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NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court Of Appeals

NOS. 1998-CA-002815-MR **and** 1998-CA-002375-MR

ELK HORN COAL CORPORATION APPELLANT

v.

APPEAL FROM FLOYD CIRCUIT COURT
HONORABLE JOHN DAVID CAUDILL, JUDGE
ACTION NO. 97-CI-00634

CHEYENNE RESOURCES, INC. and
PC&H CONSTRUCTION, INC. APPELLEES

OPINION
AFFIRMING

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BEFORE: BUCKINGHAM, KNOPF, and McANULTY, Judges.

BUCKINGHAM, JUDGE. The Elk Horn Coal Corporation ("Elk Horn") appeals from a judgment of the Floyd Circuit Court awarding damages in the amount of $9,500,000 as well as prejudgment interest to Cheyenne Resources, Inc., and PC&H Construction, Inc. (hereinafter collectively referred to as Cheyenne). The issues which resulted in a jury trial involved whether Elk Horn fraudulently induced Cheyenne to enter into a coal lease and whether Elk Horn wrongfully terminated the lease. We have examined the record, considered the oral and written arguments of counsel, and reviewed the applicable law. Finding no error, we affirm.

By a lease with an effective date of September 1, 1990, Elk Horn leased mineral holdings to four parcels of a tract of property in Floyd County, Kentucky.[1] Parcels 1 and 2--the Whitesburg Seam--were to be mountaintop mined, and Parcels 3 and 4--the Amburgey Seam--were to be deep mined. The initial term of the lease was two years, but it was to be extended if Cheyenne met certain requirements of the lease, including obtaining mining permits by a certain date. If mining then began within a year of each permit's issuance, the lease would be extended for seven years on the parcels on which mining began.

The lease contained an attachment ("Attachment E") which was prepared by Elk Horn and consisted of a series of maps which purported to represent prior mining on the parcels and the number of tons of recoverable coal in each of the seams. The maps showed some prior surface mining but not any prior deep mining. The lease also provided that Cheyenne would make escalating monthly minimum royalty payments to Elk Horn which capped at $30,000 per month at the beginning of the third year.

In April 1992, the ownership of Cheyenne changed hands. Elk Horn and Cheyenne agreed at that time in a "First Supplement" to the lease to extend the deadline to obtain permits to September 1, 1993. On September 1, 1995, a "Second Supplement" was executed which allowed Cheyenne until March 1, 1997, to "commence mining" on the property. In April 1996, Cheyenne was repurchased by its original shareholders.

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[1] The parties refer to the lease as Lease 834.

In the fall of 1996, Cheyenne was preparing to relocate its mining operations to the property, when one of its principal owners, Ricky Kirk, discovered an undisclosed commercial deep mine while walking over the property. Further research by Kirk led Cheyenne to become concerned about the existence of other undisclosed mines and the impact this would have on Cheyenne's mining plan. Claiming that Elk Horn continued to refuse to provide further information regarding previously undisclosed mining, Cheyenne elected to cease making the minimum royalty payments under the lease.

On February 28, 1997, Elk Horn sent an employee to inspect the property. Although mining activities on the lease had commenced, on March 5, 1997, Elk Horn sent Cheyenne a letter terminating the lease. The letter explained that the lease had expired due to Cheyenne's failure to "commence mining," and it also noted that Cheyenne was in default of the lease for failure to pay the minimum royalties.

On July 31, 1997, Cheyenne filed suit in the Floyd Circuit Court against Elk Horn alleging wrongful termination of the lease and fraud. Following a jury trial, a judgment in favor of Cheyenne and against Elk Horn was entered in the amount of $5,000,000 on the wrongful termination/breach of contract claim and $4,500,000 on Cheyenne's fraud claim, for a total award of $9,500,000. The judgment further provided for Cheyenne to recover prejudgment interest in the amount of eight percent per annum from the date suit was filed. This appeal by Elk Horn followed.

Elk Horn's first argument concerns an action taken by the trial court before the jury trial began. Several days before the trial, the trial judge viewed the leasehold and concluded that mining operations had commenced on the property within the meaning of the term "commence mining" as used in the Second Supplement to the lease. Citing North American Refractories Co. v. Jacobs, Ky., 324 S.W.2d 495 (1959), Elk Horn argues that the trial court erred in concluding that Cheyenne had begun mining as required to extend the lease term and that the trial court should have granted Elk Horn's motion for summary judgment.

