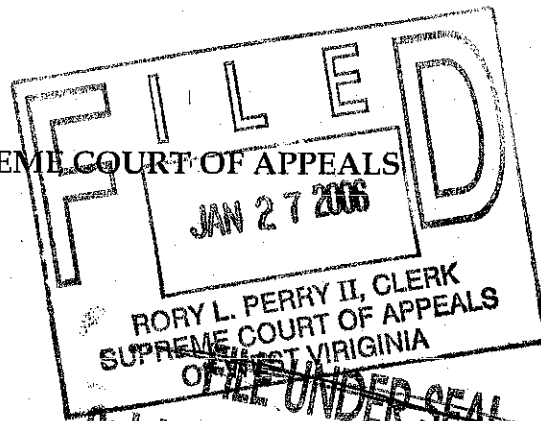


BEFORE THE WEST VIRGINIA SUPREME COURT OF APPEALS

No. 32966



ESTATE OF GARRISON G. TAWNEY, by
LELA ANN GOFF, Executrix,
LELA ANN GOFF and VERNON B. GOFF,
husband and wife, JANICE E. COOPER and
CLIFFORD R. COOPER, husband and wife,
LARRY G. PARKER, JOHN W. PARKER,
RICHARD L. ASHLEY, MYRTLE JONES,
by her Attorney-in-Fact, ORTON A. JONES,

Petitioners/Plaintiffs,

vs.

Civil Action No. 03-C-10E below
Circuit Court of Roane County

COLUMBIA NATURAL RESOURCES, LLC,
f/k/a COLUMBIA NATURAL RESOURCES, INC.,
a Texas corporation; NISOURCE INC., a
Delaware corporation; and COLUMBIA
ENERGY GROUP, a Delaware corporation,

Respondents/Defendants.

**PLAINTIFFS' BRIEF IN SUPPORT OF AFFIRMING
TRIAL COURT'S RULINGS ON CERTIFIED QUESTIONS**

Marvin W. Masters (WV Bar #2359)
THE MASTERS LAW FIRM, L.C.
181 Summers Street
Charleston, West Virginia 25301
Counsel for Petitioners/Plaintiffs

Michael W. Carey (WV Bar #635)
George M. Scott (WV Bar #4678)
Robert E. Douglas (WV Bar #1052)
CAREY, SCOTT & DOUGLAS, PLLC
707 Virginia Street, East, Suite 1701
Charleston, West Virginia 25301
Counsel for Petitioners/Plaintiffs

Scott S. Segal (WV Bar #4717)
THE SEGAL LAW FIRM
810 Kanawha Boulevard, East
Charleston, West Virginia 25301
Counsel for Petitioners/Plaintiffs

J. Thomas Lane (WV Bar #2138)
J. Mark Adkins (WV Bar #7414)
BOWLES, RICE, MCDAVID, GRAFF & LOVE
Post Office Box 1386
Charleston, West Virginia 25325-1386
Counsel for Petitioners/Plaintiffs

*Refused
By
order
3/2/06*

TABLE OF CONTENTS

I.	<u>KIND OF PROCEEDING AND NATURE OF THE RULING</u>	1
II.	<u>STATEMENT OF FACTS</u>	1
	A. <u>West Virginia Natural Gas Is Marketable Only After Processing And Transportation</u>	4
III.	<u>THE CERTIFIED QUESTIONS</u>	6
	<u>Question 1:</u>	
	Where the royalty language is as set out in Exhibit A, may a lessee of oil and gas in West Virginia deduct money and/or volume from the lessor's 1/8 royalty payments where the lease does not provide specifically that the lessee may take the deductions?.....	7
	<u>Question 2:</u>	
	Where in an oil and gas lease there is no specific provision allowing for deduction of post-production expenses does language such as "wholesale market at the well," "amount realized at the well," "net revenue realized," "1/8 of price," "net of all costs beyond the wellhead," and other language as set forth on Exhibit A, grant to the lessee the right to deduct post-production expenses from the lessor's royalty?.....	7
IV.	<u>POINTS AND AUTHORITIES RELIED UPON</u>	8
V.	<u>DISCUSSION OF LAW</u>	10
	A. <u>West Virginia Recognizes Implied Covenants In Oil And Gas Leases</u>	10
	(1) <u>The Implied Covenant To Market The Oil And Gas</u>	14
	(2) <u>The Specific Lease Language Does Not Provide For Deductions - "At The Well" Language Is Deemed To Be Silent With Respect To Post-Production Expenses Or Allocation Of Costs</u>	18

- (3) "Gross Proceeds," "Market Price," "Net Of Costs" And Other Such Language Does Not Permit Lessee To Deduct Costs To Make The Gas Marketable23
- (4) The Gas Is Marketable When The Gas Is In A Condition And Location Acceptable For Market27

VI. RELIEF PRAYED FOR30

TABLE OF AUTHORITIES

Cases:

<u>Adkins v. Huntington Dev. & Gas Co.</u> , 113 W.Va. 490, 168 S.E. 366 (1932)	12,14
<u>California Co. v. Udall</u> , 296 F.2d 384 (D.C. Cir. 1961).....	28
<u>Chandler v. French</u> , 73 W.Va. 658, 81 S.E. 825 (1914)	13
<u>Croston v. Emax Oil Co.</u> , 195 W.Va. 86, 464 S.E.2d 728 (1995)	14
<u>Dillard v. United Fuel Gas Co.</u> , 114 W.Va. 684, 173 S.E. 573 (1934)	14
<u>Eastern Oil Co. v. Coulehan</u> , 65 W.Va. 531, 64 S.E. 836 (1907)	13
<u>Flanagan v. Stalnaker</u> , 216 W.Va. 436, 607 S.E.2d 765 (2004).....	9
<u>Garman v. Conoco, Inc.</u> , 886 P.2d 652 (Col. 1994)	8, 9,16,18,19,27,30
<u>Gilmore v. Superior Oil Company</u> , 388 P.2d 602 (Kan. 1964).....	16,28
<u>Grass v. Development Co.</u> , 75 W.Va. 719, 84 S.E. 750 (1915)	12
<u>Hall v. South Penn. Oil Co.</u> , 71 W. Va. 82, 76 S.E.124 (1912).....	10,12,13
<u>Hanna Oil & Gas Co. v. Taylor</u> , 759 S.W.2d 563, 565 (Ark. 1988)	16,28
<u>Harris v. Michael</u> , 70 W.Va. 356, 73 S.E. 934 (1912).....	13
<u>Headley v. Hoopergarner</u> , 60 W. Va. 626, 55 S.E. 744 (1906).....	11
<u>Hope Natural Gas Co. v. Jarvis</u> , 88 W. Va. 396, 106 S.E. 889 (1921).....	11
<u>Jennings v. Southern Carbon Co.</u> , 73 W. Va. 215, 80 S.E. 368 (1913).....	12,13
<u>Kilcoyne v. Southern Oil Co.</u> , 61 W. Va. 538, 56 S.E. 888 (1907).....	11
<u>Lamp v. Locke</u> , 89 W. Va. 138, 108 S.E. 889 (1921)	11,13
<u>Martin v. Consolidated Coal & Oil Corp.</u> , 101 W.Va. 721, 133 S.E. 626 (1926)	9,11
<u>McMillan v. Connor</u> , 82 W. Va. 173, 95 S.E. 642 (1918).....	14

