reserve control over the means the contract miner uses to fulfill the terms of the contract mining agreement, but merely reserves the right to approve the final result.⁸⁷ A court will examine the following factors to determine if a contract miner who performs a specific duty or the owner is in control of a particular employee and liable for the employee's injuries under workmen's compensation: the terms of the contract mining agreement; the nature of the parties' work or occupation; the skill required for performance; whether the contract miner's business is considered a business separate from the owner's business; and, whether the owner makes the contract miner's day-to-day decisions.⁸⁸

The contract miner may also have workmen's compensation responsibilities under the "loaned employee" doctrine.⁸⁹ If the owner or anyone else lends an employee to the contract miner and the loaned employee is injured while working for him, the contract miner may be liable for the employee's injury under workmen's compensation.⁹⁰ The contract miner is liable for workmen's compensation under this doctrine if he controls the loaned employee's manner of performance (even though the lending employer retains the right to discharge such employee), sends a replacement employee at any time and evaluates the loaned employee's skills in the first instance.⁹¹

While the payment of workmen's compensation insurance premiums increases the employer's costs of doing business, workmen's compensation statutes generally limit the employer's liability for work-related injuries. Generally, workmen's compensation statutes provide an injured employee with the exclusive remedy to recover damages for a work-related injury.⁹²

⁸⁷ See, e.g., *Peneschi v. National Steel Corp.*, 295 S.E.2d 1 (W. Va. 1982) (an owner who hires a contractor to build a coke battery and vests exclusive control over the physical premises in the contractor is not the employer of the contractor or any subcontractor's employees); See also *Daniels v. MacGregor Co.*, 2 Ohio St.2d 89, 31 Ohio Op.2d 141, 206 N.E.2d 554 (1965) (An employer hired an individual to work exclusively for a customer and the customer had the right to control the manner and means of how the employee performed his work. The customer is responsible for employee's workmen's compensation). *Healey v. Carey, Baxter & Kennedy, Inc.*, 144 Pa. Super. 500, 19 A.2d 852 (1941) (An employee of a trucking company was injured by a flying splinter from a large piece of coal that an employee of the coal company was breaking on a coal truck. The coal company hired the trucking company specifically to haul coal and each company maintained day-to-day control over its employees and purchased workmen's compensation insurance. The court held the trucking company responsible for the injury of its employee that occurred at the coal company's mine site).

⁸⁸ *Id.*

⁸⁹ *Nelson v. Borough of Greenville*, 181 Pa. Super. 488, 124 A.2d 675 (1956).

⁹⁰ *Id.*

⁹¹ *Branan v. Union Carbide Corp.*, 17 D.&C.3d 141 (Armstrong Co. 1980).

⁹² A. LARSON, WORKMEN'S COMPENSATION LAW, § 68.13, at 8-28 (1982); *Bigley v. Unity Auto Parts, Inc.*, 496 Pa. 262, 436 A.2d 1172 (1982). See also *Fischer v. Sienna*, 119 PA L. J. 350 (1971) (An injured employee in Pennsylvania may file suit for common law damages if his employer commits an intentional tort).

West Virginia and Ohio, however, are exceptions to the general rule. In West Virginia, an employer may be liable for common law damages in addition to being liable under workmen's compensation, if he engages in willful, wanton or reckless misconduct.⁹³ In Ohio, an employee is not precluded from enforcing his common law remedies against his employer for a malicious tort⁹⁴ despite Ohio's Worker's Compensation Act, which appears to limit an employer's liability.⁹⁵

The contract miner must also be aware that if the owner hires him specifically to perform an abnormally dangerous activity, the remedy of a contract miner's injured employee is to file suit against the contract miner for damages.⁹⁶ The employees may not join the owner in the suit simply because of his ownership status. The owner must actively participate in the dangerous activity to be liable.⁹⁷

In most cases, the contract miner and the owner will not bargain over workmen's compensation issues because the contract miner will operate the entire mine site and be solely responsible for workmen's compensation liability. If both the owner and the contract miner plan to have employees at the mine site and "loan" employees to one another, the agreement should address common law liability for injuries to "loaned" employees.

B. *Black Lung Benefits*

1. State Black Lung Benefits

The contract miner should be aware that pneumoconiosis, more commonly known as black lung disease, is also compensable under state workmen's compensation statutes.⁹⁸ A few notable differences exist when a claimant files for workmen's compensation benefits for black lung disease as opposed to filing for benefits for a general injury. In Pennsylvania, the claimant can receive compensation for black lung disease only if he has had an aggregate employment of at least two years in Pennsylvania, during a period of ten years preceding the date of disability in an occupation having a coal hazard.⁹⁹ In West Virginia, a claimant must meet the same test as in Pennsylvania or

⁹³ *Mandolidis v. Elkins Industries, Inc.*, 246 S.E.2d 907 (W. Va. 1978). The West Virginia Legislature amended W. Va. Code § 23-4-2 in response to *Mandolidis* and now permits employees to recover common law damages only if the employer acted with "deliberate intention." W. VA. CODE § 23-4-2 (Supp. 1983).

⁹⁴ *Blankenship v. Cincinnati Milacron Chemicals*, 69 Ohio St.2d 608, 23 Ohio Op.3d 504, 433 N.E.2d 572 (1982), *cert. denied*, 103 S. Ct. 127 (1982).

⁹⁵ OHIO REV. CODE ANN. § 4123.74 (Baldwin 1982).

⁹⁶ See *supra* note 87.

⁹⁷ *Id.*

⁹⁸ PA. STAT. ANN. tit. 77, § 1208(k) (Purdon 1983); OHIO REV. CODE ANN. § 4123.68(Y) (Baldwin 1982). W. VA. CODE § 23-4-1 (1981); VA. CODE § 65.1-46 (1980); KY. REV. STAT. Chapter 342 (1983).

⁹⁹ PA. STAT. ANN. tit. 77, § 1401(d) (Purdon Supp. 1983).

compile an aggregate employment of at least five years during a period of fifteen years preceding the date of disability.¹⁰⁰ The Kentucky statute states that when a claimant has been exposed for ten years or more to an industrial hazard sufficient to cause black lung disease, there is a rebuttable presumption that his disability or death is due to black lung disease.¹⁰¹ The statute also states that any evidence presented should be construed liberally on behalf of the claimant.¹⁰²

Ohio does not include a rebuttable presumption in its statute but does require the claimant to file suit within eight years from the last injurious exposure.¹⁰³ Virginia requires the claimant to file a claim within three years after diagnosis of the disease or within five years of the last injurious exposure, whichever comes first.¹⁰⁴

2. Federal Black Lung Benefits

The contract miner should also be aware of his employees' rights to black lung benefits under federal law. The Federal Mine Safety and Health Amendments Act of 1977 (Mine Safety Act)¹⁰⁵ provides coal miners with an alternative federal remedy to the state remedy for black lung benefits. The Mine Safety Act requires a coal miner who believes he has acquired black lung disease to first file for benefits under the applicable state workmen's compensation statute if the state program provides benefits that the Secretary of Labor considers to be equivalent to the benefits provided in the Mine Safety Act.¹⁰⁶ Apparently, Congress believed that an applicant would rarely file for benefits under the Mine Safety Act because the state remedy would be sufficient. The opposite has occurred, however, because the Secretary of Labor has not recognized any state program as providing coverage that is equivalent to federal coverage.¹⁰⁷ Miners now generally file for benefits under the state and federal law, and contract miners must carry black lung insurance under federal law in addition to their workmen's compensation insurance requirements under state law.¹⁰⁸

Although the cost of black lung insurance varies from state to state, such cost is significant in all states and contract miners should assess these costs

¹⁰⁰ W. VA. CODE § 23-4-1 (1981).

