No. 16-0136

IN THE WEST VIRGINIA SUPREME COURT OF APPEALS

**PATRICK D. LEGGETT;**
**KATHERINE F. LEGGETT;**
**GEORGE D. MCKAIN**, by his
attorney in fact, **ANITA**
**KATHRYN MCKAIN GREER;**
and **ADELE S. McDOUGAL,**
**Plaintiffs/Petitioners,**



v.

**Civil Action No. 1:13-cv-0004 FPS**
**United States District Court**
**for the Northern District of**
**West Virginia, at Wheeling**

**EQT PRODUCTION COMPANY,**
a Pennsylvania corporation;
**EQT CORPORATION,**
a Pennsylvania corporation;
**EQT ENERGY, LLC,**
a Delaware limited liability company;
**EQT INVESTMENTS HOLDINGS, LLC,**
a Delaware limited liability company;
**EQT GATHERING, LLC,**
a Delaware limited liability company; and
**EQT MIDSTREAM PARTNERS, LP,**
a Delaware limited partnership,
**Defendants/Respondents.**

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# AMICUS CURIAE BRIEF ON BEHALF OF WEST VIRGINIA LAND AND MINERAL OWNERS' ASSOCIATION AND WEST VIRGINIA ROYALTY OWNERS' ASSOCIATION (IN SUPPORT OF PLAINTIFFS/PETITIONERS PATRICK D. LEGGETT, ET AL.)

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**(IN SUPPORT OF PLAINTIFFS/PETITIONERS PATRICK D. LEGGETT, ET AL.)**

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**To the Honorable, the Justices**
**Of the Supreme Court of Appeals of West Virginia:**

## I. Introduction

Your *amicus,* West Virginia Land and Mineral Owners' Association ("WVLMOA"), is an association with over 80 landowner members, interested in issues affecting the ownership of mineral interests in real property in West Virginia, including, but not limited to, royalty interests in oil and gas estates. WVLMOA's mission focuses on promoting positive land management practices, lobbying public issues that affect land and mineral ownership, and providing members with valuable educational and networking opportunities that can increase their effectiveness in the natural resource marketplace. The association was established by concerned West Virginians who recognized the need for a collective voice to protect and advance the interests of land and mineral owners within our state.

Your *amicus*, West Virginia Royalty Owners' Association ("WVROA"), is an association with 563 members, interested in issues affecting the ownership of royalty interests in real property in West Virginia, including, but not limited to, royalty interests in oil and gas estates. WVROA's mission is to inform West Virginia mineral owners about the state of the oil and gas industry, leasing, and their rights as real property owners, as well as promoting legislation that protects the rights of all property owners, whether fee, surface, or mineral owners, to ensure that oil and gas development in West Virginia is done responsibly and fairly.[1]

By their brief, your *amici* will attempt to add insight to the important questions before the Court in this matter regarding the continuing legal viability of so-called "Flat-Rate" oil and gas Leases, in light of *W.Va. Code §22-6-8*, and the legislative findings

[1] This brief was written entirely by undersigned counsel on behalf of the *amici*, who have received no monetary compensation from any parties.

and stated legislative purpose which underpin the same; and the effect of the aforesaid statute on the ability of lessees to deduct post-production expenses from the computation of lessors' royalty in Flat-Rate Leases which are converted thereunder.

In short, your *amici* believe that so-called "Flat-Rate" Leases are unenforceable as against public policy in light of the legislature's findings and stated purpose relative to *W.Va. Code §22-6-8*. However, to the extent the Court finds such leases to be enforceable, your *amici* believe strongly that the "at the well head" language contained in the statute as interpreted by the Court in *Tawney v. CNR*, 219 W.Va. 266, 633 S.E.2d 22 (2006), prohibits the unilateral deduction of post-production expenses by lessees to those flat-rate leases which have been "converted" in accordance with *W.Va. Code §22-6-8(e)*.

## II. Factual And Procedural History

Defendant EQT Production Company ("EQT"), the lessee, and defendants EQT Corporation, EQT Energy, LLC, EQT Gathering, LLC, EQT Investment Holdings, LLC, and EQT Midstream Partners, LP (collectively, the "non-lessee defendants") removed this action to the U.S. District Court for the Northern District of West Virginia from the Circuit Court of Doddridge County, West Virginia. The plaintiffs are owners of undivided interests in oil and natural gas interests described in a lease agreement, which was originally entered into on October 31, 1906 ("1906 lease"), and recorded in the Office of the Clerk of the County Commission of Doddridge County, West Virginia at Deed Book 21, Page 76.

Plaintiffs own the following undivided interests of the oil and gas interests under the 1906 lease: (1) Patrick Leggett and Katherine Leggett are the owners of a 12.50% undivided interest; (2) Anita Kathryn McKain Greer is the duly appointed attorney in fact for plaintiff George D. McKain, who owns a 12.50% undivided interest; and (3) Adele S. McDougal owns a 50.00% undivided interest.[2]

The 1906 lease provides for payment of a flat-rate royalty of $300 per annum for each natural gas well drilled upon the leased premises. The lease was later amended by four "Amendment and Ratification of Oil and Gas" agreements ("amendment agreements") - one for each plaintiff as captioned in this civil action - dated from January 2009 to April 2011. Defendant EQT Production Company ("EQT") is the successor-in-interest to the Philadelphia Company of West Virginia and the current lessee of the 1906 lease, with the exclusive right to produce, market, and sell oil and natural gas from the premises that are identified under the 1906 lease.

