IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA
At Charleston

NO. 21-~~0179~~ 0739

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

RESPONSE TO OPENING BRIEF OF PETITIONERS SWN PRODUCTION COMPANY, LLC AND EQUINOR USA ONSHORE PROPERTIES INC.

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The District Court certified the following four questions to this Court:

1. Is *Estate of Tawney v. Columbia Natural Resources, L.L.C.*, 219 W.Va. 274, 633 S.E.2d 22 (2006), still good law in West Virginia? The District Court's ardent belief that *Tawney* remains good law is correct. Obiter dicta expressed in *Leggett v. EQT Prod. Co.*, 239 W.Va. 264, 276-77, 800 S.E.2d 850, 862-63 (2017) (*Leggett 2*), criticizing *Tawney* and its predecessor, *Wellman v. Energy Res., Inc.*, 210 W.Va. 200, 557 S.E.2d 254 (2001), as being "inadequately reasoned" and standing on "faulty legs" was the misguided result of a false, or at least incomplete and misleading, narrative created by lessees and their supporters to paint an unflattering canvas of West Virginia courts and jurisprudence. However, both *Wellman* and *Tawney* are well reasoned and grounded in recognized principles of West Virginia contract and oil and gas law. Moreover, they both are designed to be fair to all parties. Under these circumstances, the doctrine of stare decisis requires this Court to stand by its precedent. This is particularly true in light of the West Virginia Legislature's adoption of a clarifying amendment to W.Va.Code § 22-6-8(e) that essentially overruled *Leggett 2*. Overruling *Wellman* and *Tawney* now would create the same tension between our common law and statutory law that this Court feared in *Leggett 2*.

2. What is meant by the "method of calculating" the amount of post-production costs to be deducted? Similarly to interpreting the language of statutes, each phrase and word used in a holding expressed in a syllabus point of this Court must be given significance and effect and subscribed their ordinary, common, and accepted meaning unless expressly defined elsewhere. The District Court was correct in holding that the "method of calculating" the amount of post-production costs required by Syl. Pt. 10 of *Tawney* was not mere surplusage and has a particular meaning and significance and, contrary to the suggestion of the Defendants, such meaning and

significance cannot be met by merely specifying that "all" or "reasonable" costs will be deducted. Leases must expressly explain the specific method of calculating such deductions.

3. Is a simple listing of the types of costs which may be deducted sufficient to satisfy *Tawney*? No. In addition to satisfying the requirements of *Wellman*, Syllabus Point 10 of *Tawney* holds that three additional requirements must be met: The lease must "expressly provide that the lessor shall bear some part of the costs"; the lease must "identify with particularity the specific deductions the lessee intends to take from the lessor's royalty"; and the lease must "indicate the method of calculating the amount to be deducted." *Id.*

4. If post-production costs are to be deducted, are they limited to direct costs or may indirect costs be deducted as well? Although *Wellman* and *Tawney* did not expressly address the distinction between direct and indirect costs, in order to ensure that only reasonable deductions specified in the lease and actually incurred are deducted by lessees, this Court should follow the reasoning used by courts in cases such as *W.W. McDonald Land Co. v. EQT Prod. Co.*, 983 F.Supp.2d 790, 816 (S.D.W.Va. 2013), and *Kay Co., LLC v. EQT Prod. Co.*, No. 1:13-cv-151, Slip Op., 2017 WL 10436074, at **18-19 (N.D. W. Va. Sept. 6, 2017), and hold that only reasonable, direct costs expressly stated in leases and actually incurred may be deducted.

II. Statement of the Case

A. Introduction

Only in a world where gas production companies, such as SWN and Equinor, have immense power, control, and money could such entities and their supporters dare to create a false narrative of an evil fantasyland called West Virginia where courts and opposing attorneys, all of whom are purportedly prejudiced against them, conspire to deprive the noble producers of their well-earned profits by essentially stealing such money to place it in the pockets of greedy mineral owners. The falsity or at the very least the misleading nature of the narrative contrived by the Defendants can be gleaned by the facts that the producers so obviously ignore or deemphasize.

First, the producers heavily rely upon the criticisms contained in *Leggett 2* to support their contentions that *Wellman* and *Tawney* should be overruled. Yet, they fail to acknowledge anywhere that *Leggett 2* was effectively overruled by the West Virginia Legislature's adoption of a clarifying amendment, Senate Bill 360, to W.Va.Code § 22-6-8(e); a clarification that was expressly requested by this Court to address the tensions created by its ruling between the statutory law of § 22-6-8(e), as interpreted by the then-majority of the Court, and the common law of *Wellman* and *Tawney*. Section 22-6-8(e), as now clarified, prohibits the deduction of "post-production" costs and essentially adopts the same requirements for statutorily-converted leases as *Wellman* and *Tawney* does for so-called freely negotiated leases.

Second, the producers fail to emphasize that these so-called greedy mineral owners pursuant to the so-called freely negotiated leases drafted by the producers typically only get a 1/8th royalty (or 12.5%) of the sale price of such minerals with the producer keeping 7/8th (or 87.5%) of the sale price of the minerals being extracted, produced, and marketed. Do the producers really need to pay even less than a 1/8th royalty to the actual owners of the minerals by deducting so-called "post-production" costs? Who in actuality is being greedy?

Third, many mineral owners as lessors are unsophisticated individuals who know nothing, or next to nothing, about the natural gas industry's customs, practices, and terminology, let alone the effects of regulation versus deregulation on such industry.[1] Knowledge is power and the

[1] *See, e.g., Piney Woods Country Life School v. Shell Oil Co.*, 726 F.2d 225, 236 (5th Cir. 1984) ("For a practice to be legally relevant custom, both parties to the contract must have actual or presumed knowledge of the practice. . . . Those not engaged in an industry will not be presumed to know that words which have common meanings outside the industry have a different meaning inside it." (citations omitted)); Maurice H. Merrill, *Covenants Implied In Oil and Gas Leases*, §85 at 216 (2d Ed. 1940) ("With regard to the cases that rely upon custom in the industry, 'it is to be noted that the custom is of the lessee's own making, imposed by them willy-nilly upon the lessors. In the absence of express evidence, there should be no

producers have all of the knowledge concerning the volume of gas extracted, the costs of production and "post production," the sale prices ultimately available and actually achieved, and everything in between. The mineral owners as lessees have no such knowledge unless shared with them by the producers. Accordingly, the balance of power heavily favors the producers. This uneven balance of power is somewhat righted by the transparency and accountability required by this Court's holdings in *Wellman* and *Tawney*.

Fourth, while deregulation of the natural gas industry, which began in the late 1970s and was largely completed by 1993, did result in more costs for the production or so-called "post production" of marketable gas by moving the first market for the sale of natural gas from the wellhead to a point of sale further downstream, it also offered producers many more business opportunities and the ability to achieve much higher prices for their respective sales of the natural gas. Accordingly, while production costs did increase so have the sale prices and profits obtained increased.

Fifth, the producers as lessees create the lease agreements that are entered into with mineral owners and can easily make them as detailed and unambiguous or as general and ambiguous as they choose to do. Accordingly, how is a court that enforces the implied covenant of marketability--when a lessee fails to draft a reasonably detailed and unambiguous lease that complies with legal requirements pronounced by this Court--acting unreasonably or prejudicially against the lessee?

Sixth, it also should be noted that the law review and journal articles relied upon by then-Chief Justice Allen Loughry in *Leggett* 2 and by the Defendants and their amici herein are not necessarily unbiased or neutral discussions of the law and/or the natural gas industry. Many of the

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assumption that ordinary landowners know the details of oil company practice when they execute their leases.'").

articles are written by attorneys who represent or have represented natural gas producers, their parents, and/or affiliates.[2] Can such articles truly be considered to be totally unbiased and fair?

B. Legal Background

The certifying District Court conducted a commendable analysis of West Virginia common law predating this Court's decisions in *Wellman* and *Tawney*, which involved a thorough discussion of numerous decisions in which lessees were prohibited from taking deductions from lessors' royalty payments when such deductions were not expressly permitted in clear and unambiguous language set forth in the leases, including *Kanawha Valley Bank v. United Fuel Gas Co.*, 121 W.Va. 96, 1 S.E.2d 875 (1939) (production tax); *Cole v. Pond Fork Oil & Gas Co.*, 127 W.Va. 762, 35 S.E.2d 25 (1945) (privilege/production tax); *Kohlsaat v. Main Island Creek Coal Co.*, 90 W.Va. 656, 112 S.E. 213 (1922) (war-time inflation and commissions); *Cotiga Dev. Co. v. United Fuel Gas Co.*, 147 W.Va. 484, 128 S.E.2d 626 (1963) (transportation, commingling, and handling); *Imperial Colliery Co. v. OXY USA, Inc.*, 912 F.2d 696 (4th Cir. 1990) (transportation, compression, and handling). *Kellam v. SWN Production Co.*, No. 5:20-cv-85, 2021 WL 4621067, at **3-5 (N.D.W.Va. Sept. 13, 2021) [Kellam JA at 105-10].

As noted by the District Court, *id.*, while costs at issue in *Kohlsaat*, *Cotiga Dev. Co.*, and *Imperial Colliery Co.*, could have been designated as "post-production" costs, such phraseology

[2] By way of example, Karolyn King Gillespie has worked 4 years as in-house counsel for ExxonMobile and 9 years as general counsel for EP Energy, https://www.linkedin.com/in/karolyn-king-gillespie-ab335324/; Scott Lansdown has worked as in-house counsel for ExxonMobile for over 42 years, https://www.linkedin.com/in/scott-lansdown-b253b5202/; R. Cordell Pierce worked for EQT for approximately 12 years as a landman, title supervisor, regional land manager, and regional land director, https://www.linkedin.com/in/cordell-pierce-a82ab8b/; John W. Broomes, who is now a United States District Judge, not only represented gas producers but was a member of the Kansas Independent Oil & Gas Association, https://www.judiciary.senate.gov/imo/media/doc/Broomes%20SJQ.pdf, "a nonprofit member organization representing oil and natural gas producers in Kansas, https://kioga.org/about-kioga/.

did not reach this Court until its decisions in *Wellman* and *Tawney* which specifically addressed the issue of so-called "post-production" costs. This Court in *Wellman*, *supra*, acknowledged:

> 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.
>
> In spite of this, there has been an attempt on the part of 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."