¹⁰¹ KY. REV. STAT. § 342.316(2)(b)(3) (1983).

¹⁰² KY. REV. STAT. § 342.004 (1983).

¹⁰³ OHIO REV. CODE ANN. § 4123.68 (Baldwin 1982).

¹⁰⁴ VA. CODE § 65.1-52 (Supp. 1983).

¹⁰⁵ 30 U.S.C. §§ 801-936 (1976 & Supp. V 1981). This Act was originally entitled the Federal Coal Mine Health and Safety Act of 1969. It was amended in 1977 to regulate the mining of all minerals.

¹⁰⁶ 30 U.S.C. §§ 923, 931 (Supp. V 1981).

¹⁰⁷ 20 C.F.R. § 722.152(b) (1983).

¹⁰⁸ 30 U.S.C. § 943 (Supp. V 1981).

in evaluating mining opportunities. Potential liability for black lung benefits was reduced somewhat by implementation of the Black Lung Benefit Reform Act of 1981 (Reform Act). The Reform Act eliminated three presumptions that claimants relied on to receive benefits.¹⁰⁹ This resulted in a reduction in the number of awards and a corresponding reduction in black lung insurance rates.

If a mine employee develops evidence of black lung disease, he has a right to request a transfer from his position to another area of the mine site where the respirable dust level is below one milligram of dust per cubic meter.¹¹⁰ A miner who has requested a transfer will not be entitled to receive the wage increases he would have received if he had remained in his prior position.¹¹¹ The Mine Safety Act also prohibits mine operators from discharging or otherwise discriminating against a mine employee in any other way because he suffers from black lung disease.¹¹²

C. *Safety and Health*

1. Mine Safety and Health Amendments of 1977

A contract miner, who is an operator, must comply with the mandatory safety standards and other provisions of the Mine Safety Act.¹¹³ There is little question as to who is liable for a violation of the Mine Safety Act when the contract miner has total control of the mine site. It is the policy of the Mine Safety and Health Administration (MSHA) to cite the contract miner in that situation for any violations of the Act.¹¹⁴

The difficult questions of liability for violations of the Mine Safety Act arise when the owner hires the contract miner to perform a specific service

¹⁰⁹ 30 U.S.C. § 921(c)(2), (c)(4), (c)(5) (Supp. V 1981). Claimants were previously accorded a presumption that they suffered from black lung disease based on the number of years worked in coal mines and positive chest roentgenogram readings.

¹¹⁰ 30 U.S.C. § 843(b) (Supp. V 1981).

¹¹¹ *Higgins v. Marshall*, 584 F.2d 1035 (D.C. Cir. 1978), *cert. denied*, 441 U.S. 931 (1979); *Matala v. Consolidation Coal Co.*, 647 F.2d 427 (4th Cir. 1981).

¹¹² 30 U.S.C. § 938 (Supp. V 1981).

¹¹³ 30 U.S.C. §§ 806-962 (1976 & Supp. V 1981). Section 802(d) of the Mine Safety Act defines an operator as any owner, lessee, or other person who operates, controls or supervises a coal or other mine or any independent contractor performing services or construction at such mine. An operator is subject to warrantless inspections under the Mine Safety Act and courts have held that these inspections do not violate the search and seizure clause of the fourth amendment to the Constitution of the United States. *Marshall v. Nolichecky Sand Co.*, 490 F. Supp. 1041 (E.D. Tenn. 1978), *aff'd*, 606 F.2d 693 (6th Cir. 1979), *cert. denied*, 446 U.S. 908 (1980); *Marshall v. Donofrio*, 465 F. Supp. 838 (E.D. Pa. 1978), *aff'd*, 605 F.2d 1194 (3d Cir. 1979), *cert. denied*, 444 U.S. 1102 (1980).

¹¹⁴ *Austin Powder Co.*, 2 MINE SAFETY & HEALTH REP. (BNA) 2128 (1983) (ALJ Koutras); *see also infra* note 117.

and not operate the entire mining operation. As stated earlier, the contract miner who performs a specific service is considered the classic independent contractor. MSHA, with the approval of the courts, originally cited the owner, as well as the contract miner who performs a specific service, for any violations committed by the contract miner.¹¹⁵ Owners protested this procedure vigorously because they were being cited for violations regardless of their culpability. The Secretary of Labor promulgated regulations that apportion liability between the owner and contract miner based upon responsibility for the violations.¹¹⁶ A decision issued by a Mine Safety and Health Review Commission judge upheld the Secretary's new policy.¹¹⁷

The contract miner should note that a Mine Safety and Health Administrative Law Judge refused to uphold a clause in a contract mining agreement where a contract miner attempted to limit his liability for violations of the Mine Safety Act.¹¹⁸ In *Austin Powder Company*, the contract miner argued that he was not liable for any violations under the Mine Safety Act because a clause in his contract with the owner stated that when the contract miner's employees entered the owner's property, they automatically became employees of the owner.¹¹⁹ Judge Koutras ignored that clause in the contract and focused on the actions of the contract miner's employees and their responsibilities to determine liability.

The fact that the Administrative Law Judge refused to recognize the limitation of liability clause between a contract miner and an owner would not necessarily alter a contract miner's civil remedies. If a contract miner has persuaded the owner to indemnify him for civil penalties assessed under the Mine Safety Act, a state court might uphold the indemnification agreement and require the owner to make the appropriate payments.¹²⁰ It is doubtful, however, that a state court would enforce an indemnification provision where the owner agreed to indemnify the contract miner for any criminal fines levied against him.¹²¹

¹¹⁵ *Cyrus Industrial Minerals Co. v. Federal Mine Safety and Health Review Comm'n*, 664 F.2d 1116 (9th Cir. 1981); *Harman Mining Corp. v. Federal Mine Safety and Health Review Comm'n*, 671 F.2d 794 (4th Cir. 1981).

¹¹⁶ 30 C.F.R. Part 45 (1982).

