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

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FRANCIS KAESS,

Petitioner,

v. **No.: 23-522**

BB LAND, LLC

Respondent.

Upon Certified Question from the United States District Court for the Northern District of West Virginia Case No. 1:22-CV-51

***AMICUS CURIAE* BRIEF ON BEHALF OF GAS AND OIL ASSOCIATION OF WV, INC.**

Charles B. Dollison (WVSB No. 5499)
Joshua A. Cottle (WVSB No. 12529)
Joshua A. Lanham (WVSB No. 13218)
BOWLES RICE LLP
600 Quarrier Street
Charleston, West Virginia 25301
Telephone: (304) 347-2116
Facsimile: (304) 343-2867
Email: cdollison@bowlesrice.com
Email: jcottle@bowlesrice.com
Email: jlanham@bowlesrice.com
Counsel for Amicus Curiae
Gas and Oil Association of WV, Inc.

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W. Va. R. App. P. 30(e)(5) 1

I. STATEMENT OF INTEREST OF *AMICUS CURIAE* GAS AND OIL ASSOCIATION OF WEST VIRGINIA, INC.[1]

The Independent Oil and Gas Association of West Virginia, a West Virginia non-profit corporation ("IOGA"), was created in 1959. The West Virginia Oil and Natural Gas Association ("WVONGA") was also a West Virginia non-profit corporation formed in 1988. Both trade associations have served the entire oil and natural gas industry in the State since their formation. Effective January 1, 2021, WVONGA merged into IOGA, and IOGA changed its name to the Gas and Oil Association of West Virginia, Inc. ("GO-WV"). GO-WV currently has over six hundred (600) member companies, which include independent producers, fully integrated energy companies, companies engaged in various aspects of service and supply activities, and consulting companies.[2] The members of GO-WV operate in nearly every county of West Virginia and employ thousands of people located in the State of West Virginia.[3]

Oil and gas production companies and individuals, together with their secondary suppliers and service providers, accounted for payrolls totaling over $5 billion and the employment of at least 32,300 direct jobs and 49,700 indirect jobs in the State, based on 2019 statistics.[4] In West Virginia, the industry contributed over $11 billion to gross domestic product that accounted for 14.2 percent of the State's total in 2019.[5] Producer members of GO-WV originated an estimated

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[1] Pursuant to W. Va. R. App. P. 30(e)(5), GO-WV states that no counsel for any party authored this amicus brief, in whole or in part, and no party or its counsel made a monetary contribution specifically intended to fund the preparation or submission of this amicus curiae brief. *See* W. Va. R. App. P. 30(e)(5).

[2] *Membership, Gas and Oil Association of WV, Inc.* (last accessed Dec. 4, 2023), https://gowv.com/membership/join-go-wv/.

[3] West Virginia and Regional "State of the Natural Gas and Oil Industry," published by the Gas and Oil Association of WV, Inc., November 9, 2022.

[4] The industry directly and indirectly employed 82,000 workers in 2019, who were paid $5.2 billion in total wages and accounted for 11 percent of the State's total labor income. *News Analysis: West Virginia-Made Natural Gas and Oil Drives U.S. Economic Recovery and Strengthens All Industries*, American Petroleum Institute (Jul. 20, 2021), https://www.api.org/news-policy-and-issues/news/2021/07/20/west-virginia-pwc#:~:text=West%20Virginia%20ranked%20among%20the,added%20to%20total%20labor%20income.

[5] *Id*.

85 percent of all oil and natural gas production in West Virginia from approximately 57,513 producing wells in 2021.[6] In 2022, the severance tax revenues from oil and gas production paid to state and local governments totaled $552.3 million.[7] Over the years, members of GO-WV have collectively invested billions of dollars in West Virginia to develop oil and gas assets.

