IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

No. 21-0729

SWN PRODUCTION COMPANY, LLC and
EQUINOR USA ONSHORE PROPERTIES INC.
Petitioners,
v.
CHARLES KELLAM, PHYLLIS KELLAM,
and other persons and entities similarly situated,
Respondents,

***Upon Certified Questions from the United States District Court for the Northern District of West Virginia*, Case No. 5:20-cv-85**

REPLY BRIEF OF PETITIONERS SWN PRODUCTION COMPANY, LLC AND EQUINOR USA ONSHORE PROPERTIES INC.

Marc S. Tabolsky
(admitted pro hac vice)
SCHIFFER HICKS JOHNSON PLLC
700 Louisiana
Suite 2650
Houston, TX 77002
713-357-5150
713-357-5160 (fax)
mtabolsky@shjlawfirm.com

Elbert Lin
(WVSB ID No. 12171)
Riverfront Plaza, East Tower
951 East Byrd St., 18th Fl.
Richmond, VA 23219
804-788-7202
elin@huntonak.com

Timothy M. Miller
(WVSB ID No. 2564)
Jennifer J. Hicks
(WVSB ID No. 11423)
Katrina N. Bowers
(WVSB ID No. 12337)
BABST, CALLAND, CLEMENTS & ZOMNIR, P.C.
BB&T Square Suite 1000
300 Summers Street
Charleston, WV 25301
681-205-8888
681-205-8814 (fax)
tmiller@babstcalland.com
jhicks@babstcalland.com
kbowers@babstcalland.com

Counsel for Petitioners

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

OTHER STATUTES

OTHER AUTHORITIES

I. INTRODUCTION

Respondents' brief offers little defense of the flawed doctrine created by *Wellman* and *Tawney*. As *Leggett* correctly explained, every step these decisions took was a mistake—from *Wellman*'s extension of the implied covenant to market to the question of cost allocation, to *Tawney*'s ruling that "at the wellhead" is ambiguous, and ultimately to *Tawney*'s invention of a novel three-prong test. The result is a doctrine that allows the implied covenant to market, which was never meant to reach post-production costs, to override unambiguous lease terms that specifically allow deduction of those costs. No other jurisdiction has gone that far, as even the cases cited by Respondents refuse to disregard language expressly agreed to by the parties.[1]

Unable to refute *Leggett*'s criticisms, Respondents suggest instead that they were somehow invalidated by the Legislature's follow-on amendment to the flat-rate royalty statute. But that law did not reach beyond flat-rate leases (which are not at issue here), and nothing in it disparages or even mentions *Leggett*'s critique of *Wellman* and *Tawney*. To the extent any "tension" exists in the Legislature's disparate treatment of two entirely different types of leases, that is an issue for the Legislature, not this Court.

Respondents' policy arguments fare no better. They mostly just assert that lessors should be allowed to reap the rewards of higher sale prices (downstream of the well) without having to

---

[1] *See Rogers v. Westerman Farm Co.*, 29 P.3d 887, 906 (Colo. 2001), *as modified on denial of reh'g* (Aug. 27, 2001) (honoring "express lease provisions addressing allocation of costs"); *Wood v. TXO Prod. Corp.*, 1992 OK 100, 854 P.2d 880, 882, *as corrected on reh'g* (May 24, 1993) ("If a lessee wants royalty owners to share in compression costs, that can be spelled-out in the oil and gas lease."); *Legard v. EQT Prod. Co.*, No. 1:10CV00041, 2011 WL 86598, at *9 (W.D. Va. Jan. 11, 2011), *report and recommendation adopted*, No. 1:10CV00041, 2011 WL 4527784 (W.D. Va. Sept. 28, 2011) (honoring a lease term that allows deduction of "a reasonable charge for compressing and making merchantable coal bed methane"); *Reirdon v. Cimarex Energy Co.*, 2019 WL 1302550, at *5 (E.D. Okla. 2019) (honoring a lease term that allows deduction of "a fair and reasonable charge for gathering, compressing and making merchantable such gas").

pay any share of the underlying post-production costs. But as *Leggett* and many others have recognized, that provides lessees with a clear windfall.

For these reasons and more, stare decisis should not apply here. The problems with *Wellman* and *Tawney* are too pervasive, and any legitimacy of these cases has been destroyed by *Leggett*. This Court should end the "chaos" and restore order and fairness to West Virginia law.

But if this Court does not overrule *Wellman* and *Tawney*, the Fourth Circuit's interpretation of these cases in *Young* is correct. Respondents' criticisms of *Young* are unpersuasive and, in any event, they offer no serious alternative. *Young*'s straightforward, common-sense reading—that a lease need only "identify *which* costs and *how much* of those costs will be deducted from the lessor's royalties"—is both the best and only viable option if *Wellman* and *Tawney* persist.

II. ARGUMENT.

A. Assignment of Error No. 1: This Court should overrule *Wellman* and *Tawney*.

1. *Tawney* and *Wellman* conflict with fundamental principles of contract law.

As Petitioners explained in their opening brief, it is settled law in West Virginia that: (1) a mineral lease's unambiguous terms must be enforced according to their plain meaning; and (2) a contract's unambiguous terms cannot be altered or overridden by an implied duty. Opening Br. 16–18. Neither Respondents nor their amici dispute these points. *See, e.g.*, Response Br. 22–24.

Respondents merely assert (at 22–23) that nothing in *Wellman* and *Tawney* "explicitly conflict[s]" with these general principles and that the cases acknowledge that "sufficiently clear and unambiguous terms of a lease agreement will be honored." But under the district court's reasoning, a lease that says a lessee may deduct "all costs of transporting gas from the wellhead to the point of sale" would not, under *Wellman* and *Tawney*, actually authorize deduction of those same costs. *See* Response Br. 36–37 (citing App. 124). And neither the district court nor

Respondents attempt to suggest (or could plausibly suggest) that there is anything ambiguous about the words used. Rather, the district court relies on its understanding that *Tawney* requires *more* than mere clarity: there must be "a clearly spelled out mathematical method for deducting post-production costs." App. 124; *accord* Response Br. 40 ("a mathematical formula or its equivalent[] must be specified in the lease"). As one of Respondents' amici candidly put it, *Wellman* and *Tawney* impose "*heightened* clarity requirements." Nat. Assoc. of Royalty Owners Br. 11, 13 (emphases added).