¹¹⁷ *Austin Powder Co.*, 2 MINE SAFETY & HEALTH REP. (BNA) 2128 (1983). In *Austin Powder*, Judge Koutras focused on the respective responsibilities of the coal owner and independent contractor to determine liability under the Mine Safety Act. The Judge rejected the old test of citing the owner for every alleged violation committed by the independent contractor.

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 2130.

¹²⁰ S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, §§ 1750A, 1752 (3d ed. 1972 & Supp. 1983).

¹²¹ RESTATEMENT (SECOND) OF CONTRACTS § 178 (1979). The parties should be aware that civil fines are not deductible as a business cost.

2. State Mine Safety and Health Laws

The contract miner will also be liable for any violations of the applicable state mine safety and health laws. For example, Pennsylvania regulates health and safety for underground anthracite coal mines by the Anthracite Coal Mine Act,¹²² underground bituminous coal mines by the Bituminous Coal Mine Act,¹²³ and surface mines by either the Anthracite or Bituminous Act, depending on the nature of the coal.¹²⁴ In addition, Pennsylvania has a number of other acts that regulate different aspects of coal mining.¹²⁵ The Ohio,¹²⁶ West Virginia,¹²⁷ Virginia¹²⁸ and Kentucky¹²⁹ health and safety laws are somewhat simpler; one law applies to all coal mines. In each state, regardless of the complexity of the state program, the contract miner must comply with both federal and state laws and regulations, and is subject to inspections to ensure compliance.

In the typical situation, the representative of the state mine safety and health agency will cite the contract miner for any violations at the mine site because the contract miner is usually in control of the entire mine site. Prior experience with state agencies indicates that when the owner hires the contract miner to perform a particular job, state agencies generally apply a test similar to the one used by MSHA for independent contractors and cite the party responsible for any violations of state law. The contract miner should employ the same strategy for state health and safety citations as he employs for MSHA citations and attempt to persuade the owner to indemnify him for any civil penalties assessed by the state agency.

D. *Environmental Concerns*

1. Surface Mining

SMCRA¹³⁰ establishes a general regulatory program administered by the Department of the Interior, Office of Surface Mining, regulating environmental effects of both surface and underground mining. Each state may develop its own regulatory program and assert and exercise primary jurisdiction over coal mining, as long as that program is as effective as the federal program under SMCRA.¹³¹ Pennsylvania, Ohio, West Virginia, Kentucky and

¹²² PA. STAT. ANN. tit. 52, §§ 70-101 to -1405 (Purdon 1966 & Supp. 1983).

¹²³ PA. STAT. ANN. tit. 52, §§ 701-101 to -706 (Purdon 1966 & Supp. 1983).

¹²⁴ PA. STAT. ANN. tit. 52, § 1396.4b (Purdon Supp. 1983).

¹²⁵ See *infra* note 138.

¹²⁶ OHIO REV. CODE ANN. § 4151.01(A)-4157.99 (Baldwin 1982).

¹²⁷ W. VA. CODE §§ 22-2-1 to -3-6 (1981).

¹²⁸ VA. CODE §§ 45.1-1 to -225 (1974).

¹²⁹ KY. REV. STAT. §§ 352.010-.620 (1983).

¹³⁰ 30 U.S.C. §§ 1201-1328 (Supp. V 1981).

¹³¹ 30 U.S.C. § 1235(d) (Supp. V 1981).

Virginia have secured "primacy" for their regulatory programs, and mining operations conducted in these states must comply with the state regulations.¹³²

Although the requirements vary widely from state to state, each state agency requires that a permit be acquired before surface or underground mining may be initiated or continued at the mine site. The permit applicant is to provide at least the following information: (1) who will conduct the mining operation and where it will be located;¹³³ (2) the methods of extraction to be used;¹³⁴ (3) the effect of the operation on the hydrologic balance of the permit and adjacent areas;¹³⁵ (4) whether the land can be restored successfully;¹³⁶ and, (5) whether the operator can provide a financial guarantee that the land will be restored.¹³⁷ If the state agency is satisfied that this information meets the guidelines established by the state program, the permit can be issued.¹³⁸

An issue arises as to who must apply for the permit, the owner or the contract miner. In the typical situation, the contract miner usually obtains the permit. This question is extremely important because the permittee is generally accountable to the state regulatory agency if any of the mining or

¹³² 25 PA. ADMIN. CODE §§ 86-90 (Shepherd's 1982); W. VA. CODE §§ 20-6-1 to -42 (1981); OHIO REV. CODE ANN. §§ 1513.01-99 (Baldwin 1982 & Supp. 1983); VA. CODE §§ 45.1-226 to .7 (Supp. 1983); KY. REV. STAT. §§ 350.010-990 (1983).

¹³³ OHIO REV. CODE ANN. § 1513.07(B)(2)(a)(v) (Baldwin 1982 & Supp. 1983); W. VA. CODE § 20-6-10(a)(1)(E) (1981); VA. ADMIN. REGS. V 778.13(a)(5) (1983); 405 KY. ADMIN. REGS. 8:030E.2.(1)(e) (1983).

¹³⁴ PA. ADMIN. CODE § 87.62 (Shepherd's 1982); OHIO REV. CODE ANN. 1513.07(B)(2)(g) (Baldwin Supp. 1983); W. VA. CODE § 20-6-10(a)(7) (Supp. 1983); VA. ADMIN. REGS. V 780.11(a) (1983); 405 KY. ADMIN. REGS. 8:03E.29 (1983).

¹³⁵ PA. ADMIN. CODE § 87.69 (Shepherd's 1982); OHIO REV. CODE ANN. 1513.07(B)(2)(k) (Baldwin Supp. 1983); W. VA. CODE § 20-6-13(b)(10) (Supp. 1983); VA. ADMIN. REGS. V 779 (1983); 405 KY. ADMIN. REGS. 8:030E.12 (1983).

¹³⁶ PA. ADMIN. CODE § 87.68 (Shepherd's 1982); OHIO REV. CODE ANN. § 1513.07(C) (Baldwin Supp. 1983); W. VA. CODE § 20-6-13(b)(2), (3) (Supp. 1983); VA. ADMIN. REGS. V 780.18 (1983); 405 KY. ADMIN. REGS. 8:030E.24 (1983).

¹³⁷ PA. ADMIN. CODE §§ 86.141-185 (Shepherd's 1982); OHIO REV. CODE ANN. § 1513.07(B)(2)(q) (Baldwin Supp. 1983); W. VA. CODE § 20-6-12 (Supp. 1983); VA. ADMIN. REGS. V 800-V 809 (1983); 405 KY. ADMIN. REGS. § 10:03E (1983).

