

# **Ownership, Acquisition, and Leasing Issues for Frac Sand Owners and Developers**

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## **I. Mineral Estate or Surface Estate? Ownership and Development Limitations in Split Estate Situations**

The ownership of frac sand found on a property is clear when the property is owned in fee simple. The fee simple owner has title to the frac sand. That clarity, though, quickly becomes opaque in the context of a split estate (*i.e.*, when the mineral estate has been severed from the surface estate). Is frac sand part of the mineral estate or part of the surface estate?

The term “surface estate” is a misnomer, because the surface estate includes interests in the subsurface. Indeed, the surface estate includes everything that was not reserved in the severance of the mineral estate. To avoid the implication that the surface estate is limited to surface interests, it is better to describe the surface estate as the “non-mineral estate.” Similarly, one must remember that the mineral estate includes the dominant right to use the surface to the extent reasonably necessary to explore for and extract minerals from the subject land.

Mineral reservations are not uniform. For that reason, one must review the terms of the mineral reservation and applicable law to assess the scope of the reservation. Although mineral reservations are typically construed to not include ordinary sand and gravel, if “oil, gas, minerals, and sand” were expressly reserved, sand would be part of the mineral estate.

Outside of hydrocarbons and sometimes other minerals (*e.g.*, coal, iron), mineral reservations often just generally reserve “minerals,” in which case the pertinent question is whether frac sand is a “mineral.” *See generally* George E. Reeves, “The Meaning of the Word ‘Minerals,’” 54 N.D. L. REV. 419, 472-73 (1978). *Vang v. Mount*, 220 N.W.2d 498 (Minn. 1974), is the controlling Minnesota case for assessing whether frac sand falls within the scope of a reservation of “minerals.” The trial court in *Vang* had granted summary judgment holding that limestone was not included in the following mineral reservation in land around Rochester:

“Reserving all minerals in and under said land and use of sufficient surface of said land to drill and mine for and take away for use said, gas, oil, or other minerals thereon or under to the parties of the first part.”

*Id.* at 394. The Minnesota Supreme Court first noted that when construing mineral reservations, ambiguities are not resolved in favor of the grantee. *Id.* at 396. Instead, “the proper method is to determine the intention of the parties from the entire instrument and the facts and circumstances surrounding the making of the deed.” *Id.* (quoting *Resler v. Rogers*, 139 N.W.2d 379, 383 (Minn. 1965)).

“The intention of the parties is to be ascertained from the entire instrument, including the reservation or exception. This includes the ordinary meaning of the words, recitals,

context, subject-matter, the object or purpose of introducing the exception or reservation clause, the nature of the reservation or exception, and the attending facts and circumstances surrounding the parties at the time of the making of the deed. It is also elementary that the reservation or exception is void, when totally repugnant to the granting clause. When the grant is direct and positive, it cannot be set aside by an indirect method in the form of an exception or reservation.”

*Id.* at 397 (quoting *Carlson v. Minnesota Land & Colonization Co.*, 129 N.W. 768, 769 (Minn. 1911)).

The court held that “minerals” is an ambiguous term and that questions of fact regarding the parties’ intent and the surrounding circumstances are implicated in determining whether a given substance qualifies as a “mineral” within a particular reservation. *Id.* at 400. For this reason, the court remanded the case for an evidentiary hearing. However, it did identify the following factors to be considered: (i) the value, in terms of the profitability of mining and marketing the material, or exceptional characteristics that distinguish the material from the surrounding soil; (ii) the effect of extraction of the material on the surface; and (iii) surrounding circumstances of local custom or usage. *Id.*

Unfortunately, applying the *Vang* factors to frac sand does not result in any great clarity as to whether frac sand is a “mineral.” Frac sand can be distinguished from other soils and sands both by its value and by its unique characteristics that allow it to be used for hydraulic fracturing of hydrocarbon-bearing shale formations. Although prevalent in southeastern Minnesota, unlike ordinary sand deposits, frac sand deposits are not found throughout the United States or even throughout Minnesota.<sup>1</sup> This suggests that frac sand could be a “mineral.” Surface mining methods are typically used to extract frac sand, but underground mining methods can be used in at least some situations.<sup>2</sup> This may suggest that frac sand is not a “mineral,” although taconite is often extracted using surface mining methods, but iron is certainly a mineral. Given the long history of silica sand mining in southeastern Minnesota, local customs and usages may also have an important role to play in the assessment. Although ordinary sand is typically not considered to be a “mineral,” the result for frac sand under *Vang* is uncertain.

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<sup>1</sup> Silica sand is a mineral subject to location under the federal General Mining Law of 1872. *See United States v. Kosanke Sand Corp.*, 12 IBLA 282 (1973).

<sup>2</sup> *See, e.g.,* Frederica Freyberg, Sand Mining Industry Booming in Western Wisconsin” (Dec. 13, 2012), available at [http://wpt.org/Here\\_and\\_Now/sand-mining-industry-booming-western-wisconsin](http://wpt.org/Here_and_Now/sand-mining-industry-booming-western-wisconsin).