The Jacobs case involved a clay mining lease which provided that the lease could be extended if the lessee was "operating and mining clay at the expiration of the term herein, if renewed[.]" Id. at 497. The lessee in Jacobs had not mined any clay except for test purposes. Work had been done on the property to uncover it for stripping; however, clay had not been extracted for commercial purposes. In holding that the lease had not been extended, the court held that "while appellant may have been 'operating' on the premises, it was not 'mining' clay. Mining means the excavation or removal of minerals from a natural deposit." Id.

Cheyenne asserts that Jacobs has been superseded by Litton v. Mountaineer Land Co., Ky., 796 S.W.2d 860 (1990), which is factually very similar to this case. Litton involved a coal lease which contained a provision that "if mining operations have not commenced within three years from the date hereof, Lessor may declare this lease void by giving written notice to the Company."

Id. The Kentucky Supreme Court held that this was a case of first impression in Kentucky but that there was analogous precedent in cases involving oil and gas leases. The court quoted from 2 W. Summers, The Law of Oil and Gas, § 349 (1959), as follows:

> The general rule seems to be that actual drilling is unnecessary, but that the location of wells, hauling lumber on the premises, erection of derricks, providing a water supply, moving machinery on the premises and similar acts preliminary to the beginning of the actual work of drilling, when performed with the bona fide intention to proceed thereafter with diligence toward the completion of the well, constitute a commencement or beginning of a well or drilling operations within the meaning of this clause of the lease. If the lessee has performed such preliminary acts within the time limited, and has thereafter actually proceeded with the drilling to completion of a well, the intent with which he did the preliminary acts is unquestionable, and the court may rule as a matter of law that the well was commenced within the time specified by the lease.

Id. at 861. The court then held that "[w]e are of the opinion that mining leases present an even more compelling rationale for holding that the actions of the respondent herein constituted 'mining operations' within the phraseology of the lease." Id.

As in Litton, the lessee, Cheyenne, has not actually mined any coal for commercial purposes. However, as did the lessee in Litton, Cheyenne engaged in activities which were properly construed by the trial court as a matter of law to constitute a commencement of mining. Cheyenne had engaged in construction activities including road building, had extracted coal from two seams, had engaged in core drilling on the property, had purchased surface tracts and obtained the necessary permits, and had approached the tract pursuant to a reasonable mine plan. In short, we agree with Cheyenne that no distinction should be drawn between the phraseology in the Litton lease concerning the commencement of mining operations and the phraseology of "commence mining" in the lease supplement in this case. Consequently, we conclude that the trial court did not err in holding that Cheyenne had commenced mining.

Elk Horn's second argument is that the statute of limitations barred Cheyenne's claim of fraud in the inducement. In an order entered following the liability phase of the trial, the trial court held that the five-year limitation period of KRS 413.120(12) did not begin to run until 1994 at the earliest, which was when Cheyenne's general manager, Steve Dula, became aware of the existence of a previously undisclosed deep mine. The trial court further held that Elk Horn's fraud was a continuing act which was renewed each time a supplement to the lease was executed by the parties. Additionally, the trial court held that Elk Horn waived this issue since it did not tender a jury instruction regarding the date when Cheyenne discovered or should have discovered Elk Horn's fraud.

The controlling statute provides:

> In an action for relief or damages for fraud or mistake, referred to in subsection (12) of KRS 413.120, the cause of action shall not be deemed to have accrued until the discovery of the fraud or mistake. However, the action shall be commenced within ten (10) years after the time of making the contract or the perpetration of the fraud.

KRS 413.130(3). Elk Horn cites Boone v. Gonzales, Ky. App., 550 S.W.2d 571 (1977), which holds that "when an action is brought later than five years after the alleged perpetration of the fraud there must be an allegation and proof that the fraud was not discovered within the five years and by the exercise of ordinary care could not have been discovered within that time[,]" id. at 573, and argues that Cheyenne failed to meet that burden.

