RENDERED: DECEMBER 20, 2019; 10:00 A.M.
NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2018-CA-001239-MR

QUEST ENERGY CORPORATION — APPELLANT

v.

APPEAL FROM KNOTT CIRCUIT COURT
HONORABLE KIM C. CHILDERS, JUDGE
ACTION NO. 16-CI-00343

RAY SLONE, BARBARA SLONE,
and VIRGINIA CORNETT COUCH — APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: COMBS, JONES, AND L. THOMPSON, JUDGES.

COMBS, JUDGE: Quest Energy Corporation appeals from the findings of fact, conclusions of law, and judgment of the Knott Circuit Court entered in favor of Ray and Barbara Slone on June 4, 2018. Following our review, we affirm.

On December 9, 2016, Ray and Barbara Slone filed an action against Quest Energy Corporation in Knott Circuit Court. The Slones alleged that Quest

Energy breached provisions of a contract for the acquisition of the assets of Samuel Coal Company, Inc., which the Slones formerly owned. The Slones alleged that Quest Energy failed to remit to them as former owners royalty payments totaling more than two million dollars and that it failed to provide an accounting of the coal that Quest Energy had mined following the acquisition.

Quest Energy filed a timely answer to the complaint. It denied breaching the asset-purchase agreement and asserted that any alleged breach had been waived by the Slones. Alternatively, Quest Energy alleged that any breach had been cured by the terms of a subsequent written agreement between Quest Energy and Barbara Slone.

In a counterclaim, Quest Energy alleged that the Slones made material, false representations concerning the coal mining operation to induce Quest Energy to purchase Samuel Coal. The Slones denied the allegation. On November 17, 2017, the Slones filed an amended complaint adding Virginia Cornett Couch, their daughter and former shareholder, as plaintiff.

Following discovery, the circuit court conducted a bench trial. Based upon evidence presented over a three-day period in January 2018, the court found that the terms of the agreement had been negotiated by the parties over the course of several months and that the final agreement, executed in December 2012, had been drafted by a representative of Quest Energy. It also found that Barbara Slone

and Quest Energy had executed a separate document (prepared by Quest's CFO, Thomas Sauve) in 2015, modifying the variable royalty payment schedule created by the terms of the 2012 agreement.

Because the circuit court was not persuaded that the Slones deliberately misrepresented any material facts, it dismissed the counterclaim. The court concluded that the terms of the asset-purchase agreement were enforceable and that Quest Energy owed to the Slones (and their daughter) $250,000.00 for 2013; $600,000.00 for 2014; $600,000.00 for 2016; and $600,000.00 for 2017. With credit to Quest Energy for royalty payments made totaling $105,626.63, judgment was entered in favor of the Slones (and their daughter) in the amount of $2,544,373.37. Finally, the court concluded that Quest Energy was liable to the Slones (and their daughter) for an annual minimum of $600,000.00 in royalty payments until the remainder of the purchase price of $7,000,000.00 was paid in full. The motion of Quest Energy to alter, amend, or vacate the judgment was denied. This appeal followed.

On appeal, Quest Energy argues that the judgment must be reversed because the circuit court's findings of fact are not supported by the evidence and that its conclusions of law are erroneous. Additionally, Quest Energy contends that the circuit court should have modified the asset-purchase agreement to relieve

it of any further obligation or that it should have awarded damages to Quest for fraud. We disagree with these assertions and address them one by one.

Because the circuit court conducted a bench trial in this action, the scope of our review on appeal is defined by the provisions of CR[1] 52.01. Pursuant to this rule, "[f]indings of fact, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." Where the circuit court's findings of fact are supported by substantial evidence, they are not clearly erroneous, and our review is limited to determining whether those facts support the court's legal conclusion. *Tavadia v. Mitchell*, 564 S.W.3d 322, 326 (Ky. App. 2018). While we must defer to the circuit court with respect to its factual findings, our review of its conclusions of law is *de novo*. *Hoskins v. Beatty*, 343 S.W.3d 639, 641 (Ky. App. 2011).

In an action for fraud, the complaining party must establish -- by clear and convincing evidence -- the elements of fraud, including a material misrepresentation of fact which was known to be false (or made in reckless disregard for its truth or falsity) and was made to induce another to act upon it. *United Parcel Service Co. v. Rickert*, 996 S.W.2d 464, 468 (Ky. 1999).

The circuit court found that Quest Energy had failed to meet its burden of showing by clear and convincing evidence that Ray Slone made a

[1] Kentucky Rules of Civil Procedure.

material misrepresentation which he knew was false or that he made any representation in reckless disregard for its truth or falsity. Consequently, it concluded that Quest Energy had failed to prove its fraud claim.

