22-2050

United States Court of Appeals

for the

Fourth Circuit

TRAVIS YOUNG; MICHELLE BEE YOUNG,

Plaintiffs-Appellants,

– v. –

SWN PRODUCTION COMPANY, LLC; EQUINOR USA ONSHORE PROPERTIES INC.,

Defendants-Appellees,

– and –

STATOIL USA ONSHORE PROPERTIES, INCORPORATED,

Defendant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF VIRGINIA AT WHEELING

CORRECTED BRIEF OF *AMICI CURIAE* WEST VIRGINIA ROYALTY OWNERS' ASSOCIATION AND WEST VIRGINIA FARM BUREAU IN SUPPORT OF APPELLANTS

HOWARD M. PERSINGER, III
PERSINGER & PERSINGER, L.C.
237 Capitol Street
Charleston, West Virginia 25301
(304) 346-9333
hmp3@persingerlaw.com

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

COUNSEL PRESS • VA – (804) 648-3664

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

DISCLOSURE STATEMENT

- In civil, agency, bankruptcy, and mandamus cases, a disclosure statement must be filed by **all** parties, with the following exceptions: (1) the United States is not required to file a disclosure statement; (2) an indigent party is not required to file a disclosure statement; and (3) a state or local government is not required to file a disclosure statement in pro se cases. (All parties to the action in the district court are considered parties to a mandamus case.)
- In criminal and post-conviction cases, a corporate defendant must file a disclosure statement.
- In criminal cases, the United States must file a disclosure statement if there was an organizational victim of the alleged criminal activity. (See question 7.)
- Any corporate amicus curiae must file a disclosure statement.
- Counsel has a continuing duty to update the disclosure statement.

No. 22-2050 Caption: Young v. SWN Production Company, LLC, et al.

Pursuant to FRAP 26.1 and Local Rule 26.1,

West Virginia Royalty Owners' Association and West Virginia Farm Bureau
(name of party/amicus)

____

who is amicus curiae, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☐ YES ☑ NO
If yes, identify all parent corporations, including all generations of parent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation? ☐ YES ☑ NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐ YES ☑ NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐ YES ☑ NO
If yes, the debtor, the trustee, or the appellant (if neither the debtor nor the trustee is a party) must list (1) the members of any creditors' committee, (2) each debtor (if not in the caption), and (3) if a debtor is a corporation, the parent corporation and any publicly held corporation that owns 10% or more of the stock of the debtor.

7. Is this a criminal case in which there was an organizational victim? ☐ YES ☑ NO
If yes, the United States, absent good cause shown, must list (1) each organizational victim of the criminal activity and (2) if an organizational victim is a corporation, the parent corporation and any publicly held corporation that owns 10% or more of the stock of victim, to the extent that information can be obtained through due diligence.

Signature: /s/ Howard M. Persinger, III Date: 1/9/2023

Counsel for: West Virginia Royalty Owners' Association
& West Virginia Farm Bureau

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I. STATEMENT OF *AMICUS CURIAE* PARTY'S IDENTITY, INTERESTS AND SOURCE OF AUTHORITY TO FILE THIS BRIEF

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 the resolving the issues before he Court in this case.

By their brief, *amici* will attempt to add insight to these 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 said Court in *SWN Production Co., LLC v. Kellam*, ___ W.Va. ____, 875 S.E.2d 216 (2022), in the calculation and payment of royalties due to landowners for hydrocarbons including natural gas and natural gas liquids.

II. CONTRIBUTIONS TO *AMICUS CURIAE* BRIEF

Pursuant to *Rule 29(a)(4)(E)* of the *Federal Rules of Appellate Procedure*, WVROA and WVFB represent that no counsel for a party to this appeal authored this *amicus curiae* brief in whole or in part. Neither a party to this appeal nor counsel for any party has made a monetary contribution intended to fund the preparation or submission of this brief. No person other than WVROA and WVFB, their members and counsel have contributed money intended to fund the preparation or submission of this brief. All parties have consented to the filing of this *Amicus* brief.