Again, the actual wording of the mineral reservation is crucial, as slight differences between mineral reservations can result in different outcomes. For example, when the State of Minnesota conveys land owned by the state by virtue of any act of Congress, the state reserves “any iron, coal, copper, gold, or other valuable minerals which may be in or upon the land.” MINN. STAT. § 93.02. Case law construing federal mineral reservations indicates that “valuable minerals” and “minerals” are not synonymous.<sup>3</sup>

In *Watt v. Western Nuclear*, 462 U.S. 36 (1983), the U.S. Supreme Court was called to determine whether gravel fell within the federal government’s reservation of “all the coal and other minerals” in lands patented under the Stock-Raising Homestead Act of 1916 (“SRHA”). The court set out a four-part test to determine whether Congress intended to reserve any particular material. *Id.* at 53 (“Given Congress’ understanding that the surface of SRHA lands would be used for ranching and farming, we interpret the mineral reservation in the Act to include substances that are mineral in character (*i.e.*, that are inorganic), that can be removed from the soil, that can be used for commercial purposes, and that there is no reason to suppose were intended to be included in the surface estate.”). Applying this test, the court held that “other minerals” reserved under the SRHA included gravel. *Id.* at 55.

The U.S. Supreme Court was subsequently called in *Bedroc Limited, LLC v. United States*, 541 U.S. 176 (2004), to determine whether sand and gravel fell within the federal government’s reservation of “all coal and other *valuable* minerals” in land patented in Nevada under the Pittman Underground Water Act of 1919 (“Pittman Act”). (Emphasis added.) The court distinguished *Western Nuclear*, because Congress had used the modifier “valuable” in the Pittman Act, which the court held “makes clear that Congress did not intend to include sand and gravel in the Pittman Act’s mineral reservation.” *Id.* at 183.

In light of the lack of clarity about whether frac sand is part of the mineral or non-mineral estate, what are frac sand developers to do in split estate situations? Litigation over title issues could slow the development process, particularly as the outcome under *Vang* is so fact dependent. A frac sand developer could acquire frac sand rights from both the mineral and non-mineral estate owner, but it will want to try to avoid giving both the mineral and non-mineral estate owner fair market value for the disputed frac sand

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<sup>3</sup> The use of the word “other” in a reservation like the State of Minnesota’s mineral reservation may also have significant ramifications under the *ejusdem generis* rule of construction, which calls for general words following the enumeration of particular minerals to be construed as being limited to minerals of the same general character as the enumerated minerals. See, e.g., *Chronkhite v. Falkenstein*, 352 P.2d 396 (Okla. 1960) 538 P.2d 204 (Okla. 1975) (construing a reservation of “oil, gas and other minerals” to not include gypsum rock, which unlike oil and gas is not a hydrocarbon).

(i.e., avoid paying for the frac sand twice). A frac sand developer could take leases from both the mineral and non-mineral estate owner that include suspension and proportionate reduction provisions. A suspension provision allows the lessee to suspend royalty payments to the lessor if the lessor's title is disputed and instead deposit royalty payments into an interest bearing account. Once a final title determination is reached, the deposited royalties and accrued interest would then be paid to the prevailing owner. No royalties would be owed to the non-prevailing owner pursuant to the proportionate reduction provision, because the non-prevailing owner has zero interest in the frac sand.

## II. Buying and Selling Frac Sand Property - Royalties

In many ways, buying and selling frac sand property is no different from buying and selling any other piece of real property. However, unlike the sale of residential or commercial property, the seller may seek to reserve a royalty on frac sand mined from the property.<sup>4</sup> Royalty obligations can also benefit the buyer, in that the upfront acquisition price should be less if a royalty is reserved.

A royalty provision deserves careful consideration by both the seller and the buyer to ensure that their respective interests are protected. The list below identifies common issues that can arise in negotiating, drafting, and interpreting royalty provisions in deeds and in leases:

- **Royalty Rate:** Royalties in the sand business are typically either a flat amount per ton (e.g., \$1/ton of sand produced and sold), a percentage of the proceeds (e.g., 8% of gross revenues from sand produced and sold), or a combination thereof (e.g., 8% of gross revenue or \$1/ton, whichever is greater). If the royalty is a percentage of net revenues, rather than gross revenues, the lease should clearly identify which production costs can be properly deducted from gross revenues. If the mined material might be sold to affiliates of the buyer/lessee, the royalty provision should clearly address how the sales price for such sales is to be determined. Sellers/lessors will want to ensure that the price paid by the affiliate reflects the market price.
- **Escalation:** When royalty provisions rely on a flat amount per ton, sellers/lessors may seek to escalate the flat amount so that it keeps pace with inflation, because \$1/ton today will be worth much less in “real” dollars in 2050. In that situation, buyers/lessees will want to ensure that the escalation formula works and that it relies on an appropriate index. A variety of inflation indices are published and

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<sup>4</sup> In fact, the earliest available appellate case in Minnesota involving a frac sand transaction concerned the interpretation of an advance minimum royalty provision in a 1978 option agreement. *See Unimin Corp. v. Flood*, 1993 Minn. App. LEXIS 1196 (Minn. Ct. App. Dec. 7, 1993).

could be used. However, a given inflation index will not necessarily accurately reflect rising prices in the sand industry generally or rising prices in a particular market (*e.g.*, frac sand).