<u>Millan v. Bartlett</u> , 69 W. Va. 155, 71 S.E. 13 (1911).....	11
<u>Rogers v. Westerman Farm Co.</u> , 29 P.3d 887 (Col. 2001).....	7,8, 9, 18,19,20,22,24,26,27,28,29,30
<u>Smith v. Root</u> , 66 W. Va. 633, 66 S.E. 1005 (1910)	13
<u>Starn v. Huffman</u> , 62 W. Va. 422, 59 S.E. 179 (1907).....	13
<u>Steel v. American Oil Dev. Co.</u> , 80 W. Va. 206, 92 S.E. 410 (1917).....	13
<u>Toothman v. Courtney</u> , 62 W. Va. 167, 58 S.E. 915 (1907).....	13
<u>Trimble v. Hope Natural Gas Co.</u> , 113 W. Va. 839, 169 S.E. 529 (1933).....	13
<u>TXO Production Corp. v. Commissioner of Land Office</u> , 903 P.2d 259, 263 (Okla. 1994)	9,28
<u>United Fuel Gas Co. v. Smith</u> , 93 W. Va. 646, 117 S.E.900 (1923).....	12,13
<u>Wellman v. Energy Resources, Inc.</u> , 210 W. Va. 200, 557 S.E.2d 254 (2001)	7,8,10,13,16,17,18,19,23,24,29,30
<u>West v. Alpar Resources, Inc.</u> , 298 N.W.2d 484 (N.D. 1980).....	16,28
<u>Wood v. TXO Production Corp.</u> , 854 P.2d 880 (Okla. 1992)	16

Secondary Sources:

<u>Maurice H. Merrill, Covenants Implied In Oil and Gas Leases</u> , (2d Ed. 1940).....	11,14,15
--	----------

I. KIND OF PROCEEDING AND NATURE OF THE RULING

This proceeding is for determination of the propriety of the rulings of the Circuit Court of Roane County on certified questions that were certified by Order of the Circuit Court, copy attached hereto. These certified questions arise out of motions for summary judgment where both parties claimed there were no genuine issues of material fact.

The proceeding below is a class action where royalty owners claim, among other things, that the respondent, Columbia Natural Resources (CNR), was a lessee of their oil and gas rights and had improperly deducted post-production expenses from their royalty. The class was certified on February 27, 2004.

II. STATEMENT OF FACTS

Defendants deducted certain amounts from plaintiffs' royalty payments as charges for defendants' gathering fees, line loss, processing of the gas, etc. There is no issue as to this fact; it is admitted. Defendants admit to deducting the following as a "postage stamp" rate from all royalty payments:

1. Costs (Steve Warnick Deposition Tr. at 87-88; Mark Chandler Deposition Tr. at 28);
2. Operating costs (Warnick at 87-88; Chandler at 27-28);
3. Return on investment (Warnick at 87-88; Chander at 28-29);
4. Return on investment of fixed assets (Warnick at 87-88; Chandler at 28-29);
5. Depreciation (Warnick at 95);
6. Employee salaries and benefits (Warnick at 107);

7. Uncollectable accounts (Warnick at 107);
8. Regulatory Commission expenses (Warnick at 108);
9. Income taxes (Warnick at 108);
10. Cost of royalty payments to owners (Warnick at 108);
11. Capital investment (Warnick at 112);
12. Budgeted additions, including additional capital improvements to the gathering system, new lines, compressors, etc. (Warnick at 112);
13. Accumulated deferred taxes (Warnick at 112);
14. O&M (Operations and Maintenance), which include identifiable costs directly associated with the gathering facilities such as maintenance, materials and supplies (Warnick at 112-113);
15. O&M allocation to A&G (Administrative and General), which includes operation and maintenance, administrative and general (Warnick at 114);
16. Franchise taxes (Warnick at 114);
17. Property taxes (Warnick at 114);
18. State income taxes (Warnick at 114);
19. Federal taxes (Warnick at 114);
20. Line loss, which is a level of gas lost in the gathering system between its point of receipt from the wellhead to where CNR would deliver it to the transmission pipeline grid or ultimate consumer. This is "usually attributable to leaks." (Warnick at 115-116);

21. Fuel cost, which is gas used to run CNR's compressors (Warnick at 116; Chandler at 51);
22. Assumed rate of inflation (Warnick at 119); and
23. Processing fee (Chandler at 26-27).

The above items of charges were incorporated into an across-the-board "postage stamp" rate and deducted on a unit basis from all royalty payments. Defendants' rate varied at different times from \$.28/dekatherm to \$.34/dekatherm. There were more fees charged to lessors than simply the gathering rate. They were charged for defendants' line loss and processing fees. These included a "calculated line loss" and a set processing fee.

CNR admitted that it did not need to look at plaintiffs' leases to determine what was produced or what was deducted or even how CNR arrived at the price for gas. (Steve McCracken Deposition Tr. at 21-22.) Defendants admitted that they pay all royalty owners the same way -- out of a pool. (Id. at 22-28.) Steve McCracken¹ admitted that he "did not go back and look at the plaintiffs' history of their wells and charges as part of ... preparation for this deposition." (Id. at 67.) The reason he didn't was because he didn't need to since all lessors are treated the same way. He stated without question that the deductions were arrived at based upon a standard computation. (Id. at 184.) As another Rule 30(b)(7) representative of CNR stated,

¹ Steve McCracken was a CNR's Rule 30(b)(7) witness.

"would I say that the standard is to deduct gathering and processing and line loss from the royalty calculations, that is standard." (Chandler Tr. at 34.)

Also relevant to this issue is the fact that the defendants did not divulge to plaintiffs that they were taking any deductions whatsoever. The only documents provided to lessors and other class members showing their volume of gas, prices of the gas and deductions from the gas is the information sent with each check. (Chandler Exhibits 16-25.) These examples are true for all class members. These documents show no deductions from the price. Consequently, one is led to believe that the price shown is the actual price received by CNR from the ultimate user. Lessors have now learned in discovery that this is not true for either one. CNR admitted that the documents showed "0" for deductions from the plaintiffs' royalty, which meant "no deduction." (Id. at 74-77.) Ms. Jones was only paid a rate of \$2.91 for her gas in September 2003, when gas was sold for over two to three times that price on the market.

Plaintiffs have discovered that defendants paid the royalty owners based upon sales to its own subsidiaries and a forward sales agreement, which substantially decreased the royalty, and still made these same deductions from those sales as well.

A. West Virginia Natural Gas Is Marketable Only After Processing And Transportation

West Virginia natural gas has a BTU content higher than acceptable for marketing. As the former president of CNR testified, the "gas which is of a BTU content higher than pipeline standard that would have to be treated in order for it to be marketable." (Henry Harmon Deposition Tr. at 28.)

Mr. Harmon testified as follows:

Q: The last statement is the argument in favor of allowing the deductions of these costs is that they are absolutely necessary in order for the gas to have any value whatsoever. Is that correct? That is what it says here, right?

A: That was the issue to be decided, yes.

Q: And it is my understanding that your company came to the conclusion that gas in West Virginia, at least, in order to make it have any value whatsoever, had to have these things done to it, correct?

A: It had to be transported. Most of our wells are in very rural areas where there is not a ready market to it, so it had to be transported. To have some value, it had to be transported to a sale point.

Q: And processed?

A: It had to be processed, yes.

Id. at 53-54.

CNR's 30(b)(7) witness, Mark Chandler, testified "it is charged a processing fee, like all the gas is because it has to be stripped out before it is marketable. You cannot move that gas on the interstate pipeline with the fluid." Chandler Tr. at 27. Mr. Chandler elaborated:

1. "Gas is normally sold into a pool, and a pool being an accounting pool sold at TCO's pipeline." (Chandler at 48.)