Some of the wells located on the 1906 leasehold are subject to the provisions of West Virginia so-called "Flat-Rate Statute," *W.Va. Code §22-6-8*, the predecessor of which was enacted on March 13, 1982, and became effective ninety (90) days thereafter. As a result of the Flat-Rate Statute, EQT, as lessee, is required to pay a 1/8 percentage royalty to the plaintiffs for wells remitted after 1982, in accordance with the Flat-Rate Statute's terms. EQT has paid the flat-rate royalty to plaintiffs for the remaining wells situated on the leased premises that are not subject to the Flat-Rate Statute.

In their complaint, the plaintiffs assert that the defendants failed to pay the plaintiffs the full amount of royalties due to them under the terms of the 1906 lease and amendment agreements by wrongfully deducting the post-production costs of extraction. Plaintiffs assert four claims against defendants: (1) breach of contract, (2) breach of fiduciary duties, (3) fraud, and (4) punitive damages. Following removal, EQT

[2] The owners of the remaining 25.00% interest are not parties to this action.

and the non-lessee defendants each filed motions for summary judgment. The U.S. District Court granted summary judgment in favor of the non-lessee defendants as to all of their claims. As to Defendant EQT, however, the District Court granted in part EQT's motion as to the fraud claim and punitive damages claim, and deferred ruling on the breach of contract claim as to EQT, pending certification of two questions to this Court.

By Order of Certification To the Supreme Court of Appeals of West Virginia entered February 10, 2016, the U.S. District Court of the Northern District of West Virginia, certified the two questions stated below to this Court, in accordance with *W.Va. Code §51-1A-1, et seq.*.

## III. Questions Certified

1. Does *Tawney v. Columbia Natural Resources, L.L.C.*, 219 W.Va. 266, 633 S.E.2d 22 (2006), which was decided after the enactment of *W.Va. Code §22-6-8*, have any effect upon the Court's decision as to whether a lessee of a Flat-Rate Lease, converted pursuant to *W.Va. Code §22-6-8*, may deduct post-production expenses from the lessor's royalty, particularly with respect to the language of "1/8 at the wellhead" found in *W.Va. Code §22-6-8(e)*?

2. Does *W.Va. Code §22-6-8* prohibit flat-rate royalties only for wells drilled or reworked after the statute's enactment and modify only royalties paid on a per-well basis where permits for new wells or to modify existing wells are sought, or do the provisions of *W.Va. Code §22-6-8* abrogate Flat-Rate Leases in their entirety?

## IV. Points And Authorities Relied Upon

**<u>Statutes</u>**

W.Va. Code §22-6-8....................................2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 17, 21, 22
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*Ohio County Com'n v. Manchin,* 171 W.Va. 552, 301 S.E.2d 183 (1983) .......... 18
*Payne v. Weston,* 195 W.Va. 502, 466 S.E.2d 161 (1995) .......... 19
*Shamblin v. Nationwide Mut. Ins. Co.,* 175 W.Va. 337, 332 S.E.2d 639 (1985) .......... 19
*Sizemore v. State Farm Gen. Ins. Co.,* 202 W.Va. 591, 505 S.E.2d 654 (1998) .......... 19
*Smith v. State Workmen's Comp. Com'r,* 159 W.Va. 108, 219 S.E.2d 361 (1975) .......... 18
*State ex rel. Boone Nat. Bank v. Manns*, 126 W.Va. 643, 29 S.E.2d 621 (1944) .......... 10
*State ex rel. McGraw v. Scot Runyan Pontiac-Buick, Inc.*, 194 W.Va. 770, 461 S.E.2d 516 (1995) .......... 20
*State v. Epperly,* 135 W.Va. 877, 65 S.E.2d 488 (1951) .......... 18
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*West v. Alpar Resources, Inc.*, 298 N.W.2d 484 (N.D.1980) .......... 14
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**Other**

Donley, *The Law of Coal, Oil and Gas in West Virginia and Virginia*, 436 (1951)........... 7, 13, 14
Kuntz, *A Treatise On the Law of Oil and Gas*, Vol. 3 §40.1 and pp. 311-312 ......................... 7, 8

## V. Discussion Of Law

### A. So-Called "Flat Rate Leases" Are Void As Against Public Policy Pursuant To The Legislative Findings And Stated Purpose Made Or Expressed In Conjunction With W.Va. Code §22-6-8

So-called "Flat-Rate Leases," which provide a (usually small) lump sum payment to the lessor on a per-well or per-acre basis, evolved at a time in the oil and gas industry when most drilling activity sought only oil, because profitable uses for natural gas were only then being discovered. Gas from these wells was bled off in an uncontrolled manner, allowed to freely discharge into the air.