2. ***Wellman* and *Tawney* are poorly reasoned and rest on "faulty legs."**

As recognized in *Leggett*, *Wellman* and *Tawney* are poorly reasoned and rest on "faulty legs." *Leggett v. EQT Prod. Co.*, 239 W. Va. 264, 276, 800 S.E.2d 850, 862 (2017). The doctrine they created is purportedly founded on the implied covenant to market—an implicit promise that a lessee will "make a reasonable effort to market gas" rather than leaving it in the ground. *Id.* at 275 n.15, 800 S.E.2 at 861 n.15. This duty, in and of itself, is well established and not contested here. *Id.* But through three critical errors, *Wellman* and *Tawney* stretched this implied duty beyond recognition, and devised an anomalous default rule for one issue (post-production costs) in one kind of contract (oil-and-gas leases).

First, *Wellman* erred by extending the implied covenant to market to the issue of cost allocation, creating a default rule (sometimes called the "marketable-product rule") that the lessee will bear 100% of post-production costs absent an extra clear reallocation of those costs. *See* Section II.A.2.i, *infra*. *Second*, *Tawney* erred by holding that leases that calculate royalties "at the wellhead" were not clear enough to rebut *Wellman*'s requirement of extra clarity. *See* Section

II.A.2.ii, *infra*. *Third*, *Tawney* further erred by inventing three new requirements for rebutting *Wellman*'s rule. *See* Section II.A.2.iii, *infra*. All three of these errors warrant correction.[2]

Like the district court, Respondents ultimately turn to policy justifications to save *Wellman* and *Tawney* from their flawed legal reasoning. *See* Section II.A.2.iv, *infra*. But those, too, fail. Reversing these decisions will actually restore clarity and order to the law, promote fairness, and prevent the wasting of West Virginia's natural resources.

i. *Wellman* and *Tawney* impose a flawed requirement of extra clarity regarding post-production costs.

Wellman and *Tawney*'s first mistake was extending "the implied covenant to market to reach the issue of cost allocation." Opening Br. 19 (quoting *Leggett Id.* at 275 n.15, 800 S.E.2 at 861 n.15). *Leggett* rightly deemed this extension "highly questionable" because this covenant merely prevents lessees from leaving marketable minerals in the ground—it has nothing to do with the allocation of post-production costs. *Id.* (citing Byron C. Keeling & Karolyn King Gillespie, *The First Marketable Product Doctrine: Just What Is the "Product"?*, 37 St. Mary's L.J. 1, 2 (2005) and Owen L. Anderson, *Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically? Part 2*, 37 NAT. RESOURCES J. 611, 693 n.89 (1997)).[3] In fact, *Wellman*'s requirement of extra clarity *discourages* lessees from fulfilling the covenant by forcing them to bear all the costs of doing so (both pre- and post-production), even

---

[2] The West Virginia Royalty Owners are thus correct that Petitioners are "asking [this Court] to overrule . . . West Virginia law which holds that the lessee . . . must bear all costs associated with transporting and putting gas into marketable form." WV Royalty Owners Br. 8. But to the extent they suggest that petitioners are also challenging the implied duty to market itself (as opposed to merely the extension of that implied duty to the allocation of post-production costs), they are mistaken.

[3] *See also Baker v. Magnum Hunter Prod., Inc.*, 473 S.W.3d 588, 591 (Ky. 2015) (holding that the "duty [to market] does not extend beyond selling the gas at a reasonable price at the well side") (citation omitted).

where the contract is unambiguous. *See* John W. Broomes, *Waste Not, Want Not: The Marketable Product Rule Violates Public Policy Against Waste of Natural Gas Resources*, 63 Kan. L Rev. 149, 150 (2014) ("Ironically, as a direct consequence of . . . shifting of post-production costs to lessees, natural gas leases cease to produce in paying quantities earlier in their productive life, resulting in physical waste due to premature abandonment of otherwise recoverable natural gas reserves."). Respondents do not disagree. They offer no explanation for how *Wellman*'s rule in any way furthers the implied covenant to market. Response Br. 24–35.

As Petitioners have explained, the reality is that *Wellman* created this requirement mainly because it misunderstood "the realities of deregulation in the natural gas market." Opening Br. 19 (quoting *Leggett*, 239 W. Va. at 277, 800 S.E.2d at 863); *accord id.* at 20 & n.4 (noting "a complete misunderstanding of the industry"). Both *Wellman* and *Tawney* questioned why producers began suddenly deducting post-production costs, ignoring that deregulation had caused producers to begin incurring post-production costs. Again, Respondents largely do not disagree. They do not dispute that *Wellman* and *Tawney* ignored deregulation. Instead, they claim that the Court in *Tawney*, at least, was informed of deregulation through the briefing. Response Br. 30. But that makes *Tawney*'s error even worse—it ignored deregulation *despite* the parties raising it in the briefing.

Further evidence that *Wellman* and *Tawney* misunderstood the implied covenant is their suggestion, at times, that their so-called "marketable-product rule" requires the lessee to bear post-production costs all the way to the "point of sale." As Petitioners explained, that would be out of step even with the few other states that have a similar default rule about post-production costs. Opening Br. 20–21. Respondents do not dispute that this would make West Virginia an outlier, but nevertheless assert that it *should* be the law.[4] *See* Response Br. 32 (arguing that "the lessor's 1/8th royalty should be based on such higher *sale* price") (emphasis added).