2. "All three of the costs [gathering, line loss and processing] to get it to the market [are charged to the landowner] because the well is drilled here and the market is here. You can't sell the gas anywhere in between . . ." (Id. at 49.)

3. "It has processing on this. It is wet gas. We can't sell it without processing . . ." (Id. at 50.)

4. "So to get it from the wellhead to the point where it can be sold, because it can't be sold at the wellhead . . ." (Id. at 50.)

5. "This is to get it from the wellhead to the market pool." (Id. at 50.)

6. "Gas isn't sold at the wellhead. . . ." "It is sold on pipelines now, and so gas is very rarely dedicated. Buyers don't want dedicated gas from a well because if that well doesn't produce, they don't get their gas. They want gas in a pool on TCO." (Id. at 109.)

7. "[T]he royalty calculation is based upon a weighted average sales price, and the weighted average sales price is based upon the weighted average pool price, which changes over time." (Id. at 61.)

8. "For example, gas coming out of Roane County on these systems may go into TCO's pool at a certain . . . point, and there or downstream from there may be a receipt point for people who buy gas on TCO. . . ." "Then if your 10,000 -- your 1,000 dekatherms . . . goes downstream into TCO with two BCF of other gas and in the aggregate, it gets \$3 overall average, then that well revenue is calculated on \$3." (Id. at 62.)

III. THE CERTIFIED QUESTIONS

The Circuit Court of Roane County denied CNR's motion for summary judgment and certified the following questions, with its answers, as follows:

Question 1:

Where the royalty language is as set out in Exhibit A, may a lessee of oil and gas in West Virginia deduct money and/or volume from the lessor's 1/8 royalty payments where the lease does not provide specifically that the lessee may take the deductions?

Circuit Court's ruling with respect to Question 1:

The West Virginia Supreme Court ruled in Wellman v. Energy Resources, Inc., 210 W.Va. 200, 557 S.E.2d 254 (2001): "This Court believes that the rationale employed by Colorado, Kansas, and Oklahoma in resolving the question of whether the lessor or the lessee should bear 'post production' costs is persuasive. Like those states, West Virginia holds that a lessee impliedly covenants that he will market the oil or gas produced." ... "[I]f 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." Based upon the holdings of Wellman and the case of Rogers v. Westerman Farm Co., 29 P.3d 887 (Col. 2001), this Court answers the Question 1: "No."

Question 2:

Where in an oil and gas lease there is no specific provision allowing for deduction of post-production expenses does language such as "wholesale market at the well," "amount realized at the well," "net revenue realized," "1/8 of price," "net of all costs beyond the wellhead," and other language as set forth on Exhibit A, grant to the lessee the right to deduct post-production expenses from the lessor's royalty?

Circuit Court's answer with respect to Question 2:

Based upon the rulings in Wellman and Rogers, supra, and Garman v. Conoco, Inc., 886 P.2d 652 (Col. 1994), this Court rules that "at the well," "gross proceeds," "market price," "proceeds from sale," "proceeds received," or "net of all costs" and other such language above is silent as to the right of lessee to deduct post-production expenses. This Court rules that such language is ambiguous and for the reasons set forth in the above cases does not permit deductions for post-production expenses. Therefore, the Court's answer to Question 2 is "No."

IV. POINTS AND AUTHORITIES RELIED UPON

1. 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 1/8 of the sale price received. Wellman v. Energy Resources, Inc., 210 W.Va. 200, 557 S.E.2d 254, 263 (2001).

2. The 1/8 received by a royalty owner is commonly referred to as the landowner's royalty. Id. at 263.

3. In spite of the practice of paying the owner 1/8 of the price received, there has been an attempt in recent years to charge the landowner with a pro rata share of expenses for transporting and processing the gas to make it marketable. Id. at 264.

4. Historically, the lessee has had to bear the cost of complying with his covenants under the lease. Id. at 265.

5. Requiring the lessee to pay for all such post-production costs is "consistent with the long-established expectation of lessors" that they would receive 1/8 of the sale price received. Id. at 265.

6. In a lease which provides for "royalty based on proceeds," the lessee must bear all costs incurred in exploring for, producing, marketing and transporting the product to the point of sale. Id. at 265.

7. In West Virginia the lessee must transport to "point of sale." Id. at 265.

8. Only those costs "actually incurred" and "reasonable" are chargeable; if the lease specifically provides for it, it may be charged. Id. at 265. And then only if it can be done by "accounting methods." Id.

9. Oil and gas leases are to be strictly construed against the lessee with any ambiguity resolved in favor of the lessor. Martin v. Consolidated Coal & Oil Corp., 101 W.Va. 721, 133 S.E. 626, 628 (1926), Flanagan v. Stalnaker, 216 W.Va. 436, 607 S.E.2d 765, 769-770 (2004).

10. Gas is marketable when the gas is in a condition and location acceptable for market, and the lessee must bear the cost of putting it into a condition and transporting it to the location to so make it marketable. Garman v. Conoco, Inc., 886 P.2d 652 (Col. 1994), Rogers v. Westerman Farm Co., 29 P.3d 887 (Col. 2001).

11. Costs of dehydration, compression and gathering are not chargeable to lessors because such processes are necessary to make the product marketable. TXO Production Corp. v. Commissioner of Land Office, 903 P.2d 259, 263 (Okla. 1994).

12. Leases with language such as "at the well," "gross proceeds," "proceeds from sale," "market price," "proceeds received" and such will be deemed to be silent or inadequate language to allow for the lessee to deduct for post-production expenses. Rogers v. Westerman Farm Co., *supra*, at 897-98, Wellman v. Energy Resources, Inc., *supra*, at 265.

13. For a lease to be effective to permit a lessee to deduct post-production expenses, the lease must identify the deductions the lessee intends to take and the manner of calculating or determining the amount of the deduction. *Id.*

V. DISCUSSION OF LAW

A. West Virginia Recognizes Implied Covenants In Oil And Gas Leases

West Virginia has long recognized that there are implied covenants in oil and gas leases for the benefit of the lessors. Hall v. South Penn. Oil Co., 71 W.Va. 82, S.E. 124 (1912). Noted authors on oil and gas leases have historically and consistently recognized this important aspect of the oil and gas lease and relationship between lessor and lessee.

Professor Maurice H. Merrill² wrote:

I suggested, in the first edition of this work, the desirability of a fourfold classification of the obligations placed by the courts upon the lessee into:

- I. The implied covenant to drill an exploratory well.
- II. The implied covenant to drill additional wells.

² "The subject of covenants implied in oil and gas leases was pre-empted many years ago by Professor Maurice H. Merrill when his first work on the subject was published. With the publication of the second edition of the work, Merrill became the recognized authority on the subject. His influence on the development of the law in this respect is so great that one engaged in research must not only consider cases decided on the subject but must also consider opinions expressed by Merrill." Kuntz, Oil and Gas §54.1.

III. The implied covenant for diligent and proper operation of the wells and for marketing the product, if oil or gas is discovered in paying quantities.

IV. The implied covenant to protect the leased premises against drainage by wells on adjoining land.

Maurice H. Merrill, Covenants Implied In Oil and Gas Leases, §4 at 23 (2d Ed. 1940).