In the Boone case, the plaintiff's complaint alleged the date of the fraudulent misrepresentations but did not allege the date she discovered the fraud or the circumstances surrounding its discovery. Id. at 573-74. Since the complaint was filed over five years after the alleged fraud occurred and the plaintiff made no allegations concerning when or how the fraud was discovered, the complaint was dismissed as barred by the statute of limitations. Id. In the case sub judice, however, Cheyenne alleged the date and circumstances surrounding its discovery of the fraud in its complaint. That date, 1996, was beyond the five-year limitation period of KRS 413.120(12). Assuming the fraud was discovered by Cheyenne in 1996, it was incumbent upon it to prove why it could not have discovered the fraud by the exercise of ordinary care within the five-year limitation period. See Boone, supra. On the other hand, Elk Horn claimed that when Cheyenne's general manager observed undisclosed mining in 1994, which was within the five-year limitation period, Cheyenne was put on notice to inquire into the facts and determine whether fraud had occurred.[2]

We believe the competing allegations concerning the date the fraud was discovered or could have been discovered created a fact issue subject to determination by the jury. The trial court could have denied Elk Horn's motion to dismiss and submitted the issue to the jury for determination; however, by failing to rule, it left the matter unresolved. Furthermore, Elk Horn neither requested a ruling on its motion from the trial court at the close of evidence nor requested a jury instruction to determine the issue.

The evidence at trial was sufficient to support a finding that the fraud was discovered in 1996, that the fraud could not have been discovered within the five-year limitation period by the exercise of ordinary care, and that Cheyenne's fraud action brought in July 1997 was not barred by the statute of limitations. Because Elk Horn did not request a jury instruction to resolve the matter, we conclude that it may not assign error in this regard. Kentucky Rule of Civil Procedure (CR) 51(3). See also Kroger Co. v. Willgruber, Ky., 920 S.W.2d 61, 64 (1996).

Elk Horn's third argument is that the evidence did not support the jury's verdict of fraud. While Elk Horn makes many assertions in this regard, it essentially argues that the

[2] Assuming the fraud was discovered in 1994, then under the holding in Shilling v. McGraw, 298 Ky. 783, 184 S.W.2d 97 (1944), Cheyenne would have had five years from 1994 in which to file its complaint.

evidence of fraud was insufficient and damages were not proven. With regard to the sufficiency of the evidence, we "must determine whether the jury verdict was flagrantly against the evidence so as to indicate that it was reached as a result of passion or prejudice." Bierman v. Klapheke, Ky., 967 S.W.2d 16, 19 (1998). We conclude that there was substantial evidence, including the maps which were provided in Attachment E to the lease, to support a finding by the jury that Elk Horn fraudulently induced Cheyenne to enter into the lease.

Concerning Elk Horn's argument that Cheyenne failed to prove damages from fraud, Elk Horn argues that Cheyenne's expert witness testified only about lost profits and not the correct measure of damages of the difference between the value of the property as represented by Elk Horn and its actual value. We agree with Elk Horn that the proper measure of damages in a fraudulent inducement case is the "benefit of the bargain." See Dempsey v. Marshall, Ky., 344 S.W.2d 606, 607 (1961). We conclude, however, that Cheyenne could recover lost profits as was permitted in Dempsey. Id. at 608.

Elk Horn's fourth argument is that Cheyenne affirmed the lease in 1994 and that the trial court erred by ruling that no election of remedies was required by Cheyenne until after the jury verdict on liability. Elk Horn claims that the siting of undisclosed prior mining in 1994 put Cheyenne on notice of any fraud by Elk Horn and required Cheyenne to either affirm the lease or rescind it and sue for damages. The trial court did not require Cheyenne to make an election until after the jury's special verdict on the issue of liability.

The court in Hampton v. Suter, Ky., 330 S.W.2d 402 (1959), held that

> [f]raud inducing a contract may be waived by affirmance that is equivalent to ratification of the contract by the party who claimed to have been deceived into entering into it. That ratification may be shown by his acts after he acquired full knowledge of the real facts and had shown a clear intent to affirm the contract despite the fraud, as where he accepted the benefits thereof or acted in a manner inconsistent with repudiation. The intention may be in part shown by a failure to act promptly to repudiate the transaction.