III. INTRODUCTION

WVROA and WVFB submit this *amicus curiae* brief in support of the position taken by Appellants/Plaintiffs in their brief filed with the Court on January 3, 2023, which seeks reversal of the District Court's September 2, 2022 Order (JA 190-198), denying Appellants/Plaintiffs' Cross Motion for Summary Judgment and Granting Defendants' Cross Motion for Summary Judgment, as well as the District Court's September 26, 2022 Order denying Appellants/Plaintiffs' subsequent Motion for Reconsideration (JA0225-J0273). *Amici* take issue with these orders to the extent they fail to recognize that the West Virginia Supreme Court of Appeals' recent holding in *Kellam*, *supra*, renders the reasoning underpinning this Court's prior opinion in the case *sub judice*, *Young v. Equinor USA Onshore Properties, Inc.*,

982 F.3d 201 (4th Cir. 2020), "clearly erroneous," thereby giving rise to "manifest injustice" as more extensively set forth, *infra.*

Kellam resoundingly reaffirmed *Wellman, supra,* and *Tawney, supra,* which hold that the lessee under an oil and gas lease bears all post-production costs associated with processing and transporting the oil and gas and derivative products to the "point of sale" unless there is clear lease language to the contrary. Moreover, *Kellam* resoundingly rejected the *obiter dicta* criticisms of these cases contained in *Leggett v. EQT Production Co.,* 239 W.Va. 264, 800 S.E.2d 850 (2017) ("*Leggett II*"), as well as *Leggett II's* tacit endorsement of the so-called "net back" or "work-back" method of assessing post-production deductions in the computation of the landowners' royalty, upon which this Court's prior analysis was largely predicated.

IV. STATEMENT OF THE ISSUES

1. Does the recent decision of the West Virginia Supreme Court of Appeals in *SWN Production Co., LLC v. Kellam*, ___ W.Va. ____, 875 S.E.2d 216 (2022), in which West Virginia's highest appellate court rejected obiter dicta contained in *Leggett v. EQT Prod. Co.*, 239 W.Va. 264, 800 S.E.2d 850 (2017) (*Leggett II*) that criticized the holdings and reasoning of its prior precedents in *Wellman v. Energy Res., Inc.*, 210 W.Va. 200, 557 S.E.2d 254 (2001), and *Estate of Tawney v. Columbia Natural Resources, L.L.C.*, 219 W.Va. 274, 633 S.E.2d 22 (2006), constitute a change of law (or its equivalent) so as to create an exception to

the "mandate rule" and to render the District Court no longer bound by this Court's prior decision in *Young v. Equinor USA Onshore Properties, Inc.*, 982 F.3d 201 (4th Cir. 2020) (December 1, 2020 Opinion), due to that decision's substantial reliance upon such rejected obiter dicta of *Leggett II* and improper utilization of the work-back method adopted therein?

2. Did the District Court abuse its discretion or commit an error of law in concluding that it was still bound by this Court's decision in *Young*, *Id*., in ruling upon the parties' motions for summary judgment and in denying the Appellants/Plaintiffs' motion to reconsider?

V. STATEMENT OF THE CASE

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, the West Virginia Supreme Court of Appeals 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, supra, 557 S.E.2d at 263-64 (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 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 (2001), the West Virginia Supreme Court of Appeals confirmed the importance of protecting the integrity of the lessor's property from post-production expenses, holding that since the lessee has a 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. **In view of all this, this Court concludes that if an oil and gas lease provides for a royalty based on proceeds received by the lessee, unless the lease provides otherwise, the lessee must bear all costs incurred in exploring for, producing, marketing, and transporting the product to the point of sale."**

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

Five years later, *Tawney* held that the standard "at the well" language found in many leases was ambiguous and insufficient to allow the lessee to deduct post-production expenses from the calculation of royalty. *Tawney*, *supra*, 633 S.E.2d at 30. In tandem, *Wellman* and *Tawney* represent the Court's full-throated adoption of "Marketable Product Rule," which mandates that the lessee bear all costs incurred in obtaining a marketable product and disallowing the deduction of post-production costs incurred prior to the point at which a marketable product is obtained.[1]