The West Virginia Supreme Court recognizes generally that “[a] lessee in the operation of his lease must act in good faith.” Lamp v. Locke, 89 W.Va. 138, 108 S.E. 889 (1921). The Court also recognizes that where there is an “express covenant [in an oil and gas lease] to perform certain acts, there is an implied covenant to refrain from performance of other acts which operate to defeat performance of the express covenant.” Millan v. Bartlett, 69 W.Va. 155, 71 S.E. 13 (1911). Further, there is an implied covenant to receive the amount stipulated for in the lease. Syl. Pts. 1 & 2, Kilcoyne v. Southern Oil Co., 61 W.Va. 538, 56 S.E. 888 (W.Va. 1907).

The Court also recognizes implied covenants on behalf of lessees. For example, Lessees have the implied covenant to enter upon the land and peaceably and quietly possess the same. Hope Natural Gas Co. v. Jarvis, 88 W.Va. 396, 106 S.E. 889, 890 (1921); Syl Pt. 1, Headley v. Hoopergarner, 60 W.Va. 626, 55 S.E. 744 (1906).

Corresponding with Merrill’s classifications, the West Virginia Court also recognizes the following implied covenants in oil and gas leases:

1. THE IMPLIED COVENANT TO DRILL AN EXPLORATORY WELL.

“Lessee will do all that is necessary to carry into effect the purposes and object of the lease” and oil and gas leases “are to be construed liberally in favor of the lessor and strictly against the lessee.” Martin v. Consolidated Coal & Oil Corp., 101 W.Va. 721, 133

S.E. 626, 628 (1926); Hall v. South Penn Oil Co., 71 W.Va. 82, 76 S.E. 124, 124-126 (1912); Adkins v. Huntington Dev. & Gas Co., 13 W.Va. 490, 168 S.E. 366, 367 (1932).

2. THE IMPLIED COVENANT TO DRILL ADDITIONAL WELLS. Lessee has a duty to drill sufficient wells (using sound judgment) reasonably necessary to secure the oil or gas for benefit of both lessor and lessee. Jennings v. Southern Carbon Co., 73 W.Va. 215, 80 S.E. 368, 369-370 (1913). "There is always implied in every oil and gas lease a covenant to drill the number of wells reasonably necessary to develop the property and prevent drainage by operations on adjoining lands." United Fuel Gas Co. v. Smith, 93 W.Va. 646, 117 S.E.900, 904 (1923).

3. THE IMPLIED COVENANT FOR DILIGENT AND PROPER OPERATION OF THE WELLS AND FOR MARKETING THE PRODUCT, IF OIL OR GAS IS DISCOVERED IN PAYING QUANTITIES. "The owner of a lease for production of oil and gas, containing the usual terms and conditions, must, if either mineral is found in paying quantities on the lands, exercise due and reasonable diligence in prosecuting operations thereunder for the mutual benefit of himself and his lessor [Lessees] are bound by that degree of diligence, which, surrounding circumstances and conditions being considered, would reasonably be expected of operators of ordinary prudence, experienced and engaged in the same business, having due regard for the interests and advantages of themselves and their lessors." Grass v. Development Co., 75 W.Va. 719, 84 S.E. 750, 755 (1915); Jennings v. Southern Carbon Co., 73 W.Va. 215, 80 S.E. 368, 369-370 (1913) (lessor has an implied duty to diligently prosecute the search for oil and gas and, if found, "protect the line and well develop the

territory."); Lamp v. Locke, 89 W.Va. 138, 108 S.E. 889, 893 (1921) (duty to begin within reasonable time); Harris v. Michael, 70 W.Va. 356, 73 S.E. 934, 936-937 (1912)(duty to make "a return for the lessor"); Starn v. Huffman, 62 W.Va. 422, 59 S.E. 179 (1907); Smith v. Root, 66 W.Va. 633, 66 S.E. 1005, 1007 (1910) (duty to use "diligence to develop the property"); Steel v. American Oil Dev. Co., 80 W.Va. 206, 92 S.E. 410, 412-414 (1917); Starn v. Huffman, 62 W.Va. 422, 59 S.E. 179 (1907) (duty to begin exploration and development within a reasonable time.); Chandler v. French, 73 W.Va. 658, 81 S.E. 825, 827 (1914)(duty to begin exploration and development within a reasonable time); Trimble v. Hope Natural Gas Co., 113 W.Va. 839, 169 S.E. 529, 531 (1933) (payment of delay rental does not waive lessee's duty to use diligence to develop the property). The lessee is also required, after exploring for and finding oil or gas, to produce the oil or gas. Eastern Oil Co. V. Coulehan, 65 W.Va. 531, 64 S.E. 836, 838-840 (1907). A failure to produce may violate the implied covenant and may result in loss of the leases by abandonment. Id. Finally, the lessee impliedly covenants that he will market the oil and gas produced. Wellman v. Energy Resources, Inc., 210 W.Va. 200, 557 S.E.2d 254, 255 (2001).

4. THE IMPLIED COVENANT TO PROTECT THE LEASED PREMISES AGAINST DRAINAGE BY WELLS ON ADJOINING LAND. Lessee has a duty to protect the lands from drainage through wells in adjoining lands. Jennings v. Southern Carbon Co., 73 W.Va. 215, 80 S.E. 368, 369-370 (1913); Hall v. South Penn Oil Co., 71 W.Va. 82, 76 S.E. 124, 124-126 (1912) (all that is necessary for purpose and object of lease); Toothman v. Courtney, 62 W.Va. 167, 58 S.E. 915 (1907); United Fuel Gas Co. v.

Smith, 93 W.Va. 646, 117 S.E. 900, 904 (1923); Adkins. v. Huntington Dev. & Gas Co., 113 W.Va. 490, 168 S.E. 367 (1932). Further, lessee cannot drain one of his lessor's property to the benefit of other of his lessors. Syl. Pts. 1 & 2, Dillard v. United Fuel Gas Co., 114 W.Va. 684, 173 S.E. 573 (1934); Croston v. Emax Oil Co., 195 W.Va. 86, 464 S.E.2d 728, 733 (1995); McMillan v. Connor, 82 W.Va. 173, 95 S.E. 642, 645 (1918).

(1) The Implied Covenant To Market The Oil And Gas.

While West Virginia recognizes various implied covenants in oil and gas leases, for purposes of this brief petitioners/ plaintiffs will be focusing on the implied covenant to market the oil and gas. "It is now settled that, in addition to the implied covenants for the exploration and for development, there is an implied covenant for the diligent and efficient operation of the lease and marketing of the product." Maurice H. Merrill, Covenants Implied In Oil and Gas Leases, §72 at 184 (2d Ed. 1940).

With the duty to market also comes the duty to bear all of the costs necessary to take the gas to market and make it a marketable product. As set forth in Merrill at §84:

[I]n most cases the lessor thinks of his return solely in a sense of a fixed portion of the money realized from the operations and the lessee so treats it. From this factual background has evolved that the principle [the lessee] is under a duty 'to make diligent efforts to market the production in order that the lessor may realize his royalty interest.'

Id., §84 at 212.

And, further, Merrill states:

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

Id., §85 at 214-215 (emphasis added).

Merrill, in the 1940 treatise, explains the basis upon which Courts have examined the duties between lessor and lessee.

Too much dependence is placed upon the language of a printed form, in the preparation of which at least one party has had no part and to the selection of which the other has frequently given no consideration, if upon a variance in that language a difference is established in a duty not specifically referred to. The lessor in a normal lease wants no oil or gas. He would not be prepared to deal with it or to handle it if it were tendered him. The sole thought associated with royalties in his mind is monetary return, and it is erroneous to read into the royalty clauses stipulations concerning the cost of marketing and preparation which are not specifically expressed.