Respondents ultimately respond (at 32–33) by questioning "what possible harm" *Wellman*'s requirement of extra clarity actually causes, as lessees can contract around it. But the harm is evidenced by the two decades of disputes that have followed *Wellman* over "how clear is clear enough," including *Tawney*'s disastrous attempt to articulate a workable answer to that question. In *Wellman,* the Court suggested that it "might be" clear enough for a contract to base royalties off of the "proceeds from the sale of gas as such at the mouth of the well"—drawing into question the obviously plain term "mouth of the well." *Wellman v. Energy Res., Inc.*, 210 W. Va. 200, 211, 557 S.E.2d 254, 265 (2001). But *Tawney* then held it was not, and then *Leggett* disagreed with *Tawney*. The state and federal courts of this state are littered with cases trying to make sense of *Wellman.* Indeed, this case is not even the only one currently in this Court raising a *Wellman* issue. *See* Pet. for Writ of Prohib., *TH Exploration II, LLC, et. al. v. Venable Royalty, Ltd., et. al* (Dec. 13, 2021). In short, contracting around *Wellman* is hardly as easy as Respondents suggest.

Furthermore, as explained above, *Wellman*'s requirement of extra clarity departs from basic principles of contract law that, in all other respects, apply to oil and gas leases just as to other contracts. *Wellman*'s rule is an anomaly that grants courts a power they almost never have—specifically, to interfere with a contract's plain terms and decree that the words, though clear, are not clear enough. That is not a power that should simply be left in place, barring a compelling reason. And as discussed above and by this Court in *Leggett*, there is no such reason here.

---

[4] *Wellman* and *Tawney* did not, in fact, extend this presumption to the "point of sale." Opening Br. 21. *See also* Section II.B, *infra*. But their repeated references to "point of sale" reflect a misunderstanding of the implied covenant to market and has caused considerable confusion. Opening Br. 21.

ii. *Tawney* further erred by finding the phrase "at the well" ambiguous.

After embracing *Wellman*'s flawed requirement of extra clarity, *Tawney* compounded that error by finding "at the wellhead" language not clear enough. Opening Br. 21–22. As recognized by *Leggett*, however, "the phrase 'at the wellhead' has a very precise and definite meaning" that clearly allows for deduction of post-production costs, as it refers to "the value of the gas at the well, before it is transported, treated, compressed, or otherwise prepared for market." 239 W. Va. at 278–79, 800 S.E.2d at 864–65 (citation omitted).[5] Indeed, a majority of states have concluded that the phrase "at the well" unambiguously allows deduction of post-production costs. *Id.* (collecting cases).[6] And one of Respondents' amici concedes that "'at the wellhead' . . . constitutes a technical industry term of art." WV Royalty Owners Br. 12.[7]

Respondents acknowledge that the contrary view taken in *Tawney* is the minority approach, but try to downplay that fact. Their arguments only further highlight the error in *Tawney*, however.

---

[5] *See also*, e.g., Williams & Meyers, *Oil and Gas Law,* § 645.2, at page 614.12(3) ("[T]he term 'wellhead' is very precise and definite because it is a clearly recognizable place which even laypersons can understand.")

[6] *See also Atl. Richfield Co. v. State of California*, 214 Cal. App. 3d 533, 540, 262 Cal. Rptr. 683, 687 (Ct. App. 1989); *Baker v. Magnum Hunter Prod., Inc.*, 473 S.W.3d 588, 591 (Ky. 2015); *Babin v. First Energy Corp.*, 693 So. 2d 813, 815 (La. App. 1 Cir. 3/27/97); *Pursue Energy Corp. v. Abernathy*, 77 So. 3d 1094, 1099 (Miss. 2011); *Montana Power Co. v. Kravik*, 179 Mont. 87, 94, 586 P.2d 298, 303 (1978); *Bice v. Petro-Hunt, L.L.C.*, 2009 ND 124, ¶ 17, 768 N.W.2d 496, 502; *Lutz v. Chesapeake Appalachia, LLC*, No. 4:09-CV-2256, 2017 WL 4810703, at *7 (N.D. Ohio Oct. 25, 2017), *order clarified*, No. 4:09CV2256, 2017 WL 9434016 (N.D. Ohio Nov. 13, 2017), and *aff'd sub nom. Lutz v. Chesapeake Appalachia, L.L.C.*, 807 F. App'x 528 (6th Cir. 2020); *Kilmer v. Elexco Land Servs., Inc.*, 605 Pa. 413, 429, 990 A.2d 1147, 1158 (2010); *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996); *Emery Res. Holdings, LLC v. Coastal Plains Energy, Inc.*, 915 F. Supp. 2d 1231, 1238 (D. Utah 2012).

[7] This amicus claims the term was somehow "rendered ambiguous in practice once deregulation changed the way in which gas was sold." *Id.* But this amicus offers no evidence or explanation of how the terms "well" or "wellhead," which are literal things in the oil and gas industry, somehow lost their ordinary meaning because producers began selling gas downstream of the wellhead.

To begin with, Respondents claim the count in states is "nearly even." Response Br. 33–34. Not so. All three of the state statutes they cite (at 34 n.10) simply direct lessees to bear (or presumptively bear) certain costs—they do not discuss the meaning of "at the wellhead" or "at the well," or draw any conclusions as to whether those phrases are ambiguous, which is the relevant issue here. *See* Nev. Rev. Stat. Ann. § 522.115(3); Wyo. Stat. Ann. § 30-5-304(a); Mich. Comp. Laws Ann. § 324.61503b. Similarly, Respondents argue that the federal government follows a "marketable-product" rule. But like the state statutes, there is a federal regulation that requires there be "no cost to the Federal government." Nothing in the regulation says anything about the meaning "at the wellhead" or "at the well." And *that* is the question—whether *Tawney* was in the distinct minority in finding the phrases ambiguous. It plainly was, and still is.