¹³⁸ The applicant in Ohio should note that he must also meet the statutory criteria listed in the Federal Water Pollution Control Act, which is incorporated into the Ohio program. The applicant in West Virginia must also meet the statutory criteria in the Dam Control Act of 1973, W. VA. CODE §§ 20-5D-1 to -14 (1981 & Supp. 1983) and the Water Pollution Control Act, W. VA. CODE §§ 20-5A-1 to -24 (1981 & Supp. 1983). The applicant in Pennsylvania must note that any remedies under the following acts are preserved: The Clean Streams Act, PA. STAT. ANN. tit. 35, §§ 691.1-760.2 (Purdon 1977 & Supp. 1983); The Air Pollution Control Act, PA. STAT. ANN. tit. 35, §§ 4001-4106 (Purdon 1977 & Supp. 1983); The Dams Safety and Encroachments Act, PA. STAT. ANN. tit. 32, §§ 693.1-27 (Purdon Supp. 1983); The Coal Refuse Disposal Act, PA. STAT. ANN. tit. 52, §§ 30.51-.66 (Purdon Supp. 1983); The Pennsylvania Solid Waste Management Act, PA. STAT. ANN. tit. 35, §§ 6018.101-.1003 (Purdon Supp. 1983); and The Bituminous Mine Subsidence and Land Conservation Act, PA. STAT. ANN. tit. 52, §§ 1406.1-.21 (Purdon Supp. 1983). *See also* PA. STAT. ANN. tit. 52, § 1396.4(3) (Purdon Supp. 1983).

reclamation work is not performed in accordance with statutory and regulatory guidelines.¹³⁹ Pennsylvania is an exception to the general rule and holds the owner who obtains a permit, and the contract miner who performs the mining operations, jointly and severally liable for any violations of state law committed at the mine site.¹⁴⁰

The contract miner must also be aware of possible liability for post-mining pollution discharges or other conditions constituting public nuisances. One court has held that the current mine operator is liable for any acid mine discharges from the mine site, even if the discharge does not originate at the mine site and results from the actions of others.¹⁴¹ Another court held the occupant who caused a nuisance and the owner who knew of the nuisance and received rents from the occupant for over twenty years jointly and severally liable for the nuisance.¹⁴² While state agencies usually cite the permittee for regulatory violations, the cases demonstrate that liability for acts that harm the environment is not necessarily limited to the permittee.¹⁴³ The contract miner should analyze in detail current and past mining operations at or near the proposed operation to determine the potential for post-mining discharges or other conditions constituting nuisances.

The contract miner should attempt to cover the question of liability for post-mining discharges and other nuisances in his agreement with the owner. His primary goal in the environmental area is to limit his liability and financial commitment for any environmental problems at the mine site.

2. Underground Mining—Subsidence

The contract miner who conducts an underground mining operation should be aware of his possible liability to the surface owner for mine subsidence and of the potential that a state regulatory agency might limit the percentage of underground extraction.¹⁴⁴ The surface owner is entitled to the right of support unless the surface owner waived this right.¹⁴⁵ The contract

¹³⁹ See *supra* notes 133-138.

¹⁴⁰ PA. STAT. ANN. tit. 52, § 1396.3(a)(b) (Purdon Supp. 1983).

¹⁴¹ Commonwealth v. Barnes & Tucker Co., 472 Pa. 115, 371 A.2d 461 (1977), *appeal dismissed*, 434 U.S. 807 (1979).

¹⁴² Philadelphia Chewing Gum Corp. v. Commonwealth, 35 Pa. Commw. 443, 387 A.2d 142 (1978), *aff'd in part and dismissed in part*, National Wood Preserves Inc. v. Department of Env'tl. Resources, 489 Pa. 221, 414 A.2d 37 (1980), *appeal dismissed*, 449 U.S. 803 (1980).

¹⁴³ See *supra* notes 141-42.

¹⁴⁴ 30 U.S.C. § 1266(b) (Supp. V 1981); PA. STAT. ANN. tit. 52, § 1406.4 (Purdon Supp. 1983); 25 PA. ADMIN. CODE § 89.145 (Shepherd's 1982); OHIO REV. CODE ANN. § 1513.35(A)(1), (A)(10), (B) (Baldwin Supp. 1983); W. VA. CODE § 20-6-14(b)(1), (b)(10), (c) (Supp. 1983); VA. CODE § 45.1-243 (Supp. 1983); 405 KY. ADMIN. REGS. § 8:040E.26 (Supp. 1983).

¹⁴⁵ Scranton v. Phillips, 94 Pa. 15 (1880); Godfrey v. Weyanoke Coal & Coke Co., 82 W. Va. 665, 97 S.E. 186 (1918); Ohio Collieries Co. v. Cocke, 140 N.E. 356 (Ohio 1923); Clinchfield Coal Corp. v. Compton, 139 S.E. 308 (Va. 1927); Case v. Elk Horn Coal Corp., 276 S.W. 573 (Ky. 1927).

miner should obtain relevant title documents or secure assurances from the mineral owner that the right to mine without liability for mine subsidence exists.¹⁴⁶ He should also be aware that the question of whether the surface owner waived his right to surface support is answered by state law.¹⁴⁷

E. *Public Participation In Permitting And Other Procedures Mandated by SMCRA*

One of the stated purposes of SMCRA is: "[to] assure that appropriate procedures are provided for the public participation in the development, revision, and enforcement of regulations, standards, reclamation plans, or programs established by the Secretary or any State under this Act. . . ."¹⁴⁸ SMCRA and OSM's implementing regulations fulfill this purpose. The "public" has been given the opportunity to participate in all aspects of state primacy programs from initial permitting of mining operations to bond release procedures upon completion of mining and reclamation. Such participation includes opportunities for comment and hearing on permit decisions,¹⁴⁹ access to mining properties during inspections,¹⁵⁰ rights to appeal from regulatory actions on permits,¹⁵¹ citizen's suit to compel enforcement, awards of attorney and expert witness fees¹⁵² and the right to initiate proceedings to have lands declared unsuitable for surface mining.¹⁵³ Apart from substantive considerations and issues involved in such public participation in all aspects of the regulatory process, one of the significant impacts of SMCRA is the creation of the potential for delay in all aspects of mine permitting. At every significant stage of the process, public participation can cause delay in regulatory actions necessary for the initiation, continuation or termination of a mining operation. It is absolutely essential that persons contemplating a contract mining arrangement or any operation familiarize themselves with not only the substantive regulatory requirements, but also the attitudes of the "public" toward the proposed operation. If hostility exists, it may be assumed that some delays will be encountered. Provisions covering the consequences of such delays should be negotiated in mining agreements.

Finally, under section 522 of SMCRA and cognate provisions of state laws and primacy programs, it is possible that the lands upon which a proposed operation is to be conducted may be declared unsuitable for surface

¹⁴⁶ *Id.*

¹⁴⁷ 48 Fed. Reg. 24,638 (1983). See *supra* note 145.