> In the early days of operations under the oil and gas lease, the primary objective of exploration and drilling operations was the discovery of oil, and it was justifiably regarded as a major misfortune if gas alone were found. Although gas had a value, it was difficult to market...[i]t is therefore not surprising that the standard legal form for a mineral lease at that time provided for a small lump-sum payment when natural gas was extracted. It is equally unsurprising to learn: "[i]n modern leases it is frequently provided that gas shall be on a royalty basis, which of course, is usually more profitable to the lessor."

*McGinnis v. Cayton*, 173 W.Va. 102, 312 S.E.2d 765 (1984) (*citing* Donley, *The Law of Coal, Oil and Gas in West Virginia and Virginia*, 436 (1951)). See also Kuntz, *A Treatise On the Law of Oil and Gas*, Vol. 3 §40.1 and pp. 311-312.

Not surprisingly, as the natural gas industry matured and pipelines and infrastructure sprung up throughout the country, thereby expanding the uses and market for natural gas, its value increased. This naturally led the parties to oil and gas leases to change their practices such that they began to provide for a percentage royalty on produced natural gas, measured either by volume or by the value of the gas produced. Shortly, thereafter, flat rate leases fell out of general use. Nonetheless, the presence of flat rate royalty provisions in old oil and gas leases present a continuing conundrum, since it is not uncommon for such leases to be held by production for many years, even decades. *Kuntz, supra,* Vol. 3 § 40.1 at pp. 311-312 (footnotes omitted).

In direct response to this conundrum, the West Virginia Legislature, in 1982, adopted what is now *W.Va. Code §22-6-8* (hereinafter "Flat Rate Statute"), subsection (d) of which, provides that no permit shall be hereafter issued:

> for the drilling, redrilling, deepening, fracturing, stimulating, pressuring converting, combining or physically changing to allow the migration of fluid from one formation to another, of an existing oil or gas production well, where or if the right to extract, procure or market the oil or gas is based upon a lease or leases or other continuing contract or contracts providing for flat well royalty or any similar provision for compensation to the owner which is not inherently related to the volume of oil and gas so extracted, produced or marketed.

*W.Va. Code §22-6-8(d).*

However, subsections (e) and (f) of *§22-6-8* provide:

> (e) To avoid the permit prohibition of subsection (d), the applicant may file with such application an affidavit which certifies that the affiant is authorized by the owner of the working interest in the well to state that it shall tender to the owner of the oil or gas in place **not less than one eighth of the total amount paid to or received by or allowed to the owner of the working interest at the wellhead for the oil or gas so extracted, produced or marketed before deducting the amount to be paid to or set aside for the owner of the oil or gas in place, on all such oil or gas to be extracted, produced or marketed from the well.** If such affidavit be filed with such application, then such application for permit shall be treated as if such lease or leases or other continuing contract or contracts comply with the provisions of this section.
> (f) The owner of the oil or gas in place shall have a cause of action to enforce the owner's rights established by this section.

*W.Va. Code §22-6-8(e)(f)* (emphasis added). Once the affidavit called for in subsection (e) is filed, the lease is said thereafter to be "converted," from flat rate to a 1/8 percentage royalty based on volume.

The legislative findings relative to *W.Va. Code §22-6-8* are found in subsection (a) and provide, in relevant part:

> (a) The Legislature hereby finds and declares:
>
> (1) That a significant portion of the oil and gas underlying this state is subject to development pursuant to leases or other continuing contractual agreements wherein the owners of such oil and gas are paid upon a royalty or rental basis known in the industry as the annual flat well royalty basis, in which the royalty is based solely on the existence of a producing well, and thus is not inherently related to the volume of the oil and gas produced or marketed;
>
> (2) That continued exploitation of the natural resources of this state in exchange for such wholly inadequate compensation is unfair, oppressive, works an unjust hardship on the owners of the oil and gas in place, and unreasonably deprives the economy of the state of West Virginia of the just benefit of the natural wealth of this state;
>
> (3) That a great portion, if not all, of such leases or other continuing contracts based upon or calling for an annual flat well royalty, have been in existence for a great many years and were entered into at a time when the techniques by which oil and gas are currently extracted, produced or marketed, were not known or contemplated by the parties, nor was it contemplated by the parties that oil and gas would be recovered or extracted or produced or marketed from the depths and horizons currently being developed by the well operators;
>
> (4) That while being fully cognizant that the provisions of section 10, article I of the United States Constitution and of section 4, article III of the Constitution of West Virginia, proscribe the enactment of any law impairing the obligation of a contract, the Legislature further finds that it is a valid exercise of the police powers of this state and in the interest of the state of West Virginia and in furtherance of the welfare of its citizens, to discourage as far as constitutionality possible the production and marketing of oil and gas located in this state under the type of leases or other continuing contracts described above.

