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## West Virginia

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# ONE J

*Oil and Gas, Natural Resources, and Energy Journal*

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## WEST VIRGINIA



*Andrew Graham\**

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### *I. Introduction*

This Article summarizes and discusses important developments in West Virginia oil and gas law between August 1, 2020, and July 31, 2021. This Article is divided into two parts. The first part will discuss common law developments in both state and federal courts. The second part will discuss developments in legislation and regulation.

### *II. Judicial Developments*

First, this section will discuss oil and gas cases decided by the West Virginia Supreme Court of Appeals and the United States Court of Appeals for the Fourth Circuit.

#### *A. West Virginia Supreme Court of Appeals*

##### *EQT Production Company v. Antero Resources Corporation*

The West Virginia Supreme Court of Appeals held that, by operation of West Virginia's recording act, a top lease held by Antero Resources Corporation ("Antero") took precedence over a base lease held by EQT Production Company ("EQT").<sup>1</sup>

The oil and gas owners (the "Lemasters") granted an oil and gas lease to EQT in 2011 and its primary term was due to expire on December 13, 2016.<sup>2</sup> In June 2016, before the primary term of the lease expired, the Lemasters granted a top lease to Antero, effective December 14, 2016, in which the Lemasters agreed that they would not voluntarily extend or amend the EQT base lease.<sup>3</sup> The Antero top lease was recorded on August 30, 2016.<sup>4</sup> Then, on September 24, 2016, the Lemasters agreed to extend the base lease with EQT.<sup>5</sup> This extension was recorded on December 12, 2016.<sup>6</sup> EQT employees testified that they were aware of the Antero top lease and the provision prohibiting the Lemasters from voluntarily extending the EQT base lease at the time of the extension.<sup>7</sup>

Citing West Virginia's recording act,<sup>8</sup> the court held that, at the time Antero acquired the top lease, it had no notice that EQT had extended the

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1. *EQT Prod. Co. v. Antero Res. Corp.*, 851 S.E.2d 94 (W. Va. 2020).

2. *Id.* at 95.

3. *Id.* at 96.

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. W. VA. CODE §§ 40-1-8, 9 (year).

term of the base lease past the primary term's December 31, 2016 expiration date because the two provisions by which EQT could have extended the base lease (production of oil or gas or operations) had not yet occurred.<sup>9</sup> Because the Antero top lease was recorded before the EQT extension was recorded, the Court held the Antero top lease had priority over the EQT base lease extension.<sup>10</sup>

*Ascent Resources – Marcellus, LLC v. Huffman*

The West Virginia Supreme Court of Appeals determined that a court cannot imply a right to pool and unitize the leased premises into an unambiguous oil and gas lease.<sup>11</sup> The court found that when an oil and gas lease has no ambiguity, latent or patent, and does not include a covenant to pool or unitize, no such covenant can be implied.<sup>12</sup>

Ascent Resources-Marcellus, LLC (“Ascent”) owned 50% of the oil and gas rights in a 94-acre tract of land in Tyler County, West Virginia.<sup>13</sup> The remaining 50% was owned by David L. Huffman and Triple L Land and Mineral, LLC.<sup>14</sup> In 1980, the predecessors in title to Huffman and Triple L, entered into an oil and gas lease that was still being held by production.<sup>15</sup> Ascent had also acquired the lessee's interest under the 1980 lease.<sup>16</sup> Ascent, desiring to include the leased premises in a drilling unit, asked the Circuit Court of Tyler County to declare that, even though the lease did not provide for an express right to pool, Ascent had an implied right to pool the leased premises into a drilling unit under the 1980 lease.<sup>17</sup>

The circuit court held the lease was unambiguous and did not expressly provide for the right to pool or unitize the lease. Therefore, the court could not unilaterally add a pooling provision by implication because that would entail additional burdens on the oil and gas estate that had not been bargained for by the parties to the lease.<sup>18</sup>

The West Virginia Supreme Court of Appeals affirmed the circuit court's decision and held that, under West Virginia law, oil and gas are interpreted

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9. *Id.* at 99.

10. *Id.* at 100.

11. *Ascent Res. - Marcellus, LLC v. Huffman*, 851 S.E.2d 782 (W. Va. 2020).

12. *Id.* at 783.

13. *Id.* at 784.