GO-WV is interested in the issues before this Court in the instant *Francis Kaess v. BB Land, LLC* matter ("*Kaess* case") because GO-WV's member companies will be directly and substantially affected by this Court's decision. Specifically, GO-WV members depend upon clear and rational legal decisions concerning the interpretation of laws related to production and sale of oil, gas, and natural gas liquids ("NGLs"), and GO-WV routinely advocates for consistent application of clear laws and legal principles governing the State of West Virginia's oil and gas industry. Moreover, the decision rendered by this Court in the *Kaess* case has far-reaching ramifications and the potential to significantly alter the landscape of oil and gas leases throughout the State of West Virginia because extending *Wellman* and *Tawney* to in-kind royalty clauses would result in this Court effectively rewriting hundreds, if not thousands, of in-kind royalty leases throughout the State of West Virginia to change the parties' bargained-for consideration. As a result, GO-WV contemporaneously seeks leave from this Court to file this Amicus Curiae brief and urges this Court to answer both certified questions before this Court in the negative.

II. RELEVANT FACTS AND PROCEDURAL HISTORY

GO-WV adopts, by express incorporation, the statement of the relevant facts and procedural history contained in Respondent's opening brief to this Court. In addition, it should be noted that the in-kind royalty clause at issue in the *Kaess* case, and other similar in-kind royalty

[6] *Supra* note 3.

[7] *Supra* note 3.

provisions, are prominent throughout the State of West Virginia. This Court need look no further than the amount of litigation currently pending on the applicability of *Wellman* and *Tawney* to in-kind royalty provisions. *See, e.g.*, *Braxton Minerals III, LLC et al. v. Antero Resources Corp.* No. 1:21-cv-00119, 2023 WL 6299851 (N.D. W. Va. Sept. 27, 2023); *Carolina Mineral Partners LLC v. Jay-Bee Oil & Gas Co.*, No. 5:23-cv-214, 2023 WL 7391872 (N.D. W. Va. Oct. 19, 2023); *Goodno v. Antero*, 2023 WL 6299851, at *7 (N.D. W. Va. Sept. 27, 2023); *Hopper v. Jay-Bee Oil & Gas, Inc.*, No. 5:20-cv-101, 2022 WL 19403556 (N.D. W. Va. Nov. 22, 2022).

Should this Court extend the holdings in *Wellman* and *Tawney* to include oil and gas leases containing in-kind royalty clauses, this Court should anticipate a slew of litigation in the coming years caused by newly created uncertainty in the law. The *Kaess* case presents this Court an opportunity to limit the scope of *Wellman* and *Tawney* and to create certainty in the oil and gas industry as to the allocation of expenses for in-kind royalty leases.

III. ARGUMENT

Pursuant to the Uniform Certification of Questions of Law Act, the Honorable Thomas S. Kleeh, Chief Judge of the United States Federal Court for the Northern District of West Virginia, issued the following two (2) certified questions to this Court:

1. Is there an implied duty to market for leasing containing an in-kind royalty provision?
2. Do the requirements for the deduction 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 to leases containing an in-kind royalty provision?

This Court should answer both of the certified questions in the negative. As discussed in more detail below, contrary to the factual scenarios in *Wellman* and *Tawney*, the lessee's consideration from the lessor under an in-kind royalty oil and gas lease is distinct, as it involves the receipt of a specific portion of the volume produced, not a monetary payment. The crucial

distinction lies in the ownership rights of the lessor. Under an in-kind royalty clause, the lessor owns a share of the actual production (e.g., a specific fraction of the oil or gas produced) at the wellhead, contrasting with a monetary royalty clause, where the lessor's entitlement is solely to a financial payment based on the value of the oil and gas once sold by the lessee.

The implications of this distinction are significant. In the case of an in-kind royalty clause, the lessor owns their share of the oil and gas at the wellhead and assumes responsibility for making business decisions regarding the utilization and marketing of the oil or gas received in-kind under the lease. This includes bearing all costs necessary to deliver and market the oil or gas to a commercial market, as well as ensuring the product is in a marketable condition. This responsibility and risk-taking are fundamentally different from a monetary royalty clause scenario, where the lessor does not take possession of the oil or gas produced and relies entirely on the lessee to sell it to receive monetary royalty payments. This is analogous to a situation where there are multiple lessees that all own an interest in the produced oil and gas – each of those companies owns their share of the production at the wellhead and is responsible for making decisions as to the marketing and sales of their share and the associated cost and expense.

