IN THE WEST VIRGINIA SUPREME COURT OF APPEALS
No. 23-522

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FRANCIS KAESS,

Petitioner,

v.

BB LAND, LLC,

Respondent.

AMICUS CURIAE BRIEF ON BEHALF OF WEST VIRGINIA ROYALTY OWNERS' ASSOCIATION AND WEST VIRGINIA FARM BUREAU (IN SUPPORT OF PETITIONER FRANCIS KAESS)

Dated: November 6, 2023

Howard M. Persinger, III
WV Bar ID 6943
Persinger & Persinger, L.C.
237 Capitol Street
Charleston, WV 25301
304-346-9333 Phone
304-346-9337 Fax
hmp3@persingerlaw.com

Counsel for West Virginia Royalty Owners' Association and West Virginia Farm Bureau Amici Curiae

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No. 23-522

IN THE WEST VIRGINIA SUPREME COURT OF APPEALS

FRANCIS KAESS,
Plaintiff/Petitioner,

v.

Civil Action No. 1:22-CV-51
United States District Court
for the Northern District of
West Virginia

BB LAND, LLC,
Defendant/Respondent.

AMICUS CURIAE BRIEF ON BEHALF OF
WEST VIRGINIA ROYALTY OWNERS' ASSOCIATION AND
WEST VIRGINIA FARM BUREAU
(IN SUPPORT OF PLAINTIFF/PETITIONER FRANCIS KAESS)

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

I. STATEMENTS OF INTEREST REGARDING *AMICI CURIAE*

Your Amicus West Virginia Royalty Owners' Association ("WVROA") is an association of mineral royalty owners with 1,162 members that collectively own tens of thousands of acres in the State of West Virginia and is interested in issues affecting the ownership of royalty interests in real property in West Virginia, including royalty interests in oil and gas estates. WVROA's mission is to inform West Virginia mineral owners about the state of the oil and gas industry, leasing, and their rights as real property owners, as well as to promote legislation that protects the rights of all property owners, whether fee, surface, or mineral owners, and to ensure that oil and gas development in West Virginia is done responsibly and fairly.

Your Amicus West Virginia Farm Bureau ("WVFB") represents over 22,721 members who are interested in issues affecting the ownership of mineral interests and real property in West Virginia, including the computation and payment of royalty interests in oil and gas estates. WVFB's mission is to provide leadership, education, information, training and economic services to members and county farm bureaus to enhance the quality of farming in West Virginia through the betterment of conditions of those engaged in agricultural pursuits, the improvement of the grade of their products, and development of a high degree of efficiency in their agricultural pursuits.

Amici have interest in the issues before the Court in this matter. In particular, *amici* are concerned with the preservation of the integrity of the so-called "landowners' royalty" from continued erosion via ever-evolving predatory accounting schemes, by which natural gas producers seek to endlessly and unfairly saddle landowners with excessive post-production costs, and ultimately to consume their entire royalty. Moreover, *amici* have interest in promoting clear and readily understandable reporting of the calculation of royalty due lessors under oil and gas leases. These issues directly affect the membership of *amici*, who believe that their perspective will be of assistance to this Court in resolving the issues before the Court in this case.

By their brief, *amici* will attempt to add insight to the important questions before the Court in this matter regarding the application of the holdings of the West Virginia Supreme Court of Appeals in *Wellman v. Energy Res., Inc.,* 210 W.Va. 200, 557 S.E.2d 254 (2001) and *Est. of Tawney v. Columbia Nat. Res., L.L.C.,* 219 W.Va. 266, 633 S.E.2d 22 (2006), as recently, and resoundingly, reaffirmed by this Court in *SWN Production Co., LLC v. Kellam*, ___ W.Va. ___, 875 S.E.2d 216 (2022) and the Fourth United States Circuit Court of Appeals in *Corder v. Antero Res. Corp.*, 57 F.4th 384, 396

(4th Cir. 2023), in the calculation and payment of landowners' royalties, including "in-kind" royalties, due to landowners for their hydrocarbons including natural gas and natural gas liquids.

II. CERTIFIED QUESTIONS

By Order dated August 25, 2023, the United States District Court for the Northern District of West Virginia, at Clarksburg, certified the following questions to the West Virginia Supreme Court of Appeals:

> Question 1: Is there an implied duty to market for leases containing an in-kind royalty provision?
>
> Question 2: Do the requirements for the deductions of post-production expenses from *Wellman v. Energy Resources, Inc.*,557 S.E.2d 254 (W.Va. 2001) and *Estate of Tawney v. Columbia Natural Resources*, 633 S.E.2d 22 (W.Va. 2006), apply equally to leases containing an in-kind royalty provision where the lessor is entitled to a share of the production as opposed to the proceeds from a sale to a third party?