- **Advance Minimum Royalty (“AMR”):** It is not unusual for a lessor to require that the lessee pay an AMR on an annual, quarterly, or monthly basis to incentivize production. Indeed, outside of the bonus, all non-royalty compensation serves to incentivize production as soon as possible. Production royalties are then credited against the AMR for some period of time. For example, a lease might call for a \$2,000 monthly AMR recoupable against production royalties in the month paid and the following month. In that situation, if production royalties were \$1,500 in January and \$2,500 in February, the lessee would not owe the lessor any royalties on production in February beyond the AMR because the \$500 by which production royalties exceed the AMR in February would be credited against the \$500 by which the AMR exceeded production royalties in January. A lessee will want to ensure the recoupment schedule is compatible with its expected production schedule.
- **Fair Market Value Renegotiation:** Because mining projects typically extend over a long period of time, it is not unusual for sellers/lessors to seek protections against market changes. This is typically done by providing that the royalty rate be set to fair market value after so many years. Such a lease mechanism will invariably raise the question of what is the appropriate market. Is it the market in which the mine is physically located? Is it the market in which the frac sand is sold? Is the market limited to recent transactions or does it include transactions executed in the 1980s that remain in force? Ideally, these questions will be resolved in the transaction documents. Furthermore, the transaction documents should set out the process for determining fair market value if the parties cannot agree. Will a mediator or arbitrator be used? Is the arbitrator free to settle upon any fair market value or must the arbitrator select a value proposed by a party? What if the royalty is a flat per-ton amount but the market is now a percentage royalty; can the arbitrator make that change? If costs can be deducted, can the arbitrator broaden or narrow the scope of deductible costs to reflect market?

Negotiating, drafting, and interpreting royalty provisions can raise numerous issues that will have a direct financial implications. It is imperative royalty provisions receive close scrutiny.

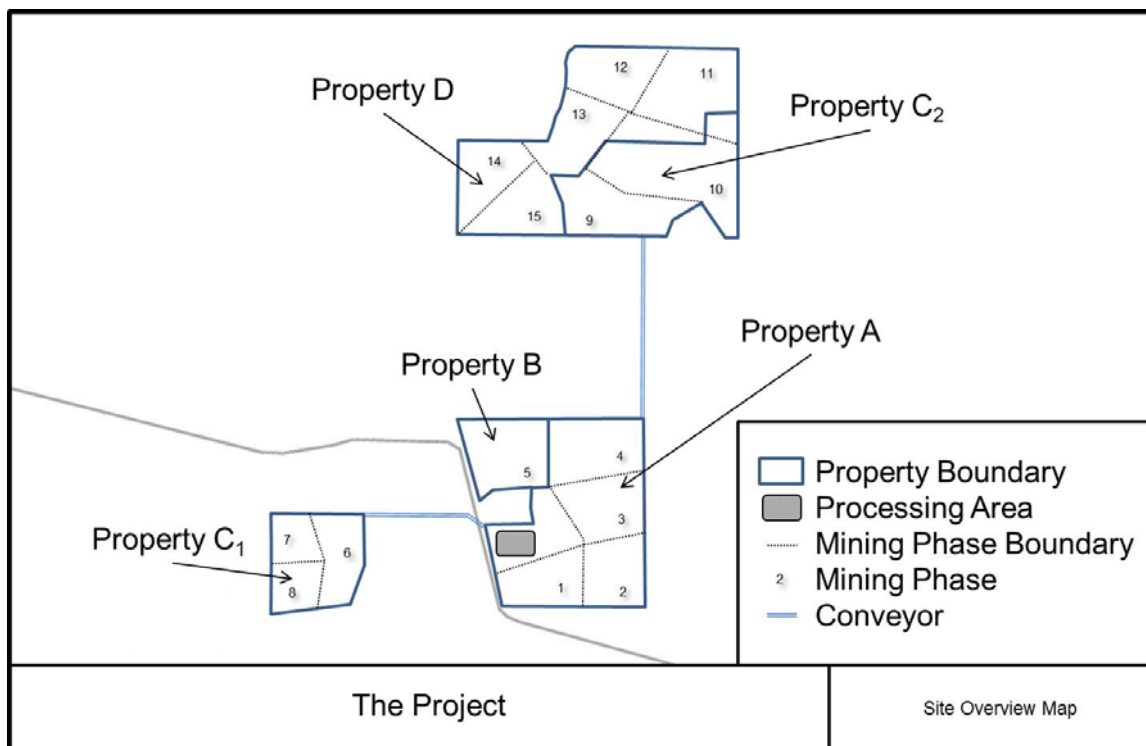
### **III. Leasing Frac Sand Property, Including Review of Sample Frac Sand Lease Terms and Conditions from Lessor and Lessee’s Perspectives**

Exhibit A contains a recent mining lease that a frac sand developer made available in connection with its conditional use permit application. Including this lease in these materials is not an endorsement by the author of its terms and conditions. Indeed, this lease has material issues from both a developer and a property owner’s perspective. It nonetheless provides a good touchstone against which to discuss generally the terms

and issues that developers and property owners should consider when negotiating a frac sand mining lease.