Wellman, 210 W.Va. at 209-10, 557 S.E.2d at 263-64.

After surveying conflicts among jurisdictions on the issue of whether "post-production" costs may be deductible, the Court explained:

> 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 less[ee].
>
> 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 211, 557 S.E.2d at 265.

This Court in *Wellman* set forth the following pertinent new syllabus points:

> 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.
>
> If an oil and gas lease provides that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, the lessee shall be entitled to credit for those costs to the extent that they were actually incurred and they were reasonable. Before being entitled to such credit, however, the lessee must prove, by evidence of the type normally developed in legal proceedings requiring an accounting, that he, the lessee, actually incurred such costs and that they were reasonable.

Syl. Pts. 4 & 5, *Wellman, id.*

Subsequently, this Court in *Tawney, supra*, reaffirmed its holdings in *Wellman* and further addressed whether leases that mentioned phrases such as "at the wellhead" altered its analysis of what had been "proceeds" leases in *Wellman*. After considering its holdings in *Wellman* and conducting its own analysis of the conflicts between "at the wellhead" states and "marketable-product rule" states, the Court set forth its ultimate holdings in two new syllabus points:

> Language in an oil and gas lease that is intended to allocate between the lessor and lessee the costs of marketing the product and transporting it to the point of sale must expressly provide that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, identify with particularity the specific deductions the lessee intends to take from the lessor's royalty (usually 1/8), and indicate the method of calculating the amount to be deducted from the royalty for such post-production costs.
>
> Language in an oil and gas lease that provides that the lessor's 1/8 royalty (as in this case) 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 all costs beyond the wellhead," or "less all taxes, assessments, and adjustments" is ambiguous and, accordingly, is not effective to permit the lessee to deduct from the lessor's 1/8 royalty any portion of the costs incurred between the wellhead and the point of sale.

Syl. Pts. 10 & 11, *Tawney, supra.*

In reaching its conclusions, the Court followed well known and accepted canons of contract construction. Significantly, the Court acknowledged 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." Syl. Pt. 4, *id.* The Court also recognized the time-honored canon that "'[t]he general rule as to oil and gas leases is that such contracts will generally be liberally construed in favor of the lessor, and strictly as against the lessee[,]'" Syl. Pt. 7, *id.* (quoting Syl. Pt. 1, *Martin v. Consolidated Coal & Oil Corp.*, 101 W.Va. 721, 133 S.E. 626 (1926)), as well as the analogous rule that "'[u]ncertainties in an intricate and involved contract should be resolved against the party who prepared it.'" Syl. Pt. 8, *id.* (quoting Syl. Pt. 1, *Charlton v. Chevrolet Motor Co.*, 115 W.Va. 25, 174 S.E. 570 (1934)).

As explained by the certifying District Court:

> When the *Tawney* and *Wellman* requirements are combined, six conditions must be met before a lessee may deduct post-production costs from royalties. These are:
>
> 1. The lease must expressly provide that the lessor shall bear some part of the costs incurred between the wellhead and point of sale;
>
> 2. The lease must identify with particularity the specific deductions that the lessee may take;
>
> 3. The lease must expressly provide for a method of calculating the amount to be deducted from royalty for post-production costs;
>
> 4. The costs, which have been identified with particularity, must be actually incurred;
>
> 5. The amount of the costs must be reasonable; and
>
> 6. The lessee must prove all costs as it would in an action for an accounting.
>
> If all six elements are not established, the lessee is not permitted to deduct post-production expenses.

Kellam v. SWN Production Co., 2021 WL 4621067, at *7 [Kellam JA at 114]. These holdings of *Wellman* and *Tawney* essentially require transparency and accountability from gas producers in their dealings with mineral owners.

Gas producers, such as the Defendants, and their supporters attack the holdings in *Wellman* and *Tawney* alleging that they are based improperly on the late Justice and Professor Robert T.

Donley's purportedly antiquated treatise, *Law of Coal, Oil and Gas in West Virginia and Virginia* § 104 (1951); an overbroad view of the implied covenant of marketability or "marketable-product rule," and a failure to recognize the effects of deregulation on the natural gas industry. Defendants' contentions are without merit or substantive effect for reasons which will be discussed below.

Unfortunately, a majority of this Court in *Leggett v. EQT Prod. Co.*, 239 W.Va. 264, 800 S.E.2d 850 (2017) ("*Leggett 2*), appeared to accept the misleading narrative contrived by gas producers and their supporters, and criticized in dicta its own precedent in *Wellman* and *Tawney* as resting on "faulty legs" and being "under-developed or inadequately reasoned." *Leggett 2*, 239 W.Va. at 276-77; 800 S.E.2d at 862-63. More specifically, in *Leggett*, the Court was asked to address certified questions concerning whether "at the wellhead" language contained in West Virginia's Flat-Rate Well Statute, W.Va.Code § 22-6-8(e), was just as ambiguous as the language found in the leases addressed in *Tawney* as to the issue of whether post-production expenses could be deducted from the mineral owner's 1/8th royalty payment. *See Leggett v. EQT Production Co.*, No. 1:13-cv-4, 2016 WL 297714, at **9-12 (N.D.W.Va. Jan. 22, 2016).

This Court's decision in *Leggett 2*, which was authored by then-Chief Justice Allen Loughry and issued after a judicial election and the subsequent granting of a petition for rehearing, was a 180^{0} change from its initial decision in *Leggett v. EQT Prod. Co.*, No. 16-0136, Slip Op. (W.Va. Nov. 17, 2016) (*Leggett 1*). Despite concluding that its holdings in *Wellman* and *Tawney* were not relevant to its analysis of W.Va.Code § 22-6-8(e) because those cases dealt with freely negotiated leases that were subject to canons of construction for contracts (as opposed to those for statutes) as well as the implied covenant of marketability which the Court concluded did not influence statutes, the Court felt "compelled" to comment on *Wellman* and *Tawney* with such criticisms in dicta.

However, the *Leggett 2* Court wisely asked the West Virginia Legislature for clarification of the law, stating

> this Court recognizes the inherent tension between holders of leases subject to our interpretation of West Virginia Code § 22-6-8 and those freely-negotiated leases which remain subject to the holdings of *Wellman* and *Tawney*. We therefore implore the Legislature to resolve the tensions as it sees fit inasmuch as this Court may only act within the confines of our constitutional charge.

Leggett 2, 239 W.Va. at 283, 800 S.E.2d at 869 (footnote omitted).

Similarly, Justice Margaret Workman in her concurrence also requested clarification from the Legislature, reasoning:

> What both the foregoing and the majority's opinion underscores is the necessity of the Legislature to address these policy-laden issues and declare, by statute, the will of the State's citizenry in this regard. This Court is constrained to our canons of statutory construction and does not make policy. . . . It is the duty of the Legislature to consider facts, establish policy, and embody that policy in legislation. . . . Where the Legislature's inaction in the face of such significant changes in the industry leaves this Court to intuit its intentions and/or retrofit outdated statutory language to evolving factual scenarios, the will of the people is improperly disregarded.

Id., 239 W.Va. at 285, 800 S.E.2d at 871.

The Legislature quickly responded in its very next session adopting a clarifying amendment, Senate Bill 360, that established that the Court's construction of W.Va.Code § 22-6-8(e) had been correct in its first decision, *Leggett 1*, rather than in *Leggett 2*. *See Kay Co., LLC v. EQT Production Co.*, Civil Action No. 1:13-CV-151, Slip. Op. [ECF Doc. 723] (N.D.W.Va. Nov. 14, 2018) (Bailey, J.)*; see also* Adam H. Wilson, *Without a Leggett to Stand on: Arguing for Retroactive Application of West Virginia's Amended Flat-Rate Well Statute*, 124 W.Va.L.Rev. 259 (2021).

As amended, effective May 31, 2018, W.Va.Code §22-6-8(e) now expressly provides:

> To avoid the permit prohibition of § 22-6-8(d) of this code, 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 gross proceeds, free from*

> *any deductions for post-production expenses, received at the first point of sale to an unaffiliated third-party purchaser in an arm's length transaction 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.

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

Should this Court now overrule *Wellman* and *Tawney*, it will create new tensions of the type feared by the Court in *Leggett 2* between the common law addressing what post-production deductions can be taken from "freely negotiated" leases and the statutory law concerning what post-production deductions can be taken from flat-rate leases converted to 1/8th royalty leases pursuant to §22-6-8(e). This Court should decline to create such an unnecessary conflict and should honor principles of stare decisis by reaffirming its decisions in *Wellman* and *Tawney*.

Unfortunately, despite what essentially constituted the Legislature's overruling of *Leggett 2*, that decision's criticism of *Wellman* and *Tawney* has still influenced some courts' opinions in other cases. *See Young v. Equinor USA Onshore Properties, Inc.*, 982 F.3d 201, 207 & 209 (4th Cir. 2020) ("although *Leggett* didn't overrule *Wellman* and *Tawney*, its criticism of those cases and its endorsement of the work-back method inform our analysis here"; "Especially in light of *Leggett*, West Virginia law demands nothing more").

Disagreements have also arisen among courts as to what is meant by the "method of calculating" the amount of post-production costs to be deducted as required by Syllabus Point 10 of *Tawney*. *Contrast Kay Co., LLC v. EQT Production Co.*, No. 1:13-cv-151, Slip Op. [ECF Doc. 469] (N.D.W.Va. Jan. 5, 2018); and *Kellam v. SWN Production Co.*, 2021 WL 4621067, at **9-10 [Kellam JA, at 120-124], *with Young v. Equinor USA Onshore Properties, Inc.*, 982 F.3d at 207-09; and *W.W. McDonald Land Co. v. EQT Production Co.*, 983 F. Supp.2d 790, 808 (S.D.W.Va. 2013).