Perhaps more importantly, Respondents fail to explain why the minority position on the meaning of "at the well" is more persuasive. The majority rule gives meaning to the lease term "at the well" or "at the wellhead" by honoring the parties' intention to calculate the royalty based on the product's value or price at that particular location. *See, e.g., Atl. Richfield Co.,* 214 Cal. App. 3d at 540, 262 Cal. Rptr. at 687 ("The term 'at the well,' when used with reference to oil and gas royalty valuation, is commonly understood to mean that the oil and gas is to be valued in its unprocessed state as it comes to the surface at the mouth of the well.").[8] In contrast, marketable-product jurisdictions "universally fail to offer any suggestion as to why the phrase 'at the well' is

[8] *See also Schroeder v. Terra Energy, Ltd.,* 223 Mich. App. 176, 189, 565 N.W.2d 887, 894 (1997) (same); *Lutz v. Chesapeake Appalachia, LLC,* No. 4:09-CV-2256, 2017 WL 4810703, at *7 (N.D. Ohio Oct. 25, 2017), *order clarified,* No. 4:09CV2256, 2017 WL 9434016 (N.D. Ohio Nov. 13, 2017), *and aff'd* 807 F. App'x 528 (6th Cir. 2020) (holding that "the 'at the well' rule . . . simply appl[ies] the clear and unambiguous language in the leases"); *Heritage Res., Inc. v. NationsBank,* 939 S.W.2d at 121 ("Market value at the well has a commonly accepted meaning in the oil and gas industry.").

included in the royalty clause," which "violates the cardinal rule of construction that courts must strive to give meaning to every term in the lease, rendering none as mere surplusage." Broomes, *Waste Not, Want Not*, 63 U. Kan. L. Rev. at 175.[9]

Switching gears, Respondents argue (at 25–26) that the West Virginia Legislature disagreed with *Leggett*'s interpretation of "at the wellhead" when it amended W.Va. Code § 22-6-8(e). But that claim is purely speculative, as Respondents point to nothing in this amendment (or the bill history) describing any disagreement with *Leggett*. If anything, it makes more sense to understand this amendment as *validating Leggett*'s interpretation of "at the wellhead," because it removed this language from the statute. *Compare* W.Va. Code Ann. § 22-6-8(e) (1994) *with* W. Va. Code Ann. § 22-6-8(e) (2018). If the Legislature disagreed with *Leggett*'s reading of that phrase, it would have been more logical to leave the language in the statute and simply pass an amendment making clear that *Leggett*'s interpretation was incorrect. What is more, the amendment applies only to *flat-rate* leases. *See* W. Va. Code Ann. § 22-6-8(d) (2018). Had the Legislature disagreed with *Leggett*'s discussion of the non-flat-rate leases governed by *Wellman* and *Tawney*, it could have afforded those leases the same protections—but it did not.

Respondents seek to bolster their speculation by consistently referring to the legislation as a "clarifying" amendment. But that misses the point. There is no dispute that the Legislature responded directly to the *result* of *Leggett* by amending the statute and thus, in one sense, clarified

---

[9] *See also* David E. Pierce, *Royalty Jurisprudence: A Tale of Two States,* 49 Washburn L.J. 347, 367 (2010) (explaining that marketable-product jurisdictions treat the term "at the well" as "meaningless"); *Lutz v. Chesapeake Appalachia, LLC*, No. 4:09-CV-2256, 2017 WL 4810703, at *7 (N.D. Ohio Oct. 25, 2017), *order clarified*, No. 4:09CV2256, 2017 WL 9434016 (N.D. Ohio Nov. 13, 2017), *and aff'd* 807 F. App'x 528 (6th Cir. 2020) ("Construing the lease under the 'marketable product' rule would ignore the clear language that royalties are to be paid based on 'market value *at the well*.'") (emphasis in original).

the law. The question here, however, is whether the Legislature also sought to overrule the reasoning of *Leggett* and how this Court interpreted the pre-amendment statutory language. On that question, there is also no plausible dispute. The Legislature never indicated—expressly or implicitly—that it thought this Court misconstrued the language as it *had been written*. To the contrary, the Legislature felt the need to *change the language* in light of *Leggett* and even acknowledged in the title of the amendment that it was "*modifying*" the statute. OIL AND GAS—ROYALTIES, 2018 West Virginia Laws Ch. 86 (S.B. 360) (emphasis added).

Lastly, Respondents argue that the Legislature's disparate treatment of flat-rate leases and other leases creates "tension" or "conflict." Response Br. 1, 3, 10–11, 14, 16, 19, 22, 33. But as *Leggett* explained, these are "two distinct types of leases of completely differing character." 239 W. Va. at 282–83, 800 S.E.2d at 868–69. And there may be good reasons to treat flat-rate leases differently. For example, the Legislature may have wanted to preserve the simplicity of a flat-rate royalty by fixing it as a percentage of the sale price, irrespective of any post-production costs. Or, the Legislature may have wanted to provide particularly generous royalties to flat-rate lessors because they had, in the Legislature's view, been treated unfairly in the past. *See* W. Va. Code Ann. § 22-6-8(a)(3) (2018) ("[A] great portion, if not all, of [flat-rate] leases . . . 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."). In any event, it is up to the Legislature whether to resolve any disparity.

iii. *Tawney* erred yet again by imposing three new requirements for rebutting *Wellman*'s default rule.

After wrongly finding the term "at the wellhead" ambiguous, *Tawney* further erred by inventing three new requirements for stating with *sufficient* clarity that lessees may deduct post-production costs. *Est. of Tawney v. Columbia Nat. Res., L.L.C.*, 219 W. Va. 266, 274, 633 S.E.2d

22, 30 (2006). In doing so, *Tawney* ruled that *expressly* providing for deduction of post-production costs is not enough—there must *also* be language that "identif[ies] with particularity specific deductions the lessee intends to take" *and* that "indicate[s] the method of calculating the amount to be deducted." 219 W. Va. at 274, 633 S.E.2d at 30.

Not surprisingly, Respondents point to no other jurisdiction that imposes anything like *Tawney*'s three-prong test. Indeed, even in Respondents' marketable-product jurisdictions that allow for leases to provide for the deduction of post-production costs, it is sufficient simply for the lease to expressly state as much. *See* Section I, *supra*, at n.1 (collecting cases). By requiring *more*, *Tawney* stands alone.