Id., §85 at 216.

Most lessors know little of the oil and gas business or of the law. The lease form is presented by the lessee or his agent. What bargaining takes place relates to whether the lease shall be executed at all, the term, the bonus, perhaps the delay rental. There is no chaffering to speak of otherwise.

Id., §202 at 436-437.

Implied covenants are imposed regardless of the intent of the parties or their manifestations of intent. Id., §220 at 464. As Merrill states, oil and gas leases are generally standard forms, prepared by the lessees. "It must be borne in mind that lessor and lessee do not usually deal on an equal footing . . . The lessee comes armed with a printed form, the product of legal and business experience, and gives the lessor the chance of accepting that or nothing." Id., §222 at 467-468.

In Wellman v. Energy Resources, Inc., 210 W.Va. 200, 557 S.E.2d 254, 263-264 (2001), the West Virginia Supreme Court recognized the historical expectation of royalty owners when they enter into oil and gas leases:

In Robert Donley, The Law of Coal, Oil and Gas in West Virginia and Virginia § 104 (1951), it is stated: "**From the very beginning of the oil and gas industry it has been the practice to compensate the landowner by selling the oil by running it to a common carrier and paying him [the landowner] one-eighth of the sale price received. This practice has, in recent years, been extended to the situations where gas is found the one-eighth received is commonly referred to as the landowner's royalty.** In Davis v. Hardman, 148 W.Va. 82, 133 S.E.2d 77 (1963), this Court stated that a **distinguishing characteristic of such a royalty interest is that it is not chargeable with any of the costs of discovery and production. The Court believes that such a view has been widely adopted in the United States.**

Wellman, 210 W.Va. 200, 557 S.E.2d at 263-64 (emphases added).

West Virginia has chosen to follow the reasoning of the Supreme Courts in Colorado, Kansas and Oklahoma.³ Those courts have been faced with the same issues as this Court. See Garman v. Conoco, 880 P.2d 652 (Colo. 1994); Wood v. TXO Production Corp., 854 P.2d 880, 882 (Okla. 1992); Gilmore v. Superior Oil Company, 388 P.2d 602 606 (Kan. 1964). See also Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563, 565 (Ark. 1988) West v. Alpar Resources, Inc., 298 N.W.2d 484, 491 (N.D. 1980). These cases were discussed by West Virginia's Supreme Court in Wellman, *supra*, at 263-265.

The West Virginia Court stated:

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

³ West Virginia Supreme Court specifically rejected Texas and Louisiana's holdings allowing deductions for post-production expenses. Wellman, at 264.

produce oil or gas, but he 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.

Id. at 264 (emphasis added).

The Wellman Court then held:

This Court believes that the rationale employed by Colorado, Kansas, and Oklahoma in resolving the question of whether the lessor or the lessee should bear "post-production" costs is persuasive. Like those states, **West Virginia holds that a lessee impliedly covenants that he will market oil or gas produced.** See Robert Tucker Donley, The Law of Coal, Oil and Gas in West Virginia and Virginia §§ 70 & 104 (1951). Like the courts of Colorado, Kansas, and Oklahoma, **the Court also believes that historically the lessee has had to bear the cost of complying with his covenants under the lease.** It, therefore, reasonably should follow that the lessee should bear the costs associated with marketing products produced under a lease. **Such a conclusion is also consistent with the long-established expectation of lessors in this State, that they would receive one-eighth of the sale price received by the 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, id. at 265 (emphases added).

Lastly, the Court in Wellman also concluded:

[I]f 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.

Id.

In the case at bar, most of the leases are form leases and have no provision allowing the lessee to deduct for post-production expenses. However, the few number of leases where the lease does provide for deduction, the defendants cannot meet the criteria of Wellman allowing only for deductions for the expenses specifically provided for and only to the extent actually incurred and to the extent they were reasonable. As set forth above, defendants deducted the same for everyone, regardless of the actual cost and included everything imaginable in the deduction. Further, they deducted for processing and line loss.

(2) **The Specific Lease Language Does Not Provide For Deductions - "At The Well" Language Is Deemed To Be Silent With Respect To Post-Production Expenses Or Allocation Of Costs.**

Subsequent to its own decision in Garman, and essentially contemporaneous with the West Virginia Supreme Court of Appeals' decision in Wellman, the Colorado Supreme Court was faced with the task of applying and further delineating the above principles in regard to specific lease language contained in varying leases in the case of Rogers v. Westerman Farm Co., 29 P.3d 887 (Colo. 2001). More specifically, in Rogers, the Colorado Supreme Court was faced with four types of lease language pertaining to approximately 200 natural gas wells, all of which provided, with some variation, for royalties to be paid based on the gas "at the well" or "at the mouth of the well." The court was required to determine whether such language was "sufficiently clear to set forth the proper allocation between the parties of the costs of gathering, compressing, and dehydrating the gas prior to its entry into the interstate pipeline." Id. at 891.

In viewing the importance of the Rogers case with the issues in this case, the Court should note the timing of the West Virginia Wellman decision and the Colorado Rogers decision. Wellman, supra, was decided in West Virginia on July 6, 2001. The Colorado Supreme Court, on a more specific issue, decided Rogers v. Westerman Farm Company, 29 P.3d 887 (Colo. 2001) on July 2, 2001. Rogers dealt with "at the well," "at the mouth of the well," and other such language interposed in gas leases by the lessees. Garman v. Conoco, 886 P.2d 652 (Colo. 1994), had earlier held that where a lease is silent as to allocation of costs, the implied covenant to market obligates the lessee to incur the costs necessary to render the gas marketable.

In beginning its analysis, the Colorado Supreme Court in Rogers reasoned:

We first note that there are four variations of lease language at issue in this case. However, notwithstanding the distinct language of each of the four lease types, there is some language common to all four lease types. Specifically, all of the leases contemplate that the royalties are to be computed "at the well" or "at the mouth of the well." We have not previously interpreted the type of lease language presented by the leases at issue in this case. Despite the differing language in each of the four types of leases, and despite the arguments raised that the "at the well" and "at the mouth of the well" language provides for the allocation of costs, we conclude that all of the leases are, in fact, silent with respect to the allocation of costs.

Id. at 896-897 (emphases added).

The Rogers Court then further explained:

Our view that the leases are silent with respect to the allocation of costs is further solidified by the notion in contract law that language should be construed as a whole, and specific phrases or terms should not be interpreted in isolation. . . . Specifically with respect to oil and gas leases, "a royalty clause should be construed in its entirety and against the party who offered it, and in light of the fact that the royalty clause is the means by which the lessor receives the primary consideration for a

productive lease.” Owen L. Anderson, Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically, Part 2 (Should Courts Contemplate the Forest or Dissect Each Tree?), 37 Nat. Resources J. 611, 636 (1997) [hereinafter Anderson, Part 2]. The parties argue that the “at the well” and “at the mouth of the well” language at issue in this case is meaningful in allocating costs between the lessees and lessors. However, as we have discussed, this language in isolation is actually silent with respect to those costs. Moreover, the lease language contained in the rest of the contracts does not shed any light onto how, or even whether, this phrase was intended to address the allocation of costs.

Although courts and commentators have disagreed over whether “at the well” language addresses allocation of costs, other jurisdictions have acknowledged that “at the well” lease language is silent as to allocation of costs. For example, in Fox Wood III v. TXO Production Corps, 854 P.2d 880 (Okla. 1992), the Oklahoma Supreme Court implicitly determined that “at the well” language in a lease was silent regarding allocation of costs. Although the Oklahoma Supreme Court did not explicitly state that the lease provision was silent, it did conclude that, without an agreement that the lessee and lessor would share costs, the lessor could not be required to bear compression costs. Id. at 881.