C. Statement of Facts.

Plaintiffs/Respondents, Charles Kellam and Phyllis Kellam, executed an oil and gas lease agreement (the "Kellam Lease") with Great Lakes Energy Partners, LLC in August 2007. The Memorandum of Lease for such agreement was recorded in the records of the County Commission of Ohio County, West Virginia at Deed Book 780, Page 154, on or about October 10, 2007. Chesapeake Appalachia, LLC, obtained an assignment of the Kellam Lease from Great Lakes Energy Partners, LLC, and, thereafter, entered into activities to create and operate oil and gas wells and production units within which the Kellam property is and has been included. Defendants/Petitioners SWN Production Company ("SWN") and Equinor USA Onshore Properties Inc. ("Equinor"), formerly known as Statoil USA Onshore Properties, Inc., subsequently acquired working interests, with SWN now operating oil and gas wells and production units within which the Kellam's leased lands are included. [Kellam JA, at 2-3].

The Kellam lease provides, in pertinent part:

> 4. In consideration of the premises the Lessee covenants and agrees:
>
> (A) To deliver to the credit of the Lessor in tanks or pipelines, as royalty, free of cost, one-eighth (1/8) of all oil produced and saved from the premises, or at Lessee's option to pay Lessor the market price for such one-eighth (1/8) royalty oil at the published rate for oil of like grade and gravity prevailing on the dates such oil is sold into tanks or pipelines. Payment of royalty for oil marketed during any calendar month to be on or about the 60th day after receipt of such funds by the lessee.
>
> (B) To pay to the Lessor, as royalty for the oil, gas, and/or coalbed methane gas marketed and used off the premises and produced from each well drilled thereon, the sum of one-eighth (1/8) of the price paid to Lessee per thousand cubic feet of such oil, gas, and/or coalbed methane gas so marketed and used, measured in accordance with Boyle's Law for the measurement of gas at varying pressures, on the basis of 10 degrees Fahrenheit, without allowance for temperature and barometric variations less any charges for transportation, dehydration and compression paid by Lessee to deliver the oil, gas, and/or/or coalbed methane gas for sale. Payment for royalty for oil, gas, and/or coalbed methane gas marketed during any calendar month to be on or about the 60th day after receipt of such funds by the Lessee.

[Kellam JA, at 2 & 57].

Paragraph 10 of the Kellam lease addresses the issue of unitization and provides that if the leased premises are consolidated with other lands to form a development unit: "the Lessor agrees to accept, in lieu of the one-eighth (1/8) oil, gas, and/or coalbed methane gas royalty hereinbefore provided, that proportion of such one-eighth (1/8) royalty which the acreage consolidated bears to the total number of acres comprising said development unit." [Kellam JA, at 58]. Paragraph 11 of the Kellam lease addresses the issue of when a lessor possesses less than the entire and undivided fee simple interest in the land, and provides: "In case the Lessor owns a less interest in the above described premises than the entire and undivided fee simple therein, then the royalties and rentals herein provided for shall be paid to the Lessor only in the proportion which such interest bears to the whole and undivided fee." *Id.*

The Plaintiffs submit that the Defendants have taken deductions improperly and in violation of this Court's holdings in *Wellman* and *Tawney*. More specifically, while the royalty language may allow for the deduction of certain "charges for transportation, dehydration and compression," the lease at issue in this case still fails to appropriately "indicate the method of calculating the amount to be deducted from the royalty share for such post-production costs" as required by Syl. Pt. 10 of *Tawney, supra*. The lease does not specifically state that the Plaintiffs will incur any particular percentage or share of any alleged costs. Indeed, the lease does not discuss the proportional calculation or sharing of post-production costs and it does not reference any well-head valuation principles or standards as contemplated by the discussion in *Leggett 2, supra*, or those in *Young*, 982 F.3d at 203-04 & 208. Additionally, Defendants must be able to demonstrate that any deductions they took were reasonable and actually incurred, by evidence of the type normally developed in legal proceedings requiring an accounting. Syl. Pt. 5, *Wellman, supra*.

D. Procedural History.

The procedural history of this lawsuit is adequately set forth by the Defendants in their opening brief so as to not require additional comments by the Plaintiffs other than to note that Plaintiffs have argued to the certifying District Court that not only do the deductions taken by Defendants violate the law of West Virginia as set forth by *Wellman* and *Tawney*, but also that the facts of this case are distinguishable from those in *Young*. [Kellam JA, at pp. 62-73]. The District Court has yet to rule on the Defendants' motion for judgment on the pleadings, rather seeking this Court's clarification of the law first in light of the Fourth Circuit's ruling in *Young*, *supra*.

III. Summary of Argument.

A. Assignment of Error/Certified Question No. 1: This Court Should Reaffirm *Wellman* and *Tawney* and Honor Principles of Stare Decisis.

This Court should decline to hear this certified question under W.Va.Code § 51-1A-3 because both *Wellman* and *Tawney* are controlling law in this jurisdiction and entitled to the highest precedential value accorded to decisions of this Court. Any criticisms of *Wellman* and *Tawney* contained in *Leggett 2* were mere dicta that do not alter the current controlling nature of those precedents under principles of stare decisis. Should this Court now overrule *Wellman* and *Tawney*, it will create new tensions of the type feared by the Court in *Leggett 2* between the common law affecting "freely negotiated" leases and the statutory law set forth for flat-rate leases converted to $1/8^{th}$ royalty leases pursuant to §22-6-8. This Court should decline to create such an unnecessary conflict and should honor principles of stare decisis by declining to hear the District Court's certified question; thereby, indicating that its decisions in *Wellman* and *Tawney* remain the law of this State.

Should this Court decide to entertain said question, it must be recognized that this Court in both *Wellman* and *Tawney*, after discussing and considering the conflicts among jurisdictions as to whether post-production costs maybe deducted, based their holdings upon well-established law of this jurisdiction, including the implied covenant of marketability that honors the long-established expectation of lessors in this State that they would receive a royalty of $1/8^{th}$ of the sale price received by the lessees, and canons of contract construction. The canons of construction included those that address when an ambiguity will be found in the terms of a lease and the corollary rules that an oil and gas lease shall be liberally construed in favor of the lessor and that uncertainties in an intricate and involved contract shall be resolved against the party who prepared it. Of course, in accordance with other canons of contract construction, both *Wellman* and *Tawney* acknowledge that a lessee who wishes to have a lessor share in any such so-called post-production costs can do so by placing such intent into the lease in clear and unambiguous terms that satisfy the requirements of the Court as pronounced in *Wellman* and *Tawney*.

The holdings of this Court in *Wellman* and *Tawney* require that lessees act with transparency and accountability in their dealings with lessors. Moreover, they recognize that the parties may agree to modify the duties and responsibilities of the implied covenant of marketability by express language in the lease agreement and essentially elucidate what is required for express language to be sufficiently clear and unambiguous to be applied and what proof is required to satisfy the law of this State when sought to be enforced. The Kellam lease was executed in 2007 [Kellam JA, at 2-3 & 57-58], before *Leggett 2*, when this Court's decisions in *Wellman* and *Tawney* were undisputedly the recognized law of West Virginia. Accordingly, any lessees drafting this lease certainly should have been aware of such law and drafted the lease to be in accordance with *Wellman* and *Tawney* inasmuch as that law has become part of the lease to the same extent as if they were expressly incorporated in its terms.

Defendants rely upon the criticisms of *Wellman* and *Tawney* contained in *Leggett 2* in arguing that such decisions should be overruled. However, nowhere in the Defendants' brief do they recognize or emphasize any importance in the West Virginia Legislature effectively overruling *Leggett 2* by adopting a clarifying amendment, Senate Bill 360, to W.Va.Code §22-6-8(e). Section 22-6-8(e), as now clarified, prohibits the deduction of "post-production" costs and essentially adopts the same requirements for statutorily-converted leases as *Wellman* and *Tawney* do for so-called freely negotiated leases; thereby, reaffirming this State's clear public policy against permitting lessees to deduct post-production costs from lessors' $1/8^{th}$ royalty payments.

In essence, the holdings of *Wellman* and *Tawney* honor the lessor-lessee relationship as it has always been understood in West Virginia, consistent with the implied covenant of marketability--such understanding including that the lessee incurs all of the cost of producing and selling the gas in exchange for getting $7/8^{th}$ of the sale price. This reasonable expectation of the lessor, who as the mineral owner and not a working-interest owner, only receives $1/8^{th}$ of the sale price, demands that if the lessee wants to alter such approach and have the lessor share in the costs of the so-called "post production" activities that the lessee must clearly explain that in the lease in clear and unambiguous language consistent with this Court's holdings.

Accordingly, contrary to the argument of Defendants, the holdings in *Wellman* and *Tawney* do not result from an "unwillingness to accept the realities of deregulation," but rather from this understanding and acceptance that royalty owners should not be treated as working-interest owners without the corresponding rights of those entities unless expressly set forth in the lease in clear and unambiguous language. This same rationale justifies why this Court specified the "point of sale" in its holdings in Syl. Pts. 4 & 5 of *Wellman* and Syl. Pts 1, 2, 10 & 11 of *Tawney* instead of the first market for the sale of the gas. If the lessee or its affiliate sells the gas to an unaffiliated third-party purchaser in an arms-length transaction at the first market for the sale of gas, the locations will be the same and the distinction will be one without meaning. However, if the lessee decides to sell the gas further downstream than the first market because it or one of its affiliates can obtain a more lucrative sale price and corresponding profit, then the lessor's $1/8^{th}$ royalty should be based upon such higher sale price. These holdings of *Wellman* and *Tawney* are fair and just to all parties and should be upheld and reaffirmed by this Court.

B. Assignments of Error/Certified Questions Nos. 2 & 3: This Court's Holding That a Lease Must Include the Method of Calculating the Amount of Post-Production Costs Means Just That and a Mere Simple Listing of the Types of Costs Which May Be Deducted Is Not Sufficient to Satisfy *Tawney*.