*W.Va. Code §22-6-8(a).*

Based on these findings, the Legislature in subsection (b) of the statute then declares the public policy of the state which underlies the Flat-Rate Statute as follows:

> (b) In the light of the foregoing findings, **the Legislature hereby declares that it is the policy of this state, to the extent possible, to prevent the extraction, production or marketing of oil or gas under a lease or leases or other continuing contract or contracts providing a flat well royalty or any similar provisions for compensation to the owner of the oil and gas in place, which is not inherently related to the volume of oil or gas produced or marketed**, and toward these ends, the Legislature further declares that it is the obligation of this state to prohibit the issuance of any permit required by it for the development of oil or gas where the right to develop, extract, produce or market the same is based upon such leases or other continuing contractual agreements.

*W.Va. Code §22-6-8(b)* (emphasis added).

The West Virginia Supreme Court of Appeals has long recognized that Courts may declare void those contracts which contravene public policy, based upon the maxim that "no action can be predicated upon a contract of any kind or in any form which is expressly forbidden by law or otherwise void." *See e.g. State ex rel. Boone Nat. Bank v. Manns*, 126 W.Va. 643, 647, 29 S.E.2d 621, 623 (1944) *(overruled on other grounds).*

> "Public policy" is that principal of law which holds that "no person can lawfully do that which has a tendency to be injurious to the public or against public good...even though no actual injury may have resulted therefrom in a particular case to the public." It is a question of law which the court must decide in light of the particular circumstances of each case.

*Cordle v. General Hugh Mercer Corp.,* 174 W.Va. 321, 325 S.E.2d 111, 114 (1984) (quoting *Allen v. Commercial Casualty Ins. Co.,* 37 A.2d 37 (1944)). This Court has further held that sources determinative of our public policy include federal and state constitutions, statutes and judicial decisions, common law and the acknowledged prevailing concepts of the federal and state governments relating to and affecting the safety health, morals and general welfare of the people for whom government is factually established. *Cordle, supra.*

The West Virginia Legislature's findings and declaration of public policy relative to *W.Va. Code §22-6-8*, as set forth above, remove all doubt that flat rate leases are indeed void as against public policy and unenforceable *per se.* Specifically, the Legislature found that the continued "exploitation" of natural resources leases in exchange for "wholly inadequate compensation" is "unfair," "oppressive" and works an "undue hardship" on the oil and gas lessors, and "unreasonably deprives" West Virginia's economy of the just benefit of the natural wealth of the state. It then expressly declared that it is the policy of this state to the extent possible "to prevent the extraction, production or marketing of oil or gas under a lease or leases or other continuing contract or contracts providing a flat well royalty or any similar provisions for compensation to the owner of oil and gas in place, which is not inherently related to the volume of the oil or gas produced or marketed..." *W.Va. Code § 22-6-8(a) (1982).*

It has long been the law of West Virginia that a legislative declaration of fact relating to a matter within the legislature's police power, if not arbitrary, is final and binding on the judiciary, and that courts are to presume that the Legislature has made the fullest investigation before declaring such "facts." *Verba v. Ghaphery,* 210 W.Va. 30, 552 S.E.2d 406, 411 (W.Va. 2001) (Appellate courts ordinarily will not reexamine independently the factual basis for the legislative justification for a statue; the proper inquiry is whether the legislature reasonably could conceive to be true the facts on which the challenged statute was based.); see also *Lemon v. Rumsey,* 108 W.Va. 242, 150 S.E. 725 (1929); *Woodall v. Darst,* 71 W.Va. 350, 80 S.E. 367 (1912).

While it is true that the West Virginia Supreme Court of Appeals has, in cases decided since the adoption of the original Flat-Rate Royalty Statute in 1982, seemingly acknowledged and sanctioned the payment of flat-rate royalties to lessors under pre-existing leases, none of the cases in which it has done so involved a direct challenge to the continued viability of the lease and flat-rate royalty clause on the basis that it was void and unenforceable as against the expressed public policy of this State. *See e.g. Bruen v. Columbia Gas Transmission Corp.,* 188 W.Va. 730, 426 S.E.2d 522 (1992).

Moreover, although the Legislature did not enact a legislative remedy within the construct of *§22-6-8* for Flat-Rate Leases with wells which were permitted prior to its effective date, this fact does not in any way preclude or weaken the argument that public policy, as expressed in the preliminary findings and purpose of statute, renders flat-rate royalty clauses void as against public policy and unenforceable generally.

Indeed the legislative findings of fact cited above, leave little doubt that the continued exploitation of this State's natural resources presented by all Flat-Rate Royalty Leases is unfair, oppressive and works an unjust hardship on the owners of the oil and gas in place and is contrary to substantial public policy of the State of West Virginia. It is furthermore clear that, the subsequent statement of public policy set forth in *W.Va. Code §22-6-8*, facially applies to *all Flat-Rate Royalty Leases*, not just those leases where activity occurs after the effective date of the statute that is required to be permitted. Indeed, This was the conclusion reached by Circuit Judge Evans in *Tawney v. CNR, LLC*, 2006 WL 605669 (West Virginia Circuit Court) (Trial Order) wherein six hundred fifty-one (651) Flat-Rate Leases were found by the Trial Court to be void and unenforceable as contrary to the public policy of the State of West Virginia contained in *W.Va. Code §§22-6-8(a) and (b), Id.* The same result is compelled in the second certified question currently before the Court. Accordingly, all Flat-Rate Leases are indeed abrogated by the provisions of *W.Va. Code §22-6-8.*