Id. at 406. The evidence indicates that Cheyenne did not become aware of Elk Horn's fraud until the fall of 1996 and that it did not ratify or affirm the contract as evidenced by its withholding of the monthly minimum royalty payments. We find no error in this regard.

Elk Horn's fifth argument is that the trial court erred in refusing Elk Horn's instruction regarding delay damages and that, at any rate, Cheyenne's damages were based on impermissible speculation. Elk Horn contends that, at worst, Cheyenne lost interest on delayed profits since it could have reinstated the lease by paying the minimum royalties and begun mining at a later date in accordance with Elk Horn's offers following the lease termination. Elk Horn's offers were merely settlement offers, however, and Cheyenne was under no obligation to accept them. Therefore, Cheyenne was not limited to recovering delay damages only.

Elk Horn also contends that the damage award was impermissibly speculative because "Cheyenne has never mined coal, has no equipment, has no cost data, has no experience with the high wall mining equipment which is essential to its claim of estimated profits, and has no history of profitability from mining." In Pauline's Chicken Villa, Inc. v. KFC Corp., Ky., 701 S.W.2d 399 (1985), it was held that "the test is not whether the business is a new or unestablished one, without a history of past profits, but whether damages in the nature of lost profits may be established with *reasonable certainty*." Id. at 401. There was expert witness testimony as well as testimony from an owner of Cheyenne concerning profit expectations and Cheyenne's history and mining experience. We conclude that the damages were proven with reasonable certainty.

Elk Horn's sixth argument is that it was entitled to exercise its option regarding the surface rights acquired by Cheyenne. There was a provision in the lease giving Elk Horn an option for ninety days "after termination of this Lease for any reason" to purchase or lease "any and all" surface rights acquired by Cheyenne during the course of the lease. The trial court ruled that Elk Horn had no right to acquire surface properties because it wrongfully terminated the lease.

Elk Horn acknowledged in a letter dated March 18, 1997, that the lease had terminated as of February 28, 1997. Since Elk Horn did not attempt to exercise its option until May 30, 1997, which was ninety-one days after the termination of the lease, Elk Horn did not timely exercise its option.

Elk Horn's seventh and final argument is that the trial court's award of prejudgment interest on the damage award was improper as an abuse of discretion. The award of prejudgment interest was within the discretion of the trial court, even though the claim was unliquidated. Nucor Corp. v. General Electric Co., Ky., 812 S.W.2d 136, 143-44 (1991). In light of the finding of fraud, we conclude that the award of prejudgment interest was not an abuse of the trial court's discretion.

The judgment of the Floyd Circuit Court is affirmed.

KNOPF, JUDGE, CONCURS; McANULTY, JUDGE, DISSENTS BY SEPARATE OPINION.

McANULTY, JUDGE, DISSENTING. Respectfully, I dissent. The Litton case relied upon by the majority is not factually similar to the case sub judice since the contract in that case required "mining operations" to extend the contract. That is not a term in the contract between the parties in the case at bar. This court may not expand upon the terms of the contract of the parties. The lease and its supplements in this case required Cheyenne to conduct "mining" in order to avoid termination of the lease. No mining was conducted on the property. Furthermore, Jacobs is on point and it states that there is a distinction between "mining" and "operating" on the site of a mine. Jacobs has not been overruled or disaffirmed in subsequent cases, and so it has not been superseded by the Litton case as the majority implicitly finds.

Jacobs controls this situation. Thus, I believe the trial court improperly determined that prospecting and other activities conducted on the site qualified as mining. As a result, there was a submissible issue to the jury whether, under all of the circumstances of the case, there was a wrongful termination in light of the fact that Cheyenne had not commenced mining.

Additionally, I believe Elk Horn argues correctly that Cheyenne affirmed the lease by not promptly seeking recission upon discovering evidence of fraud. Cheyenne concedes that it continued operating on the site after the discovery. Cheyenne's continued activity evidenced an intention to affirm the lease while reserving the right to seek reparation for damages from the fraud. The consequence of this is that Cheyenne continued to be liable to Elk Horn for royalty payments under the terms of the lease while it continued its activity on the property.

Other aspects of this case are troublesome as well. I would reverse for a reconsideration of the wrongful termination claim and the damages due to the foregoing errors of law.

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