The discussion below is not intended to highlight every issue or even to address every term in this lease. Instead, the discussion below provides a high-level overview of certain terms in this lease and other lease issues to consider.

Lease terms should not be read in isolation nor should they be negotiated without a solid understanding of the proposed development, because the proposed development will shape the content and appropriateness of the lease terms. Here, the frac sand developer proposed to mine five properties owned by four landowners. (Property C<sub>1</sub> and Property C<sub>2</sub> on the site overview map below are owned by one individual.) The attached lease concerned Property A, although all four of the leases for the project contained consistent terms and conditions. Mining would occur in fifteen phases over the course of 20 to 30 years with each mining phase expected to be completed in roughly one to two years. Each phase would be reclaimed as mining is completed for that phase. In the conditional use permit application for the project, the frac sand developer proposed that mining would occur from 6:00 a.m. to between 6 and 8 p.m. Monday through Saturday with the processing plant operating 24 hours per day, 7 days per week.



With that context in mind, let's consider the lease's terms and conditions in the order in which they appear in the lease.

**1. Premises and Term.** The lease excepts “6 acres for [the landowners’] home site” from the leased land. However, the lease does not describe where these six acres are located. If the landowners’ home is currently on the property, locating the “home site” may not be difficult, but what are the boundaries for the six acres in which the home site is located? Avoiding the uncertainty that arises by not describing the location of these six acres would have been in both the frac sand developer’s and the landowners’ interest.

**2. Rental.** The “rental” described in Paragraph 2 of the lease is more appropriately considered a bonus as it is effectively a lump sum, paid in two payments, that the landowners receive for executing the lease. Bonus payments are common in mineral leases, particularly when there is competition between developers for the lease. Interestingly, however, here the first bonus payment is described as an “initial deposit.” Paragraph 11 of the lease states that the frac sand developer’s “*obligations* under this Agreement are conditioned upon Tenant obtaining any zoning or other governmental approvals required to permit” frac sand mining. (Emphasis added.) Does this limitation coupled with the lease’s description of the first bonus payment as a “deposit” with the second bonus payment payable upon “permit” approval mean that if the unspecified permit is not obtained, the developer has no obligation to pay the bonus and the landowners must return the “deposit” to the frac sand developer? Bonuses are typically non-refundable, and the landowners should not have created uncertainty about their right to retain the “initial deposit.” Paragraph 2 also does not identify the permit that triggers the obligation to make the second bonus payment, and Paragraph 11 refers to a variety of approvals that are necessary to “permit” this use. Must all approvals be obtained to trigger the frac sand developer’s obligation to make the second bonus payment or does one particular “permit” trigger this obligation? The lease does not say.

**3. Royalties.** As described above, royalties in the sand business are typically either a flat amount per ton, a percentage of the proceeds, or a combination thereof. This lease appears to use a flat amount per ton. This royalty, though, is not paid on the quantity of frac sand removed from the landowners’ property, but rather it is paid on the quantity of frac sand removed from the “project,” which the lease defines in the introductory paragraph as consisting of the property of all four landowners (*i.e.*, Property A, B, C<sub>1</sub>, C<sub>2</sub>, and D on the site overview map above). Because all four of the leases for this project are similar, this means that the owner of Property D will enjoy the benefits (*i.e.*, royalties) of sand mined from Property A but will not have to bear any of the burdens of the mining operation for up to 20 years (*i.e.*, until the frac sand developer starts mining Phase 10, which is the first phase that includes Property D).

This royalty provision does mean that the Property A landowners will receive royalties long after mining is finished on Property A. Such compensation is arguably appropriate in the context of Property A, because Property A will be used for processing during the entire life of the project. However, is such compensation appropriate for the Property B landowner, who would continue to receive royalties well after Property B is reclaimed? From a frac sand developer’s perspective, should it continue to pay the owner of Property B money 15 years after mining is completed on Property B? This issue highlights the need to understand the project and the role that property plays in the project when negotiating the lease.



The second sentence in Paragraph 3 states that the landowners will get an additional flat amount royalty “split based on ownership of total reserves determined by [the frac sand developer], between . . . the four landowners in the . . . project.” Under the terms of the lease, this additional royalty is not based on sand removed, although the parties likely so intended. The lease also does not specify whether this royalty is based on sand removed from the project or from Property A. Because this royalty is to be split amongst all the project landowners, it seems likely that this royalty is based on sand removed from the project. But if so, this royalty seems to add unnecessary complexity, since the first royalty could have been increased by some amount, thereby eliminating the need for this second royalty.

Neither of these flat amount royalties are tied to an annual escalation clause. Because of inflation, the landowners will be receiving less money in relative terms over the course of this 20-year lease. Also, lessors often seek “favored nation” provisions, which ensure that the lessor’s royalty will be automatically increased to equal to any greater royalty the lessee agrees to pay a third party. A mine operator can use the existence of “favored nation” provisions in one lease to argue against giving a subsequent lessor a greater royalty because that would have broader effects on the economics on the entire project.

