The concept of royalties evolved from a time when the government owned all of the land, including mines, to the situation where free miners won the right to claim minerals but paid a portion of their production to the royal treasury. Today, a mineral royalty is a payment to the owner of the mineral rights for the privilege of producing the mineral commodity. However, some people incorrectly believe that the selling price and the royalty are the same thing. The contract between the owner (lessor) and the mining company (lessee) is the mineral lease. Some clauses that are common to mineral leases include: identification of property, granting clause, reservations, definitions, royalty rate, taxes and title, indemnity, termination, inspection, assignability, successors, and reclamation.

There often are variations in royalty rates for a given commodity that reflect differences in location, quality, market conditions or public versus private ownership.

History

In the time of ancient Rome, the government owned the mining properties by virtue of conquest. It would lease the mines to favored citizens who would pay rent to the State.

Various conditions of sovereign ownership of both land and mineral rights continued in Europe until the Renaissance. As the laws evolved for land ownership by private citizens, the concept that minerals belonged to the State (King, Crown, sovereign) continued until about the 15th century.

Free miners challenged the notion of sovereign ownership and won the right to discover and claim minerals. But a portion of their production had to be paid to the sovereign - a royalty. So, the original concept of a mineral royalty was a tax on production that was due to the Crown or Church.

The term mineral royalty, as it is known today, is a payment to the owner of the mineral rights (formerly the royal owner) for the privilege of mining and producing the mineral commodity. The owner of the mineral rights, the lessor, and the mine operator, the lessee, enter into an agreement to mine the property. The agreement is the lease.

While this concept is common, there are some who do not understand that the royalty is a portion of production paid to the owner as agreed on in the lease document. This author has seen reports where the selling price of a commodity has been quoted as the royalty. ("They get 70 cents a ton royalty at their pit and the guy down the road only has a 65 cent royalty.") These reports have been authored by people not familiar with the mining industry.

Lease clauses

In addition to the amount to be paid the lessor, there are several other items to be addressed in the lease agreement. The following list may not be all inclusive, but briefly describes most of the common clauses any good mining lease should contain.

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1 Combined excerpts from July 1989 and July 1992 issues of Mining Engineering with the same title.
Identification: This opening clause names the owner (lessor) and the operator (lessee), the address of each, and gives the legal description of the property.

Granting clause: This part of the lease gives the time period or duration of the agreement and information about renewal periods. It also has language about the exclusive right of the lessee to mine the property.

Reservations: If the owner wants to exclude any portion of the property or set some specific conditions about the operation, there needs to be a clause that describes these reservations.

Definitions: This section should address some of the technical terms that the lessor may find confusing - short tons versus cubic yards, dollars versus percentage of average selling price, any escalator indices such as consumer price index or producer price index, and material mined versus material sold.

Royalty: This section spells out what the royalty rate will be, how often it will be paid, if there is an annual minimum, the pay dates, and how the records will be kept. This section also describes the conditions under which the lessee is exempt from the annual minimum natural disasters, strikes, governmental actions, or other causes referred to as force majeure.

Taxes and title: The lease needs to identify who is responsible for the property taxes, severance taxes (if applicable), and other taxes that relate to the mining activity - taxes on equipment, improvements, or stockpiles. This is a good place in the lease for the owner to certify his ownership of the property and its mineral rights and also certify that no other leases are in effect. The lessees may want language that allows them to pay mortgages or other debts on the property to keep their lease in effect.

Indemnity: This portion of the lease identifies that the lessee assumes the risks for lessee's mining operation. Lessor should expect indemnification by the lessee through standard insurance policies - workers compensation, liability and property damage.

Termination: Both the lessor and lessee want language that will allow them to terminate the lease. This section of the lease describes the conditions under which one of the parties may terminate the lease (failure of the lessee to make the royalty payments, or change in ore grade). Here, the lease gives the notification period for termination.

Inspection: The lessor expects to be able to come on site to inspect the operation and to audit the records of the lessee. The inspection should not interfere with the operations and a records audit should be preceded by a written notice. The right to a records audit often continues after the termination of the lease.

Successors: This clause in the lease tells whether the agreement is binding to the benefit of the heirs, transferees, successors, or assignees of the parties.

Assignability: Usually states that lessor can sell the property subject to the conditions of the lease. The lessee may not assign the lease without the lessor's permission.

Reclamation: If the lessee is to be responsible for reclamation or restoration, the plans or description of the landscaping need to be spelled out in the lease.
Variations in royalty rate

The specific details of these clauses bear on the royalty rate paid to the lessor. The lessor may offer services that will be paid through an increased royalty (stripping, drilling, and blasting). Likewise, the lessee may offer reclamation or restoration of the landscape after mining, which could reduce the royalty paid.

The following are other factors that may influence the royalty rate for a given commodity.

Location: The location of the deposit with respect to the market, transportation routes, competitive sources, influences the royalty value. This is especially true for industrial minerals at one end of the spectrum. But it is rarely important in oil and gas leases.

Quality, grade, or volume: A high quality ore with little or no overburden commands a higher royalty than an inferior deposit. This obvious fact can be subtle and requires a knowledgeable lessor and lessee. A deposit that only contains enough material to last a short time is not as valuable as a similar (location and grade) deposit that contains a much larger volume of material. The amount of processing required influences the value to the lessee. This, in turn, will effect the royalty rate.

Market conditions: The rules of supply and demand effect royalty rates the same as they influence commodities. If the lease is drawn when market conditions are poor, the lessor can expect to receive a smaller royalty, and vice versa. This is why many newer leases are written with escalator/deescalator clauses, or a percentage royalty rather than a fixed amount. Such clauses protect both lessor and lessee from economic variations in the marketplace.

Market conditions can change after a lease is written. If the royalty rate is fixed too low, the lessor will try to terminate the lease and had a new operator who is willing to pay more. If the rate is too high due to a change in the market, the lessee may have to default on his agreement and lose the right to mine the deposit. The effect of market conditions on royalty require a knowledgeable lessee and lessor.

Public versus private ownership: Usually, when the government is the lessor, the royalty for a given commodity is less than when the lessor is a private citizen or a profit making organization. This is especially true for industrial minerals. The bulk (more than 90%) of government royalty income comes from oil and gas leases - the common 1/8th royalty.

Usually States or the Federal government do not have the staffs to assess the value of each deposit. Both may have a variety of commodities that fall under their dominion. Often the governments will develop a flat royalty rate (often a percentage of the average selling price or net smelter return) for various commodities. This approach ignores the factors just described that effect variations in royalty rate.

Royalty data

The table shows the range of royalties and the variations on the basis of computing the fees. In a few instances, it gives the cost of acquired reserves based on purchase price and quantitative estimates of the material in place.

The table first lists the commodity. The columns then give the location by state, US geographic area, Canadian Province or country; the cost - royalty (R) and purchased (P) cost: and the year in which the lease or purchase agreement occurred. Then come the comments or, in some instances, a footnote number for more information. The cost column requires more explanation.