Although Anderson does not necessarily agree with the view that “at the well” language is silent with respect to allocation of costs, he does suggest that this language is sufficiently unclear that it may or may not accomplish the lessees’ objectives, to share proportionately in costs, when read together with the royalty clause as a whole. See Anderson, Part 2, at 635. Moreover, Anderson has suggested that lessees, in order to avoid alerting lessors of their motives, have intentionally used “at the well” language to avoid directly stating their objectives in sharing costs. See id. In a similar view, the Kansas Supreme Court, in Gilmore v. Superior Oil Co., implicitly suggested that a lease containing “at the well” language was ambiguous, and as such, should be construed in favor of the lessor and against the lessee. 192 Kan. 388, 388 P.2d 602, 605 (Kan. 1964).

Rogers, 29 P.3d at 898-99 (citations omitted, emphases added).

The Rogers Court then rejected the interpretation of some courts that the “at the well” and “at the mouth of the well” language provides a location for royalty valuation purposes and therefore provides for the allocation of transportation costs, reasoning:

[Such] interpretation does not acknowledge that the "at the well" and "at the mouth of the well" language has greater implications than the limited significance of a mere determination of a location for royalty valuation purposes. Thus, attempting to give such limited significance to "at the well" language requires assumptions to be made about the nature of the costs involved. Specifically, the suggestion that "at the well" language allocates transportation costs, without allocating other costs, attempts to give limited significance to that phrase, without acknowledging that transportation costs often include other costs. Accordingly, "at the well" language cannot adequately address the allocation of transportation costs without also addressing other costs associated with transporting gas. The cost of gathering, compression, and dehydration should be included, because they may all be necessary to physically transport the gas. Thus, it is inconsistent to carve out a rule for transportation costs alone. In addition, we conclude that it is also inconsistent to carve out a rule for different types of transportation costs. Whether transportation costs are incurred to transport the gas for a short distance or to a distant market is irrelevant in determining whether those costs should be allocated between the lessors and the lessees. Instead, the determination of whether transportation costs (either short or long distance) are to be allocated between the parties is based on whether the gas is marketable before or after the transportation costs are incurred.

Gas marketability must be addressed first, together with the function of the actual costs incurred. It must be determined whether those actual costs stem from the transportation of a marketable product, or whether they were costs incurred to make the product marketable. Therefore, we decline to adopt the view that "at the well" or "at the mouth of the well" language determines the allocation of transportation costs, but is silent with respect to all other costs. This view is both internally inconsistent and inconsistent with our view that the implied covenant to market controls the allocation of costs under circumstances where lease language fails to address cost allocation.

* * *

The general rule that transportation costs are allocated between the two parties after the gas is marketable is really part of a much broader rule. That broader rule holds that costs incurred after a marketable product has been obtained, that either enhance the value of the product or cause the product to be transported to another location, are shared by the lessee and the lessor. 3 Eugene Kuntz, A Treatise on the Law of Oil and Gas, § 40.5, at 351 (1989 & 2001 Supp.) [hereinafter Kuntz]. Accordingly, the analysis of whether transportation costs are

deductible begs the question of when the gas is marketable.

If gas is marketable at the physical location of the well, then transportation costs may be shared between the lessee and the lessor. However, if gas is not marketable at the physical location of the well, either because it is not in a marketable condition, or because it is not acceptable for a commercial market, then the lessee has not met its burden of making the gas marketable. Thus, transportation costs may not be deducted from royalty payments. Adopting the view that the "at the well" language determines which costs are deductible from royalty payments fails to acknowledge that deductibility of costs is determined by whether gas is marketable, not by the physical location of the gas or the condition of the gas. Accordingly, we decline to hold here that transportation costs are deductible from royalty payments as a matter of law when a lease includes "at the well" language.

Rogers, at 899-901 (emphases added; footnotes omitted).

The Rogers Court also noted:

[I]n interpreting leases like those in this case, we are mindful of the generally accepted rule that oil and gas leases are strictly construed against the lessee in favor of the lessor. Wilson v. Wakefield, 146 Kan. 693, 72 P.2d 978, 980 (1937); Ladd v. Upham, 58 S.W.2d 1037, 1039 (Tex.Civ.App.1933); Davis v. Cramer, 837 P.2d 218, 225 (Colo.App. 1992) (oil and gas leases are construed liberally in favor of lessor and strictly against lessee); Hill v. Stanolind Oil & Gas Co., 119 Colo. 477, 489, 205 P.2d 643, 649 (1949) (doubt as to contract's meaning should be resolved against the one who prepared it); Anderson, Part 2, supra, at 636 ("an oil and gas lease offered by a lessee should be construed against the lessee"); 2 W.L. Summers, The Law of Oil and Gas § 372, at 487-94 (1959 & 2000 Supp.) [hereinafter Summers] (uncertainty or ambiguity as to meaning of contract will be construed against party who prepared the contract; in oil and gas industry that is usually the lessee). This rule is generally based on the recognition that the bargaining power between a lessor and lessee is similar to that historically found between an insurance company and its customers. Ladd, 58 S.W.2d at 1039. Thus, the parties are in similar unequal positions. For example, lessors are not usually familiar with the law related to oil and gas leases, while lessees, through experience drafting and litigating leases, generally are. Id.; see also West v. Alpar Res., Inc., 298 N.W.2d 484, 490-91 (N.D. 1980) (failure to expressly provide for deductions of expenses in ambiguous lease language will result in disallowance of such deductions because lease must be construed strongly against lessee).

Accordingly, based on our interpretation of the "at the well" and "at the mouth of the well" language common to the four lease types at issue, we conclude that the leases in this case are silent with respect to allocation of costs. We disagree with those jurisdictions that conclude that "at the well" is sufficient to allocate costs. Moreover, we disagree with the conclusion that "at the well" language addresses transportation costs, while not addressing other costs incurred in processing the gas. Instead, we conclude that because the leases are silent, we must look to the implied covenant to market, and our previous decision in Garman v. Conoco, to determine the proper allocation of costs.

Id. at 901-902 (emphases added).

(3) "Gross Proceeds," "Market Price," "Net Of Costs" And Other Such Language Does Not Permit Lessee To Deduct Costs To Make The Gas Marketable.

In Wellman, supra, the West Virginia Supreme Court made clear that a "1/8 of the market value of such gas at the mouth of the well" did not grant to the lessee the right to charge plaintiffs for the cost to make the gas marketable. Wellman, supra, at 265.

As set forth above in section (2), supra, "at the well" language does not allow for deductions. In Wellman, supra, the West Virginia Supreme Court chose to follow the reasoning and analysis of Colorado, Kansas and Oklahoma when looking at an implied covenant of production of marketing of gas. Id. at 265. This is critical to whether "proceeds" or "market price" or other such language modifying the royalty has any real meaning to the lessor and, therefore, to the interpretation of the lease. It should always be kept in mind that oil and gas leases are not the common leases of land. The oil and gas lease is based upon the landowner receiving part of the profit from the sale of the gas from his land for profit. It is a relationship. The lessor is totally dependent upon

the honesty and integrity of the lessee who prepares the lease, drills the well, sells the gas and sends the lessor a check and accounting -- generally by mail. Courts, particularly the Colorado, Kansas and Oklahoma courts, have looked carefully at the leases from the relationship standpoint.