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[1] A majority of states who have analyzed the issue currently favor the Marketable Product Rule, and when analyzed on the basis of acreage, the Marketable Product Rule applies to a significantly greater volume of gas producing property than the so-called "Property" or "Net Back" rules which allow the lessee to deduct all costs from

In its December 1, 2020 Opinion, this Court explicitly notes that "*Leggett* **didn't overrule *Wellman* and *Tawney*"** and upholds their three-pronged test to rebut the presumption that the lessee will bear all post-production costs" (emphasis added):

> [A]n 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."

Young, *supra,* 982 F.3d at 206-207 (quoting *Tawney, supra*, 633 S.E.2d at 30).

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royalty past the wellhead irrespective of whether or not the gas is sold or placed in marketable form at the wellhead. At least six major producing states and two lesser ones follow in one way or another, the Marketable Product Rule. These are Arkansas, Colorado, Kansas, Oklahoma, and West Virginia by case law. *See Hanna Oil & Gas Co. v. Taylor*, 759 S.W.2d 563, 564-565 (Ark. 1988); *Garman v. Conoco*, 886 P.2d 652 (Colo. 1994); *Est. of Tawney v. Columbia Nat. Res., L.L.C.,* 219 W.Va. 266, 633 S.E.2d 22 (2006); *Gilmore v. Superior Oil Co*., 388 P.2d 602 (Kan. 1964); and Wyoming, Michigan, and Nevada by statute *Wyo. Stat. § 30-5-304(a)(i)* (1999); *Mich. Comp. Laws Ann. § 03(b)(1)* (1999). Moreover, a Federal Magistrate in Virginia has ruled Virginia would follow it as well. S*ee Leggett v. EQT Prod. Company*, 2011 WL 86598 at 9-13 (Jan. 11, 2011), *denying motion to certify question to Virginia Supreme Court*, 2011 WL1087160 (W.D. Va. Mar. 24, 2011).

It should also be noted that the Federal Government, the largest landowner in the country, follows a version of the Marketable Product Rule as well, pursuant to the Mineral Leasing Act, which requires payment under most Federal Leases to be based upon "the amount or value" of production and allows the Secretary of the Interior to determine said value on not less than "the gross proceeds received for said gas." *See* 30 C.F.R. § 1205.152(h)-(i) (2010).

However, the December 1, 2020 Opinion also tacitly adopts *Leggett II's* reasoning, in reversing the District Court's finding that the lease in question satisfied the three pronged test, stating: "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*." *Id.,* 982 F.3d at 208 (emphasis added). Specifically, the December 1, 2020 Opinion appears to adopt *Leggett II*'s validation of the so-called "net-back" or "work-back" method of deducting costs under West Virginia's prior version of its so-called "flat rate statute" and then to inappropriately apply this same reasoning to royalty calculations made under the private lease in question, finding that West Virginia law "doesn't demand that an oil and gas lease set out an Einsteinian proof for calculating post-production costs" in order to allow such deductions. *Id.*, 982 F.3d at 208.

Two years later, in *SWN Production Co., LLC v. Kellam*, ___ W.Va. ____, 875 S.E.2d 216 (2022), the West Virginia Supreme Court of Appeals, after once again roundly reaffirming *Wellman* and *Tawney,* definitively rejected *Leggett II's* reasoning, stating:

> It is *Leggett* which forms the basis of the SWN and Equinor's instant challenges to the current validity of *Tawney* and precipitated the district court's first certified question. This is so because this Court in *Leggett* undertook an examination of the legal underpinnings of *Wellman* and *Tawney*, while correctly noting that neither case, nor the implied covenant to market upon which they are founded, were applicable to its analysis of West Virginia Code § 22-6-8(e). *See Leggett*, 239 W. Va. at 275-76, 800 S.E.2d at 861-62 ("Accordingly, the implied covenant to

> market relied upon by the *Wellman* and *Tawney* Courts has no application as pertains to leases affected by West Virginia Code § 22-6-8."); *see also id.* at 276, 800 S.E.2d at 862 ("We therefore conclude that neither *Wellman* nor *Tawney* are applicable to an analysis of the 'at the wellhead' language contained in West Virginia Code § 22-6-8(e).").