**B. Even If "Flat Rate" Royalty Clauses Entered Into Prior To The Enactment of *W.Va. Code §22-6-8* Are Not Void As Against Substantial Public Policy And Remain Enforceable, The "At The Wellhead" Language Contained In The Statute, As Construed By The Supreme Court Of Appeals In *Tawney v. Columbia Natural Resources, LLC,* 219 W.Va. 266, 633 S.E.2d 22 (2006), Precludes The Unilateral Deduction Of Post-Production Expenses By Lessees, Under So-Called "Converted Leases."**

**1. The Default Rule In West Virginia Is That Post Production Expenses Are Not Deductible By A Lessee In The Absence Of Express Lease Language Allowing The Same.**

Oil and gas lessors paying lessees a royalty interest of 1/8 of the amount received, without deductions, is an age-old industry practice in West Virginia. In discussing the evolution of gas-royalty clauses and the "long-established" expectation of lessors in this State, the West Virginia Supreme Court of Appeals has explained:

> In Robert Donley, *The Law of Coal, Oil and Gas in West Virginia and Virginia* § 104 (1951), it is stated: "From the very beginning of the oil and gas industry it has been the practice to compensate the landowner by selling the oil by running it to a common carrier and paying him [the landowner] one-eighth of the sale price received. This practice has, in recent years, been extended to the situations where gas is found . . . ." the one-eighth received is commonly referred to as the landowner's royalty. In *Davis v. Hardman*, 148 W.Va. 82, 133 S.E.2d 77 (1963), this Court stated that a distinguishing characteristic of such a royalty interest is that it is not chargeable with any of the costs of discovery and production. The Court believes that such a view has been widely adopted in the United States...[I]n spite of this, there has been an attempt on the part of the oil and gas producers in recent years to charge the landowner with a *pro rata* share of various expenses connected with the operation of an oil and gas lease such as the expense of transporting oil and gas to a point of sale, and the expense of treating or altering the oil and gas so as to put it in a marketable condition. To escape the rule that the lessee must pay the costs of discovery and production, these expenses have been referred to as "post-production expenses." Two states, Texas and Louisiana, have recognized that a lessee may properly charge a lessor with a *pro rata* share of such "post-production" (as opposed to production or development) costs. On the other hand, it appears that a number of other states have rejected this position where a lease, such as the ones in the

> present case, calls for the payment of royalties on the basis of what the lessee receives from the sale of oil and gas.

*Wellman v. Energy Resources, Inc.*, 210 W.Va. 200, 209-10, 557 S.E.2d 254, 263-64 (2001).

The rationale for holding that a lessee may not charge a lessor for "post-production" expenses appears to be most often predicated on the idea that the lessee not only has a right under an oil and gas lease to produce oil or gas, but also has a duty, either express, or under an implied covenant, to market the oil or gas produced. The *Wellman* Court went on to adopt this reasoning, stating that since the lessee has a duty to market oil and gas produced, and to pay the costs associated therewith, it also has the duty to bear the costs of preparing the oil and gas for market and to pay the cost of transporting them to market, citing authority to this effect from other jurisdictions.

> In Kansas and Oklahoma a ... rule has developed based on an operator's implied duty to market gas produced under an oil and gas lease. *Wood v. TXO Production Corp.,* 854 P.2d 880, 882 (Okla.1992) ("[T]he implied duty to market means a duty to get the product to the place of sale in marketable form."); *Gilmore v. Superior Oil Company,* 192 Kan. 388, 388 P.2d 602, 606 (1964) ("Kansas has always recognized the duty of the lessee under an oil and gas lease not only to find if there is oil and gas but to use reasonable diligence in finding a market for the product."). Wyoming has codified the marketability approach. The Federal government also requires that a lessee "place gas in marketable condition at no cost to the Federal Government...." 30 C.F.R. § 206.153(l) (1993). Arkansas and North Dakota have reached similar conclusions when considering lease royalty clauses which are silent as to allocation of post-production costs. A lease which provides for the lessor to receive "proceeds at the well for all gas" means gross proceeds when the lease is silent as to how post-production costs must be borne. *Hanna Oil & Gas Co. v. Taylor,* 297 Ark. 80, 759 S.W.2d 563, 565 (1988); *see also West v. Alpar Resources, Inc.,* 298 N.W.2d 484, 491 (N.D.1980) (when the lease does not state otherwise lessors are entitled to royalty payments based on percentage **265 *211 of total proceeds received by the lessee, without deduction for costs)." This Court believes that the rationale employed by Colorado, Kansas, and Oklahoma in resolving the question of whether the lessor or the lessee should bear "post-production" costs is persuasive. Like those states, West Virginia holds that a lessee impliedly covenants that he will market oil or gas produced. *See* Robert Tucker Donley, *The*

> *Law of Coal, Oil and Gas in West Virginia and Virginia* §§ 70 & 104 (1951). Like the courts of Colorado, Kansas, and Oklahoma, the Court also believes that historically the lessee has had to bear the cost of complying with his covenants under the lease. It, therefore, reasonably should follow that the lessee should bear the costs associated with marketing products produced under a lease. Such a conclusion is also consistent with the long-established expectation of lessors in this State, that they would receive one-eighth of the sale price received by the lessor. **In view of all this, this Court concludes that if an oil and gas lease provides for a royalty based on proceeds received by the lessee, unless the lease provides otherwise, the lessee must bear all costs incurred in exploring for, producing, marketing, and transporting the product to the point of sale.**

*Wellman*, 210 W.Va. at 210-11, at 264-65 (quoting *Garman v. Conoco, Inc.,* 886 P.2d. 652, 658 (1994)) (emphasis added).