Compounding this problem, *Tawney* provided essentially no guidance for how to satisfy its new requirements, which has led to "chaos." Opening Br. 23–24 (quoting *Leggett*, 234 W. Va. at 277, 800 S.E.2d at 863). Respondents concede (at 11) that *Tawney*'s three-prong test has caused "[d]isagreements . . . among courts." And their amicus, too, acknowledges that this test "suffers from a dearth of development." WV Mineral Owners Br. 12. In defense of *Tawney*, Respondents' amicus suggests that this confusion is unavoidable, because the "common law has always developed incrementally." *Id.* at 14. But *Tawney* was anything but incremental. It went well beyond the "at the wellhead" language that was before it and pronounced three new generally applicable requirements entirely unmoored from the facts of the case. It is, in fact, a textbook example of how *not* to develop the common law.

iv. Respondents' policy concerns are misplaced.

Both Respondents and the district court largely fall back to policy justifications for *Wellman* and *Tawney*'s requirement for extra clarity. The district court relied on concerns that (1) many leases are entered into by unsophisticated individuals, (2) lessees may engage in unfair related-party transactions, or (3) lessors are not in a position to audit the lessee's numbers. *Id.*

Similarly, Respondents characterize the *Tawney* rule as justified by "requirements of transparency and accountability." Response Br. 38.

But policy concerns cannot justify nullifying unambiguous language in a lease. *Cotiga Development Co. v. United Fuel Gas Co.*, 147 W. Va. 484, 494, 128 S.E.2d 626, 634 (1963) (holding that "any difficulty or hardship" imposed by a lease provision "cannot serve to alter the plain provisions of the lease"). And in any event, the law provides other protections that address these issues: any ambiguity in a lease will be construed against the lessee (if the lessee drafted it), Opening Br. 25–26, and any affiliate transactions are limited by the rule that deducted costs must be actually incurred and reasonable, as well as other doctrines that could allow a court to disregard corporate separateness, *id.*

To the extent lessors lack information about post-production costs, Response Br. at 36, the lessor can negotiate for such access in the lease. And even absent such rights, a lessor can sue for an accounting for royalties, *see Peterson v. McIntire*, 94 W. Va. 559, 119 S.E. 554 (1923), or to challenge whether deducted costs were, in fact, incurred and reasonable.

As to Respondents' suggestion that lessors have always expected to get 1/8 of the sale price of oil or gas as a royalty, Response Br. 32 (citing *Wellman*, 210 W. Va. at 211, 557 S.E.2d at 265), it is premised on the same blinkered view of deregulation that infects *Wellman* and *Tawney*. *Wellman*'s suggestion that lessors historically expected 1/8 of the sale price was referring to sale price *at the well*, where gas was almost always sold prior to deregulation. *See* 210 W. Va. at 211, 557 S.E.2d at 264. It is hardly clear that, as a matter of policy, that historical expectation should continue to carry weight in the very different deregulated world.

Finally, Respondents contend that prohibiting lessees from sharing post-production costs (despite unambiguous lease language to the contrary) will not discourage the marketing of gas. As support, they point to leases with governments (both state and federal) that expressly prohibit the deduction of post-production costs. Response Br. 34–35. But in those cases, the lessees have willingly agreed to this arrangement, which might make sense when contracting with governments (based on economies of scale, the other terms in the contracts, or any number of other factors). That in no way suggests that judicially reallocating costs in private leases would not reduce the lessee's incentives to market gas.

3. Stare decisis does not justify preserving *Wellman* and *Tawney*.

Respondents and their amici also suggest that stare decisis should save *Wellman* and *Tawney*. *See, e.g.,* Response Br. 20–22. But to uphold these cases five years after *Leggett* exposed their "faulty legs" would undermine the very judicial policies stare decisis is intended to protect.

As even Respondents must admit, stare decisis is far from absolute. This Court has long recognized that it "should not be reluctant to discard prior rulings when cogent reasons demand that cases be overruled." *Sizemore v. State Workmen's Comp. Com'r*, 159 W. Va. 100, 107–08, 219 S.E.2d 912, 916 (1975). Similarly, "a rule of principle of law should not be adhered to if the only reason therefor is that it has been sanctified by age." *Faith United Methodist Church & Cemetery of Terra Alta v. Morgan*, 231 W. Va. 423, 437, 745 S.E.2d 461, 475 (2013) (overruling precedent dating back 90 years). "No legal principle is ever settled until it is settled right." *Id.* at 438, 745 S.E.2d at 476.

Accordingly, this Court has identified three factors that should be considered when evaluating a "longstanding rule." *Meadows v. Meadows*, 196 W. Va. 56, 64, 468 S.E.2d 309, 317 (1996). Those factors are "[1] the desirability that the law furnish a clear guide for the conduct of individuals, to enable them to plan their affairs with assurance against untoward surprise; [2] the importance of furthering fair and expeditious adjudication by eliminating the need to relitigate every relevant proposition in every case; and [3] the necessity of maintaining public faith in the judiciary as a source of impersonal and reasoned judgments." *Id.* (quoting *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375, 403 (1970)).

Here, none of these factors supports preserving *Wellman* or *Tawney*. *First*, *Wellman* and *Tawney* do not provide a "clear guide" to the oil and gas industry. As explained in *Leggett*, *Tawney* and *Wellman* stand on "faulty legs" and were "inadequately reasoned," which has led to "chaos." 239 W. Va. at 276–77, 800 S.E.2d at 862–63. This "chaos" is reflected in the conflicting decisions of courts that have had to apply *Wellman* and *Tawney*. Some have found sufficient a lease that says "all" of an identified post-production cost may be deducted; others have not and demanded more but offered little useful guidance.[10] *Second*, and relatedly, this "chaos" has impeded fair and expeditious adjudication by requiring continuous litigation over what *Wellman* and *Tawney* mean.