SWN Production Co., LLC v. Kellam, ___ W.Va. ____, 875 S.E.2d 216 (2022).

The *Kellam* Court then went on to explicitly reject *Leggett II's* "faulty legs" analysis stating:

> By its own admission, [*Leggett II*]'s ensuing discussion of those cases and their "faulty legs" was mere obiter dicta and of no authoritative value to this Court today. Just as the United States Supreme Court has recognized, "we are not bound to follow our dicta in a prior case in which the point now at issue was not fully debated." *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 363, 126 S.Ct. 990, 163 L.Ed.2d 945 (2006). Accordingly, we see little reason to justify *[Leggett II]'s* criticism of *Wellman* and *Tawney* with any further discussion other than to simply reiterate that those cases are the result of a reasonable and justifiable interpretation of this State's common law as evidenced by the fact that several other states employed nearly identical reasoning in concluding that, absent a contract provision to the contrary, the implied covenant to market requires the lessee to bear all post-production costs. . . .
>
> In short, neither the parties, nor the [*Leggett II*] Court in criticizing the legal underpinnings of *Wellman* and *Tawney*, have articulated any reason sufficient to justify the overruling of those cases. Accordingly, we decline to do so, and necessarily conclude that those cases remain in effect. As such, we answer the district court's first certified question in the affirmative: *Tawney* is still good law in West Virginia.

SWN Production Co., LLC v. Kellam, ___ W.Va. at ____, 875 S.E.2d at 224-27 (emphases added; footnote omitted).

Since the criticisms of *Tawney* and *Wellman* contained in *Leggett II*, form the basis of this Court's tacit adoption of the "work back" method in its December 1, 2020 Opinion, their clear rejection by the *Kellam* Court means the reasoning contained in that opinion is also unsound and the District Court's failure to so hold was "clearly erroneous."

VI. ARGUMENT

A. The District Court Erred in Failing to Recognize that the West Virginia Supreme Court of Appeals' Sweeping Rejection of *Leggett II* Rendered this Court's Previous Opinion "Clearly Erroneous" and that Its Continued Application Gives Rise to "Manifest Injustice."

In its September 2, 2022 "Order on Motions for Summary Judgment" and its subsequent September 26, 2022 Order denying the related "Motion for Reconsideration," the District Court found that even though the ruling in *Kellam* called into question the reasoning contained in the December 1, 2020 Opinion ultimately this Court's determination that the lease language in question satisfied the *Tawney* requirements was dispositive on the issue of whether or not *Kellam* dictated a different outcome. ECF Doc. No. 135, at p. 6.

In rendering this conclusion, the District Court cited the "law of the case" doctrine and the "mandate rule" which dictates that once a case is decided upon appeal and a mandate issued, the decision becomes the "law of the case" and a lower Court may not deviate therefrom. *Stamper v. Baskerville,* 724 F.2d 1106, 1107 (4th

Cir. 1984). However, there are recognized exceptions to these rules. *White v. Murtha,* 377 F.2d 428 (5th Cir.1967) (The law of the case doctrine is not an "inexorable command" but rather a prudent judicial response to the public policy favoring an end to litigation.) *Great Western Tel. Co. v. Burnham,* 162 U.S. 339, 344, 16 S.Ct. 850, 852, 40 L.Ed. 991 (1896) (Clearly, courts could not perform their duties "satisfactorily and efficiently ... if a question once considered and decided ... were to be litigated anew in the same case upon any and every subsequent appeal."). *Copra, Inc. v. Ward Foods, Inc.,* 567 F.2d 1316 (5th Cir.1978) (Although the doctrine applies both to questions actually decided as well as to those decided by "necessary implication," it does not reach "questions which might have been decided but were not.").