¹⁴⁸ 30 U.S.C. § 1202(i) (Supp. V 1981).

¹⁴⁹ 30 U.S.C. § 1263 (Supp. V 1981).

¹⁵⁰ 30 U.S.C. § 1271(a)(1) (Supp. V 1981).

¹⁵¹ 30 U.S.C. § 1264(f) (Supp. V 1981).

¹⁵² 30 U.S.C. § 1275(e) (Supp. V 1981).

¹⁵³ 30 U.S.C. § 1272 (Supp. V 1981).

mining operations.¹⁵⁴ This can occur even where the owner is otherwise recognized to have the right to mine the property and the land is located in the midst of other mining operations.

F. *Wage and Mechanic's Liens*

The contract miner is responsible to his employees for their wages and fringe benefits.¹⁵⁵ Consequently, the contract miner is subject to any wage or mechanic's liens filed by his employees if he fails to honor the wage agreement.¹⁵⁶ He is also subject to any mechanic's liens filed by suppliers.

The contract miner in West Virginia has the additional burden of having to file a wage bond with the state if his company has not been doing business in West Virginia for at least five years.¹⁵⁷ When a wage bond statute does not exist or is not applicable, the contract miner should avoid being required to furnish the owner with a wage bond. The contract miner should also attempt to avoid the inclusion of a clause in the contract requiring him to indemnify the owner for any costs the owner may incur if any liens are filed against the owner because of the miner's failure to make appropriate payments.¹⁵⁸

VI. THE CONTRACT MINING AGREEMENT

A. *Introduction*

The Specimen Contract in the accompanying article is a good example of an agreement drafted to protect the interests of the owner. Needless to say, a contract miner presented with a draft in this form will want to negotiate certain different and additional terms. In this section we examine the contract mining agreement from the contract miner's perspective and discuss various alternative provisions intended to protect his interest.

¹⁵⁴ 30 U.S.C. § 1272 (Supp. V 1981); PA. STAT. ANN. tit. 52, 1396.4e (Purdon Supp. 1983); OHIO REV. CODE ANN. § 1513.073 (Baldwin Supp. 1983); W. VA. CODE § 20-6-22 (1981); VA. CODE § 45.1-252 (Supp. 1983); KY. REV. STAT. § 350.610 (Supp. 1983).

¹⁵⁵ *Farley v. Zapata Coal Corp.*, 281 S.E.2d 238 (W. Va. 1981). Fringe benefits may include accrued vacation pay, unused sick leave, pension and benefit trust payments, sickness and accident benefits, and liquidated damages incurred by the contract miner for nonpayment of wages. *Id.*

¹⁵⁶ PA. STAT. ANN. tit. 43, § 221 (Purdon 1964); PA. STAT. ANN. tit. 49, §§ 1101-1902 (Purdon 1965 and Supp. 1983); OHIO REV. CODE ANN. §§ 1311.34-1311.37 (Baldwin 1982); W. VA. CODE § 38-2-1 to -39 (1981 and Supp. 1983); KY. REV. STAT. §§ 376.010 (1981).

¹⁵⁷ W. VA. CODE, § 21-5-14 (1981).

¹⁵⁸ The contract miner's employees may file a mechanic's lien against him or the coal owner. *Farley v. Zapata Coal Corp.*, 281 S.E.2d 238 (W. Va. 1981). Items subject to lien include equipment, buildings or structures, and courts construe these terms broadly to satisfy liens. *Id.*

B. *Representations*

Representations in a contract are intended to set forth many of the basic factual assumptions on which the contract is based. In the event of a material breach of a representation or warranty, the injured party has a cause of action for damages or rescission, or perhaps fraud. Contract mining agreements do not generally contain separate representations such as might be found in a loan agreement or an asset purchase agreement. Instead, the representations are dispersed throughout the agreement in close proximity to the related covenants.

Paragraphs 25 and 26 of the Specimen Contract are fairly typical of provisions found in most owner-drafted contract mining agreements. They provide that the contract miner accepts the premises in their existing condition and acknowledges that he has made an investigation of the premises, the equipment required and all other aspects of the proposed mine, including latent dangers and dangerous conditions. The owner expressly disclaims any representations as to the quantity, quality or mineability of the coal, the condition of the premises or his title thereto. The intent of these paragraphs is to shift to the contract miner all the risks associated with the mining operation, including title and condition of the premises. Although these provisions may be effective to shift these risks as between the parties to the agreement, these provisions may not have an effect on the rights of employees of the contract miner or other third parties.

Unless these provisions represent bargained for concessions by the contract miner, his interests would be better served by including in the contract, in lieu of paragraphs 25 and 26, a provision containing representations on certain underlying factual matters and an indemnity provision in which the owner agrees to indemnify the contract miner for any claims, liabilities or losses sustained as a result of breach of any of the representations. The following discussion covers some of the areas which should be addressed by such representations.

1. Title

One of the principal areas of concern to the contract miner is the owner's right to mine the coal covered by the contract. If the owner's mining rights are derived from a lease, a copy of the lease, including all amendments, should be attached to the agreement or furnished to the contract miner prior to signing. The owner should represent to the miner that such copy is a true and correct copy of the lease, that the lease is in full force and effect on the date of the agreement and that there are no existing defaults under the lease or events which, with the lapse of time or notice, or both, would become an event of default thereunder. In addition, the contract miner should ask the owner to furnish the miner with a copy of all title opinions and engineering

data, including records of core drillings and surveys of the premises and prior workings, which are in the possession or control of the owner.

2. Dangerous Conditions on the Premises

Where an owner knows or should have known of dangerous conditions on the premises and an employee of the contract miner is injured as a result of such condition, the owner may be liable to the injured employee and the insurance carrier paying workmen's compensation benefits to the injured employee.¹⁵⁹ Although it may be desirable for the contract miner to have a representation from the owner that the owner knows of no latent dangers or dangerous conditions on the premises, in practice such a representation may be difficult to obtain, since one of the principal concerns of the owner in structuring the contract mining relationship is to shield himself from liability for injuries to employees of the miner.

3. Environmental Matters

A contract miner who enters into possession of the premises and partially contributes to the continuation of an environmental violation may become liable to abate a condition to which he is only a minor contributor.¹⁶⁰ Accordingly, prior to signing the agreement the contract miner should investigate the premises for possible environmental violations and make inquiries of local regulatory authorities to determine the existence of any environmental violations on the property. In addition, the contract miner should seek a representation from the owner that there are no existing violations of environmental laws or any outstanding judgments or decrees related to the premises. Where the owner has previously obtained the necessary mining permits and bonds, the contract miner will want to review copies of these documents and should ask for a representation that such permits and bonds are in full force and effect. If any permits or bonds are to be transferred to the contract miner, the agreement should contain a representation that all required consents to such transfer have been obtained.