(*See* JA - 321.)

III. RELEVANT FACTS AND PROCEDURAL HISTORY

Petitioner owns the minerals underlying approximately 103.5 acres in Pleasants County, West Virginia (the "Subject Property"). He entered into an oil and gas lease dated January 6, 1979, to which Respondent BB Land, LLC (""BB Land") is the current lessee (the "Base Lease"). The Base Lease provides for the following royalty to be paid from lessee to lessor:

> In consideration of the premises the said Lessee covenants and agrees as follows:
>
> 1. To deliver to the credit of Lessors free of cost in the pipelines to which he may connect his wells, the equal one-eighth (1/8) part of all oil produced and sold from the leased premises.
>
> 2. To deliver to the credit of Lessors free of cost in the pipeline to which he may connect his wells, the equal one-eighth (1/8) part of

> <u>all gas produced and marketed</u> from the leased premises, and the Lessors shall have the right to free gas from any such well or wells for hearing [sic] and lighting any building on or off the property, making their own connections therefor at their own risk and expense.

(*See* JA - 49) (emphasis added).[1]

In March 2018 BB Land, or its affiliates, began producing gas from a 64 acre portion of the Subject Property as part of a larger 624 acre unit they had previously organized. (*See* JA -6.) Petitioner filed suit against BB Land in the United States District Court for the Northern District of West Virginia asserting three causes of action: (1) Payment Misallocation; (2) Improper Deductions; and (3) Excessive Deductions. In the underlying lawsuit, Petitioner alleges BB Land/lessee has improperly deducted post-production costs in the calculation of his royalty. (*See* JA -1-90.) BB Land responded that since the Base Lease provides for an "in-kind" royalty, but Petitioner has never elected to receive his royalty as a physical share of the gas produced, and BB Land has taken Petitioner's share of production to market along with its share, and, thus, is allowed to deduct post-production costs from calculation of Petitioner's royalty. Central to BB Land's argument is the notion that since the "in-kind" royalty would be physically delivered to the lessor at the wellhead, then all costs incurred after that point are to be the lessee's responsibility. (*See* JA – 270-284.)

On March 7, 2023, the Federal District Court granted in part and denied in part a motion to dismiss filed by the Defendants such that only BB Land remained as a defendant, and only Count Two and a portion of Count One remained. (*See* JA – 151-165.) At the conclusion of discovery, the Defendant filed a motion for summary

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[1] On May 19, 2016, Plaintiff and BB Land modified the Base Lease by entering into a Pooling Modification Agreement which added certain voluntary pooling and unitization terms and conditions. (*See* JA – 52-53.)

judgment, and on July 21, 2023, the Court granted in part and denied in part its motion. (*See* JA – 252-268.)

In its Order, the Court denied summary judgment as to Count Two, in which Petitioner alleged that the BB Land breached the Base Lease by improperly taking post-production costs from his share of production royalties and found in the process that the holdings of *Wellman* and *Tawney* **do** apply regardless of whether the lease at issue is an in-kind or proceeds lease. *Id.* However, in a subsequent Order dated August 25, 2023, the District Court granted the Defendant's request for leave to file a motion to certify questions of law to the WVSCA. (*See* JA – 321-326.)

IV. SUMMARY OF ARGUMENT

Your *amici* urge the Court to reject the arguments of the Respondent to the effect that the "in-kind" natural gas royalty provisions such as the one contained in the Base Lease are not subject to longstanding holdings of the West Virginia Supreme Court of Appeals' in *Wellman v. Energy Resources, inc.*,557 S.E.2d 254 (W.Va. 2001) and *Estate of Tawney v. Columbia Natural Resources*, 633 S.E.2d 22 (W.Va. 2006), as recently and resoundingly reaffirmed in *SWN Production Co., LLC v. Kellam*, ___ W.Va. ___, 875 S.E.2d 216 (2022) and *Corder v. Antero Res. Corp.*, 57 F.4th 384, 396 (4th Cir. 2023), which require clear lease language identifying specific deductions of post-production costs and indicating their method of calculation.

Amici further urge the Court to reaffirm the application of the implied covenant to market to the calculation of all oil and gas royalties, under all types of royalty provisions including "in-kind" provisions which provide for deliveries of the physical oil and gas to the lessor.