> When a decision of an appellate court establishes "the law of the case," it "must be followed in all subsequent proceedings in the same case in the trial court or on a later appeal ... unless: (1) a subsequent trial produces substantially different evidence, (2) controlling authority has since made a contrary decision of law applicable to the issue, or (3) the prior decision was **clearly erroneous** and would work **manifest injustice**."

EEOC v. International Longshoremen's Assoc., 623 F.2d 1054 (5th Cir.1980). *Sejman v. Warner-Lambert Co., Inc.*, 845 F.2d 66, 68-69 (4th Cir. 1988) (emphases added; footnoted omitted). *Accord United States v. Bennerman*, 785 Fed.Appx. 958, 962-63 (4th Cir. 2019) ("We have thus recognized exceptions to the doctrine where new evidence becomes available, the controlling law changes, or the prior decision

was clearly wrong."; also finding the doctrine to not apply and explaining "intervening changes in the law have given our decision a significance that we could not have predicted at the time"); *Am. Canoe Ass'n v. Murphy Farms, Inc.*, 326 F.3d at 515 ("[l]aw of the case is just that however, it does not and cannot limit the power of a court to reconsider an earlier ruling. The ultimate responsibility of the federal courts, at all levels, is to reach the correct judgment under law."); *United States v. Aramony,* 166 F.3d 655, 661 (4th Cir.1999).

Accordingly, given *Kellam's* sweeping rejection of *Leggett II's* reasoning, which was central to this Court's December 1, 2020 Opinion, neither the "law of the case" or "mandate" doctrines support the District Court's Orders.

B. The Reasoning Contained in the December 1, 20202 Opinion is Inextricably Grounded in *Leggett II's* Improper Endorsement of the "Work-Back Method."

It is simply undeniable that the reasoning contained it the Court's December 1, 2020 Opinion is inextricably grounded in the reasoning of *Leggett II,* and in particular it's tacit endorsement of the so-called "net back" or "work back" method of computing royalty. In reaching its conclusions, this Court stated:

> The West Virginia Supreme Court of Appeals most recently expounded on *Wellman* and *Tawney* in *Leggett v. EQT Production Co.*, 239 W.Va. 264, 800 S.E.2d 850 (2017). There the Court considered whether those cases applied in the context of West Virginia Code §22-6-8e (1994) [West Virginia's "Flat Rate Statute"] which provides that a lessee must pay to lessor "not less than one eighth of the total amount paid to or received . . . at the wellhead for the oil or gas" extracted from the wells leased at a flat rate. The lessors there argued that the statute's "at the

> wellhead" language was inadequate for the reasons explained in *Tawney* such that lessee's could not overcome the *Wellman* presumption and deduct post-production costs from the lessor's flat rate royalties. *Leggett,* 800 S.E.2d at 854. The Court ultimately concluded that *Wellman* and *Tawney's* common law principles didn't inform the interpretation of the statute, and that the statute permitted the deduction of post-production costs. *Id.* at 862. But in doing so, the Court went out of its way to "illustrate the faulty legs upon which *Wellman* and *Tawney* purport to stand." *Id.*
>
> The Court recited an array of stinging criticism from scholars complaining that *Wellman* and *Tawney* rest on an "unwillingness to accept the realities of deregulation in the natural gas market. . ." *Id.* at 863. *Leggett* did however expressly reject *Tawney's* assertion that the phrase "at the wellhead" as facially ambiguous. Instead, it interpreted the statutory phrase to require the calculation of royalties based on the value of gas at the well before it is transported, treated, compressed or otherwise prepared for market. *Id.* at 864-65. The Court determined that the "most logical way to ascertain the wellhead price" under the section 22-6-8 was "to deduct the post-production costs from the value added downstream price." *Id.* at 866. This "work back method of royalty calculations" prevents the lessees from "unfairly maximizing their royalty payments without commensurately bearing the costs of achieving the maximum value." *Id.* at 867. Reading these cases together, we glean the following principles of West Virginia law: an oil and gas lease must satisfy *Tawney's* three prong test to rebut the *Wellman* presumption that the lessee will bear all post-production costs period and although *Leggett* didn't overrule *Wellman* and *Tawney,* **it's criticism of those cases and its endorsement of the "work back" method inform our analysis here.**