Subsequently, in *Tawney v. Columbia Natural Resources, LLC*, 219 W.Va. 266, 268-69, 633 S.E.2d 22, 24-25 (2006), the West Virginia Supreme Court of Appeals, building on its holding in *Wellman*, *supra*, expressly adopted the so-called "marketable-product rule," which mandates that the lessee bear all costs in obtaining a marketable product and disallows the deduction of post-production costs until a marketable product is obtained. The Court's reasoning was based on the recognition that since gas is generally not sold "at the wellhead," but instead at a remote point of sale, usually after the lessee adds value to it by preparing it for market, processing it, and transporting it to the point of sale, the lessee must bear all costs of marketing and transporting the gas to the point of sale. *Id.* at 270.

Conversely, *Tawney* expressly rejects the rule adhered to by states such as Kansas and Texas, which holds that gas is to be valued for royalty purposes "at the wellhead" with all costs incurred beyond that point deductible by the lessee. In fact, *Tawney* framed the issue presented as "whether the 'at the wellhead'-type language at issue is sufficient to alter [the State's] generally recognized rule that the lessee must bear all costs of marketing and transporting the product to the point of sale." *Tawney*, at 272. This is evident in the Court's reformulation of the certified question:

> Question: In light of the fact that West Virginia recognizes that a lessee to an oil and gas lease must bear all costs incurred in marketing and transporting the product to the point of sale unless the oil and gas lease provides otherwise, is lease language that provides that the lessor's 1/8 royalty is to be calculated "at the well," "at the wellhead" or similar language, or that the royalty is an amount equal to 1/8 of the price, net of all costs beyond the "wellhead," or "less all taxes, assessments, and adjustments" sufficient to indicate that the lessee may deduct post-production expenses from the lessor's 1/8 royalty, presuming that such expenses are reasonable and actually incurred?
> Answer: No.

*Id.* (emphasis added)

In arriving at its ultimate conclusions, the Court found the "at the wellhead" language as used in the leases at issue to be ambiguous and not sufficient, by itself, to alter the default rule that the lessee must bear all post-production expenses necessary to put the gas in marketable form.

> [T]he present dispute boils down to whether the "at the wellhead"-type language at issue is sufficient to alter our generally recognized rule that the lessee must bear all costs of marketing and transporting the product to the point of sale. We conclude that it is not...We believe that the "wellhead"-type language at issue is ambiguous. First, the language lacks definiteness. In other words, it is imprecise. While the language arguably indicates that the royalty is to be calculated at the well or the gas is to be valued at the well, the language does not indicate *how* or *by what method* the royalty is to be calculated or the gas is to be valued. For example, notably absent are any specific provisions pertaining to the marketing, transportation, or processing of the gas. In addition, in light of our traditional rule that lessors are to receive a royalty of the sale price of gas, the general language at issue simply is inadequate to indicate an intent by the parties to agree to a contrary rule-that the lessors are not to receive 1/8 of the sale price but rather 1/8 of the sale price less a proportionate share of deductions for transporting and processing the gas.

*Tawney, supra* at 272.

Accordingly, in both *Wellman* and *Tawney*, the Court began its reasoning from the default position that the lessee owes the lessor a duty to market and transport the product from the wellhead to the point of sale and must bear all costs associated with transporting and putting gas into marketable form, a rule which our Legislature is presumed to have known of when it enacted the Flat Rate Statute in 1992. *W. Virginia Educ. Ass'n v. Preston Cty. Bd. of Educ.*, 171 W. Va. 38, 41, 297 S.E.2d 444, 447 (1982). It then concluded in *Tawney*, that the "at the wellhead"-type language similar to that used in *W.Va. Code §22-6-8* was not sufficient to alter the application of the default rule.

### 2. The Plain Language Contained In *W.Va. Code §22-6-8(e)* Provides Lessees May Not Deduct Post-Production Expenses Under Converted Leases.

The age-old industry practice in West Virginia and other states is that the producers (oil and gas companies) pay their lessors a royalty consisting of 1/8 or 12.5% of the proceeds received as their portion of the proceeds from sale of the lessors' gas. The producer retains the remaining 87.5% in view of its assumption of all costs as attendant business risk relating to the drilling of the well and subsequent production therefrom.