Consistent with the well-reasoned and thorough analysis of the certifying District Court, if the words of this Court are to be given their express meaning, merely providing a simple listing of the types of costs which may be deducted is not sufficient. A lease must "identify with particularity the specific deductions the lessee intends to take from the lessor's royalty[.]" Syl. Pt. 10, *Tawney*, *supra*. Similarly, unless the express holdings of this Court are to be treated as mere surplusage, a lease must "indicate the method of calculating the amount to be deducted from the royalty for such post-production costs." *Id.* Contrary to the Defendants' suggestion otherwise, merely alluding how much of those costs will be deducted from the lessor's royalties by stating that "all" or "reasonable" costs will be deducted is clearly insufficient to meet the express holdings of *Tawney*. Unless this Court honors the actual language contained in the holdings of both *Wellman* and *Tawney*, the transparency and accountability that they demand of lessees in their dealings with lessors will be lost to the harm and detriment of mineral owners.

C. Only Specified Direct Post-Production Costs That Are Identified with Particularity in a Lease Can Be Properly Deducted and Not Indirect Costs, Including Those of an Affiliate.

Although *Wellman* and *Tawney* did not expressly address the distinction between direct and indirect costs, in order to ensure that only reasonable deductions specified in the lease with particularity and actually incurred are deducted by lessees, this Court should follow and adopt the reasoning used by courts in cases such as *W.W. McDonald Land Co. v. EQT Prod. Co.*, 983 F.Supp.2d at 816, and *Kay Co., LLC v. EQT Prod. Co.*, 2017 WL 10436074, at **18-19, on this issue and prohibit lessees from taking indirect costs, including those of an affiliate, from the royalty payments of lessors. These holdings are consistent with this Court's holdings in *Wellman* and *Tawney* that any post-production costs must be both reasonable and actually incurred, and that any specific deductions must be identified with particularity. Otherwise, the transparency and accountability required by lessees will be emasculated to the harm and detriment of lessors.

IV. Statement Regarding Oral Argument.

As noted by Defendants, this Court has already directed that this matter should be scheduled for oral argument under Rule 20 of the West Virginia Rules of Appellate Procedure. Given the importance of the issues presented in this case and their potential impact upon both mineral owners and gas producers, should this Court continue to exercise its discretion to answer the proposed certified questions, Plaintiffs respectfully request that each side be given thirty minutes for oral argument.

V. Argument.

A. Standard of Review

The Uniform Certification of Questions of Law Act, W.Va.Code § 51-1A-3 (1996), provides, in pertinent part:

> The supreme court of appeals of West Virginia may answer a question of law certified to it by any court of the United States . . ., if the answer may be determinative of an issue in a pending cause in the certifying court **and if there is no controlling appellate decision, constitutional provision or statute of this state**.

W.Va.Code § 51-1A-3 (emphasis added).

Therefore, certification is only appropriate when "there is no controlling appellate decision[.]" *Id. E.g., James G. v. Caserta*, 175 W.Va. 406, 408 n. 2, 332 S.E.2d 872, 874 n.2 (1985) ("This procedure is used when there is no controlling State precedent on the issue certified."); *Taylor v. Nationwide Mut. Ins. Co.*, 214 W.Va. 324, 326, 589 S.E.2d 55, 57 (2003) ("The answer to the certified question herein is determinative of an issue in a pending cause of action in the federal district court, and there is no controlling precedent."); *McDavid v. U.S.*, 213 W.Va. 592, 594 n. 2, 584 S.E.2d 226, 228 n. 2 (2003) (same); *Lilly v. Overnight Transp. Co.*, 188 W.Va. 538, 540, 425 S.E.2d 214, 216 (1992) (same).

This Court's conclusion in *Leggett 2, supra*, that *Wellman* and *Tawney* were not relevant to its analysis of W.Va.Code § 22-6-8(e) because those cases dealt with freely negotiated leases that were subject to canons of construction for contracts (as opposed to those for statutes) as well as the implied covenant of marketability which the Court concluded did not influence statutes were relevant and necessary to its decision. However, as acknowledged by the Court, itself, any other criticisms of *Wellman* and *Tawney* were mere dicta that do not alter the current controlling nature of those precedents under principles of stare decisis. *Leggett 2*, 239 W.Va. at 277; 800 S.E.2d at 863. *Accord Cather v. EQT Production Co.*, No. 1:17-cv-208, 2019 WL 3806629, at *5 (N.D.W.Va. Aug. 13, 2019) (Kleeh, J.) ("*Wellman* and *Tawney* continue to have the same vitality and scope they have had since being decided."). Should this Court now overrule *Wellman* and *Tawney*, it will create new tensions of the type feared by the Court in *Leggett 2* between the common law affecting "freely negotiated" leases and the statutory law set forth for flat-rate leases converted to $1/8^{th}$ royalty leases pursuant to §22-6-8. This Court should decline to create such an unnecessary conflict and should honor principles of stare decisis by declining to hear the District Court's certified questions; thereby, essentially indicating that its decisions in *Wellman* and *Tawney* remain the law of this State.

Should this Court decide to answer any of the certified questions, it applies a de novo standard in addressing legal issues presented in certified questions from a federal court. Syl. Pt. 1, *Leggett 2, supra*.

B. Assignment of Error/Certified Question No. 1: This Court Should Reaffirm *Wellman* and *Tawney* and Honor Principles of Stare Decisis.

1. Principles of Stare Decisis Require That *Wellman* and *Tawney be Upheld and Reaffirmed.*

This Court in *State v. McKinley*, 234 W.Va. 143, 764 S.E.2d 303 (2014), held:

> Signed opinions containing original syllabus points have the highest precedential value because the Court uses original syllabus points to announce new points of law or to change established patterns of practice by the Court.
>
> Signed opinions that do not contain original syllabus points also carry significant, instructive, precedential weight because such opinions apply settled principles of law in different factual and procedural scenarios than those addressed in original syllabus point cases.
>
> Signed opinions, both those including new syllabus points and those not containing new syllabus points, are published opinions of the Court. As such, they should be the primary sources relied upon in the development of the common law.

Syl. Pts. 1-3, *McKinley, id.*

This Court's opinions in *Wellman* and *Tawney* both contain original as well as pre-existing syllabus points and, thus, are entitled to the highest precedential value among this Court's decisions. Syl. Pt. 1, *id.* In discussing the doctrine of stare decisis, this Court has explained:

> The principle of stare decisis, however, is firmly rooted in our jurisprudence. Uniformity and continuity in law are necessary. Douglas, *Stare Decisis*, 49 Colum.L.Rev. 735. While the principle of stare decisis admits of exception, deviation from its application should not occur absent some urgent and compelling reason. As this Court said in *Adkins v. St. Francis Hospital*, 149 W.Va. 705, 718, 143 S.E.2d 154, 162:
>
> "* * * Stare decisis is not a rule of law but is a matter of judicial policy. * * * It is a policy which promotes certainty, stability and uniformity in the law. It should be deviated from only when urgent reason requires deviation. * * * In the rare case when it clearly is apparent that an error has been made or that the application of an outmoded rule, due to changing conditions, results in injustice, deviation from that policy is warranted."
>
> We may have felt differently about the disposition were we reviewing *Bethlehem Mines* again for the first time. If the doctrine of stare decisis is to play any judicial role, however, we cannot overrule a decision so recently rendered without any evidence of changing conditions or serious judicial error in interpretation. Mere disagreement as to how a case was decided is not a sufficient

> reason to deviate from a judicial policy promoting certainty, stability and uniformity in the law.

Dailey v. Bechtel Corp., 157 W.Va. 1023, 1028-29, 207 S.E.2d 169, 173 (1974). *Accord Woodrum v. Johnson*, 210 W.Va. 762, 766-67 & n. 8, 559 S.E.2d 908, 912-13 & n.8 (2001).

In the present case, there are no changing conditions since this Court's decisions in *Wellman* and *Tawney* which justify departing from them. Rather, Defendants suggest that this Court failed to consider prior changes to the gas industry caused by deregulation in deciding *Wellman* and *Tawney*. However, just because the Court did not expressly mention the purported effects of deregulation does not mean that this Court was not aware of them. Briefing by defendants and their amici in *Tawney* informed this Court of deregulation and its purported effects. But, simply put, not every alleged fact or issue which a party believes is material will be deemed so by this Court or have the desired effect that the party proposes.

Also, it is important to acknowledge that this Court in both *Wellman*, 210 W.Va. at 209-11, 557 S.E.2d at 263-65, and *Tawney*, 219 W.Va. at 270-72, 633 S.E.2d at 26-28, were "aware of conflicting decisions [from other jurisdictions] and gave at least some persuasive discussion" as to the reasons for its holdings therein. *See State v. Guthrie*, 194 W.Va. 657, 679 n. 28, 461 S.E.2d 163, 185 n. 28 (1995) ("Precedent does not cease to be authoritative merely because counsel in a later case advances a new argument. . . . But, as a practical matter, a precedent-creating opinion that contains no extensive analysis of an important issue is more vulnerable to being overruled than an opinion which demonstrates that the court was aware of conflicting decisions and gave at least some persuasive discussion as to why the old law must be changed." (internal citation omitted)).

Moreover, as to any argument that *Leggett 2's* criticism of *Wellman* and *Tawney* should justify overruling them, this Court has previously acknowledged:

> [W]e believe:

> "Remaining true to an 'intrinsically sounder' doctrine established in prior cases better serves the values of stare decisis than would following a more recently decided case inconsistent with the decisions that came before it; the latter course would simply compound the recent error and would likely make the unjustified break from previously established doctrine complete. In such a situation 'special justification' exists to depart from the recently decided case." *Adarand Constr., Inc. v. Pena,* 515 U.S. 200, [231], 115 S.Ct. 2097, 2115, 132 L.Ed.2d 158, 185 (1995).
>
> Overturning precedent with a long standing in the law that has become an integrated fabric in the law is different. Therefore, we leave in tact the *Clifford* rule as amplified by *Hatfield. So by refusing to follow Schrader but continuing Clifford and Hatfield, "we do not depart from the fabric of the law; we restore it." Adarand Constructors, Inc. v. Pena,* 515 U.S. at [234], 115 S.Ct. at 2116, 132 L.Ed.2d at __.