Young v. Equinor USA Onshore Properties, Inc., 982 F.3d 201, 206-207 (4th Cir. 2020) (emphasis added). Then, as the Court considered the "reasonableness" of the deductions taken by the lessee under the lease language, it further held:

> In setting out these methods for calculating not only the amount of designated post-production costs to be deducted, but also the pool from which to deduct them, and the manner in which to arrive at the ultimate

> royalty payment, the lease **effectively mirrors the work-back method of calculation approved in *Leggett*.** *See* 800 S.E.2d at 867.

Young v. Equinor, supra, 982 F.3d at 208-209 (emphasis added). As *Kellam* made exceedingly clear, the *obiter dicta* contained in *Leggett II* did <u>not</u> approve the so-called "work-back" method of calculating royalty and this observation is "clearly erroneous."

Accordingly, it is simply beyond cavil that what this Court perceived as *Leggett II's* approval of the so-called "net back" or "work back" method of making deductions from gross revenue in the calculation of the lessor's royalty was central to its decision to reverse the District Court's findings that the lease in question did not comply with the dictates of *Tawney* and *Wellman*. Given *Kellam's* solid rejection of these primary concepts, allowing this reasoning to stand results in a "manifest injustice," necessitating a departure from the "mandate rule."

C. The "Net Back" or "Work Back" Method Runs Afoul of *Wellman* and *Tawney's,* and Now *Kellam's* Requirement of a Clear Statement of Which Deductions Which are Being Taken and the Method of Calculation Which is Essential to Protect Royalty Owners from the Producer/Lessee's "Death by a Thousand Cuts" Strategy of Operations.

Because they are compelled to rely entirely upon the lessee to market their gas, lessors generally have little to no control over factors such as which entity actually markets and sells the gas, or the "point of sale" or "market" component in the foregoing analysis. They are more or less completely beholden to their lessees.

Accordingly, clear, simple to understand reporting of the deductions being taken and the method by which they are calculated is of seminal importance to lessors.

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), provides an apt description of the various, sundry and deeply conceived strategies by which the producers and, in particular, the large national producers regularly use against their lessors in a decades-long effort to completely consume the entire landowner's royalty through a "death by a thousand cuts" type strategy deployed by them through accounting-based chicanery:

> 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).[2]

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

[2] In *W.W. McDonald v. EQT Production Co.,* 983 F. Supp. 2d, 790 (S.D. W. Va. 2013), 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.

(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, *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 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).

VII. CONCLUSION

For all the reasons set forth herein, your *amici*, WVROA and WVFB respectfully request that this Court overrule the District Court's Order granting Appellees/Defendants' Motion for Summary Judgment and denying Appellants/Plaintiffs' Motion for Reconsideration.

STATEMENT REGARDING ORAL ARGUMENT

Amicus Curiae parties WVROA and WVFB will participate in oral argument for this appeal if the Court determines that their participation would be useful and only with the Court's prior permission.

DATED: January 9, 2023

Respectfully submitted,

WEST VIRGINIA ROYALTY OWNERS' ASSOCIATION and WEST VIRGINIA FARM BUREAU

/s/ Howard M. Persinger, III

HOWARD M. PERSINGER, III
W.Va. Bar No. 6943
Persinger & Persinger, L.C.
237 Capitol Street
Charleston, WV 25301
304-346-9333 Phone
304-346-9337 Fax
Email: hmp3@persingerlaw.com

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
Effective 12/01/2016

No. 22-2050 **Caption:** Young, et al. v. SWN Production Co., LLC, et al.

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