In the aftermath of cases like Wellman, courts across the land have been asked to further examine other language in the royalty clauses which lessees contended allowed post-production deductions.

The case of Rogers v. Westerman Farm Co., 29 P.3d 887 (Colo. 2001), delved into the heart of this issue.⁴ There are numerous variations of royalty clauses whose language means little or nothing to lessors, except to answer the question -- What is the fraction the lessor is getting from the gas sales? -- "1/8." In Rogers, the court carefully analyzed four specific royalty clauses.

The Rogers Court began its analysis by examining the lease language contained in the four types or variations of leases.

TYPE I: GROSS PROCEEDS

Notwithstanding an initial misleading appearance that the lease language provides for allocation of costs, it is apparent that when scrutinized in depth, each lease clause provision inadequately addresses allocation of costs. For example, the Type I lease contains two separate clauses. The first clause provides for royalties based on the gross proceeds from the sale of gas at the wellhead. Assuming a commonly understood definition of "gross proceeds," this language seemingly suggests that costs would not be shared. For example, gross proceeds means "the total monies and other consideration accruing to an oil and gas lessee for the disposition of the oil." Oil and Gas Terms, *supra*, at 472; see also Mittelstaedt v. Santa Fe Minerals, Inc. 1998 OK 7,

⁴ Rogers, *supra*, also held that "at the well" was deemed silent with respect to deduction of costs.

954 P.2d 1203, 1206 (Okla. 1998) (plain meaning of "gross proceeds" suggests payment to lessor is without deduction). Moreover, the second clause further confuses the meaning of the lease language as a whole. This clause provides that, for sales not occurring at the well, the royalties are to be paid based on the market value at the well, but in no event shall those royalties total more than 1/8th of the amount actually received for the sale. While this portion of the lease suggests that the royalties be paid based on the market value, there is no indication as to how such value is to be determined. Furthermore, this language does not indicate whether the calculation of market value at the well includes or excludes costs, and does not describe how those costs should be allocated, if at all, between the parties. Thus, because the lease language fails to even describe either the costs or the allowable deductions, it is silent with respect to all deductions.

TYPE II: PROCEEDS FROM SALE

Similarly, the Type II lease provides that the royalties are to be calculated based on "the proceeds from the sale of gas . . . at the mouth of the well." Commentators have suggested that a proceeds clause must either specify the place where proceeds are to be calculated, or the expenses which can be deducted. 3 Howard R. Williams & Charles J. Meyers, Oil and Gas Law § 646.1, at 608.4-608.6 (2000) [hereinafter Williams & Meyers]. Assuming this position is adopted, this lease language indicates that the royalties are to be paid based on sales at the physical location of the well. However, this is not the only view. The Arkansas Supreme Court, for example, has held that "proceeds at the well" means gross proceeds where the lease does not refer to costs or use the term "net proceeds." Hanna Oil & Gas Co. v. Taylor, 297 Ark. 80, 759 S.W.2d 563, 564-65 (Ark. 1988). Thus, there is uncertainty as to how royalties should be calculated under this language. Moreover, this language does not provide any guidance in calculating a royalty payment for gas sold anywhere other than at the physical location of the well. Accordingly, this lease language not only fails to allocate costs between the parties, it fails to address costs in any sense.

TYPE III: MARKET PRICE

Likewise, the Type III lease provides that the royalties are to be paid based on the "market price at the well for the gas sold." While the term "market price" suggests the actual price for which gas is purchased or sold, commentators and courts have also used the term interchangeably with "market value." Oil and Gas Terms, *supra*, at 605-606. For gas actually sold at the well, this language might suggest that

the royalty payments should be equal to the actual price received when the gas is sold, without any deductions for costs. Assuming, under the language in this type of lease, that the gas is sold at the well, there may be no costs to be allocated because this language only contemplates a sale at the physical location of the wellhead. However, because the sale of gas anywhere other than at the wellhead is not even contemplated by this language, this provision is surely silent with respect to any gas sold away from the well.

TYPE IV: PROCEEDS RECEIVED

Finally, the Type IV lease provides that royalties are to be calculated based on the "proceeds received for gas sold from each well . . . or the market value at the well of such gas used off the premises." The first portion of this language regarding proceeds is unclear as to whether it is intended to refer to proceeds from the sale at the location of the well, or proceeds from the sale at the place of sale, if other than at the physical location of the well. In a proceeds type lease, the instrument should specify either the place where royalties are to be calculated, or the expenses to which the lessor is subject. 3 Williams & Meyers, supra, § 646.1, at 608.4-628.6. Thus, differing interpretations of this language are possible because the intended meaning of this clause is unclear.

Furthermore, the reference to a calculation based on market value of gas used off the premises does not clearly establish whether such a calculation would apply to gas sold off the premises. The use of the word "or" in the lease implies that there is a distinction between the calculation for gas sold from the physical location of a well and gas used off the premises. Neither phrase, referring to proceeds for gas sold at the well, or market value at the well for gas used off the premises, indicates whether there was an intent to allocate costs between the parties, nor whether deductions would be made prior to calculating royalties. Thus, like the other three types of leases, the Type IV lease language is also silent as to cost allocation.

Rogers, 29 P.3d at 897-98 (emphases added; footnote omitted).

Accordingly, the court in Rogers⁵ found that terms such as “gross proceeds,” “proceeds,” “market value,” or “market price” when used in conjunction with phrases such as “at the well,” “at the place of sale,” or “used off premises” either do not provide for the deduction of costs, are silent on the issue, or are ambiguous or otherwise inadequate to address the issue of whether and which costs, if any, may be deducted.

(4) **The Gas Is Marketable When The Gas Is In A Condition And Location Acceptable For Market.**

The Colorado Supreme Court in Garmon v. Conoco, *supra*, stated “the common thread connecting these theories is the existence of an obligation upon the lessee . . . to complete all operations necessary to market the gas produced from the leasehold.” Garman, at 659. The explanation for when the gas becomes marketable is set forth in Garman, at 661: “Our answer is limited to those post-production costs required to transform raw gas into a marketable product.”

As the court in Rogers held, gas is marketable when:

(1) it is in the physical condition such that it is acceptable to be bought and sold in a commercial market place, and

(2) it is in the location of a commercial marketplace, such that it is commercially saleable in the oil and gas marketplace. Rogers v. Westerman Farm Co., 29 P.3d at 906 (Colo. 2001).

⁵ See also opinion of Savage v. Williams Production RMT Company, 2005 W.L. 2665652 (Colo. App. Dis. III). Note that the opinion is not released for Permanent Law Report.

The Oklahoma Supreme Court held that costs for dehydration, compression and gathering are not chargeable to lessors because such processes are necessary to make the product "marketable." TXO Production Corp. v. Commissioner of Land Office, 903 P.2d 259, 263 (Okla. 1994). (Also Gilmore v. Superior Oil Co., 388 P.2d 602, 605-607 (Kan. 1964) held "no part of the costs of marketing or of preparation for sale is chargeable to the lessor. This is supported by the general current of authority.") See also West v. Alpar Resources, Inc., 298 N.W.2d 484, 490-491 (N.D. 1980)(disallowing deductions); California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961)(Lessee required to pay to make gas marketable); Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563, 564-565 (Ark. 1988)("Proceeds" means "total proceeds" and lessee can't deduct).