State v. Guthrie, 194 W.Va. at 676, 461 S.E.2d at 182 (emphasis added).

As previously argued herein, overruling the holdings of this Court in *Wellman and Tawney* in favor of the criticisms contained in *Leggett 2* would have the deleterious effect of creating the same tensions feared in *Leggett 2* between this Court's treatment of so-called post-production deductions in "freely negotiated" 1/8th royalty leases and those same deductions in 1/8th royalty leases converted from flat-rate leases by W.Va.Code § 22-6-8(e), as amended by the clarifying amendment, Senate Bill 360, that effectively overruled *Leggett 2*. Accordingly, by rejecting the criticisms of *Leggett 2* and reaffirming *Wellman* and *Tawney*, this Court does not depart from the fabric of the law, but instead restores it. *State v. Guthrie*, 194 W.Va. at 676, 461 S.E.2d at 182.

2. The Implied Covenant of Marketability/"Marketable-Product Rule" Governs the Presumed Intentions of Parties to Oil and Gas Leases Unless the Express and Unambiguous Terms of the Lease Differ.

Defendants cite several cases which apply the express and unambiguous terms of various lease agreements. *See Ascent Resources-Marcellus, LLC v. Huffman*, 244 W.Va.119, 125, 851 S.E.2d 782, 788 (2020); *Faith United Methodist Church & Cemetery of Terra Alta v. Morgan*, 231 W.Va. 423, 444, 745 S.E.2d 461, 482 (2013); *Bruce McDonald Holding Co. v. Addington, Inc.*, 241 W.Va. 451, 463-64, 825 S.E.2d 779, 791-92 (2019). However, there is nothing contained in *Wellman* and *Tawney* which explicitly conflict with the holdings of these decisions. Indeed, *Tawney*, itself, discussed some of the same principles of contract construction. *See* Syl. Pts. 3 & 4, *Tawney*, *supra*. And the holdings of both *Wellman* and *Tawney* acknowledge that sufficiently clear and unambiguous terms of a lease agreement will be honored. Syl. Pts. 4 & 5, *Wellman*, *supra*; Syl. Pts. 1, 2, 10, & 11, *Tawney*, *supra*. These syllabus points of *Wellman* and *Tawney* essentially elucidate what is required for such language to be sufficiently clear and unambiguous to be applied and what proof is required to satisfy the law of this State when sought to be enforced.

Additionally, it should be acknowledged:

> "'An oil and gas lease (or other mineral lease) is both a conveyance and a contract. It is designed to accomplish the main purpose of the owner of the land and of the lessee (or its assignee) as operator of the oil and gas interests: securing production of oil or gas or both in paying quantities, quickly and for as long as production in paying quantities is obtainable.' Syllabus Point 1, *McCullough Oil, Inc. v. Rezek*, 176 W. Va. 638, 346 S.E.2d 788 (1986)."

Syl. Pt. 2, *Ascent Resources—Marcellus, LLC v. Huffman*, *supra*.

The implied covenant of marketability recognizes what the presumed intentions of parties to an oil and gas lease are as well as what their corresponding duties and responsibilities are to accomplish these intentions. *See Wellman*, *supra*; *Tawney*, *supra*. Defendants cite *Thompson Dev., Inc. v. Kroger Co.*, 186 W.Va. 482, 485, 413 S.E.2d 137, 140 (1991), and *Leggett 2*, 239 W.Va. at 275, 800 S.E.2d at 861, for the proposition that an implied covenant cannot override express terms of the contract that are contrary to duties imposed by the implied covenant. Again, however, both *Wellman* and *Tawney* recognize that the parties may agree to modify such duties and responsibilities by express language in the lease agreement and essentially elucidate what is required for express language to be sufficiently clear and unambiguous to be applied and what proof is required to satisfy the law of this State when sought to be enforced. There is nothing inherently in conflict with these particular holdings of these cases.[3] *See also Cather v. EQT Production Co.*, 2019 WL 3806629, at **3-5.

Moreover, cases cited by the Defendants importantly acknowledge that "[a] lease will be interpreted and construed as of the date of its execution." Syl. Pt. 4, *Ascent Resources—Marcellus, LLC v. Huffman*, *supra*. Indeed, "'[t]he laws which subsist at the time and place where a contract is made and to be performed enter into and become a part of it to the same extent and effect as if they were expressly incorporated in its terms.' Syllabus point 1, *Franklin Sugar Ref. Co. v. Martin–Nelly Grocery Co.*, 94 W. Va. 504, 119 S.E. 473 (1923)." Syl. Pt. 6, *Bruce McDonald Holding Co. v. Addington, Inc.*, *supra*. The Kellam lease was executed in 2007 [Kellam JA, at 2-3 & 57-58], before *Leggett 2*, when this Court's decisions in *Wellman* and *Tawney* were undisputedly the recognized law of West Virginia. Any lessees drafting this lease certainly should have been aware of such law and drafted the lease to be in accordance with *Wellman* and *Tawney* inasmuch as that law has become part of the lease to the same extent as if they were expressly incorporated in its terms. *Id.*

3. ***Wellman* and *Tawney* Do Not Rest upon Faulty Premises or Otherwise Improperly Rewrite Leases Nor Are Courts Improperly Using Policy Concerns to Override Express Terms of Leases Through the Use of Implied Covenants.**

Defendants rely upon the criticisms of *Wellman* and *Tawney* contained in *Leggett 2* in arguing that such decisions should be overruled, including those law review or journal articles cited therein by then-Chief Justice Allen Loughry. Interestingly, but perhaps not surprisingly, nowhere in the Defendants' brief do they recognize or emphasize any importance in the West Virginia Legislature effectively overruling *Leggett 2* by adopting a clarifying amendment,

[3] Defendants' arguments notwithstanding, as a practical matter for the purposes of this appeal, because there is no inherent conflict in these decisions of the Court, an in-depth analytical or philosophical discussion of "whether the chicken or the egg came first" is of little significance or import.

Senate Bill 360, to W.Va.Code §22-6-8(e). *See Kay Co., LLC v. EQT Production Co.*, Civil Action No. 1:13-CV-151, Slip. Op. [ECF Doc. 723] (N.D.W.Va. Nov. 14, 2018) (Bailey, J.)*; see also* Wilson, *Without a Leggett to Stand on: Arguing for Retroactive Application of West Virginia's Amended Flat-Rate Well Statute*, 124 W.Va.L.Rev. 259 (2021).[4]

Without doubt, the clarification of § 22-6-8(e), which as previously noted had been requested by this Court in *Leggett 2*, 239 W.Va. at 283 & 285, 800 S.E.2d at 869 & 871, establishes that our Legislature agreed with this Court's initial interpretation of § 22-6-8(e) contained in *Leggett 1*, No. 16-0136, Slip Op. (W.Va. Nov. 17, 2016), rather than that contained in *Leggett 2*. In *Leggett 1*, this Court had found that the holdings in *Wellman* and *Tawney* concerning so-called "freely negotiated" leases were relevant, helpful, and instructive in interpreting the meaning of similarly ambiguous "at the wellhead" language contained in § 22-6-8(e). *Id.* Indeed, the clarified version of § 22-6-8(e) is identical to the holdings reached by this Court in *Leggett 1* as to the issue of whether post-production deductions can be taken from flat-rate leases converted to 1/8th royalty leases by such Statute.

It should also be noted that this Court has acknowledged:

> """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

[4] As to clarifying amendments, Courts have explained: "We note at the outset that when an amendment alters, even 'significantly alters,' the original statutory language, this does 'not necessarily' indicate that the amendment institutes a change in the law." *Brown v. Thompson*, 374 F.3d 253, 259 (4th Cir. 2004) (quoting *Piamba Cortes v. American Airlines, Inc.*, 177 F.3d 1272, 1283 (11th Cir. 1999) (internal quotation marks and citation omitted)). "[C]hange[ ] in statutory language need not *ipso facto* constitute a change in meaning or effect. Statutes may be passed purely to make what was intended all along even more unmistakably clear." *United States v. Montgomery County*, 761 F.2d 998, 1003 (4th Cir. 1985). *Accord, e.g., Wesson v. United States*, 48 F.3d 894, 901 (5th Cir. 1995) ("an amendment to a statute does not necessarily indicate that the previous version was the opposite of the amended version"); *United States v. Sepulveda*, 115 F.3d, 882, 885 n.5 (11th Cir. 1997) (noting that the legislature may amend a statute to establish new law, but that it may also enact an amendment "to clarify existing law, to correct a misinterpretation, or to overrule wrongly decided cases." (internal quotation marks and citation omitted)).

> design thereof, if its terms are consistent therewith." Syllabus Point 5, *State v. Snyder,* 64 W.Va. 659, 63 S.E. 385 (1908).' Syl. Pt. 1, *State ex rel. Simpkins v. Harvey,* 172 W.Va. 312, 305 S.E.2d 268 (1983), *superseded by statute on other grounds as stated in State ex rel. Hagg v. Spillers,* 181 W.Va. 387, 382 S.E.2d 581 (1989)."

Syl. Pt. 2, *State ex rel. Hall v. Schlaegel*, 202 W.Va. 93, 502 S.E.2d 190 (1998).

Now, despite the clarifying amendment of § 22-6-8(e) that essentially overruled *Leggett 2* and which they ignore, Defendants insist that this Court should overrule *Wellman* and *Tawney* largely based upon the criticisms found in *Leggett 2* and the reasoning of law reviews and journals cited therein; many articles of which have been written by lawyers who represent or have represented natural gas producers and/or their parents or affiliates. (*See* fn. 2, *supra*). Is it really any wonder that such articles appear to advance the viewpoint of gas producers rather than that of mineral owners who must struggle to keep even their paltry 1/8th royalty payments?