The *Wellman* and *Tawney* decisions, and others in their lineage, are thus distinguishable based on this substantial factual difference between in-kind and monetary royalty interests. The *Wellman* court established an implied duty for the lessee to market oil and gas that a lessor has a royalty interest in. This rationale was predicated on the idea that the lessee has not only the right but also the duty to market the oil or gas upon which the royalty owner will receive royalty payments. However, this reasoning does not extend to leases with in-kind royalty clauses, where the lessee does not agree to market the oil and gas that are owned and controlled by the lessor at the wellhead.

Further, the Court in *Tawney*, while upholding *Wellman*, clarified the language necessary in a lease with a monetary royalty clause to allocate post-production expenses against the lessor's royalty payments. However, the parties to an in-kind lease do not intend for monetary payments or post-production expense allocations, as the lessor agrees to receive a portion of the oil and gas volume produced at the wellhead. If the parties do not intend for there to be any monetary payments made under the lease for oil and gas taken in-kind, why would the parties ever include the language required by *Tawney* to permit deduction of post-production expenses? Accordingly, the holding in the *Tawney* case is not factually similar or applicable to Petitioners' in-kind royalty interest in the 1/8 volume of the actual gas and oil produced under the subject lease.

Undoubtedly, expanding the scope of *Wellman* and *Tawney* to this case would create an additional implied covenant wherein lessees must shoulder the burden of post-production expenses to oil and gas owned by the lessor, and that lessees never contractually agreed to possess, own, or market. Ultimately, this would necessitate that the lessee, at its own cost, and not the lessor, bear the burden and cost of making the lessor's very own oil or gas marketable and then marketing and selling the same on behalf of and for the benefit of lessor to prevent waste. Those are duties that the lessor agreed to undertake when accepting in-kind royalty of oil and gas by volume. The implied covenant created in *Wellman* cannot triumph over the express and unambiguous intent of the parties to an oil and gas lease containing an in-kind royalty clause like that presented in the *Kaess* case. The parties' original intent, as expressed in the subject lease, should not be judicially disturbed by this Court.

A. *Wellman* and *Tawney*'s holdings do not apply in this case because the lessee's consideration from the lessor, in an oil and gas lease containing an in-kind royalty clause, is to receive a portion of the volume produced at the wellhead, as opposed to an oil and gas lease containing a monetary royalty clause.

While the language contained in leases may vary, there are generally only three different types of oil and gas lease royalty provisions. *See, e.g.*, Byron C. Keeling, *Fundamentals of Oil and Gas Royalty Calculations*, 54 St. Mary's L.J. 705 (2023). ("Although there is no standard or uniform royalty clause, most royalty clauses tend to fall into one of three categories**:** (1) fixed price royalty clauses; (2) in-kind royalty clauses; or (3) monetary royalty clauses."). Keeling succinctly distinguishes the substantial differences in the lessor's royalty interest in leases containing in-kind royalty clauses versus leases containing monetary royalty clauses as follows:

> **An in-kind royalty clause specifies that the royalty owner is entitled to receive a share of the product itself . . . [u]nlike a fixed price or monetary royalty clause in which the royalty owner owns only a right to a potential royalty in the form of a monetary payment, a royalty owner under an in-kind royalty clause owns its royalty share of the production**. If, for example, a royalty clause in an oil and gas lease states that the royalty owner is entitled to 1/8 of the oil production, then 1/8 of every barrel of oil that the lessee produces from the lease belongs to the royalty owner.

Id. at 710-711 (emphasis added).

Because the lessor receives an agreed-upon volume of actual oil or gas, in-kind, as consideration under an oil and gas lease containing an in-kind royalty clause, the lessor must generally make its own business decisions, at its own cost and expense, on how to utilize or market the in-kind volume received under the lease. "While the first marketable product doctrine demands that a lessor need not bear the costs necessary to produce a first marketable product, **a lessor who takes possession of royalty oil or gas under an in-kind royalty clause must make its own marketing decisions—with all of the attendant business risks—and bear all of the costs necessary to deliver the oil or gas to a commercial market and place the production in a**

marketable condition." Byron C. Keeling, Karolyn King Gillespie, *The First Marketable Product Doctrine: Just What is the "Product"?*, 37 St. Mary's L.J. 1, 100 (2005) (emphasis added).[8]