Amici further submit it is unclear that the royalty provision contained in Respondent's lease is truly and "in-kind" provision since it references "the equal one eighth part of all gas produced <u>and marketed</u> from the leased premises…." At best, this language is ambiguous and should therefore be construed against the lessee.

V. ARGUMENT

A. Irrespective of Whether the Lease Language Calls for a Royalty Based Upon "Proceeds" Received, "Market Value" of the Gas Sold or an "In-Kind" Distribution, in the Absence of Clear Lease Language Authorizing Deductions, the Producer/Lessee Must Bear All the Costs Incurred in Producing, Marketing and Transporting the Product to the "Point of Sale," Under the West Virginia Supreme Court of Appeals' Landmark Rulings in *Wellman v. Energy Resources, Inc.*, 557 S.E.2d 254 (W.Va. 2001) and *Estate of Tawney v. Columbia Natural Resources*, 633 S.E.2d 22 (W.Va. 2006), as Recently Reaffirmed in *SWN Production Co., LLC v. Kellam*, ___ W.Va. ___, 875 S.E.2d 216 (2022) and *Corder v. Antero Res. Corp.*, 57 F.4th 384, 396 (4th Cir. 2023).

Oil and gas lessees paying their lessors an undiluted royalty from the proceeds received from the sale of the oil and gas produced is an age-old industry practice in West Virginia. In discussing the evolution of gas-royalty clauses and the "long-established" expectation of lessors in the state, this Court has explained:

> 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] [a portion] of the sale price received. This practice has, in recent years, been extended to the situations where gas is found....the [portion] received is commonly referred to as the landowner's royalty.

Wellman v. Energy Res., Inc., 210 W.Va. 200, 557 S.E.2d 254, 263-264 (2001) (citing Robert Donley, The Law of Coal, Oil and Gas in West Virginia and Virginia § 104 (1951)) (emphasis added).

The well-established principle is that the landowners' royalty is passive in nature and not subject to the costs of production. Instead, producers pay their lessors a royalty

out of the proceeds received from sale of the gas, with the producer retaining the balance in view of its assumption of all costs as attendant business risk relating to the drilling of the well and subsequent production therefrom. See Donley, *supra* at §104. West Virginia law has long held that charging a royalty owner with the costs of transporting and treating the gas produced from her property impermissibly places the landowner/lessor in the position of business partner with the lessee. In *Davis v. Hardman,* 148 W.Va. 82, 133 S.E.2d 77 (1963), the West Virginia Supreme Court of Appeals stated:

> The distinguishing characteristics of a [landowners] non-participating royalty interest are: (1) Such share of production is not chargeable with any of the costs of discovery and production; (2) the owner has no right to do any act or thing to discover and produce the oil and gas; (3) the owner has no right to grant [other] leases; (4) the owner has no right to receive bonuses or delay rentals.

Id., 133 S.E.2d at 82.

In 2001, in *Wellman v. Energy Res., Inc.,* 210 W.Va. 200, 557 S.E.2d 254, 263-264 (2001), this Court reaffirmed the importance of protecting the integrity of the lessor's property from post-production expenses, holding that since the lessee has an implied duty to market the oil and gas produced, and to pay the costs associated therewith, it also has the duty to bear the costs of preparing the oil and gas for market and to also bear the cost of transporting them to market.

> Like the courts of Colorado, Kansas, and Oklahoma, the Court also believes that historically the lessee has had to bear the cost of complying with his covenants under the lease. It, therefore, reasonably should follow that the lessee should bear the costs associated with marketing products produced under a lease. Such a conclusion is also consistent with the long-established expectation of lessors in this State, that they would receive one-eighth of the sale price received by the lessor.

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

To this end, the *Wellman* Court issued the following syllabus points:

> 4. 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.
>
> 5. 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.

Wellman, 557 S.E.2d at 263-64, syl. pts 4 and 5. Under *Wellman*, therefore, unless there is clear lease language to the contrary, the lessee must bear all costs incurred in exploration, production, marketing, and transportation of the product to "the point of sale." *Wellman*, 557 S.E.2d 254, at syl. pt. 4.

Five years later, in *Est. of Tawney v. Columbia Nat. Res., L.L.C.,* 219 W.Va. 266, 633 S.E.2d 22 (2006) this Court held that the standard "at the well" language found in many oil and gas leases was ambiguous and insufficient to allow the lessee to deduct post-production expenses from the calculation of royalty using the so-called "net back" or "work back" method whereby all costs incurred after a designated point (in that case, the "wellhead") are deducted from the calculation of royalty.