Contrary to the assertions of Defendants and the majority in *Leggett 2*, this Court's decisions in *Wellman* and *Tawney* do not rest on faulty premises. As previously discussed, after surveying conflicts among jurisdictions on the issue of whether "post-production" costs may be deductible, the *Wellman* Court explained:

> 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 less[ee].
>
> 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 211, 557 S.E.2d at 265.

This Court in *Wellman* set forth the following original syllabus points:

> 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.
>
> If an oil and gas lease provides that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, the lessee shall be entitled to credit for those costs to the extent that they were actually incurred and they were reasonable. Before being entitled to such credit, however, the lessee must prove, by evidence of the type normally developed in legal proceedings requiring an accounting, that he, the lessee, actually incurred such costs and that they were reasonable.

Syl. Pts. 4 & 5, *Wellman, id. See also* J. Thomas Lane & Joel E. Symonds, "*Accounting for Cotenants, Trustees, Lessees, Trespassers and the Like*," 27 Energy & Min. L. Inst. ch. 8 (2007).[5]

This Court's holdings in *Wellman* were, indeed, consistent with well-established law. As explained by Professor Maurice H. Merrill, who was considered the preeminent expert on implied covenants,[6] "[i]t is now settled that, in addition to the implied covenants for the exploration and for development, there is an implied covenant for the diligent and efficient operation of the lease and marketing of the product." Maurice H. Merrill, *Covenants Implied In Oil and Gas Leases*, § 72 at 184 (2d Ed. 1940). As to this implied covenant of marketability, Professor Merrill explained:

> Production, no matter how diligent, is futile without disposition of the product.... [I]n most cases the lessor thinks of his return solely in a sense of a fixed portion of the money realized from the operations and the lessee so treats it. From this factual background has evolved that the principle [the lessee] is under a duty "to make

[5] While J. Thomas Lane has represented lessors in cases, including *Tawney*, he is well respected for his intellectual abilities and ethics both as a lawyer and the former Robert T. Donley Adjunct Professor of Law at the West Virginia University College of Law who taught a course in Coal, Oil and Gas Law from 1986 until 2005. Moreover, the Article was published by the Energy & Mineral Law Foundation which "is a nonprofit educational organization that has become the premiere provider of continuing legal education for the energy and mineral industries in the Eastern United States." 27 Energy & Min. L. Inst., Preface (2007).

[6] Eugene Kuntz, *Law of Oil and Gas* § 54.1 (1978) ("With the publication of the second edition of the work, Merrill became the recognized authority on the subject. His influence on the development of the law in this respect is so great that one engaged in research must not only consider cases decided on the subject but must also consider opinions expressed by Merrill.").

> diligent efforts to market the production in order that the lessor may realize his royalty interest."

Merrill, *Covenants Implied In Oil and Gas Leases*, § 84 at 212.

> If it is the lessee's obligation to market the product, it seems necessarily to follow that his is the task also to prepare it for market, if it is unmerchantable in its natural form. *No part of the cost of marketing or of preparation for sale is chargeable to the lessor. This is supported by the general current of authority.*

Id., § 85 at 214-215 (emphasis added; footnotes omitted).

Subsequently, as also previously discussed, this Court in *Tawney, supra,* addressed whether leases that mentioned phrases such as "at the wellhead" altered its analysis of what had been "proceeds" leases in *Wellman.* The Court set forth its ultimate holdings in two original syllabus points:

> Language in an oil and gas lease that is intended to allocate between the lessor and lessee the costs of marketing the product and transporting it to the point of sale must expressly provide that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, identify with particularity the specific deductions the lessee intends to take from the lessor's royalty (usually 1/8), and indicate the method of calculating the amount to be deducted from the royalty for such post-production costs.
>
> Language in an oil and gas lease that provides that the lessor's 1/8 royalty (as in this case) 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 all costs beyond the wellhead," or "less all taxes, assessments, and adjustments" is ambiguous and, accordingly, is not effective to permit the lessee to deduct from the lessor's 1/8 royalty any portion of the costs incurred between the wellhead and the point of sale.

Syl. Pts. 10 & 11, *Tawney, supra.*

In reaching its holdings, the Court also followed established canons of contract construction. Significantly, the Court acknowledged 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." Syl. Pt. 4, *id.* The Court also recognized the time-honored canon that "'[t]he general rule as to oil and gas leases is that such contracts will generally be liberally construed in favor of the lessor, and strictly as against the lessee[,]'" Syl. Pt. 7, *id.* (quoting Syl. Pt. 1, *Martin v. Consolidated Coal & Oil Corp.*, 101 W.Va. 721, 133 S.E. 626 (1926)), as well as the analogous rule that "'[u]ncertainties in an intricate and involved contract should be resolved against the party who prepared it.'" Syl. Pt. 8, *id.* (quoting Syl. Pt. 1, *Charlton v. Chevrolet Motor Co.*, 115 W.Va. 25, 174 S.E. 570 (1934)).

These canons of construction are well known and widely accepted. As explained by one author:

> These contracts [oil and gas leases] are looked upon somewhat in the same light as contracts of insurance. By long experience insurance companies have been enabled to draw a policy which is often difficult to determine just what their liability may be. They have their attorneys who have spent years in studying contracts of insurance and the decisions of the courts, until they have become thoroughly versed in all phases of such contracts. On the other hand, the insured is usually without advice when entering into a contract of insurance, and he is almost universally ignorant of the rules of law applicable to such obligations. To such an extent is this true that the courts have adopted a construction, in cases of doubt or obscurity, favorable to the insured. What is true of insurance contracts may be said to be true of oil or gas leases (if not of mining leases). The lessor usually knows nothing of the law applicable to such instruments; while the operator is usually well informed. Years of experience have shown the operator how to draw a lease giving him many advantages, of which the lessor has not even thought. For this reason the courts have adopted a rule to the effect to construe an oil or gas lease most favorably to the lessor, where its terms can be so construed without doing violence to the language used.

1 W.W. Thornton, *The Law Relating to Oil and Gas* § 251 (1925). *Accord Ladd v. Upham*, 58 S.W.2d 1037, 1039 (Tex. Civ. App.-Ft. Worth 1933) (quoting same), *aff'd Upham v. Ladd*, 128 Tex. 14, 95 S.W.2d 365 (Tex. Comm'n App. 1936); Owen L. Anderson, *Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically? (Part 2)*, 37 Nat. Resources J. 611, at 636 n. 109 (1997) (quoting same; also opining at 635-36, "The flip side of this policy question is whether lessees should be rewarded for not clearly stating that lessors must bear a proportionate share of post-wellhead costs. I submit that lessees should not be rewarded for three reasons. First, they could have clearly stated their objective. Second, their

chosen language is susceptible to a construction that is more in harmony with the royalty clause as a whole. Third, an oil and gas lease offered by a lessee should be construed against the lessee." (footnotes omitted)).

As previously noted, reviewing the briefs submitted on the *Tawney* appeal, reveals that the issue of deregulation was brought to the Court's attention by the parties[7] and amici curiae. However, the fact that the Court did not expressly mention such issue does not mean that it ignored it or otherwise misunderstood it. What a party may believe or even insist is a material issue may not appear to be one to this Court. The fact that deregulation resulted in a change in the location of the market for the first point of sale of natural gas from the wellhead to a point further downstream does not necessarily change any of the duties and responsibilities of the respective parties under the implied covenant of marketability. Moreover, it does not mean that the gas producers have not attempted to "escape the rule that the lessee must pay the costs of discovery and production" by referring to these expenses "as 'post-production expenses.'" *Wellman*, 210 W.Va. at 210, 557 S.E.2d at 264.

Additionally, although a cursory reading of Defendants' brief could lead one to assume that the shifting of the first marketplace for the sale of natural gas has only resulted in an increase of the costs of production or so-called post-production borne by the lessee, a careful review of Defendants' brief also reflects that they admit that they may now sell gas in more lucrative markets than before deregulation and, accordingly, may make greater profits from the heightened sale prices available in such markets. If deregulation has led to more costs being incurred by producers but also higher sale prices and correspondingly the opportunity for higher profits, then why must lessees be expected to have their mere 1/8th royalty reduced by being required to share in such

[7] Indeed, defense counsel Timothy M. Miller, who represents Defendants herein also represented the defendants in *Tawney*.

costs? Why would or should the implied covenant of marketability be changed in any manner under such circumstances? Why is the scope of what constitutes "production costs" for these lessees not merely enlarged as opposed to "post-production costs" being created? Defendants and their supporters choosing to say so, does not make it so for this Court. In essence, the holdings of *Wellman* and *Tawney* honor the lessor-lessee relationship as it has always been understood in West Virginia, consistent with the implied covenant of marketability--such understanding including that the lessee incurs all of the cost of producing and selling the gas in exchange for getting 7/8th of the sale price. This reasonable expectation of the lessor, who as the mineral owner and not a working-interest owner, only receives 1/8th of the sale price, demands that if the lessee wants to alter such approach and have the lessor share in the costs of the so-called "post production" activities that the lessee must clearly explain that in the lease in clear and unambiguous language consistent with this Court's holdings.

As succinctly explained by one court which follows a version of the marketable-product rule:

> The lessor, who generally owns the minerals, grants an oil and gas lease, retaining a smaller interest, in exchange for the risk-bearing working interest receiving the larger share of proceeds for developing the minerals and bearing the costs thereof. Part of the mineral owner's decision whether to lease or to become a working interest owner is based upon the costs involved. We consider also that working interest owners who share costs under an operating agreement have input into the cost-bearing decisions. The royalty owners have no such input after they have leased. In effect, royalty owners would be sharing the burdens of working interest ownership without the attendant rights. If a lessee wants royalty owners to share in compression costs, that can be spelled-out in the oil and gas lease. Then, a royalty owner can make an informed economic decision whether to enter into the oil and gas lease or whether to participate as a working interest owner.