If the miner is to secure the permits, the agreement should deal with the situation where some or all permits cannot be secured or where permit issuance is delayed.

C. Indemnity Provision

In order to define the consequences of a breach of a representation, the contract miner should require an indemnity clause indemnifying it against

¹⁵⁹ *Gulf Oil Corp. v. Bivens*, 276 F.2d 753, 758 (5th Cir. 1960), *cert. denied*, 364 U.S. 835 (1960); *Ashland Oil & Ref. Co. v. Betram & Thacker, Inc.*, 572 S.W.2d 166 (Ky. App. 1978).

¹⁶⁰ *Commonwealth v. Barnes & Tucker Co.*, 9 Pa. Commw. 1, 303 A.2d 544 (1973), *rev'd*, 455 Pa. 392, 391 A.2d 871 (1974), *on remand*, 23 Pa. Commw. 496, 353 A.2d 471 (1976), *aff'd*, 472 Pa. 115, 371 A.2d 461, *appeal dismissed*, 434 U.S. 807 (1977).

any claims, liabilities or damages arising out of a breach of a representation by the owner. In addition, the contract miner should be indemnified against all costs, expenses and attorney's fees incurred by the miner in connection with such breach since, in most jurisdictions, these amounts may not be recoverable unless specifically provided by contract.¹⁶¹

D. *Work to be Performed*

The Specimen Contract contains a general description of the work to be performed and a broad standard of performance applicable to the work. Paragraph 7 of the Specimen Contract requires a contractor to promptly commence and diligently prosecute its operations in a careful, skillful and workmanlike manner, in accordance with recognized modern methods and practices, so as to secure the greatest possible recovery of mineable coal. This provision raises a myriad of questions which, if a dispute arises, can ultimately be resolved only by a judge or a jury based upon possibly conflicting testimony of the parties and their expert witnesses. Thus, a contract miner is far better served by a more definite description of the work and the particular standards to be applied.

E. *Payment Terms*

1. Introduction

The contract miner is typically paid a set fee for each ton of coal mined although there may be situations in which the contract miner is paid a percentage of the gross or net sales proceeds. His fee is compensation for all of his work and services under the contract, including reclamation work and other obligations. Occasionally, the owner will insist that such payment covers all losses, damages and expenses related to unforeseen obstructions or difficulties, but this may present a conflict with the indemnity by the owner for misrepresentations.¹⁶² The fee is structured as a payment for services to protect the owner's claim to an economic interest in and title to the coal, thus preserving its claim to depletion. In addition, characterizing the payment as a payment for services strengthens the owner's claim that the contract does not constitute a sublease. Typically the intention of the parties is to designate the contract miner as an independent contractor to avoid liability by the owner for certain of the contract miner's actions.

2. Methods of Computation

Payment may be made either on a clean coal basis, a raw coal basis or some combination of the two. Where payment is made on a raw coal basis, there are relatively few grounds for dispute concerning the amount of the

¹⁶¹ S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, § 786 (3d ed. 1972 & Supp. 1983).

¹⁶² *Id.*

payment, since there are no questions about the accuracy of the sampling procedure or the efficiency of the owner's washing or preparation plant. This is an advantage to both the owner and the contract miner; however, it provides a contract miner with little incentive to eliminate rock and dirt during the mining process. Payment on a clean coal basis provides a strong incentive in this regard but involves all the complexity associated with determining what is the clean coal tonnage.

There are various ways for overcoming the problems in determining clean coal tonnage. One method is to base payment on raw coal tonnage after deduction of a certain percentage of the weight, as determined from the ash or moisture content of the coal. This reduced weight is the basis for payment under the agreement. In such a case, the contract would include as an exhibit a schedule showing various ash or moisture levels and the corresponding percentage of the coal which is to be treated as reject. A second method is to determine the reject percentage based upon the ash or moisture level and deduct a certain percentage of weight for each incremental increase in the ash or moisture level above a certain base level. A third method is to determine the reject percentage by performing a sink/float analysis at a particular specific gravity and converting that analysis to a reject percentage and adding a certain percentage to account for plant inefficiency. Finally, a fourth method is to determine the price on a sliding scale based upon the ash and ash/moisture or Btu content of the coal.

3. Sampling Procedure

The sampling and testing procedures under any of the payment methods based on coal quality are of critical importance to the parties. At a minimum, the contract miner should have the right to inspect the sampling procedure if the owner is performing the sampling. In addition, the miner may insist on the right to have the sampling performed by an independent testing laboratory or have other options where there is a dispute as to the sampling of testing procedure.

4. Purchase Option for Rejected Coal

The owner may insist on the right to reject any coal which fails to meet certain specifications. Under these circumstances, the contract miner may wish to have a provision reserving the right to purchase any rejected coal at a predetermined price.

5. Time of Payment

Payment is normally made on a regular basis. For a contract miner facing normal cash flow problems, a semi-monthly basis with payment ten days after the last delivery is a desirable payment term. All payments should be accom-

panied by certified weight slips. Some owners may seek to limit the time in which payments are subject to challenge, but a contract miner will naturally seek to keep this private statute of limitations fairly long, perhaps six months to one year.

For long term contracts there should be some price adjustment mechanism. These provisions are very well developed in long term coal supply contracts. Typically, these provisions are based on certain indexes which reflect escalation in labor, fuel and other costs of mining. In addition, there may be a price opener clause under certain circumstances; however, space does not permit a full discussion of the variety of factors relevant to these provisions.¹⁶³

Where the method of payment creates certain penalties, it would be natural for the contract miner to insist that there be certain bonuses as well. For example, the contract miner might ask for some form of production bonus if average production for the month exceeds a set production level. The contract miner would then be entitled to a fixed or sliding scale bonus for each ton produced.

F. *Term*

The term of a contract mining agreement will vary depending upon the respective objectives of the owner and the contract miner and their relative bargaining power. If the owner has the equipment, manpower and experience to mine the coal itself, the contract mining agreement may be entered into as a means for adding additional mining capacity when demand is strong. In that case, the owner will likely seek to make the term of the agreement consistent with his view of how long the demand will last or at least will want an early termination provision without penalty. This will not be a situation in which a contract miner should make a significant investment in equipment or development costs since an early termination may occur before the contract miner has recouped his investment. If the contract miner is expected or required to make a substantial capital investment in connection with the mine, the contract miner will seek a long-term contract to protect his investment or at least insist on a liquidated damage clause in the event of early termination. On the other hand, the contract miner may want a short term relationship where he is not required to make significant capital expenditures and has a short term availability of equipment and manpower.

¹⁶³ See generally Carney and Metz, *Risk Allocation in the Long-Term Coal Sales Agreement*, 1 E. MIN. L. INST. 9-1 (1980). Perl & Dunbar, *Indexing Coal and Other Mineral Contracts*, 3 E. MIN. L. INST. 1-1 (1982).