Tawney set forth the following syllabus points:

> 10. 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.

> 11. 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.

Tawney, 633 S.E.2d at 23-24, syl. pts 1, 10, 11.

Tawney thus both reaffirmed *Wellman's* core holdings and extended them by further holding that "at the wellhead" language commonly found in the royalty clauses, especially in older gas leases, is not sufficiently clear to permit the lessee to calculate and deduct post-production expenses utilizing the so-called "net back" method, where the lessee simply deducts a pro-rata portion of all expenses incurred after the gas leaves the ground. *Id. See also, Young v. Equinor USA Onshore Properties, Inc.,* 982 F.3d 201, 206-207 (4th Cir. 2020), 206-207 (quoting *Tawney, supra*, 633 S.E.2d at 30). ([*Tawney* holds that an] oil and gas lease that intends to allocate post-production costs between the lessor and lessee must: (1) "expressly provide that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale"; (2) "identify with particularity the specific deductions the lessee intends to take from the lessor's royalty"; and (3) "indicate the method of calculating the amount to be deducted from the royalty for such post-production costs.")

Thus, *Tawney* reaffirmed West Virginia's "longstanding" rule that the lessee is to bear all costs prior to the point of sale. Moreover, while *Wellman's* holding was circumscribed to so-called "proceeds" leases, *Tawney's* language broadened its scope to any other type of lease, including co-called "market value" leases, as well as "in-kind leases" which contained the ambiguous "at the wellhead" language. In fact, the *Tawney* Court re-framed the issue presented as "whether the 'at the wellhead'-type language at

issue is sufficient to alter West Virginia's general rule that the lessee must bear all costs of marketing and transporting the product to the point of sale." *Tawney*, supra, 219 W.Va. at 272, fn 2.[2]

Most recently, in *SWN Production Co., LLC v. Kellam*, ___ W.Va. ___, 875 S.E.2d 216 (2022), this Court once again resoundingly reaffirmed *Wellman* and *Tawney,* as well as the application of the implied covenant to market in leases which are silent on the calculation of post-production costs. *Kellam*, 875 S.E.2d at 223-226.[3]

Thus, it is undeniable that the collective force of *Wellman, Tawney* and their progeny point toward the unshakeable rule that there can be no post-production deductions from royalty without clear supporting lease language. There is simply no reason to assume that this reasoning does not also apply with equal force to "in-kind" leases. Since the Base Lease contains no such language, no post-production deductions are permissible.

[2] The application of *Wellman* and *Tawney* beyond so-called "proceeds" leases has been recognized by Federal Courts in West Virginia. *See, Corder v. Antero Resources Corp.,* 332 F.Supp.3d 710 (N.D. W.Va. 2018) (*Wellman/Tawney* apply not only to "proceeds" leases but also "market value" leases); *See also, Goodno v. Antero Resources Corp.*, Case No. 5:20-CV-00100-JPB U.S. District Ct. N.D. W.Va. (Doc 23, July 21, 2020); *Cather v. EQT Prod. Co.*, 2019 WL 3806629 (N.D. W.Va. August 13, 2019).

[3] In *Corder v. Antero Resources Corp.,* 57 F.4th 384 (4th Cir. 2023), the Fourth Circuit Court of Appeals also concluded that market value type royalty provisions in oil and gas leases are also subject to *Wellman* and *Tawney*. The key to the Court's holding was that while the various lease types before the Court called for the computation of royalty by different methods, each was "silent" on the allegation of post-production costs and therefore failed to satisfy the *Tawney* requirement and therefore, "did not permit Antero to apply the so-called "net back" or "work back" method to deduct costs of transportation and processing incurred between the wellhead and the point of sale." *See Corder*, 57 F.4th at 390, 392. In the process of completing its analysis, the *Corder* Court also rejected the lessee/producer's argument that the "net back" method could be applied at some point between the wellhead and the point of sale where the gas became "marketable" stating:

> Ultimately, though, we cannot ignore the express "point of sale" language in the syllabus points in Wellman, *Tawney*, and *Kellam*.

Corder, 57 F.4th at 397.

B. Allowing Lessees to Deduct Post-Production Costs on "In-Kind" Royalties, Where the Lease Language is Silent on Deductions, Would Be No Different Than Allowing Them to Employ the "Net Back Method" of Deducting Costs, Which the Court has Already Rejected.