The lease provides that the sand is to weighed using a scale “installed on the Premises.” This makes sense for the lease of Property A, because the processing plant is proposed to be located on Property A. However, requiring a scale on each of the four leased properties makes no sense. For example, is the frac sand developer to weigh sand from Property C on a scale on Property C before it is transported to Property A for processing? This would seem to be unnecessary from a practical perspective because at least one of the royalties is based on sand produced anywhere within the project. Is the frac sand developer to install a scale on Property A, Property B, Property C<sub>1</sub> and C<sub>2</sub>, and Property D and then weigh the same sand on each of the four scales? This seems unnecessary, but it appears to be what the leases require.

To ensure that royalties are calculated properly, property owners would want to require monthly production reports, regular inspection and certification of scales, and the frac sand developer’s retention of scale tickets and other records, and to obtain the right to audit the frac sand developer’s records. It is not unusual for mining leases to require that the frac sand developer make-up at least some percentage of underpaid royalties if the scales are inaccurate or if an audit reveals an underpayment. In addition, property owners would want interest to accrue on late royalty payments. The lease is silent on these issues.

Mining leases also often include provisions regarding stockpiling mined materials and commingling materials mined from different properties. With a flat amount royalty based on production from all the properties, these issues are not as much of a concern here, although the landowners might have prohibited stockpiling materials mined from non-project lands on the project to avoid issues about what is project-sand and what is non-project sand.

Paragraph 3 also provides for an AMR starting on the first anniversary of the lease's execution. However, the AMR is tied to "material hauled from Landlord[']s Premises" rather than the project, which is what at least one of the royalties is based upon. The lease then states that the AMR "[m]ean[s] that additional monthly payment to Landlord will begin to accrue once Tenant hauls 500 ton[s] from Landlord[']s Premises," which suggests that notwithstanding the fact that at least one of the royalties is based upon production from the project, the landowners are only entitled to a royalty after 500 tons are removed from the landowners' property. This would mean that unless sand is being removed from Property A, the landowners' continuing compensation is limited to the AMR. Depending up the size of the AMR, this may be problematic for Property A, which will be used for processing for decades. This uncertain language should not have been used.

**4. Possession.** Paragraph 4 gives the landowners the right to "continue to complete" certain activities "on the portion of the [P]remises." However, the lease does not describe what portion of the leased land to which this right pertains. Also, for those properties that would not be mined for years, does "continue to complete" mean that the landowners can, for example, farm these lands until mining commences or can they only complete the farming season in which the lease was signed? More unnecessary ambiguities.

**5. Use and Condition of Premises.** Paragraph 5(a) does not expressly limit the frac sand developer to using the leased land for frac sand mining. Paragraph 5(b) obligates the frac sand developer to maintain a "'good neighbor policy' with adjacent property owners," but does not describe what the policy is. Does the policy concern compensating adjacent property owners for decreased property values due to mining? Does it concern something else? Are the adjacent property owners third-party beneficiaries to this lease that could sue to enforce the nebulous "good neighbor policy" obligation? These are questions that the frac sand developer should have answered in the lease. The crop and timber loss compensation provision in Paragraph 5(e) raises multiple issues. Must the frac sand developer compensate the landowners for crop and timber losses? It does not say that. What if the parties cannot agree on the amount of compensation? Is the compensation based on one year's crop loss or can the property owner seek compensation for crop loss over multiple years (*e.g.*, for crops that would have been planted but for mining roads)? This is an issue where it may be useful to describe the loss calculation methodology to be utilized and to provide for a speedy and binding determination by a neutral third-party.

**7. Option to Renew.** The lease provides for 10-year renewal terms "on the same terms and condition[s] as the original term, except that no initial deposits will be paid for any renewal term." Because only one of the two bonus payments described in Paragraph 2 is termed an "initial deposit," must the frac sand developer make the second bonus payment if it renews the lease?

More troublesome from the frac sand developer's perspective is the provision in Paragraph 7 that "[t]he amount of [r]oyalties shall be negotiated for any renewal term of this lease." By indicating that the parties must agree on the royalty amount for any

renewal term, the lease has likely negated the frac sand developer's option to renew the lease. What if the parties do not agree on the royalty amount? The lease does not provide a process for determining the royalty amount in the absence of an agreement (*e.g.*, by arbitration) nor does it provide an objective standard for determining the new royalty amount (*e.g.*, a royalty equal to the current fair market royalty rate for frac sand mined within 100 miles of the leased land). For the frac sand developer, this is a material deficiency in the lease terms, because when the lease comes up for renewal, the frac sand developer will likely have already invested significant capital in its mine and the property owner will have greater leverage over the frac sand developer.

**8. Quiet Enjoyment.** This is a frac sand developer-friendly provision. It is not unusual for property owners to refuse to warrant their title to the leased property reasoning that the lessee should do its own due diligence on the lessor's title.

**10. Indemnity.** The frac sand developer is a limited liability company, and we have no information about its financial wherewithal. If it has limited assets, this indemnity is effectively worthless. In order to protect against this type of risk, property owners often require that the lessee maintain various types of insurance (*e.g.*, commercial general liability, automobile) and have the property owner named as an additional insured on such policies. Alternatively or in addition, property owners might seek a guaranty from the frac sand developer's parent company or owners.