The term of the agreement may also be influenced by such legal considerations as whether the mining relationship is to be structured as a contract in order to avoid violation of a nonassignment clause in the owner's lease. In that situation, the parties will seek a shorter term since it strengthens the argument that the contract does not constitute an assignment of the lease.

Following the decision of the United States Supreme Court in *United States v. Swank*, neither the term of the agreement nor the existence of an early termination provision will be determinative of whether the contract miner is entitled to claim depletion for federal income tax purposes.

The Specimen Contract provides for an initial term of one year with an automatic renewal, absent notice of termination. The agreement terminates upon removal of all mineable coal and compliance by the contract miner with all applicable laws. Naturally, there are various other options as to the term of the contract. It may provide for a fixed term, with a right of renewal by either the owner or the contract miner. In absence of a specific term, the agreement will be terminable at will.¹⁶⁴

When the agreement provides that it has a fixed primary term and will continue "so long as coal is being mined on the property," the agreement will end automatically after the primary term if the contract miner is not then producing coal from the property. If the miner is producing coal at the end of the primary term, the agreement will terminate automatically when the miner ceases production. No notice or other affirmative act of the owner is necessary to effect the termination.¹⁶⁵

G. *Early Termination Absent Default*

The contract mining agreement may contain a provision providing for termination without cause upon sixty or ninety days notice at the option of the owner or the contract miner, or both. If the contract miner is required to make a significant capital investment or incur substantial development expenses and the owner insists on an early termination clause, the contract miner will want to insist that the contract include a liquidated damage clause or other form of compensation for the contract miner's unrecovered capital investment at the date of termination. A typical liquidated damage clause might give the contract miner the option to require the owner to purchase

¹⁶⁴ *Berry v. Walton*, 366 S.W.2d 173 (Ky. 1963); *Warren v. Cary-Glendon Coal Co.*, 313 Ky. 178, 230 S.W.2d 638 (1950).

¹⁶⁵ *Dethloff v. Ziegler Coal Co.*, 82 Ill.2d 393, 412 N.E.2d 526 (1980), *cert. denied*, 451 U.S. 910 (1981); *Brown v. Haight*, 435 Pa. 12, 255 A.2d 508 (1969); *Freemont Lumber Co. v. Starrell Petroleum Co.*, 228 Ore. 180, 364 P.2d 773 (1961). *See generally* Armstrong and Dixon, *Dollar Related Clauses in Coal Leases*, 2 E. MIN. L. INST. 9.03 (1981).

the fixtures and equipment at their depreciated book value and reimburse or share unamortized development costs.

Where there is a gross disparity in bargaining power between the owner and the contract miner, the owner should not be so zealous and demand that the contract be totally one-sided. Such a contract, particularly the termination provision, may be deemed to be unconscionable by analogy to section 2-302 of the Uniform Commercial Code and may thus be unenforceable in whole or part.¹⁶⁶ A contract miner which has made a substantial investment in equipment or development expenses and is faced with an early termination may also argue that the contract granted a mining license which was rendered irrevocable by the contract miner's expenditures or that the owner is estopped from exercising its right to terminate by virtue of expenditures. Although this argument may not be accepted in all jurisdictions, it may provide grounds for equitable relief in others.¹⁶⁷

The contract mining agreement may provide that either party may terminate the agreement in certain events. This occurs, for example, in the event that the contract miner reasonably determines that mining operations cannot be carried on in a profitable manner or that the owner is unable to market the coal. In addition, the agreement may provide for early termination in the event of an extended *force majeure*.

H. Termination on Default

Absent a clause permitting termination on default, the default must be material in order to excuse performance or entitle the injured party to cancel the contract.¹⁶⁸ To avoid the uncertainty created by having to determine what constitutes a material default, the owner may insist on a provision which enumerates specific events of default entitling the owner to terminate the contract. Typically, these will include failure of the contract miner to perform or observe any covenant or condition of the agreement, any representation or warranty which proves to be inaccurate when made, or the occurrence of any one of a number of bankruptcy or insolvency related defaults. In negotiating

¹⁶⁶ See *Shell Oil Co. v. Marinello*, 63 N.J. 402, 307 A.2d 598 (1973), *cert. denied*, 415 U.S. 920 (1974) (oil company's right to terminate dealer agreement on ten days' notice void against public policy; but superseded by statute); *Jordan, Unconscionability at the Gas Station*, 62 MINN. L. REV. 813, 837-40 (1978); see also *Ashland Oil, Inc. v. Donahue*, 223 S.E.2d 433 (W. Va. 1976) (ten day termination clause in gasoline dealership lease held unconscionable); but see *Witmer v. Exxon Corp.*, 260 Pa. Super. Ct. 537, 394 A.2d 1276 (1978), *aff'd*, 495 Pa. 540, 434 A.2d 1222 (1981) (action by oil dealers in which doctrine of unconscionability held unavailable as a defense).

¹⁶⁷ Compare *Tucker v. Carter Oil Co.*, 315 Ill. App. 264, 43 N.E.2d 99, 101 (1942); with *Shuster v. Pennsylvania Turnpike Comm'n*, 395 Pa. 441, 454-58, 149 A.2d 447, 454 (1959). See generally 3 AMERICAN LAW OF MINING §§ 14.5, 14.6 (1982).

¹⁶⁸ 6 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, § 812 (3d ed. 1972).

these provisions, the contract miner should insist that the breach of a covenant or representation be material and that the owner give notice of the breach and provide an opportunity to cure. The notice and cure period will naturally vary depending upon the nature of the default. For example, the owner may be unwilling to acquiesce to a notice and cure provision where the contract miner has failed to maintain an important permit. However, where the default is the filing of an involuntary petition in bankruptcy, the owner may be willing to allow sixty or ninety days for the petition to be dismissed since, as a practical matter, dismissal before that time may not be possible.

Where the contract miner is engaged in other mining operations for the owner on adjacent or even geographically distant parcels, the owner may insist on a provision making a default under any of the other contracts a default under the present contract. Such a cross-default clause may work to the disadvantage of the contract miner if he has a significant number of relationships with the owner. In addition, the owner may insist on a cross-default clause if he has made loans to the contract miner to purchase mining equipment or has leased the equipment to the contract miner. The cross-default clause in that situation would provide that a default under the lease or the loan agreement will constitute a default under the contract mining agreement and vice versa. As with other defaults, the contract miner should seek notice and opportunity to cure prior to termination.