The reasoning underlying *Wellman, Tawney* and their progeny centers on the recognition that natural gas is generally not sold "at the wellhead," but instead at a remote point of sale, usually after the lessee adds value to it by preparing it for market, processing it, and transporting it to a "point of sale," and that the lessee must bear all costs of marketing and transporting the gas to the point of sale. *Wellman, supra,* 210 W.Va. at 270. In *Tawney,* the Supreme Court of Appeals held that the standard "at the well" language found in many form oil and gas leases is ambiguous and insufficient to allow the lessee to deduct post-production expenses incurred after that point using the "net back" or "work back" method. Instead, *Tawney* specifically held that any deductions for costs incurred between the wellhead or point of production in the "point of sale" could only be sustained via clear lease language identifying and authorizing them. from the calculation of royalty. *Id.,* 633 S.E.2d at 30.

However, because they have relied entirely upon Petitioners to market their gas, Respondents have no control over the "point of sale," they are beholden to BB Land to market oil and gas from their leases and to define a "point of sale" in that marketing effort.

In *Burlington Res. Oil & Gas Co., v. Texas Crude Energy, LLC, 573 S.W.3d 198 (Tex. 2019)* and *Nettye Engler Energy, LP v. Bluestone Natural Resources II, LLC*, 639 S.W.3d 682 (Tex. 2022), both of which are cited by BB Land in support of its argument, the Supreme Court of Texas equated the "into the pipeline" language found in the Base Lease and many "in-kind" oil and gas royalty provisions with the "at the wellhead" language which the *Tawney* Court found to be ambiguous and insufficient to support the

"net back" calculation advanced by the operator defendants in that case. *See Burlington*, 573 S.W.3d at 211; *Nettye*, 639 S.W.3d at 696. Thus, allowing lessees to deduct post-production costs based on form lease language that calls for delivery of gas into a pipeline, which the lessee controls and which represents the sole mode of gathering and transportation for the lessor's gas, is the functional equivalent of allowing those deductions based on proceeds received or value measured "at the wellhead," pursuant to the "net back" method[4] and is accordingly not allowed under West Virginia law.

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[4] A recent article in the West Virginia Law Review, 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.R. 259 (2021), describes the inherent unfairness of allowing producers to utilize the "net back" method in the absence of clear lease language authorizing post production deductions

> At first blush, the net-back method may sound like an equitable way to allocate costs between lessor and lessees; however, lessees use the net-back method to fleece lessors of their valuable minerals. Gas companies–EQT in particular–best effectuate this by creating wholly-owned subsidiary companies that charge the mineral owner with what would be otherwise impermissible deductions.
>
> EQT Corporation, the parent company, utilizes three main subsidiaries while producing natural gas. First, EQT Production Company ("Production") is responsible for leasing property and, as lessee, drilling for and producing natural gas. Production then sells the gas to EQT Energy, L.L.C., ("Energy") at the wellhead. Energy relies on EQT Gathering, L.L.C., ("Gathering") to gather and transport the gas until Energy sells it to a downstream buyer.
>
> These relationships become even more convoluted, and at times intertwined, once payments are due. The best way to fully appreciate these intricacies is to work backwards, beginning downstream, and finishing at the wellhead. Energy ultimately sells the gas to an unaffiliated third-party buyer, where it receives the gross proceeds. Gathering then charges Energy for its transportation services, based on an annual rate that Gathering sets; Energy pays Gathering by deducting the gathering and transportation costs from the gross proceeds and is left with the net proceeds. Energy pays the net proceeds to Production, which it claims to be the "wellhead price." Production uses the net proceeds–instead of the gross proceeds–to calculate the mineral owner's royalty.
>
> Interestingly, EQT Corporation ("EQT") appears absent from the entire process, from well to sale. This is not because EQT is uninvolved with its subsidiaries, but quite the opposite. EQT uses these subsidiaries as alter egos to avoid paying the full royalties owed to mineral owners. EQT restructured its business–forming these subsidiaries–following *Wellman*'s holding that the mineral owner's royalty must be based on the first point of sale. EQT relies on the fallacy that these intra-company sales are arm's-length transaction among independent entities, allowing it to base royalties on the wellhead sale between Production and Energy. This position is indefensible because these entities are one and the same. EQT and its subsidiaries act in unison and assign profits to each group. The entities then agree to a consolidated business plan with the aim of doing what is best for EQT. Any profits the subsidiaries accrue ultimately make their way back to EQT Corporation, as the parent company controls what capital each subsidiary may own….