On the other hand, in an oil and gas lease containing only a monetary royalty clause—as opposed to this case where the lease contains only an in-kind royalty provision—the lessor does not take possession of any oil or gas produced, and the lessor in such cases relies exclusively on the lessee to market the oil or gas produced, because the lessor only owns an interest in a portion of the monetary value of the oil and gas produced, marketed, and sold by the lessee. The lessor, in such a position, cannot market the oil or gas itself, and that reality, in part, formed the basis for this Court's adoption of the first marketable product doctrine in *Wellman*, *Tawney*, and their progeny. Such rationale does not support extending those holdings to oil and gas leases containing in-kind royalty clauses because the lessor, as owner of a portion of the actual volume of oil or gas produced, must generally "bear all of the costs necessary to deliver the oil or gas to a commercial market and place the production in a marketable condition." *Id.*

B. *Wellman*, *Tawney*, and their progeny are not controlling precedent in this case because those cases apply their logic to oil and gas leases' monetary royalty clauses. The rationale behind the implied covenant to market in those cases does not apply to leases containing in-kind royalty clauses, because the lessee never agreed to market the oil and gas actually owned by the lessor.

In the instant case, under the parties' subject lease, Petitioner (the lessor) is contractually entitled to the physical delivery of oil or gas in its raw form at the wellhead. This is in stark contrast to the monetary royalty clauses, like those presented in *Wellman*, *Tawney*, and their progeny, where the lessors' royalty interests under those leases was in the monetary value derived

[8] *See also* Gary B. Conine, *Speculation, Prudent Operation, and the Economics of Oil and Gas Law*, 33 WBN L.J. 670, 690-691 (1994) ("If the royalty clause requires that the lessee deliver a portion of the production to the lessor rather than a portion of the proceeds of the sale of production . . . the lessor is responsible for arranging its own sales terms and the lessee's marketing practices become irrelevant to the interest of the lessor.").

from the actual sale of the oil or gas by the lessee. This Court's holdings and the underlying reasoning in *Wellman*, *Tawney*, and their progeny shed light on the substantial factual distinctions between an in-kind royalty interest lease versus proceeds-based leases at issue in those cases.

In *Wellman*, the lessee contractually agreed to "pay to Lessor for gas produced from any oil well and used by Lessee for the manufacture of gasoline or any other product **as royalty one-eighth (1/8) of the market value of such gas** at the mouth of the well . . . [if] such as is sold by the Lessee, **then as royalty one-eighth (1/8) of the proceeds from the sale of gas** as such at the mouth of the well where gas, condensate, distillate, or other gaseous substance is found[.]" *Wellman*, 557 S.E.2d at 257-58 (emphasis added). Ultimately, the lessor sold the natural gas to Mountaineer Gas Company and deducted post-production expenses from the lessee's royalty interest, which led to the *Wellman* case. *Id.* at 258-59.

In holding that the lessee owed an implied duty to the lessor to make the oil and gas produced marketable, the *Wellman* court held as follows:

> 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.

Id. at Syl. Pt. 4.[9] The *Wellman* court further explained the rationale behind its holding:

> The rationale for holding that a lessee may not charge a lessor for 'post-production' expenses appears to be most often predicated on the idea that the lessee not only has a right under an oil and gas lease to produce oil or gas, but he [or she] also has a duty, either express, or under an implied covenant, to market the oil or gas produced. The rationale proceeds to hold the duty to market embraces the responsibility to get the oil or gas in marketable condition and actually transport it to market.

[9] The *Wellman* court looked to "the rationale employed by Colorado, Kansas, and Oklahoma in resolving the question of whether the lessor or the lessee should bear 'post-product' costs[.]" *Id.* at 265.