*W.Va. Code, § 22-6-8(e)* expressly provides that the lessee shall:

> ...tender to the owner of the oil or gas in place <u>not less than</u> one eighth of the <u>total amount paid to or received by or allowed to</u> the owner of the working interest at the wellhead <u>for the oil or gas so extracted, produced or marketed</u> before deducting the amount to be paid to or set aside for the owner of the oil or gas in place, <u>on all such oil or gas to be extracted, produced or marketed from the well.</u> If such affidavit be filed with such application, then such application for <u>permit shall be treated as if such lease or leases or other continuing contract or contracts comply</u> with the provisions of this section.[3]

*Id.*

[3] Actually, this language suggests the Legislature expected the affidavit to become part of the lease.

In addressing principles of statutory construction, the West Virginia Supreme Court of Appeals has explained:

> In deciding the meaning of a statutory provision, "[w]e look first to the statute's language. If the text, given its plain meaning, answers the interpretive question, the language must prevail and further inquiry is foreclosed." *Appalachian Power Co. v. State Tax Dep't,* 195 W.Va. 573, 587, 466 S.E.2d 424, 438 (1995). *See also* Syl. pt. 2, *Crockett v. Andrews,* 153 W.Va. 714, 172 S.E.2d 384 (1970) ("[w]here the language of a statute is free from ambiguity, its plain meaning is to be accepted and applied without resort to interpretation."); Syl. pt. 2, *State v. Epperly,* 135 W.Va. 877, 65 S.E.2d 488 (1951) ("[a] statutory provision which is clear and unambiguous and plainly expresses the legislative intent will not be interpreted by the courts but will be given full force and effect.").
>
> When endeavoring to construe the meaning of an ambiguous statute, we must be mindful that "[t]he primary object in construing a statute is to ascertain and give effect to the intent of the Legislature."

*Smith v. State Workmen's Comp. Com'r,* 159 W.Va. 108, 219 S.E.2d 361, Syl. pt. 1 (1975). *See also Ohio County Com'n v. Manchin,* 171 W.Va. 552, 301 S.E.2d 183, Syl. pt. 1 (1983) ("Judicial interpretation of a statute is warranted only if the statute is ambiguous and the initial step in such interpretative inquiry is to ascertain the legislative intent."). See also *Davis Memorial Hosp. v. West Virginia State Tax Com'r*, 222 W.Va. 677, 682, 671 S.E.2d 682, 687-88 (2008), *compare with Tawney*, 219 W.Va. at 272, 633 S.E.2d at 28 ("[a] valid written instrument which expresses the intent of the parties in plain and unambiguous language is not subject to judicial construction or interpretation but will be applied and enforced according to such intent."

Per the plain language of the statute, the lessee must pay lessor 1/8 of the <u>total</u> received by the lessee "on all such oil or gas to be extracted, produced or marketed from the well," calculated before deducting even the amount paid to the owner. The legislature also made clear that the 1/8 royalty was to be paid on all gas which was extracted produced or marketed from the well and eventually placed in marketable form by the lessee, not on the volume used by defendants in processing, compression and otherwise lost in transmission after it leaves the wellhead. Nowhere in the statue is there even a hint that the Legislature intended for deductions of any kind could be taken, or that the lessee might be able to escape that liability by any other trickery in accounting or legal manipulation. Simply put, this language clearly indicates that lessors are to receive nothing less than a full 1/8 of the amount paid to the lessee on the final marketable product at the point of sale without deduction for its own costs in getting the gas in a marketable condition and delivered to market.

### 3. To The Extent There Is Any Ambiguity In The Statutory Language, It Must Be Resolved In Favor Of The Lessees

To the extent the "at the wellhead" language contained in the statute renders its meaning ambiguous, the ambiguity must be resolved in favor of lessees. As set forth above, the *Tawney* Court found the phrase "at the wellhead" to be ambiguous. Defendant will likely argue that *Tawney* is inapplicable because it involved construction of a lease language and not a statute. However, the same test for determining whether language is ambiguous in a contract also applies to statutes.

> Indeed, this Court has held that "[a] statute is open to construction only where the language used requires interpretation because of ambiguity which renders it susceptible of two or more constructions or of such doubtful or obscure meaning that reasonable minds might be uncertain or disagree as to its meaning."

*Sizemore v. State Farm Gen. Ins. Co.,* 202 W.Va. 591, 596, 505 S.E.2d 654, 659(1998) (internal quotations and citation omitted). *Cotiga Development Co. v. United Fuel Gas Co.,* 147 W.Va. 484, 128 S.E.2d 626, Syl. pt. 1 (1963). *Payne v. Weston,* 195 W.Va. 502, 507, 466 S.E.2d 161, 166 (1995), *quoting*, in part, *Shamblin v. Nationwide Mut. Ins. Co.,* 175 W.Va. 337, 332 S.E.2d 639, Syl. pt. 1 (1985)"). (However, when a contract is ambiguous, it is clearly subject to construction. This Court has said that "[t]he term 'ambiguity' is defined as language 'reasonably susceptible of two different meanings' or language 'of such doubtful meaning that reasonable minds might be uncertain or disagree as to its meaning.'") *Accord Mace v. Mylan Pharmaceuticals, Inc.*, 227 W.Va. 666, 673, 714 S.E.2d 223, 230 (2011).