Wilson, supra, 124 W. Va. L.R. at 282-83 (citations omitted). The article goes on to expose the fallacy of allowing producers to utilize the "work back" or "net back" method of gas valuation in the absence of clear lease language authorizing the same:

Gas companies claim the net-back method is a fair way of allocating to mineral owners their *pro rata* share of expenses, but this pays mere lip service to the idea of equity. Instead, lessees carefully structure their businesses–by forming alter egos–in order to maximize the amount of deductions that can be taken, thereby diluting the mineral owner's royalty payment. Such a scheme enables the lessee to dictate how much the lessor's royalty will be, to the point he receives wholly inadequate compensation for his valuable minerals.

> Proponents of the net-back method argue that mineral owners should not fret about gas companies inflating costs because the latter is responsible for the remaining seven-eighths. This position is incorrect because it fundamentally misunderstands how the net-back method works in practice. While the total costs are in fact a zero-sum game, which costs are deductible remains in flux. Each subsidiary, Production, Energy, and Gathering, are best thought of as departments, amongst which EQT's total costs must be distributed. Because Production's costs are not deductible, EQT has no incentive to allocate expenses to Production. On the other hand, every expense Gathering accounts for can be charged to the mineral owner as a post-production expense, thereby incentivizing EQT to assign Gathering as many expenses as possible. Unsurprisingly, EQT does exactly that. The rate that Gathering charges includes not only the costs of gathering and transporting the gas but also meals and entertainment, uniforms, meter operations and repair, personal property taxes, salaries, retirement, medical insurance, and office supplies.

Wilson, supra, 124 W. Va. L.R. at 284-85 (citations omitted). In *W.W. McDonald v. EQT Production Co.,* 983 F. Supp. 2d, 790 (S.D. W. Va. 2013), U.S. District Judge Goodwin explicitly rejected a producer's attempted employment of the so-called "work back method" in deducting costs incurred between the wellhead and the point of sale in order to arrive at its fictional "at the well" price—stating plainly that "*Tawney* requires lessees to pay royalties free of all [post-production costs which enhance the value of the gas from the interstate connection price]," holding in essence that in the absence of clear language to the contrary, the "market" and the "point of sale" are one in the same. 983 F.Supp.2d, at 804. The Court should roundly reject Petitioners' arguments and reaffirm these holdings. In addition to these strategies, other producers have also attempted to manipulate costs deductions from royalty by artificially fixing the "point of sale" at some arbitrary point upstream of processing the final products actually sold via sales contracts, in which the lessor has no involvement or say, are a continuation of such predatory schemes. *See State ex rel. TH Expl. v. Venable Royalty Ltd.,* No. 21-1004 (West Virginia Supreme Court of Appeals, Memorandum Decision, October 21, 2022). Central to combatting any such schemes is the *Wellman/Tawney* Courts' acknowledged requirement that the lease:

> identify with particularity the specific deductions that the lessee may take … expressly provide for a method of calculating the amount to be deducted from royalty for post-production costs…

The great disparity in both information and resources between the lessors and lessees virtually insures the continuing development of new and more formidable accounting strategies to continuously degrade the integrity of the lessor's royalty. These can only be effectively combatted through rigorous observance and enforcement of *Tawney's* requirement that all deductions be identified and clearly explained in the lease itself. This was expressly recognized by Chief Justice Hutchison in his concurring opinion in *Kellam*:

> I question the *Young* court's statement that *Tawney* only requires a lease to contain a "simple formula" and not "an Einsteinian proof" describing how a lessee's post-production costs of getting oil and gas to market will be deducted from a lessor's royalty. This statement is correct only if the oil-and-gas lessee is actually taking simple, clear, and unambiguous deductions from the royalties. The problem that I see demonstrated by the case law is that oil-and-gas lessees insist on taking estimated costs or vague, malleable, impossible-to-measure deductions from royalties – in essence, using Einsteinian methods that are incomprehensible to all but the most clever industry accountants. Lessees are using accounting-based chicanery and devising deductions designed to completely consume the lessor's royalty through a "death by a thousand cuts" strategy…. [citations omitted] Frankly, if the lease does not contain a clear explanation of any and all deductions or how those deductions are calculated, understandable by both the oil-and-gas lessee and the mineral owning lessor, then no contract has been formed and the deductions cannot be taken.

SWN Production Co., LLC v. Kellam, ___ W.Va. ___, 875 S.E.2d 216, 234 (2022) (Hutchison, C.J., concurring).