Id. at 264. The *Wellman* decision only considered a lease containing a monetary royalty clause, and the *Wellman* holding only applied to "**an oil and gas lease [that] provides <u>for a royalty based on proceeds</u> received by the lessee**." *Id.* at Syl. Pt. 4, in part (emphasis added). While *Wellman* remains good law, it is clear that the holding does not govern lease provisions containing take in-kind clauses because in such cases the oil and gas lease does not provide for royalties based on proceeds—it provides for the lessor to receive at the wellhead a share of the physical amount of oil and gas produced.

In *Tawney*, this Court upheld *Wellman* and expanded upon *Wellman* by clarifying, in general, the type of language that must be included in a lease that contains a monetary royalty clause to allocate some, or all, of the post-production expenses to the lessor. *See* Syl. Pts. 1 & 2, *Estate of Tawney v. Columbia Natural Resources, LLC*, 633 S.E.2d 22 (W. Va. 2006). Unlike the instant matter before this Court, the *Tawney* case, like the *Wellman* case, dealt with leases that contained monetary royalty clauses—and not an in-kind royalty clause as presented in the *Kaess* case.[10] Moreover, extending Tawney's holding to the in-kind royalty clause contained in the subject lease in this case would lead to illogical and hugely inequitable results never contemplated by the parties because the parties to an oil and gas lease containing an in-kind royalty provision do not intend that the lessee will pay monetary value for oil and gas marketed and sold. That is because the lessor agreed to receive a portion of the volume of oil and gas produced as a royalty interest to market or to hold as the lessor so desires. If the parties do not intend for there to be any monetary payments made under the lease, why would the parties ever include the language required by *Tawney* to permit deduction of post-production expenses? Accordingly, the holding

[10] *See, e.g.,* Syl. Pts. 1, 10, & 11, *Tawney*, 633 S.E.2d at 22.

in the *Tawney* case is not factually similar or applicable to Petitioners' in-kind royalty interest in the 1/8 volume of the actual gas and oil produced under the subject lease.

In 2017, in *Leggett*, this Court considered whether a lessee may deduct post-production expenses from the lessor when the lease is a "flat-rate lease" under West Virginia Code § 22-6-8(e). *Leggett v. EQT Production Co.*, 800 S.E.2d 850 (W. Va. 2017), *superseded by* W. Va. Code § 22-6-8(e). While subsequently superseded by the West Virginia Legislature, the *Leggett* court held that lessees may deduct certain reasonable post-production expenses from the lessor's flat-rate lease, which is governed by statute under West Virginia Code § 22-6-8(e).[11] In the *Leggett* decision, the majority opinion, through *dicta*, seriously questioned the soundness of the *Wellman* and *Tawney* decisions.[12] The *Leggett* court was not presented directly with the issue, but the majority opinion left open to be decided "another day the continued vitality and scope of *Wellman* and *Tawney*." *Id.* at 277.

This case presents the Court with the opportunity to squarely address the **scope** of *Wellman* and *Tawney* because those cases, and their progeny, all relate to a lessee's implied covenant to market oil and gas under leases containing monetary royalty clauses. While the actual language and yardsticks contained in the monetary royalty clauses in that line of cases may vary, the end result is the same: the lessor is entitled to monetary proceeds derived from oil and gas produced, marketed, and sold by the lessee. That is not so in the *Kaess* case, as the lessor agreed to receive his royalty interest in-kind, based upon volume of raw oil and gas produced.

In *Kellam*, a 2022 opinion, this Court held that *Tawney* is still good law in West Virginia in light of the *Leggett* decision. *SWN Prod. Co., LLC. v. Kellam*, 875 S.E.2d 216, 221 (W. Va.

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[11] *See* W. Va. Code § 22-6-8 (2018).

[12] "Before leaving our discussion of *Wellman* and *Tawney*, however, we are compelled to further illustrate the faulty legs upon which this precedent and its iteration of the marketable product rule purports to stand." *Id.* at 276.

2022) (holding that *Wellman* and *Tawney* "firmly cemented West Virginia as a 'marketable product rule' state, meaning that the lessee bears all post-production costs incurred until the product is first rendered marketable, unless otherwise indicated in the subject lease."). The lease at issue in *Kellam* contained a monetary royalty clause, and the issue before this Court was whether language contained in the lease concerning the allocation of post-production expenses met the particularity requirements set forth in *Tawney*.