Since the same test for ambiguity exists between contractual language and statutory language, if at-the-wellhead-type language is ambiguous in a contractual lease, such language is also ambiguous when used in the same context within a statute. As the applicable rules of statutory construction make clear, the Legislature is presumed to know the existing state of the law, including common law, statutory law, and constitutional law, and to intend statutes it enacts to be in harmony with our existing law. *State v. Snyder,* 64 W.Va. 659, 63 S.E. 385, Syl. pt. 5 (1908); *Buda v. Town of Masontown,* 217 W.Va. 284, 617 S.E.2d 831, Syl. pt. 3 (2005), ("A statute should be so read and applied as to make it accord with the spirit, purposes, and objects of the general system of law of which it is intended to form a part; it being presumed that the legislators who drafted and passed it were familiar with all existing law applicable to the subject-matter, whether constitutional, statutory, or common, and intended the statute to harmonize completely with the same and aid in the effectuation of the general purpose and design thereof, if its terms are consistent therewith.")

Moreover, where, such as here, a statute is remedial in nature, the law is that it should be construed so as to give it the most beneficial operation. See *State ex rel. McGraw v. Scot Runyan Pontiac-Buick, Inc.*, 194 W.Va. 770, 777, 461 S.E.2d 516, 523 (1995). *Accord Dunlap v. Friedman's, Inc.*, 213 W.Va. 394, 399, 582 S.E.2d 841, 846 (2003); *Bradshaw v. Soulsby*, 210 W.Va. 682, 687, 558 S.E.2d 681, 686 (2001); *McDavid v. U.S.*, 213 W.Va. 592, 596, 584 S.E.2d 226, 230 (2003).

> "The law favors a liberal construction of certain statutes to give them the most beneficial operation . . . Two classes of statutes are liberally construed-remedial statutes, and statutes which concern the public good or the general welfare . . . The modern doctrine is that to construe a statute liberally or according to its equity is nothing more than to give effect to it according to the intention of the lawmaker, as indicated by its terms and purposes. This construction may be carried beyond the natural import of the words when essential to answer the evident purpose of the act; so it may restrain the general words to exclude a case not within that purpose. . . . Where the intent of the act is manifest, particular words may have an effect quite beyond their natural signification in aid of that intent."

*Davis v. Hix*, 140 W.Va. 398, 417, 84 S.E.2d 404, 420 (1954).

It cannot be disputed that the West Virginia Flat-Rate Statute, *W.Va. Code §22-6-8,* is a remedial statute designed to benefit landowners who retain their natural-gas, mineral rights and to correct the past injustices and inequities created by Flat-Rate Leases. If the use of such language, alone, in leases is ambiguous and cannot be held to demonstrate an intent to permit the deduction of post-production expenses from the landowner's percentage royalty interest in the context of a private lease, it would simply be absurd to suggest that the legislature intended the use of such language, alone, in a remedial statute-designed to benefit landowners to lead to a different result, and provide lessees with an unfair monetary windfall.

Indeed, it would also be unjust and inequitable to have landowner lessors receive a greater amount as royalty as a result of a lease using the same "at the wellhead"-type of language than a landowner lessor would receive as a result of a conversion dictated by the West Virginia Flat-Rate Statute.

## VI. Prayer For Relief

Your *amici*, WVLMOA and WVROA respectfully request the Court find that the legislative findings and stated purpose of *W.Va. Code §22-6-8* renders all "Flat-Rate

Leases" void and unenforceable as a matter of law[4] and, in any event, does not permit deduction of post-production expenses by the lessee producer.


Respectfully Submitted,

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[4] in the alternative the Court could enter an order "equitably adjusting" the royalty provisions of all Flat-Rate Leases to bring them into compliance with *W.Va. Code §22-6-8(e)*. See e.g. *McGinnis v. Cayton, supra*, at 775 (Harshbarger, J. concurring) ("If the increased utility of and consistent advances in technology to capture and produce natural gas were unpredictable, supervening events working to undermine the purpose of the contract (for lessor and lessee to reap fair and equitable benefits from the extraction and sale of valuable minerals on the leased tract), discharge from performance is not the only possible remedy. The contract may be reformed, duties may be enhanced, or restitution ordered for unjust enrichment.") This remedy would avoid the recession of all such leases in their entirety and the wholesale forfeiture of contractual rights and duties attended thereto.

## CERTIFICATE OF SERVICE

I, Howard M. Persinger, III, hereby certify that on the 9th day of June, 2016, the foregoing, "***AMICUS CURIAE* BRIEF ON BEHALF OF WEST VIRGINIA LAND AND MINERAL OWNERS' ASSOCIATION AND WEST VIRGINIA ROYALTY OWNERS' ASSOCIATION (IN SUPPORT OF PLAINTIFFS/PETITIONERS PATRICK D. LEGGETT, ET AL.)**" was served upon the following counsel to Plaintiffs/Petitioners and Defendants/Respondents by email and by depositing a true copy thereof in the United States mail, first class, postage prepaid, and addressed as follows:

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