I. *Force Majeure*

Since a contract mining agreement is structured as a contract for services and not a contract for the sale of goods, the Uniform Commercial Code, including section 2-615 (relating to commercial impracticability), does not apply except by analogy. Rather than relying upon the common law doctrine of impossibility of performance, the contract miner should insist on the inclusion of a *force majeure* clause to provide relief where performance is prevented by a sudden, unforeseen occurrence which is outside of the control of the parties.¹⁶⁹ The *force majeure* clause actually serves three functions: (1) it excuses what would otherwise be an event of default and thus avoids the consequences of default; (2) it terminates, suspends or modifies the obligation of the parties to perform their other obligations under the agreement; and, (3) it extends the time for performance and the term of the agreement for periods of *force majeure*. Typically, the owner will insist on notice of an event of *force majeure* and a provision allowing him to terminate the agreement if the event of *force majeure* is not lifted after a certain period. The

¹⁶⁹ See generally Williams, *Coping with Acts of Gods, Strikes and Other Delights—The Use of Force Majeure Provisions in Mining Contracts*, 22 ROCKY MTN. MIN. L. INST. 433 (1976); Young, *Construction and Enforcement of Long Term Coal Supply Agreements—Coping with Conditions Arising from Foreseeable and Unforeseeable Events, Force Majeure and Gross Inequity Clauses*, 27A ROCKY MTN. MIN. L. INST. 127 (1982).

contract miner may wish to include in the *force majeure* provision a clause requiring the owner to pay a proportionate share of the actual expense of maintaining the mine during an event of *force majeure* or, in the event of an early termination, to pay a cancellation charge as compensation to the contract miner for all or a portion of the contract miner's unrecovered capital investment in the mine.

VII. BANKRUPTCY OF LESSOR OR LESSEE

A. *Introduction*

Section 365 of Title 11 of the United States Code¹⁷⁰ governs the treatment of coal leases and contract mining agreements upon the bankruptcy of any party to those agreements. Section 365(a) allows the trustee, or the debtor in possession in a Chapter 11 proceeding, to assume or reject any executory contract or unexpired lease of the debtor, subject to court approval.¹⁷¹

If the contract or lease is in default, the trustee may not assume the contract or lease unless it; (1) cures such default or provides adequate assurance that it will cure such default; (2) compensates the other party for pecuniary losses resulting from such default or gives adequate assurance that it will promptly provide such compensation; and, (3) gives adequate assurance of future performance.¹⁷² These requirements do not apply where the default relates to the financial condition of the debtor or to bankruptcy or insolvency.¹⁷³

In a Chapter 7 proceeding, the contract or lease is deemed rejected if it is not assumed or rejected within sixty days after the filing of the petition.¹⁷⁴ If the contract is assumed, the trustee may assign the contract or lease without the consent of any of the other parties if it provides adequate assurance of future performance by the assignee.¹⁷⁵ This right is unimpaired by a clause in the contract or lease which prohibits assignment.¹⁷⁶ After assignment, the trustee is relieved of any liability with respect to the contract or lease.¹⁷⁷

B. *Bankruptcy of Lessor*

If the lessor files a petition in bankruptcy and the trustee elects to reject the unexpired lease, section 365(h)(1) of the Bankruptcy Code¹⁷⁸ gives the

¹⁷⁰ 11 U.S.C. § 365 (1982).

¹⁷¹ 11 U.S.C. § 365(a) (1982).

¹⁷² 11 U.S.C. § 365(b)(1) (1982).

¹⁷³ 11 U.S.C. § 365(b)(2) (1982).

¹⁷⁴ 11 U.S.C. § 365(d)(1) (1982).

¹⁷⁵ 11 U.S.C. § 365(f)(1) (1982).

¹⁷⁶ 11 U.S.C. § 365(f)(3) (1982).

¹⁷⁷ 11 U.S.C. § 365(k) (1982).

¹⁷⁸ 11 U.S.C. § 365(h)(1) (1982).

lessee the right to treat the lease as terminated by such rejection or to remain in possession of the property for the balance of the term of the lease plus any renewals or extensions that are legally enforceable by the lessee.¹⁷⁹ In this situation, the contract miner's rights will be protected only if the lessee elects to remain in possession of the property despite the owner's rejection of the lease.

To protect the contract miner from the potential loss of his rights under these circumstances, the drafter of the contract mining agreement should include provisions in the agreement which would require the lessee to elect to remain in possession for the term of the lease (and all enforceable extensions and renewals thereof) should the owner of the property declare bankruptcy and reject the lease.

C. *Bankruptcy of Lessee*

If the lessee declares bankruptcy, the lessee may accept the lease and reject the contract mining agreement. If such is the case, the lessee will be able to retain the leasehold interest in the coal and avoid any contractual arrangement with the contract miner.

The contract miner can protect against the risk of the lessee rejecting both the lease and the contract mining agreement, by entering into a separate agreement with the lessor in which the lessor gives the contract miner the right to cure any default under the lessee's lease and requires the lessor to give notice to the contract miner of any default by the lessee under the lease. If the lessee declares bankruptcy and rejects the lease, the agreement should provide the contract miner with the right to obtain a new lease from the lessor. Thus, in the event of a bankruptcy by the lessee, the contract miner will have the right to mine the property should the lessee default or declare bankruptcy and reject the lease.

D. *Preferences*

A preference is a transfer of the property of the debtor, made within the ninety-day period before the filing of a bankruptcy petition, to or for the benefit of a creditor, on account of an antecedent debt, which enables the creditor to receive more than it otherwise would receive on its claim in a Chapter 7 liquidation.¹⁸⁰

There are, however, several exceptions to the preference provisions of the Bankruptcy Code. One exception is a payment in the ordinary course of

¹⁷⁹ *In re Penn Central Transp. Co.*, 458 F. Supp. 1346 (E.D. Pa. 1978); *In re 1438 Meridian Place, N.W., Inc.*, 11 Bankr. 353 (Bankr. D.C. 1981); and *In re LHD Realty Corp. v. Metropolitan Life Ins. Co.*, 20 Bankr. 717 (Bankr. S.D. Ind. 1982).

¹⁸⁰ 11 U.S.C. § 547 (1982).

business not later than forty-five days after the debt was incurred.¹⁸¹ Thus, if an owner makes a payment to the contract miner within ninety days before the owner files a petition in bankruptcy, but more than forty-five days after the payment was due, and if this allows the contract miner to receive more than he would otherwise have received in a Chapter 7 liquidation, the trustee may be able to void the payment as a preference.

VIII. CONCLUSION

Although many contract mining agreements fall into an established pattern, there are many opportunities to tailor the agreement to fit the peculiar characteristics of a given situation. As has been shown, once the parties have generally decided upon the division of engineering, mining and marketing responsibilities and the price per ton, there are a myriad of practical and legal problems in negotiating and drafting an agreement which meets the objectives of both parties. With a basic understanding of the current law in the areas of property, contracts, federal and state taxation, tort liability, health and safety, environmental compliance and bankruptcy, the parties can address the significant issues which may arise during the term of the contract.

¹⁸¹ 11 U.S.C. § 547(c)(2) (1982).

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