Similar to the majority opinion's dicta in *Leggett*, Chief Justice Walker's dissent in *Kellam*, once again, called into question the vitality and scope of *Wellman*, *Tawney*, and their progeny. *Id.* at 235-237 (Walker, C.J., dissenting) ("Five-years ago when this Court decided *Leggett*, we highlighted the flawed reasoning in *Wellman* and *Tawney* when we were 'compelled to further illustrate the faulty legs upon which [they] and [their] iteration of the marketable product rule purports to stand.' *Tawney* was the next step in the illogical path blazed in *Wellman*, and we should take this opportunity to overrule them both."). Chief Justice Walker's dissent concluded by calling for this Court to "correct[] the flawed reasoning that started in *Wellman* and continued in *Tawney*." *Id.* at 237.

The instant case presents this Court with an opportunity to bring some clarity to lessors and lessees throughout this State and to follow long-established West Virginia contract principles by interpreting the intent of the parties through their written lease agreements. In this case, the lessor and lessee agreed that lessor would receive gas and oil royalties in-kind based upon the volume produced at the wellhead.

Earlier this year, the Fourth Circuit of the United States Court of Appeals, in *Corder v. Antero Resources Corp.*, 57 F.4th 384, 394 (4th Cir. 2023), held that while *Wellman* and *Tawney* only expressly referenced proceeds-based leases, "the[ir] analysis applies with equal force to leases that calculate royalties based on the 'value' of gas at the wellhead." 57 F.4th 384, 394 (4th Cir.

2023). Petitioner, in her opening brief to this Court, argues that *Corder* firmly establishes that *Wellman* and *Tawney*'s holdings apply to all lease provisions, including the in-kind royalty provision at issue in the *Kaess* case. However, Petitioner overlooks the fact that *Corder* court was, once again, considering oil and gas leases containing monetary royalty clauses, and the *Corder* decision expressly does not extend to in-kind royalty provisions because the holding states that *Wellman* and *Tawney* apply to "**leases that calculate royalties based on the 'value' of gas**[.]" *Id.* (emphasis added). Obviously, the parties to an oil and gas lease containing an in-kind royalty clause like the one present in the *Kaess* case do not intend to "calculate royalties" based on "the 'value' of gas," but, rather, on the volume of gas produced.

C. Extending *Wellman* and *Tawney* to oil and gas leases would substantially alter the express intent of the parties to those agreements and override express covenants in favor of implied covenants that do not fill in gaps but, instead, rewrite the leases.

Expanding the scope of *Wellman* and *Tawney* to this case would create an additional implied covenant wherein lessees must shoulder the burden of post-production expenses to oil and gas that lessees never contractually agreed to possess, own, or market. In fact, extending *Wellman* and *Tawney* to oil and gas lease in-kind royalty provisions would result in lessees bearing costs and expenses that are clearly and squarely owned by the lessors on gas and oil that the lessors own at the wellhead. Those are duties that the lessor assumes when accepting the oil and gas ownership at the wellhead. The implied covenant created in *Wellman* cannot triumph over the express and unambiguous intent of the parties to an oil and gas lease containing an in-kind royalty clause like that presented in the *Kaess* case. The parties' original intent, as expressed in the subject lease, should not be judicially disturbed by this Court.

IV. CONCLUSION

For the reasons set forth herein, and for all those apparent from the record, GO-WV respectfully asks that this Court answer the two certified questions before this Court in the negative

and firmly reject that *Wellman* and *Tawney*'s principles apply to oil and gas leases containing in-kind royalty clauses.

Respectfully submitted,

GAS AND OIL ASSOCIATION OF WV, INC.,
Amicus Curiae
By Counsel.

/s/_*Joshua A. Lanham*
Charles B. Dollison (WVSB No. 5499)
Joshua A. Cottle (WVSB No. 12529)
Joshua A. Lanham (WVSB No. 13218)
BOWLES RICE LLP
600 Quarrier Street
Charleston, West Virginia 25301
Telephone: (304) 347-2116
Facsimile: (304) 343-2867
Email: jcottle@bowlesrice.com
Counsel for Amicus Curiae