Accordingly, irrespective of whether the particular royalty provision at issue is categorized as "proceeds," "market value" or "in-kind," *Amici* urge the Court to continue to require that leases contain clear language authorizing the taking of deductions via the "net back" method. Both *Tawney* and *Wellman* clearly and repeatedly provide that the lessee "must bear all costs incurred in marketing and transporting the product to the point of sale unless the oil and gas lease provides otherwise." *Tawney*, 633 S.E.2d at 30, syl. pts. 10 and 11 (emphasis added); *Wellman*, 557 S.E.2d at 256 ("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") (emphasis added).

C. None of the Remaining Cases Cited by the Respondent in Support of Its Argument that *Wellman and Tawney* and Their Progeny Do Not Apply to "In-Kind" Royalty Provisions is Apposite to the Facts of this Case.

In addition to the cases discussed above, none of the remaining cases cited by the Respondent in its Motion to the Federal District Court to Certify their Questions to this Court lends support to their contention that *Wellman* and *Tawney, infra,* do not apply to the calculation of royalty due a lessor under an "in-kind" type provision. In the first instance, several of the cases cited relate solely to oil leases.

Oil leases and production are fundamentally different than leases for natural gas and hydrocarbons. Indeed, there is a fundamental difference in the very nature of the product being produced in that:

> Oil is liquid and more or less easily stored on lease or in the field unless susceptible to periodic as opposed to continuous marketing. In contrast, gas by its very nature cannot be stored on lease or in the field and requires a series of pipes from wellhead to the end user (or to regional underground storage reservoirs) in order for a gas well to even produce. The infrastructure required for gas marketing is much more pervasive and

> capital intensive than for oil. Overlaying this requirement for gas marketing is the fundamental change in the regulatory environment pertaining to gas pipelines which has transformed pipelines from their pre-1980s role of gas merchants which contracted with producers to purchase gas, transported the gas through the lines which they had built and resold it sometimes to industrial or other end users but most often to local distributions companies ("LDC's") who further distributed the gas to industrial, commercial and residential customers.

James C. T. Hardwick, *Private Landowner Royalties on Oil – Theory and Reality*, Rocky Mountain Mineral Special Institute, 2003-1RMMLF-INST. 10 (2003). Not surprisingly, therefore, the "in-kind" royalty clause became the dominant type of royalty clause with respect to oil leases. It is employed with much less frequency in the context of natural gas and hydrocarbons given the obvious fact that the gathering system employed by the lessee is generally the sole path for the gas from wellhead to market.

This truth is illustrated in *Vedder Petroleum Corp. v. Lambert, Etc. Co.,* 50 Cal.App.2d 102, 122 P.2d 600 (Cal. Ct. App. 1942), which is cited by the Petitioner in his Certification Motion. *Vedder* involved an oil and gas lease which provides for "a royalty of an equal 1/6th part of the value of all oil produced and saved from wells…" The long and complicated royalty provision in the lease provided lessor with the option of having the oil "delivered into lessor's tanks" which said tanks may be located upon the same parcel from which the oil production is being obtained or at the option of lessee into tanks located upon any other part of the leased premises. *Vedder*, 50 Cal.App.2d at 105. Accordingly, the lessor had the option of placing its own tanks on the leased premises for delivery of the "in-kind" royalty. Since natural gas cannot be stored in this fashion, this is not an option for gas lessors who must utilize the lessee's gathering system to get their gas to market.

Wall v. United Gas Public Service Co., 178 La. 908, 152 So. 561 (La. 1934) involved an oil and gas lease where the oil royalty due the lessor was "1/8th part of all oil produced and saved from the leased premises while the gas was "1/16 of the value of such gas based on the market price of such gas where sold off the premises." *Id.* at 561. *Clark v. Slick Oil Co.,* 211 P. 496, 1992 OK 137, 88 Okla. 55 (Okla. 1922), analyzed the "in-kind" provision relating to production of oil and whether or not cost relating to providing storage tanks on the leased premises were chargeable to lessor. *Id.*

Wood v. TXO Production Corp., 854 P.2d 880, 1992 OK 100 (Okla. 1992), involved an oil and gas lease which did not provide for a "in-kind" royalty, instead calling instead for the lessee "to pay the lessor 3/16 at the market price at the well for the gas sold is entitled to deduct the cost of gas compression from the lessor's royalty interest" which is clearly a "market value" royalty provision. *Id.*