**11. Zoning.** This provision simply makes no sense. The frac sand developer's obligations are conditioned on "obtaining" permits "on or before the commencement date of this Agreement" with the landlord agreeing to assist and cooperate in obtaining such permits. However, the commencement date of the lease is the same date it was executed, but the conditional use permit application was *submitted* over one month *after* the lease commenced. Furthermore, Paragraph 11 provides that "all plans for the Premises are subject to Landlord's approval." This concept is not necessarily inappropriate, but the lease does not provide any boundaries on the landowners' decision to approve or deny the frac sand developer's plans. For example, how long do the landowners have to review and make a decision about the plans? What if they do not approve the plans? Is there an objective standard against which the plans are to be judged (*e.g.*, not involve more impacts to the leased land than is reasonably necessary for economic recovery of frac sand)? Without such a standard, the frac sand developer likely has little recourse if the property owner unreasonably denies approval of project plans.

**16. Sand for Tenant.** Strangely, the parties did not specify a maximum required size for the stockpile the frac sand developer must maintain for the landowners, even though the lease plainly contemplated specifying a maximum required size. A maximum size limits the burden on the frac sand developer, and the lease does not impose a minimum size obligation on the frac sand developer, which would ensure that the stockpile is sufficiently large for the landowners.

**18. Surface Rights of Tenant.** Even though Paragraph 5(e) suggests that the frac sand developer must compensate the landowners for timber losses, Paragraph 18

does not give the frac sand developer the right to cut timber. In addition, Paragraph 18 provides that the frac sand developer “may erect a [processing] plant or plants on the” leased land? The frac sand developer certainly needs this for Property A, but did the owners of Property B, Property C<sub>1</sub> and C<sub>2</sub>, and Property D also need to give the frac sand developer this right?

**19. Protection and Restoration of Surface.** The lease requires that at the end of the term, the land must be left in a reasonably level condition. As the project contemplates phased mining, why would the landowner not require that each phase be reclaimed to a reasonably level condition following the completion of that mining phase? Also, the frac sand developer has one year after the lease expires to remove any structures and equipment. This is a long period of time, particularly considering the landowners will then not be receiving any compensation from the lessee. The lease does not include any incentives for the lessee to more quickly remove the structures and equipment.

**23. Assignability.** Paragraph 23 and Paragraph 5(c) provide no limits on the frac sand developer’s right to assign the lease. This is an important issue for landowners, because they likely would prefer to have some ability to ensure that the assignee is a reputable company with mining experience. This can easily be accomplished by requiring the landowners’ prior written consent, which consent shall not be unreasonably withheld or delayed. If the landowners had more specific concerns, more specific standards that the assignee must satisfy could have been included in the lease. Interestingly, this lease does not expressly provide that the frac sand developer can encumber its interest in the leased land in connection with financing the project.

**25. Provisions Binding.** The lease purports to be binding on the parties’ respective successors and assigns, but would such parties necessarily be on notice of the existence of this lease? The lease does not provide for recording a memorandum in the county’s property records. Successors-in-interest to the landowners of Property A would likely be on inquiry notice due to the processing plant being located on Property A. The likely result is less certain for the other properties. For example, Property D may not be mined for up to 20 years. How will any successors-in-interest to the owner of Property D have notice of the lease of Property D during this period? The frac sand developer should have had a memorandum executed and recorded.

**26. Setbacks.** This provision is not limited to the buildings, well, and septic system that are on the lease land on the lease’s commencement date, which would be helpful to the frac sand developer. Also, the lease contemplates the lessor’s removal of buildings, well, and septic systems. Again, though, what if the parties cannot agree on a price for the removed items? A process and standard should be included to determine the price if the parties fail to agree.

**Other Provisions to Consider:** There are numerous other issues that could have been addressed in the lease. For example, as the owners of Property A apparently have a homesite adjacent to the leased land, they could have sought to limit the hours of operation for both mining and the processing plant. Other potential provisions to consider include (i) cross-mining rights, (ii) requiring that operations be conducted in a

workman-like manner, consistent with good mining and engineering practices and methods, in ways that maximize recovery and utilization of the available frac sand, (iii) limiting the number of acres that can be open for mining at any one time, (iv) the lessor obtaining a security interest in mined frac sand until royalties are paid, (v) access to geologic data, (vi) protection from liens, (vii) after acquired rights, (viii) surrendering all or any portion of the lease, (ix) payment in lieu of covenants, (x) suspension of payments if a dispute arises regarding the lessor's title, (xi) proportionate reduction if the lessor owns less than the entire interest in the frac sand, (xii) default, opportunity to cure, and cancellation provisions, and (xiii) force majeure.

**Exhibit A**

Sample Frac Sand Mining Lease

FOR DISCUSSION ONLY;  
NOT AN ENDORSEMENT OF ITS TERMS AND CONDITIONS

Lease Agreement

THIS LEASE AGREEMENT, ("the Agreement") is entered into this 25 day of March, 2013 by [REDACTED], husband and wife, ("Landlord") whose address for the purpose of this lease is [REDACTED] and [REDACTED], LLC, ("Tenant"), whose address for the purpose of this lease is [REDACTED]. The [REDACTED] Project referred to in the lease consists of four land owners, [REDACTED].