Wood v. TXO Prod. Corp., 854 P.2d 880, 882–83 (Okla. 1993). *Accord Legard v. EQT Prod. Co.*, No. 1:10-cv-00041, 2011 WL 86598, at **10-11 (W.D. Va. Jan. 11, 2011), *adopted by*, 2011 WL 4527784 (W.D. Va. Sept. 28, 2011).

This same rationale justifies why this Court specified the "point of sale" in its holdings in Syl. Pts. 4 & 5 of *Wellman* and Syl. Pts 1, 2, 10 & 11 of *Tawney* instead of the first market for the sale of the gas. If the lessee or its affiliate sells the gas to an unaffiliated third-party purchaser in an arms-length transaction at the first market for the sale of gas, the locations will be the same and the distinction will be one without meaning. *See also* W.Va.Code § 22-6-8(e) (2018) ("received at the first point of sale to an unaffiliated third-party purchaser in an arm's length transaction"). However, if the lessee decides to sell the gas further downstream than the first market because it or one of its affiliates can obtain a more lucrative sale price and corresponding profit, then the lessor's 1/8th royalty should be based upon such higher sale price. *See Wellman*, 210 W.Va. at 2011, 557 S.E.2d at 265 ("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 less[ee]."). For these reasons, the Defendants' argument as well as the conclusion of the district court in *W.W. McDonald Land Co.*, 983 F. Supp.2d at 800-02, are incorrect in concluding that this Court did not mean what it actually held in such decisions.

Accordingly, contrary to the argument of Defendants, the holdings in *Wellman* and *Tawney* do not result from an "unwillingness to accept the realities of deregulation," but rather from the understanding and acceptance that royalty owners should not be treated as working-interest owners without the corresponding rights of those entities unless expressly set forth in the lease in clear and unambiguous language. Moreover, what possible harm is caused gas producers when both *Wellman* and *Tawney* expressly acknowledge that a lessee who wishes to have a lessor share in any such so-called post-production costs can do so by placing such intent into the lease in clear and unambiguous terms that satisfy the requirements of the Court as pronounced in such decisions? How then are such decisions and their holdings unfair to lessees or otherwise contrary to law? The truthful answer is they are not unfair or contrary to the law. They simply are inconvenient to the false or misleading narrative that gas producers, such as the Defendants, wish to contrive in order to paint mineral owners as greedy and gas producers as victims. Instead, *Wellman* and *Tawney* require transparency and accountability from lessees that require them to reveal what they intend to do and to suffer the consequences if they fail to do so.

Additionally, it is disingenuous to suggest that West Virginia's marketable-product rule by not automatically allowing for the deductions of post-production costs from a lessor's royalty payment will lead to the wasting of natural gas because lessees will prematurely abandon gas wells to avoid such costs in contravention of the public policy of West Virginia. The West Virginia Legislature adopted the Flat-Rate Well Statute primarily because West Virginia's public policy disapproved of the "exploitation of the natural resources of this state" in exchange for "wholly inadequate compensation." W.Va.Code § 22-6-8(a)(2). That Legislature's recent amendment of § 22-6-8(e) to clarify that royalty payments under statutorily converted leases must be "free from any deductions for post-production expenses" reveals a clear public policy against deducting post-production costs from a lessor's royalty payments. W.Va.Code § 22-6-8(e).

It should also be noted that Defendants through the articles they cite depict that states following a version of the "marketable-product rule," such as West Virginia, are in a minority compared to those states which follow the "at the wellhead rule" and which automatically permit deductions for post-production costs. However, in reality, this is not true as the jurisdictions are more evenly split. Suffice it to summarize that eight states have adopted the "at the wellhead" rule: California, Kentucky, Louisiana, Mississippi, Montana, North Dakota, Pennsylvania, and Texas.[8]

[8] *See Atl. Richfield Co. v. State of California*, 214 Cal. App. 3d 533, 541-42 (Cal. Ct. App. 1989); *Baker v. Magnum Hunter Prod., Inc.*, 473 S.W.3d 588, 591-595 (Ky. 2015); *Babin v. First Energy Corp.*, 693 So. 2d 813, 815 (La. App. 1 Cir. 1997); *Pursue Energy Corp. v. Abernathy*, 77 So. 3d 1094, 1099 (Miss. 2011); *Montana Power Co. v. Kravik*, 586 P.2d 298, 303 (Mont. 1978); *Bice v. Petro-Hunt, L.L.C.*, 768 N.W.2d 496, 502 (N.D. 2009); *Kilmer v. Elexco Land Servs., Inc.*, 990 A.2d 1147, 1158 (Pa. 2010); *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 122 (Tex. 1996).

Federal district courts in two other states – Ohio and Utah – have predicted that such state's highest courts would adopt the "at the wellhead rule."[9]

Conversely, eight states have adopted – either through decisions or statutes – some form of the marketable-product rule: Arkansas, Colorado, Kansas, Michigan, Nevada, Oklahoma, West Virginia, and Wyoming.[10] In addition, a Virginia federal district court has predicted that the Virginia Supreme Court would adopt a version of the marketable-product rule.[11] Thus, the count of "at the wellhead" states versus "marketable-product rule" states is nearly even.

However, it must also be recognized that because the federal government, which is the largest royalty owner of all, requires that its lessees "must place gas, residue gas, and gas plant products *in marketable condition and market the gas*, residue gas, and gas plant products for the mutual benefit of the lessee and the lessor *at no cost to the Federal government[,]*" 30 C.F.R. § 1206.146 (emphases added), a majority of the natural gas production in the United States is in reality governed by the marketable-product rule. *See* John Burritt McArthur, *Some Advice on Bice, North Dakota's Marketable-Product Decision*, 90 N.D. L. Rev. 545, 549-563 (2014). Additionally, it should be noted that state agencies in many producing states–even "at the wellhead rule" states such as Texas and Louisiana–employ variations of the marketable-product rule in their

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[9] *See Lutz v. Chesapeake Appalachia, LLC*, 2017 WL 4810703, at *8 (N.D. Ohio Oct. 25, 2017); *Emery Res. Holdings, LLC v. Coastal Plains Energy, Inc.*, 915 F. Supp. 2d 1231, 1242 (D. Utah 2012). However, the Supreme Court of Ohio in reality has declined to adopt either rule, instead emphasizing a case-by-case approach dependent upon the express terms of the lease. *Lutz v. Chesapeake Appalachia*, L.L.C., 148 Ohio St. 3d 524, 526, 71 N.E.3d 1010, 1012 (2016).

[10] *See Hanna Oil & Gas Co. v. Taylor*, 759 S.W.2d 563, 564-565 (Ark. 1988); *Rogers v. Westerman Farm Co.*, 29 P.3d 887, 906 (Colo. 2001); *Fawcett v. Oil Producers, Inc. of Kansas*, 352 P.3d 1032, 1041 (Kan. 2015); Mich. Comp. Laws Ann. § 324.61503b (2000); Nev. Rev. Stat. Ann. § 522.115 (1991); *Wood v. TXO Prod. Corp.*, 854 P.2d 880, 882–83 (Okla. 1993); *Tawney*, 219 W. Va. at 272, 633 S.E.2d at 28; Wyo. Stat. Ann. § 30-5-304 (1989).

[11] *See Legard v. EQT Prod. Co.*, 2011 WL 86598, at *11 (W.D. Va. Jan. 11, 2011), *adopted by*, 2011 WL 4527784 (W.D. Va. Sept. 28, 2011). *Accord Adair v. EQT Prod. Co.*, 320 F.R.D. 379, 427 (W.D. Va. 2017).

own leases. *See* McArthur, *supra*, at 553.[12] Accordingly, when the public land owned by the federal and state governments are also included in the tally, it is clear that the majority of natural gas production that occurs in our Country transpires under some variation of the "marketable-product rule."

Moreover, our own State of West Virginia, when it acts as lessor through its Division of Natural Resources, expressly disallows deductions for post-production costs. Those State leases which are published online by the Department of Commerce each contain the following or substantially similar language:

> **Production & Post-Production Costs.** *Neither Lessee, nor any Affiliate of Lessee, may reduce Lessor's royalty for any post-production expense*, including, by way of example and not limitation, pipelines, surface facilities, telemetry, gathering, dehydration, transportation, fractionation, compression, manufacturing, processing, treating, or marketing of the Granted Minerals or any severance or other taxes of any nature paid on the production thereof. *Royalties under this Lease shall be based on the total proceeds of sale of the Granted Minerals, exclusive of any and all production and/or post-production costs.*

See http://wvmineraldevelopment.org/mineral-development-properties.html (emphases added).

Interestingly, these leases evince not only what our State views as fair leases concerning the minerals in public land, but also that gas producers in this State are able to operate profitably under leases that not only prohibit post-production deductions but that require a $1/5^{th}$ (20%) royalty for the lessor instead of the standard $1/8^{th}$ (12.5%) royalty. These leases further demonstrate that the State is not concerned that prohibiting such deduction of post-production costs will lead to waste of natural gas by causing gas producers to prematurely abandon such wells to avoid such costs.

[12] Although some count Ohio as an "at the well" state based on a federal district court decision, Ohio's statute governing state lands disallows deductions for post-production costs. *See* Ohio Rev. Code Ann. §§ 155.30(B); 155.34(A)(1)(b).

C. Assignments of Error/Certified Questions Nos. 2 & 3: This Court's Holding That a Lease Must Include the Method of Calculating the Amount of Post-Production Costs Means Just That and a Mere Simple Listing of the Types of Costs Which May Be Deducted Is Not Sufficient to Satisfy *Tawney*.

As previously noted, this Court in Syllabus Point 10 of *Tawney* held:

> Language in an oil and gas lease that is intended to allocate between the lessor and lessee the costs of marketing the product and transporting it to the point of sale must expressly provide that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, identify with particularity the specific deductions the lessee intends to take from the lessor's royalty (usually 1/8), and indicate the method of calculating the amount to be deducted from the royalty for such post-production costs.