Then in Rogers, the Colorado Supreme Court further elaborated on the definition of marketable with reference to the post-production expenses. The court in Rogers reasoned:

In order to resolve the dispute between the parties in this case, we must define marketability under Colorado law, and specifically under the implied duty to market found in every oil and gas lease. . . . [W]e believe that **the more accurate definition of marketability includes both a reference to the physical condition of the gas, as well as the ability for the gas to be sold in a commercial marketplace.**

Id. at 363 (emphasis added).

In looking to the first-marketable product rule for guidance in defining marketability, we must look to the practical implications of such a rule. In defining whether gas is marketable, there are two factors to consider, condition and location. First, we must look to whether the gas is in a marketable condition, that is, in the physical condition where it is acceptable to be bought and sold in a commercial marketplace. Second, we must look to location, that is, the commercial marketplace, to determine whether the gas is commercially saleable in the oil and gas marketplace.

A market is a "place of commercial activity in which goods, commodities, securities, services, etc., are bought and sold." Black's Law Dictionary 970 (6th ed. 1990). It is also defined as "the region in which any commodity or product can be sold; the geographical or economic extent of commercial demand." Id. Thus, the determination of when gas is first-marketable is driven in part by the commercial realities of the marketplace. See Anderson, Part 2, supra, at 637 n. 112 (recognizing that a lease is a commercial transaction between lessee, as merchant, and lessor, as nonmerchant, and should be viewed based on commercial realities in the marketplace).

It may be, for all intents and purposes, that gas has reached the first-marketable product status when it is in the physical condition and location to enter the pipeline. See TXO Prod. Corp., 903 P.2d 259, 262-63 (implying that the standard for determining when gas is marketable is when it is fit to enter the pipeline, because costs of dehydration and gathering, which are required in order for the gas to enter the pipeline, are expenses borne by the lessee as part of the duty to market gas, and are not deductible expenses from royalty payments); R.E. Yarbrough & Co., 122 IBLA 217, 223 (1992) (gas not in marketable condition until prepared for delivery into pipeline); Wyo. Stat. § 30-5-304 (2000) (lessee pays all non-deductible costs of production including costs of gathering, compressing, dehydrating, and transporting the gas into the market pipeline); Jay G. Martin, Summary of Significant Gas Market and Transportation Changes Affecting Producers in the 1990's, 37 Rocky Mtn. Min. L. Inst. § 16.01 (1991) (production function of gas industry includes producer being responsible for "putting the gas into a marketable state by removing its impurities and gathering the gas from the various points of production (wellhead), and delivering it via gathering lines to a common point for delivery into the large diameter transmission lines").

Rogers, 29 P.3d at 903-06 (emphases added; footnotes omitted).

Wellman may go beyond the above authority to a simpler definition and rule of law. West Virginia's Supreme Court in Wellman stated that the "lessee must bear all costs incurred in exploring for, producing, marketing, and transporting the product to the POINT OF SALE." Wellman at 265 (emphasis added). The point of sale of all of the leases is at least at TCO's transportation line if not at the ultimate purchaser. Therefore,

marketable could be defined as the cost of making the gas acceptable for purchase at TCO's facility.

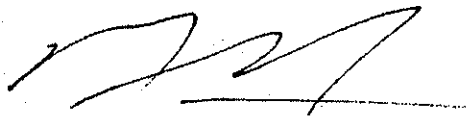
The plaintiffs' gas required transportation to a pipeline and to go through processing to remove impurities. Therefore, clearly, applying Wellman, Garman and Rogers, supra, the gas was not marketable until it at least reached the TCO (Columbia Gas Transmission) pipeline.

VI. RELIEF PRAYED FOR

Petitioners pray that this Honorable Court affirm the trial court rulings as to the certified questions, and that the Court thereupon remand the proceedings for resolution based upon the rulings on the certified questions, and for such other, further and general relief as the Court deems just and proper.

Respectfully submitted,

ESTATE OF GARRISON G. TAWNEY, by
LELA ANN GOFF, Executrix, et al.



Marvin W. Masters (WV Bar #2359)
THE MASTERS LAW FIRM, L.C.
181 Summers Street
Charleston, West Virginia 25301
(304) 342-3106
Counsel for Petitioners/Plaintiffs

Scott S. Segal (WV Bar #4717)
THE SEGAL LAW FIRM
810 Kanawha Boulevard, East
Charleston, West Virginia 25301
Counsel for Petitioners/Plaintiffs

Michael W. Carey (WV Bar #635)
George M. Scott (WV Bar #4678)
Robert E. Douglas (WV Bar #1052)
CAREY, SCOTT & DOUGLAS, PLLC
707 Virginia Street, East, Suite 1701
Charleston, West Virginia 25301
Counsel for Petitioners/Plaintiffs

J. Thomas Lane (WV Bar #2138)
J. Mark Adkins (WV Bar #7414)
BOWLES, RICE, McDAVID, GRAFF & LOVE
Post Office Box 1386
Charleston, West Virginia 25325-1386
Counsel for Petitioners/Plaintiffs

BEFORE THE WEST VIRGINIA SUPREME COURT OF APPEALS

No. 32966

ESTATE OF GARRISON G. TAWNEY, by
LELA ANN GOFF, Executrix,
LELA ANN GOFF and VERNON B. GOFF,
husband and wife, JANICE E. COOPER and
CLIFFORD R. COOPER, husband and wife,
LARRY G. PARKER, JOHN W. PARKER,
RICHARD L. ASHLEY, MYRTLE JONES,
by her Attorney-in-Fact, ORTON A. JONES,

Petitioners/Plaintiffs,

vs.

Civil Action No. 03-C-10E below
Circuit Court of Roane County

COLUMBIA NATURAL RESOURCES, LLC,
f/k/a COLUMBIA NATURAL RESOURCES, INC.,
a Texas corporation; NISOURCE INC., a
Delaware corporation; and COLUMBIA
ENERGY GROUP, a Delaware corporation,

Respondents/Defendants.

CERTIFICATE OF SERVICE

I, Marvin W. Masters, counsel for Plaintiffs, do hereby certify that true and exact copies of the foregoing "Petitioners/Plaintiffs' Brief in Support of Affirming Trial Court's Rulings on Certified Questions" were served upon:

Honorable Thomas C. Evans, III
Jackson County Courthouse
116 Court Street
Ripley, West Virginia 25271

Timothy M. Miller
Robinson & McElwee, PLLC
Post Office Box 1791
Charleston, West Virginia 25326
Counsel for Defendant, Columbia Natural Resources, LLC


W. Henry Lawrence
Steptoe & Johnson, PLLC
Bank One Center, Sixth Floor
Post Office Box 2190
Clarksburg, West Virginia 26302-2190
and
Patricia Proctor
Steptoe & Johnson, PLLC
1000 Fifth Avenue, Suite 250
Post Office Box 2195
Huntington, West Virginia 25722-2195
Counsel for Defendants, NiSource Inc. and Columbia Energy Group

Michael W. Carey
Robert E. Douglas
George M. Scott
Carey, Scott & Douglas, PLLC
707 Virginia Street, East, Suite 901
Charleston, West Virginia 25301
Co-Counsel for Plaintiffs

Scott S. Segal
The Segal Law Firm
810 Kanawha Boulevard, East
Charleston, West Virginia 25301
Co-Counsel for Plaintiffs

J. Thomas Lane
J. Mark Adkins
Bowles, Rice, McDavid, Graff & Love
Post Office Box 1386
Charleston, West Virginia 25325-1386
Counsel for Sub-Class Members

in envelopes properly stamped, addressed and deposited in the regular course of the
United States Mail, this 27th day of January, 2006.



Marvin W. Masters