Third, and perhaps most important, "public faith" in *Wellman* and *Tawney* has already been shattered. As the district court itself recognized, this Court "cast a pall on *Tawney* when it criticized its own holding in *Leggett*." App. 124. Having extensively laid bare *Wellman*'s and *Tawney*'s flawed bases and reasoning in *Leggett*, to now hold that they cannot be overruled on stare decisis grounds would undermine, not maintain, "public faith in the judiciary as a source of impersonal and reasoned judgments." *Meadows*, 196 W. Va. at 64, 468 S.E.2d at 317.

---

[10] *Compare Young v. Equinor USA Onshore Properties, Inc.*, 982 F.3d 201, 208–09 (4th Cir. 2020) (holding that lease that stated lessee could deduct "all" of a list of specified post-production costs satisfied *Tawney*); *W.W. McDonald Land Co. v. EQT Production Co.*, 983 F.Supp.2d 790, 807–808 (S.D. W. Va. 2013) (holding that "received by the Lessee shall be adjusted downward to reflect a reasonable charge for compressing, desulphurization and/or transporting gas from the well to the point of sale" sufficed under *Tawney* to permit deduction of costs for compression, desulphurization, and transportation"); *with Kay Co., LLC v. EQT Prod. Co.*, No. 1:13-cv-00151, Dkt. No. 469, Second Order Resolving Motions at pp. 24–26 (N.D. W. Va. Jan. 5, 2018) (expressly disagreeing with *W.W. McDonald*) *and Young v. SWN Prod. Co.*, No. 5:17-CV-82, 2018 WL 11218647, at *3 (N.D.W. Va. Apr. 11, 2018) (holding that a lease that stated lessee could deduct "all" of a list of specified post-production costs did not satisfy *Tawney* before being vacated by Fourth Circuit).

As a last-ditch effort, Respondents contend that even if this Court overrules *Wellman* and *Tawney*, they should still apply to their lease because those cases were the law at the time the lease was signed in 2007. Simply put, that is not how the common law works. In fact, the court in *W. W. McDonald* rejected a similar argument, noting that "[a]s a general rule, judicial decisions are retroactive in the sense that they apply both to the parties in the case before the court and to all other parties in pending cases." 983 F. Supp. 2d at 804 (quoting *Caperton v. A.T. Massey Coal Co.*, 225 W. Va. 128, 690 S.E.2d 322, 350 (2009)). If the Court overrules *Tawney* and *Wellman*, that ruling should apply to the parties in this case as well as in any other pending case.

B. Assignments of Error Nos. 2 and 3: If this Court does not overrule *Wellman* and *Tawney*, it should confirm that *Young*'s interpretation of those cases is correct.

If this Court does not overrule *Wellman* and *Tawney*, it should at least reject the district court's overly rigorous interpretation of *Tawney*'s three-prong test. Opening Br. 26–31. Instead, this Court should read *Tawney* in the same commonsense manner as the Fourth Circuit did in *Young*, which held that a lease need only "identify *which* costs and *how much* of those costs will be deducted from the lessor's royalties." *Young*, 982 F.3d at 208. The lease here clearly satisfies this test, as it specifies *which* costs ("transportation, dehydration and compression," App. 57) and *how much* of those costs (the lessor's one-eighth proportionate share of all costs, App. 58).

As Petitioners have explained, under this straightforward approach, the answers to Certified Questions 2 and 3 are clear. The answer to Certified Question 3—"[i]s a simple listing of the types of costs which may be deducted sufficient to satisfy *Tawney*?"—is "not entirely." Opening Br. 29–30. The listing satisfies the first two prongs of *Tawney* (whether and which costs will be deducted) by indicating *which* post-production costs will be deducted. Certified Question 2 actually addresses the final prong of *Tawney*, asking "[w]hat is meant by the 'method of calculating the amount of post-production costs to be deducted.'" The answer there is that the lease must indicate *how much* will be deducted—*e.g.*, a proportionate share of "all" or "reasonable" post-production costs. *Id.* at 29.

Respondents reject this interpretation but offer no serious alternative. They assert that a simple listing of costs is not *alone* sufficient, Response Br. 36, but no one has suggested that it is. They then argue that additional language specifying *how much* of the costs will be deducted would still not suffice. *Id.*; *see also* WV Mineral Owners Br. 16–17. But as to what *would* be sufficient, Respondents suggest only a "mathematical formula or its equivalent" with no further explanation. Response Br. 40; *see also* WV Mineral Owners Br. 16–17 (requiring a "formula or explanation of the process to be used in calculating royalties").

Respondents seem to want the "Einsteinian proof" described by the district court, *Young*, 982 F.3d at 208—requiring the lease to specify a "procedure, technique, or process for mathematically determining" each and every potential post-production cost, App. 120. This elaborate process would need to address in detail, at the time the lease is executed, a litany of theoretical and potentially unknowable issues such as whether the deducted costs would include "uniforms" and "personnel costs" for the workers who provide the post-production services, as well as "other questions" the district court left unspecified. App. 124.

This requirement would be impossible to satisfy. Lessees could not provide an accounting formula that addresses every possible future cost permutation at the time a lease is drafted and negotiated—long before the lessee drills its first well, begins production of oil and gas, and starts negotiating contracts to gather, handle, transport, and market production. For example, how is the lessee supposed to know in advance exactly what components or formulary may be used by gatherers and other service providers in their contracts for compression, gathering, and transportation services? Unsurprisingly, *no* lease is drafted with the type of detail the district court envisioned: neither the Kellam's lease here nor the lease the Fourth Circuit confronted in *Young*. But both are detailed and provide more than sufficient notice. If those leases are inadequate to permit deductions, despite their express and unambiguous language, then so too are thousands of leases throughout West Virginia that use similar language to clearly state the parties' intent to allow the sharing of post-production costs. *Tawney* should not, and need not, be read to support that absurd result.[11]

Beyond adopting *Young*'s commonsense reading of *Tawney*, if this Court reaffirms *Wellman* and *Tawney*, it should also make clear that it is not expanding this doctrine beyond its existing limits. Opening Br. 30.[12] *First*, this Court should confirm that the default rule in these cases extends only to the first available market. As noted above, Respondents urge this Court to hold that the rule applies to the point of sale. Response Br. 32. But when read in their entirety, it is clear that *Wellman* and *Tawney* contemplate the default rule extending only to the first market. Opening Br. 30 (discussing *W.W. McDonald*). Respondents have no response to this point.[13] Nor do Respondents have any answer to *Leggett*'s recognition that this would provide "an even bigger windfall for lessors." 239 W. Va. at 276–77, 800 S.E.2d at 862–63 (citation omitted).