Quest Energy argues that the undisputed facts prove fraud and deliberate misrepresentation. It stresses that neither its CEO, Mark Jensen, nor its CFO, Thomas Sauve, had much experience in the coal mining business at the time of the acquisition and that neither had any legal or engineering training. With their experience in finance, Jensen and Sauve had raised capital in New York and decided to invest in coal mining operations in Knott County. Quest Energy did not have an office or any support staff in Eastern Kentucky at the time of the purchase of Samuel Coal. (However, it had access to corporate counsel, Greg Jensen; to its environmental compliance officer, Steve Kendrick; and to its chief engineer, Sid Stanley.) Quest Energy notes that Ray Slone, on the other hand, had been a deep mine operator for most of his working life and had experience assembling and structuring deep mining operation assets for acquisition. It emphasizes that Slone had ready access to a local attorney and to an engineering firm, Bocook Engineering, headed by Dewey Bocook, Jr.

While Quest Energy expected to purchase an essentially "going concern" in Samuel Coal, its evidence tended to show that there were issues with some of the leases (including rights of entry) and with the activation of certain

mining permits (including provisions restricting the operation to underground mining and prohibiting blasting). Its evidence also showed that it relied to its detriment on the Bocook Reserve Report cited in the acquisition agreement -- a report that it took to mean that millions of tons of coal were ready to be mined immediately. Quest Energy contends that the Bocook Reserve Report was woefully inaccurate because it incorporated erroneous assumptions drawn from narratives included in certain underground mining permit applications and detailed mining and reclamation plan maps prepared for Ray Slone. It argues that Dewey Bocook "got it so wrong" because he relied on misinformation provided to him by Ray Slone and that the "thread of fraud" began here.

Ray Slone testified that Quest Energy requested detailed information concerning the assets of Samuel Coal during the parties' negotiations. He provided a list of assets that was later memorialized in the acquisition agreement. He also referred Quest Energy to Dewey Bocook, Jr. Slone indicated that Samuel Coal had commissioned Bocook to perform a coal reserve study of the leased and permitted property in June 2012 and that he (Slone) had provided to Bocook copies of the relevant leases and permits. Slone reviewed a draft report and received a copy of the final report forwarded to Quest Energy in advance of its acquisition of Samuel Coal. Slone testified that at the time of the sale of Samuel Coal's assets, Samuel Coal held a right of entry to all the areas for which it had obtained an underground

mining permit and that he had not given Bocook any information that he believed to be inaccurate or incomplete.

Bocook indicated that he had worked with Ray Slone before and that he had no concern that Slone had provided him with inaccurate information. He testified that he was careful to note in his report which property was held by Samuel under leases and which property was not. He included copies of the permit applications, various leases, and the mining and reclamation plan maps provided to him by the Commonwealth in a package prepared and forwarded to Quest Energy more than three months before the transaction was concluded.

In his testimony, CFO Thomas Sauve admitted that he had no experience reviewing coal reserve study reports. CEO Mark Jensen admitted that he had chosen not to have anyone outside of Quest Energy to review the documents or to evaluate Bocook's coal reserve study. Greg Jensen, corporate counsel, admitted that he had not reviewed the report prior to the purchase of Samuel Coal. Sauve also admitted that he had no recollection of ever having sent to the Slones written notice of any breach as required by the terms of the acquisition agreement or having afforded them an opportunity to cure as required by provisions of the acquisition agreement. Quest Energy represented in the parties' agreement that it had examined all the assets of Samuel Coal and that it had reviewed to its satisfaction all the furnished documents.

The circuit court observed the witnesses and evaluated the conflicting testimony. It was in the best position to assess the credibility of each witness, and it found that Quest Energy failed to establish -- through clear and convincing evidence -- that Ray Slone made a material misrepresentation of fact which was known to be false (or made in reckless disregard of the truth) for the purpose of inducing Quest Energy to enter into the acquisition agreement. The finding of the circuit court was amply supported by substantial evidence, and it was not clearly erroneous. Moreover, that fact supports the circuit court's legal conclusion that Quest Energy did not establish its fraud claim. Consequently, the circuit court's judgment cannot be reversed on this basis.

Next, Quest Energy argues that the circuit court erred by concluding that it had waived the effect of Slone's fraud either by failing to notify the Slones of the perceived breach and giving them an opportunity to cure it or by entering into the subsequent agreement that modified the original royalty payment schedule. However, we need not consider this allegation of error.

In its judgment, the circuit court found unequivocally that Quest Energy had failed to meet its burden of proof as to fraud or misrepresentation. Additionally, it observed **parenthetically** that it:

> would find that even if [Quest Energy had proven its fraud claim, Quest Energy] waived any claim of fraud or misrepresentation in that it failed under the contract provisions to allow [the Slones] an opportunity to cure

> any alleged defects, as well as entering into an agreement modifying the payment schedule after, by [Quest Energy's] own testimony, it learned of the alleged fraud and continued to operate and mine the assets . . . acquired under the acquisition agreement.

This qualified statement is **not** part of the circuit court's legal conclusion, and, by its own language, it had no bearing on the judgment. We need not address it.