1. **PREMISES AND TERM.** The landlord, in consideration of the rent, agreements, and conditions contained herein, leases to the Tenant and Tenant leases from Landlord, the following described real estate in [REDACTED] County, [REDACTED]:

106.03 acres located at [REDACTED] containing parcels [REDACTED]. [REDACTED] (except that [REDACTED] shall be allowed 6 acres for his home site that is not part of the Premises. [REDACTED])

[REDACTED]

for a term commencing March 25, 2013 and ending March 25 2033.

2. **RENTAL.** Tenants agree to pay to Landlord as rental for said Premises the sum of [REDACTED] as an initial deposit to be paid in full on the execution of this lease. Upon permit approval, an additional [REDACTED] will be paid to the Landowner.
3. **ROYALTIES.** In addition to the rental due under paragraph 2 above, Landlord shall be paid at the rate of [REDACTED] per ton for frac sand weighed and removed from the [REDACTED] project. In addition [REDACTED] per ton to be split based on ownership of total reserves determined by tenant, between [REDACTED] the four landowners in the [REDACTED] project. Said material shall be weighed across a scale provided and installed on the Premises by Tenant. Sand to be weighed at mine site scale and to be paid for within 30 days. 12 months after signing lease Landlord shall be guaranteed the sum of [REDACTED] per month draw on royalty payments, with any material hauled

from Landlords Premises first being credited towards the \_\_\_\_\_ per month draw. Meaning that additional monthly payments to Landlord will begin to accrue once Tenant hauls 500 ton from Landlords Premises. No additional property shall be added to the \_\_\_\_\_ project without 80% of the existing landowners reserves used.

4. **POSSESSION.** Tenant shall be entitled to possession on the commencement date, and shall yield possession to the Landlord upon expiration of this Agreement. Landlord shall have the absolute right to continue to complete hunting, cropping, and farming activities on the portion of the premises and is backed by tenant.

5. **USE AND CONDITION OF PREMISES.**

- (a) Tenant intends to utilize the Premises to mine sand to be used by Tenant for commercial purposes.
- (b) Tenant will maintain a "good neighbor policy" with adjacent property owners.
- (c) Tenant may sub-contract, assign, or sub-lease all or any part of the Premises in a manner that is compatible with Tenant's objectives. All provisions of this lease, including provisions relating to royalties and the business manner of Tenant shall apply to any assignee, sub-contractor or sub-lessee so that no harm or distress is caused upon Landlord.
- (d) Tenant will provide Landlord 90 days notice of Tenants intent to begin mining operations on the Premises.
- (e) Landlord and Tenant will meet and agree upon any crop loss calculations and or timber loss calculations, prior to any activity that would result in crop loss or timber loss.
- (f) Tenant will be responsible for reclamation pursuant to a reclamation plan approved by the governing body issuing the permit for Tenants mining activity.

6. **TERMINATION AND OPTION TO RENEW.** This lease shall terminate upon expiration of the original term; or if an option to renew is exercised by the Tenant, then this lease will terminate at the expiration of the option term or terms.



7. **OPTION TO RENEW.** Tenant may renew this lease for an additional term of ten years by giving landlord a written notice of intent to renew at least thirty days prior to the expiration of the term that proceeds each such renewal term. Each renewal will be on the same terms and condition as the original term, except that no initial deposits will be paid for any renewal term. Royalties will continue to be paid as incurred by Tenant. The amount of Royalties shall be negotiated for any renewal term of this lease.
8. **QUIET ENJOYMENT.** Landlord covenants that its estate in said premises is in fee simple and that the Tenant, if not in default, shall peaceably have, hold and enjoy the premises for the term of this lease.
9. **REAL ESTATE TAXES.** Landlord shall pay all real estate taxes and assessments for the Premises due in the amount at time of lease, any property tax increase due to the effects of the Tenant's presence on the property, including structures, roads, property values due to mining operations shall be paid by Tenant.
10. **INDEMNITY.** Except for the negligence of Landlord, Tenant will protect, defend and indemnify Landlord from and against all loss, costs, damage and expenses occasioned by, or arising out of, any accident or other occurrence, causing or inflicting injury or damage to any person or property, happening or done in, upon or about the premises, or due directly or indirectly to the tenancy, use or occupancy thereof, or any part thereof by Tenant or any person claiming through or under Tenant.
11. **ZONING.** Tenant's obligations under this Agreement are conditioned upon Tenant obtaining any zoning or other governmental approvals required to permit the use set forth in paragraph 5 above on or before the commencement date of this Agreement. Said approvals include, but are not limited to, and permits or approvals required by the [REDACTED] Department of Natural Resources, the United States Mine Safety and Health Administration, any county permits, and any mining plans and reclamation plans as may be required. Landlord agrees to assist and cooperate in obtaining any such approvals or permits and Tenant agrees that all plans for the Premises are subject to Landlord's approval.
12. **NOTICES AND DEMANDS.** Notices as provided for in this lease shall be given to the respective parties hereto at the respective addresses designated on page one of this lease unless either party notifies the other, in writing, of a different address. Without prejudice to any other method of notifying a party in writing or making demand or other communication, such message shall be considered given under the terms of this lease when sent, addressed as above designated, postage prepaid, by certified mail deposited in a United States mailbox.