XAE Corp. v. SMR Property Management Co., 968 P.2d 1201, 1998 OK 51, 69 OBJ 2137 (Okla. 1998) involved an overriding royalty agreement between the lessee and a third party. Key to the *XAE* Court's reasoning was the fact that the implied covenant to market and other implied covenants normally present in oil and gas leases cannot be enforced by an overriding royalty interest who is ordinarily a third party with no privity of contract to the lessor. *See XAE Corp.,* 968 P.2d at 1204, citing 3 Summers, *The Law of Oil and Gas,* § 554 (Perm. Ed. Supp.1997). Williams and Meyers, *Oil and Gas Law,* § 420, p. 356-357 (1981) ("The owner of an overriding royalty is not entitled to the benefit of the covenants of the base lease, express or implied, in the absence of an express provision in the instrument creating the overriding royalty."). Moreover, the *XAE* Court noted that the royalty provision present in the overriding royalty agreement

called for “an undivided 1/8 of 7/8 of all gas, gas condensate or other gaseous hydrocarbons which may be produced under the terms of the oil and gas leases.” *XAE Corp.*, 968 P.2d at 104. The Court reasoned that since the overriding royalty granted was a fraction of gas produced instead of the gas sold, the agreement therefore contained no express provision placing a duty on the lessee to market the product.

D. The Lease Provision at Issue Here is Not Actually an “In-Kind” Royalty Provision Because It Explicitly Provides that the Lessor’s Royalty is to Be Calculated on Gas “Produced” and “Marketed.

Unlike the language cited in the cases discussed in subsection C, *supra,* the royalty language in the subject lease is not actually an “in-kind” royalty provision because it calls for a royalty “equal” to 1/8 of the gas produced “and marketed” from the leased premises. Since “marketing” by definition occurs well after and down the line from “production,” the reasonable interpretation of this lease language indicates that the royalty should be based upon the price received by the lessee at the “point of sale.”

“A valid written instrument which expresses the intent of the parties in plain and unambiguous language is not subject to judicial construction or interpretation but will be applied and enforced according to such intent.” syl. pt. 3, *Est. of Tawney v. Columbia Nat. Res., L.L.C.,* 633 S.E.2d 22 (W.Va. 2006); syl. pt. 1, *Cotiga Dev. Co. v. United Fuel Gas Co.,* 128 S.E.2d 626 (W.Va. 1962).

Indeed, the royalty language contained in the Base Lease is much more akin to the market value lease language contained in the *Wood v. TXO Corp.* case discussed, *supra,* in subsection C than that discussed in the *XAE Corp.* case on which it relies so heavily (*see* Subsection C, *supra).*

At a minimum, the language is ambiguous and should therefore be construed in favor of the lessor. *See e.g., Tawney, supra,* 633 S.E.2d syl. pt. 7. (“The 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." Syllabus Point 1, *Martin v. Consolidated Coal and Oil Corp.,* 101 W.Va. 721, 133 S.E. 626 (1926).").

VI. PRAYER FOR RELIEF

Your *amici*, WVLMOA and WVROA respectfully request the Court find that the Answer the certified question is the affirmative, as did the District Court.

Respectfully Submitted,

*/s/ Howard M. Persinger, III*_____
HOWARD M. PERSINGER, III
WV Bar ID 6943
Persinger & Persinger, L.C.
237 Capitol Street
Charleston, WV 25301
304-346-9333 Phone
304-346-9337 Fax
hmp3@persingerlaw.com

Dated: November 6, 2023

CERTIFICATE OF SERVICE

I, Howard M. Persinger, III, hereby certify that on the 6th day of November, 2023, the foregoing, "***AMICUS CURIAE*** **BRIEF ON BEHALF OF WEST VIRGINIA ROYALTY OWNERS' ASSOCIATION AND WEST VIRGINIA FARM BUREAU (IN SUPPORT OF PETITIONER FRANCIS KAESS)**" was filed via the Court's electronic File and ServeXpress system, which will send a notice of the electronic filing to the following counsel for Plaintiffs/Petitioners and Defendants/Respondents:

James Anthony Edmund, Jr., Esq.
Michael B. Baum, Esq.
Edmond & Baum, PLLC
1300 Market Street, Suite 102
Wheeling, WV 26003
Counsel for Petitioner

Charles R. Bailey, Esq.
Josef A. Horter, Esq.
Bailey & Wyant PLLC
500 Virginia Street East
Suite 500
Charleston, WV 25301
Counsel for Respondent.

*/s/ Howard M. Persinger, III*____________
HOWARD M. PERSINGER, III
(WV Bar ID#6943)
Persinger & Persinger, L.C.
237 Capitol Street
Charleston, WV 25301
304-346-9333 (Phone)
304-346-9337 (Fax)
hmp3@persingerlaw.com