Finally, Quest Energy argues that the circuit court erred by failing to enforce the parties' written modification agreement executed on March 31, 2015, according to its plain meaning. The acquisition agreement executed in 2012 provided that Quest Energy would pay one million dollars in cash on or before December 24, 2012, for the assets of Samuel Coal. Quest Energy agreed to pay -- over time -- an additional six million dollars in "Acquisition Royalty Payments." These payments were subject to an annual minimum schedule. Quest Energy agreed to make a minimum of $250,000 in Acquisition Royalty Payments on or before December 31, 2013. Thereafter, Quest Energy was required to make a minimum annual Acquisition Royalty Payment of $600,000 until six million dollars was paid. Subject to the annual minimum, the Acquisition Royalty Payments were based upon a scale derived from the per-ton sales price of the coal that Quest Energy mined from the acquired property. The scale ranged from $2.00 per ton in Acquisition Royalty Payments if the coal sold for $70.00 or less per ton

to $10.00 per ton in Acquisition Royalty Payments if the coal sold for more than $110.00 per ton.

On March 31, 2015, Barbara Slone and Quest Energy CEO Mark Jensen entered into a letter agreement drafted by Quest Energy CFO Thomas Sauve. In imprecise language, the letter agreement acknowledged that the Slones had "accepted and [have] been paid a revised Acquisition Royalty Payment rate than what is described in the [acquisition agreement.]" The agreement further acknowledged that the revised "Acquisition Royalty Payment rate is $1.00 per ton of coal mined from the Samuel Coal site in place of the previously stated minimums and royalty rates in the [acquisition agreement.]"

Quest Energy argued that the language of the letter agreement was plain and that its meaning was clear. It contended the letter agreement constituted a forward-looking modification of Quest Energy's obligations under the original acquisition agreement and that it was no longer obligated to pay the remainder of the seven-million-dollar purchase price; rather, it argued that it was to pay to the Slones a straight $1.00 per ton of coal extracted and sold. The Slones argued that the terms of the letter agreement had not modified the total purchase price nor the minimums going forward but merely acknowledged that they had accepted a change in the variable rate schedule based on the sale price of the mined coal to a fixed rate of $1.00 per ton.

The circuit court found that the meaning of the letter agreement was indeed ambiguous. It concluded that the terms of the agreement must be construed against the drafter, Quest Energy, and it accepted the Slones' interpretation of the text.

"[T]he construction and interpretation of a contract, including questions regarding ambiguity, are questions of law to be decided by the court[.]" *Frear v. P.T.A. Industries, Inc.*, 103 S.W.3d 99, 105 (Ky. 2003) (quoting *First Commonwealth Bank of Prestonsburg v. West*, 55 S.W.3d 829, 835 (Ky. App. 2000)). Consequently, we review *de novo* the circuit court's conclusion that the agreement is ambiguous and its interpretation of the terms. *McMullin v. McMullin*, 338 S.W.3d 315, 320 (Ky. App. 2011).

A contract provision is ambiguous if the provision is susceptible to multiple or inconsistent interpretations. *Transport Ins. Co. v. Ford*, 886 S.W.2d 901, 905 (Ky. App. 1994). If an ambiguity exists, "the court will gather, if possible, the intention of the parties from the contract as a whole, and in doing so will consider the subject matter of the contract, the situation of the parties and the conditions under which the contract was written[.]" *Frear*, 103 S.W.3d at 106 (quoting *Whitlow v. Whitlow*, 267 S.W.2d 739, 740 (Ky. 1954)). Finally, the rule *contra proferentem* is a maxim of contract interpretation that requires that ambiguities be construed more strictly against the drafter of a contract. *McMullin*,

supra. "This maxim has long been followed in the Commonwealth." *Id.* at 322 (citing *B. Perini & Sons v. Southern Ry. Co.*, 239 S.W.2d 964, 966 (Ky. 1951)).

The letter agreement of March 2015, is indeed susceptible of inconsistent interpretations, and the circuit court did not err by concluding that its terms must be construed against Quest Energy. Its adoption of the construction put forward by the Slones constitutes a fair interpretation of the letter agreement.

The language of the agreement provides that the "Seller" (the Slones) "has accepted and has been paid a revised Acquisition Royalty Payment" -- a rate less than the rate schedule included in the original agreement mandated. The language suggests that it was the intention of the parties merely to memorialize the Slones' acceptance of this rate. The court's opinion that the parties did not intend by this language to scrap entirely the annual minimums and to forgo full payment of the seven-million-dollar purchase price is reasonable -- especially in light of the conditions under which the letter agreement was written. The agreement is exceedingly brief and appears to have been hastily prepared by a layman. One might reasonably expect more deliberate language in a more formal setting if it had been the intention of the parties to extinguish the remainder of a seven-million-dollar purchase agreement.

We AFFIRM the judgment of the Knott Circuit Court.

ALL CONCUR.

BRIEFS FOR APPELLANT:

Calvin R. Tackett
Whitesburg, Kentucky

BRIEF FOR APPELLEES:

Ned Pillersdorf
Prestonsburg, Kentucky