13. **CHANGES TO BE IN WRITING.** None of the covenants, provisions, terms or conditions of this lease shall be modified, waived or abandoned, except by a written instrument duly signed by the parties. This lease contains the whole agreement of the parties.
14. **CONSTRUCTION.** Words or phrases herein, including acknowledgement hereof shall be construed as in the singular or plural number, and a masculine, feminine or neuter gender according to the context.
15. **CERTIFICATION.** Tenant certifies that it is not acting, directly or indirectly, for or on behalf of any person, group, entity or nation named by an Executive Order of the United States Treasury Department as a terrorist, "Specially Designated National and Blocked Person" or any other banned or blocked person, entity, nation or transaction pursuant to any law, order, rule or regulation that is enforced or administered by the Office of Foreign Assets Control; and it is not engaged in this transaction, directly or indirectly on behalf of, or instigating or facilitating this transaction, directly or indirectly on behalf of, any such person, group, entity or nation. Tenant hereby agrees to defend, indemnify, and hold harmless Landlord from and against any and all claims, damages, losses, risks, liabilities and expenses (including attorney's fees and costs) arising from or related to any breach of the foregoing certification.
16. **SAND FOR TENANT.** Tenant agrees to maintain a sand stockpile in an amount not to exceed \_\_\_\_ tons, for miscellaneous use. Landlord shall be entitled to utilize sand from the stockpile for his own purposes or processing except that Landlord may not sell this sand to any party or person.
17. **SAND WASHING.** Tenant shall have the right to wash and screen sand if feasible in the future.
18. **SURFACE RIGHTS OF TENANT.** Tenant may clear brush and undergrowth from such portions of the Property as may be reasonably necessary to explore for materials or to locate pits, quarries, roads, and stockpile areas. Tenant shall have the right to make use of all roadways presently existing on the Property, and shall have the further right to build such additional roads as may be necessary for the production and removal of materials hereunder. In building such roads, Tenant may use materials from the Property, and Tenant shall not be required to pay royalties to Landlord for materials so used. In addition tenant may erect a plant or plants on the Property, if it should so desire, to process materials thereon. Tenant may also erect such buildings and install such machinery and equipment, including but not limited to wells, scales, as may be useful in connection with its operations hereunder. Tenant shall retain title to



all structures and equipment hereafter placed or erected on the Property by Tenant.

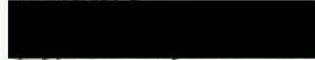

19. **PROTECTION AND RESTORATION OF SURFACE.** At the termination of this Lease or any extension or renewal thereof the Tenant shall be obligated to remove all structures and equipment located on the Property, provided, however, that Tenant shall be allowed one (1) year from the date of termination of this Lease or any extension or renewal thereof to remove any or all structures or equipment. At the termination of this Lease or any extension or renewal thereof the tenant shall remove all trash, junk, and/or salvage located on the Property and shall leave the land surface of the Property in a reasonably level condition. Landlord and Tenant agree that, for purposes of this paragraph, a reasonably level land surface would be such that a farm tractor would be able to ride across the surface area. The provisions of this paragraph shall survive any termination of this Lease.
20. **USE AND CONDITION OF PREMISES.** Tenant may subcontract all mining operations of the Property.
21. **RIGHT OF FIRST REFUSAL.** Landlord agrees and hereby grants to Tenant the right of first refusal to purchase the Property (hereinafter "Right of First Refusal") as long as Tenant is not in default under this lease. Under this Right of First Refusal, any offer to purchase the property made by a third party during the term of this Lease or any extensions thereto, shall be first communicated to Tenant in writing. Tenant shall have the option to purchase at the same price and upon the same terms of said offer. Said refusal or exercise of option by Tenant shall be made within thirty (30) days from when written notice received from Landlord.
22. **Severability.** If any portion of this lease shall be held to be invalid or unenforceable for any reason, the remaining provisions shall continue to be valid and enforceable. If a court finds that any provisions of this Lease is invalid or unenforceable, but that by limiting such provision, it would become valid and enforceable, then such provisions shall be deemed to be written, constructed and enforced as so limited.
23. **ASSIGNABILITY.** Tenant may assign its rights under this Lease.
24. **GOVERNING LAW.** This agreement shall be governed by and construed in accordance with the laws of the State of [REDACTED].
25. **PROVISIONS BINDING.** Each and every covenant and agreement herein contained shall extend to and be binding upon the respective successors, heirs, administrators, executors and assigns of the parties hereto.

26. **Setbacks.** 100 foot set back from all buildings, well, and septic. In event they are to be removed Landlord and Tenant must agree on set price.

LANDLORD:



TENANT:

  
\_\_\_\_\_  
 LLC