Syl. Pt. 10, *Tawney, supra.*

Clearly, if the words of this Court are to be given their express meaning, merely providing a simple listing of the types of costs which may be deducted is not sufficient. A lease must "*identify with particularity the specific deductions* the lessee intends to take from the lessor's royalty[.]" *Id.* (emphasis added). Similarly, unless the express holdings of this Court are to be treated as mere surplusage, a lease must "indicate the *method of calculating the amount to be deducted* from the royalty for such post-production costs. *Id.* (emphasis added). Contrary to the Defendants' suggestion otherwise, merely alluding how much of those costs will be deducted from the lessor's royalties by stating that "all" or "reasonable" costs will be deducted is clearly insufficient to meet the express holdings of *Tawney*.

As insightfully recognized by the certifying District Court:

> [T]he ***Tawney*** requirements should remain the law in West Virginia for several reasons. First, many of these leases are entered into with unsophisticated individuals who lack the expertise and experience to understand the terms of the lease. Second, with no clear statement as to methodology, the lessee could sell to a related company and thereby control the amount of post-production costs, yet make a large profit downstream. Third, the lessee can include indirect costs that are unrelated to the true post-production costs. It must be emphasized that it is the lessee that controls the information. Most lessors are ill-equipped to conduct an audit of the lessee's numbers, even if they were allowed to do so. This Court believes that *Tawney* should remain the law and require a clearly spelled out mathematical method for deducting post-production costs.

Kellam v. SWN Production Co., 2021 WL 4621067, at *11 [Kellam JA, at 124]. In essence, unless this Court honors the actual language contained in the holdings of both *Wellman* and *Tawney*, the transparency and accountability that they demand of lessees in their dealings with lessors will be lost to the substantial detriment of lessors.

It is well-established law that, unless otherwise required by expressed definition or specialized customs or usages of trade, courts will utilize the common and ordinary meaning and definitions of words. *See, e.g., State ex rel. State Farm Mut. Auto. Ins. Co. v. Bedell*, 228 W.Va. 252, 267, 719 S.E.2d 722, 737 (2011) (applying rule to words used in Court order); *Jackson v. Belcher*, 232 W.Va. 513, 519, 753 S.E.2d 11, 17 (2013) (applying rule to words used in legislative enactments); *Faith United Methodist Church and Cemetery of Terra Alta v. Morgan*, 231 W.Va. 423, 444, 745 S.E.2d 461, 482 (2013) (applying rule to words used in deed).

The certifying district court gave a thorough and well-reasoned analysis of these issues in its Order of Certification:

> While "reasonableness" may be a common legal standard, the ***Tawney*** Court did not hold that to allow a lessee to deduct post-production costs from the lessor's royalty, the lease must generically recite a common legal standard; rather, it held that the lease must "indicate the **method of calculating** the amount to be deducted[.]" *See* Syl. Pt. 10, ***Tawney***, 633 S.E.2d 22 (emphasis added). Plainly, "reasonableness" is not a method of calculation. Indeed, the word "method" means "a procedure or process for attaining an object: such as ... a way, technique, or process of or for doing something." The word "calculate" means "to determine by mathematical processes." Thus, a "method of calculation" is a procedure, technique, or process for mathematically determining something.
>
> The word "reasonable" is merely an adjective, not a mathematical formula or process. The same goes for the terms "actual" and "incurred," as neither of these terms indicate any particular mathematical process.
>
> Most importantly, the words "reasonable," "actual," and "incurred" give prospective lessors no information as to how deductions will be calculated. Stating in a lease that deductions will be "reasonable" does not describe any particular mathematical process nor objective limitation. Instead, it forces prospective lessors to rely on the lessee's conclusory representation that the calculation will be "reasonable" without giving the prospective lessor an opportunity to evaluate for

> himself or herself whether the lessee's methods are "reasonable." . . . Similarly, stating in a lease that the lessee will deduct "actual" post-production costs or "incurred" post-production costs tells prospective lessors utterly nothing about the method of calculation used to derive those "actual" and/or "incurred" post-production costs.
>
> . . . [A]s previously discussed, the ***Tawney*** Court was concerned with making sure that lease language intended to permit deductions for post-production costs clearly states the method of calculating those deductions so that lessors are informed as exactly how their royalties are to be calculated. *See* 633 S.E.2d at 28, 29–30, 219 W.Va. at 273. Accordingly, the ***Tawney*** Court held in plain terms that lease language intended to allocate a portion of the post-productions costs to the lessors) must "indicate the method of calculating the amount to be deducted from the royalty for such post-production costs." ***Id.*** at 30, 274 (emphasis added). . . .

Kellam v. SWN Production Co., 2021 WL 4621067, at **9-10 [Kellam JA, at 120-24].

The District Court's analysis of this issue is legally sound and compelling. Unfortunately, the criticisms of *Wellman* and *Tawney* contained in *Leggett 2*, despite its subsequent abrogation by the Legislature, have caused courts such as the Fourth Circuit in *Young v. Equinor USA Onshore Properties, Inc.*, *supra*, to doubt either that they mean what the plainly state or that this Court will continue to follow them. For these reasons, the holdings of *Wellman* and *Tawney* must be upheld and reaffirmed in order to assure that lessees are bound to the requirements of transparency and accountability established by this Court therein.

D. Only Specified Direct Post-Production Costs That Are Identified with Particularity in a Lease Can Be Properly Deducted and Not Indirect Costs, Including Those of an Affiliate.

While a distinction between direct and indirect post-production costs were not expressly discussed in *Wellman* and *Tawney*, the reasoning of the courts in *W.W. McDonald Land Co.*, 983 F. Supp.2d at 816, and *Kay Co., LLC*, 2017 WL 10436074, at **18-19, on this issue are consistent with the holdings of this Court in *Wellman* and *Tawney* and should be followed by this Court. A lessee seeking to take indirect post-production costs from a lessor's royalty payment is troubling, particularly when they involve the indirect costs of an affiliate.

In *W.W. McDonald Land Co.*, the Court concluded as to affiliate sales:

> The defendants cannot calculate royalties based on a sale between subsidiaries at the wellhead when the defendants later sell the gas in an open market at a higher price. Otherwise, gas producers could always reduce royalties by spinning off portions of their business and making nominal sales at the wellhead. I predict with confidence that, if confronted with this issue, the Supreme Court of Appeals would hold the same. *See Howell v. Texaco, Inc.,* 112 P.3d 1154 (Okla.2004) ("an intra-company contract is not an arm's length transaction, [and] it is not a legal basis on which [a producer] can calculate royalty payments"); *Beer v. XTO Energy, Inc.,* CIV–07–798–L, 2010 WL 476715 (W.D.Okla. Feb. 5, 2010) (gas sale at wellhead between two controlled, affiliated companies not appropriate for royalty calculation).

W.W. McDonald Land Co., 983 F. Supp.2d at 804. *Compare with* W.Va.Code § 22-6-8(e) (2018) ("received at the first point of sale to an unaffiliated third-party purchaser in an arm's length transaction").

As to the issue of indirect costs, the Court reasoned:

> The provisions at issue are not ambiguous. They permit deductions only for "compressing, desulphurization and/or transporting gas." I **FIND** that meals and entertainment, uniforms, meter operations and repair, and personal property taxes are not costs of compression, desulphurization, or transportation. I further **FIND** that deductions for "personnel costs, indirect costs, production management costs, depreciation and return on capital investment," are too vague to be specifically related to compression, desulphurization, or transportation. These costs are not identified with what I predict the Supreme Court of Appeals of West Virginia would find to be sufficient "particularity." Accordingly, these costs may not be deducted pursuant to lease (*l*) and (m).

W.W. McDonald Land Co., 983 F. Supp.2d at 816.

In *Kay Co.*, the Court held as to such issues:

> For those leases which do permit the deduction of post-production expenses, such costs must be reasonable and actually incurred. Charges submitted from an affiliate or an alter ego, which is not part of a true arms-length transaction, cannot properly be included because they would not constitute true, actually incurred costs. Should any such deductions be permitted by the lease, they must be for only that sum of costs actually incurred by the company in getting the gas to market. As Judge Goodwin held [in *W.W. McDonald Land Co.*], indirect costs, including meals and entertainment, uniforms, meter operations and repair, personal property taxes, personnel costs, production management costs, depreciation, and return on investment are not directly related to the cost of getting gas to market. Moreover, lessors have no control over the construction and maintenance of the gathering system.

Kay Co., LLC, 2017 WL 10436074, at **18-19.

These holdings are consistent with this Court's holdings in *Wellman* and *Tawney* that any post-production costs must be both reasonable and actually incurred, and that any specific deductions must be identified with particularity. Syl. Pts. 4 & 5, *Wellman, supra*; Syl. Pts. 1, 2, 10 & 11, *Tawney, supra*. Accordingly, they should be followed and adopted by this Court.

VI. Conclusion.

For all of the foregoing reasons, Plaintiffs/Respondents respectfully pray that Your Honorable Court uphold and reaffirm its holdings in *Wellman* and *Tawny* and further hold that this Court's holding that a lease must include the method of calculating the amount of post-production costs means what is says--that an actual method of calculating the amount of the deductions, i.e., a mathematical formula or its equivalent, must be specified in a lease--and that a mere simple listing of the types of costs which may be deducted or words such as "all" or "reasonable" are not sufficient to satisfy *Tawney*. Additionally, Plaintiffs/Respondents pray that the Court hold that only specified direct post-production costs that are identified with particularity in a lease can be properly deducted and not indirect costs, including those of an affiliate. Plaintiffs/Respondents request all further relief that this Court deems appropriate, equitable, and just.

PLAINTIFFS/RESPONDENTSCHARLES KELLAM AND PHYLLIA KELLAM AND OTHER PERSONS AND ENTITIES SIMILARLY SITUATED,

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CERTIFICATE OF SERVICE

Service of the foregoing ***Response to Opening Brief of Petitioners SWN Production Company, LLC and Equinor USA Onshore Properties Inc.*** was had upon counsel for Petitioners herein by regular U.S. mail, postage prepaid, this 9th day of February, 2022 to the following:

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