---

[11] Respondents' amicus argues that leases could simply provide a flat rate for post-production costs, like "12 cents per dekatherm." Nat. Assoc. of Royalty Owners Br. 15. They explain that while an "Einsteinian proof" is not required, *some* mathematical formula is. But what petitioners and *Young* proffer—a simple explanation of "how much," such as a defined proportionate share of "all" or "reasonable" post-production costs—is no less a mathematical formula that permits lessors to "check whether the lessee has properly calculated deductions." *Id.*

[12] Respondents' amicus argues that this Court does not have jurisdiction to address these limits. Mineral Owners 15. But that merely underscores Petitioners' point—which is that this Court should decline to issue a ruling that could inadvertently expand this doctrine into new territory.

[13] Respondents' amicus asserts that *W.W. McDonald* held "in essence that in the absence of clear language to the contrary, the 'market' and the 'point of sale' are one in the same. WV Royalty Owners 20 (citing 983 F. Supp. 2d at 804). But that is plainly false—*W.W. McDonald* held that "when *Tawney* and *Wellman* are read in their entirety, it becomes clear that lessees must bear the costs of bringing gas *to the market*, not to a point of sale." 983 F. Supp. 2d at 800.

Second, this Court should also confirm that it is not expanding *Wellman* and *Tawney* to market-value leases. Opening Br. 31. Respondents do not disagree. *See* Response Br. 28 (conceding that *Wellman* and *Tawney* concerned proceeds leases). And while one amicus does, WV Royalty Owners Br. 14–16, it has no response to the fact that the syllabus points in *Wellman* and *Tawney* are limited to proceeds leases, or the fact that *Wellman* expressly excluded market value leases from its discussion, Opening Br. 31. *See also Cabot Oil & Gas Corp. v. Beaver Coal Co., Ltd.,* No. 16-0904, 2017 WL 5192490, at *7 n.16 (W. Va. Nov. 9, 2017) ("*Wellman* was 'expressly limited to 'proceeds' leases, [and] excluded 'value' leases from the discussion.").[14]

C. Assignment of Error 4: The district court's question regarding indirect costs is based on flawed premises.

As Petitioners have explained (at 31), the district court's question about whether purported "indirect costs" may be deducted is based on its mistaken premise that leases have to provide some sort of mathematical formula regarding how post-production costs are calculated. If the Court overrules *Tawney* or reads it as Petitioners urge above, the Court need not reach this question.

But if the Court reaches this issue, it should hold that when a lease says that all of the costs associated with transporting, dehydrating, and compressing gas produced from the leased premises may be deducted, the question of what constitutes those costs will be a fact question. For example, if a lessee pays another company to transport the gas from the wellhead, the transportation cost is the amount the lessee pays that other company. As long as the lessee actually incurs the cost and the cost is reasonable, a court would not need to delve any farther into how the price was arrived

[14] This amicus also argues that *Tawney* referred to leases with royalties based on "market price at the wellhead." WV Royalty Owners Br. 15. But *Tawney* plainly understood "market price" as a proceeds term that "contemplates the actual sale of gas." 219 W. Va. at 273, 633 S.E.2d at 29 (emphasis added); *see also* 3 Eugene Kuntz, A Treatise on the Law of Oil & Gas, § 40.4(d) (2021) (citation omitted) ("market price" refers to "the price that is *actually paid* by buyers").

at. And even if the lessee itself provided the transportation of gas, the subsidiary costs that made up the total cost of transportation would be a question of fact based on the evidence presented.

Respondents cite *W.W. McDonald* and *Kay* to support their view that purported "indirect costs" may not be deducted. Response Br. 38–39 (citing *W.W. McDonald*, 983 F.Supp.2d at 816; *Kay Co., LLC v. EQT Prod. Co.*, No. 1:13-CV-151, 2017 WL 10436074, at *18–19 (N.D.W. Va. Sept. 6, 2017)). But Respondents and *Kay* (and the district court below) misread *W.W. McDonald*.

First, *W.W. McDonald* did not create some artificial distinction between direct costs and indirect costs. The term "indirect costs" was an undefined term the defendant included as part of its post-production costs. 983 F.Supp.2d at 816. The court's opinion does not reflect that there was any evidence regarding what constituted the "indirect costs." *Id.*

Second, to the extent that *W.W. McDonald* held that certain specific costs could not be deducted, those holdings appear to turn on the specific evidence presented in the case. For example, the court held that costs such as "meals and entertainment, uniforms, meter operations and repair, and personal property taxes are not costs of compression, desulphurization, or transportation" were "not costs of compression, desulphurization, or transportation." *Id.* But as the court noted, the lessee failed to timely present a brief on this issue. *Id.* at 819. Nothing in the opinion forecloses a different holding if evidence were presented that the uniforms were flame-retardant safety clothing provided by the company that the employees responsible for working on the compressors had to wear. The same is true of the holding that "personnel costs, indirect costs, production management costs, depreciation and return on capital investment," were "too vague to be specifically related to compression, desulphurization, or transportation." *Id.* at 815–16. Again, nothing in the opinion suggests this was anything but a ruling based on the evidence (or lack thereof) in the case. There is no indication that the lessee established that the "personnel costs" were for the employees who managed, operated, and repaired the facilities that provided the enumerated services.

In sum, *W.W. McDonald* did not create or define a category of "indirect costs." Nor did the case categorically state that any particular costs could never be deducted. The best reading of the case is that the evidence did not show that those categories of costs were sufficiently related to services for which the cost could be deducted. Of course, this Court is not bound to follow *W.W. McDonald* in any event. Irrespective of what the case says, there is no good reason for this Court to further complicate the *Wellman/Tawney* regime—if it survives—by creating out of whole cloth an undefined (and undefinable) category of "indirect costs."

Certain amici also contend that this Court's decision in *Bryan v Big Two Mile Gas Co.*, 213 W. Va. 110, 577 S.E.2d 258 (2001), which was decided five years before *Tawney*, somehow answers this question. It does not. *Bryan* does not even pertain to royalty calculations, let alone distinguish between purported direct and indirect post-production costs. *Id.* Rather, *Bryan* addressed the measure of damages to a mineral owner when a defendant innocently trespasses and removes minerals. 213 W. Va. at 121, 577 S.E.2d at 269. It held that an innocent trespasser must pay the value of the gas taken less the actual cost of production. *Id.* Then, citing *Wellman*, *Bryan* stated that the cost of production that the trespasser seeks to deduct must be actually incurred and reasonable. *Id.* at 121–22, 577 S.E.2d at 269–70. *Bryan* thus stands for the unexceptional proposition (that Petitioners have never disputed) that deducted post-production costs must be actually incurred and reasonable. With respect to Question 4, that is what this Court should hold again, and nothing more.

PETITIONERS SWN PRODUCTION COMPANY, LLC and EQUINOR US ONSHORE PROPERTIES INC.

By Counsel:

Timothy M. Miller

Timothy M. Miller
(WVSB ID No. 2564)
Jennifer J. Hicks
(WVSB ID No. 11423)
Katrina N. Bowers
(WVSB ID No. 12337)
BABST, CALLAND, CLEMENTS & ZOMNIR, P.C.
BB&T Square Suite 1000
300 Summers Street
Charleston, WV 25301
681-205-8888
681-205-8814 (fax)
tmiller@babstcalland.com
jhicks@babstcalland.com
kbowers@babstcalland.com

Elbert Lin
(WVSB ID No. 12171)
Riverfront Plaza, East Tower
951 East Byrd St., 18th Fl.
Richmond, VA 23219
804-788-7202
elin@huntonak.com

Marc S. Tabolsky
(admitted pro hac vice)
SCHIFFER HICKS JOHNSON PLLC
700 Louisiana
Suite 2650
Houston, TX 77002
713-357-5150
713-357-5160 (fax)
mtabolsky@shjlawfirm.com

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

No. 21-0729

SWN PRODUCTION COMPANY, LLC and

EQUINOR USA ONSHORE PROPERTIES INC.

Petitioners,

v.

CHARLES KELLAM, PHYLLIS KELLAM,

and other persons and entities similarly situated,

Respondents,

Upon Certified Questions from the United States District Court for the Northern District of West Virginia, Case No. 5:20-cv-85

REPLY BRIEF OF PETITIONERS SWN PRODUCTION COMPANY, LLC AND EQUINOR USA ONSHORE PROPERTIES INC.

CERTIFICATE OF SERVICE

I hereby certify that on March 1, 2022, I filed by hand delivery the foregoing REPLY BRIEF OF PETITIONERS SWN PRODUCTION COMPANY, LLC AND EQUINOR USA ONSHORE PROPERTIES INC. and true copies have been sent by electronic mail and regular U.S. mail to the following:

James G. Bordas III, Esq. (WV Bar No. 8518)
Bordas & Bordas, PLLC
1358 National Road
Wheeling, WV 26003
jbordasiii@bordaslaw.com
Counsel for Respondents

12501317

Michael W. Carey, Esq. (WV Bar No. 635)
David R. Pogue, Esq. (WV Bar No. 10806
Carey Douglas Kessler & Ruby PLLC
901 Chase towers
707 Virginia Street East
Charleston, WV 25323
304-345-1234
mwcarey@csdlawfirm.com
drpogue@cdkrlaw.com
and
Marvin W. Masters, Esq. (WV Bar No. 2359)
April D. Ferrebee, Esq. (WV Bar No. 8034
The Masters law Firm lc
181 Summers Street
Charleston, WV 25301
(304) 371-7894
mwm@themasterslawfirm.com
adf@themasterslawfirm.com
Counsel for National Association of Royalty Owners, Appalachia

Victor S. Woods, Esq.
Bailey Glasser LLP
209 Capitol Street
Charleston, WV 25301
vwoods@baileyglasser.com
304-345-6555
877-852-0342
304-342.1110 FAX
and
Scott A. Windom, Esq.
Windom Law Offices, PLLC
101 East Main Street
Harrisville, WV 26362
swindom@windomlawoffices.com
www.windomlawoffices.com
304-643-4440
304-643-2947 fax
Counsel for West Virginia Land and Mineral Owners Association and the West Virginia Association for Justice

Howard M. Persinger, III, Esq.
Persinger & Persinger
237 Capitol Street
Charleston, WV25301
304-646-9333
304-346-9337 (FAX)

Counsel for West Virginia Royalty Owners Association
West Virginia Farm Bureau
Bounty Minerals LLC
Siltstone Resources, LLC
Hmp2@persingerlaw.com

W. Henry Lawrence, Esq. (WV Bar No. 2156)
Amy M. Smith, Esq. (WV Bar No. 6454)
Steptoe & Johnson PLLC
400 White Oaks Boulevard
Bridgeport, WV 26330
(304) 933-8000
hank.lawrence@steptoe-johnson.com
amy.smith@steptoe-johnson.com
Counsel for American Petroleum Institute, Gas and Oil Association of WV, Inc. and West Virginia Chamber of Commerce
Amerci Curiae

Timothy M. Miller

Timothy M. Miller (WVSB ID No. 2564)
300 Summers Street, Suite 1000
Charleston, WV 25301
681-205-8888
681-205-8814 (fax)

Marc S. Tabolsky, Esq.
Schiffer Hicks Johnson PLLC
700 Louisiana, Suite 2650
Houston, TX 77002

Elbert Lin, Esq.
Hunton Andrews Kurth LLP
Riverfront Plaza, East Tower
951 East Byrd St., 18th Floor
Richmond, VA 23219-4074