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at 786.

under principles of contract law.<sup>19</sup> Under these principles, only ambiguous leases are subject to interpretation by the courts.<sup>20</sup> Since the oil and gas lease at issue was unambiguous, the court held the right to pool could not be implied into the lease because there was no evidence that the original parties to the lease had intended to burden the oil and gas interest in such a manner.<sup>21</sup>

*Klein v. McCullough*

The West Virginia Supreme Court of Appeals held that, within the context of a deed, a right of first refusal, being neither a reservation nor an exception, is not subject to the stranger-to-the-deed rule.<sup>22</sup>

In 1995, Benjamin McCullough acquired a tract of land from his mother by a deed that contained a clause which gave Lanna Klein (“Klein”), his sister who was not a party to the deed, a right of first refusal concerning the surface and mineral rights.<sup>23</sup> In 2010, Benjamin McCullough died, leaving his entire estate to his wife, Darlene McCullough (“McCullough”).<sup>24</sup> McCullough then conveyed the parcel to two other individuals who subsequently leased the oil and gas without giving a right of first refusal to Klein.<sup>25</sup>

Consequently, Klein filed suit in the Circuit Court of Tyler County seeking to enforce her right of first refusal.<sup>26</sup> In response, McCullough argued that Klein was a stranger to the 1995 deed and as such the right of first refusal is void.<sup>27</sup> The circuit court agreed and held that the right of first refusal was void under the stranger-to-the-deed rule.<sup>28</sup>

Klein appealed and the West Virginia Supreme Court of Appeals reversed the circuit court’s decision and held that since rights of first refusal are not reservations or exceptions, they are not subject for the stranger-to-the-deed rule.<sup>29</sup>

In his opinion for the court’s majority, Justice Hutchinson described how several states have abolished the stranger to the deed rule, but the court

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19. *Id.* at 787.

20. *Id.* at 788.

21. *Id.*

22. *Klein v. McCullough*, 858 S.E.2d 909 (W. Va. 2021).

23. *Id.* at 912.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.* at 913.

28. *Id.*

29. *Id.* at 915.

refrained from out-right abolishing the rule at this time as the issue was only presented to the court during oral arguments and not in the original proceedings.<sup>30</sup> Nevertheless, Justices Armstead and Wooton filed a concurring opinion in which they agreed with the court's judgment but stated their opposition to abolishing the stranger-to-the-deed rule.<sup>31</sup>

*B. Federal Courts*

*Young v. Equinor USA Onshore Properties, Inc.*

The United States Court of Appeals for the Fourth Circuit held an oil and gas lease satisfied the three-prong test under West Virginia law necessary to rebut the presumption that the lessees must bear all post-production costs.<sup>32</sup>

Travis and Michelle Young (“the Youngs”) granted an oil and gas lease for a tract of land containing 69.5 acres in Ohio County, West Virginia, to SWN Production Company who, in turn, assigned a leasehold interest to Equinor USA Onshore Properties, Inc.<sup>33</sup> The lease included several provisions setting forth how the Youngs’ royalty payments would be calculated. The court described the royalty provisions as:

The royalty clause (1) grants the Youngs a royalty equal to “fourteen percent of the net amount realized” by SWN and Equinor; (2) states that post-production costs shall be deducted from the “gross proceeds” to calculate the net amount realized; (3) specifies seven types of such post-production costs, including a “catchall” provision for “any and all other” post-production costs; and (4) allows SWN and Equinor to either contract with others to perform the post-production operations or perform them using their own pipelines and equipment, in which case post-production costs also include the “reasonable depreciation and amortization expenses related to such facilities, together with Lessee’s cost of capital and a reasonable return on its investment.”<sup>34</sup>

In 2016, SWN started deducting post-production cost when it calculated the Youngs’ royalty payments and the Youngs filed suit for damages and declaratory judgment that the lease failed to satisfy West Virginia’s

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30. *Id.* at 916.

31. *Id.* at 917.

32. *Young v. Equinor USA Onshore Props., Inc.*, 982 F.3d 201 (4th Cir. 2020).

33. *Id.* at 203.

34. *Id.* at 204.

requirements for allocating post-production costs.<sup>35</sup> Under *Tawney v. Columbia Nat. Res., LLC*, 633 S.E.2d 22 (W. Va. 2006), post-production costs can be deducted when royalty payments are calculated if the lessee can satisfy the following three-prong test:

[T]he lease 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.<sup>36</sup>

The court determined that the parties mostly agreed that prongs one and two had been satisfied, but disagreed over whether prong three had been satisfied and this district court had relied upon this disagreement when it ruled in favor of the Youngs.<sup>37</sup> The district court defined prong three as requiring a mathematical formula for the calculation of royalties.<sup>38</sup> However, the Fourth Circuit disagreed and held the lessee only needed to identify which costs and how much of those costs would be deducted from the lessee's royalties.<sup>39</sup> Thus, the Fourth Circuit held the third prong of the *Tawney* test was satisfied and ruled in favor of SWN and Equinor.<sup>40</sup>

\* *Note: The author's firm represented Equinor USA Onshore Properties, Inc. in the case.*

### III. Legislative and Regulatory Developments

#### A. Legislative Enactments

##### *Senate Bill 404*

Senate Bill 404 allows the West Virginia Department of Environmental Protection ("WVDEP") to charge permit modification fees of \$2,500.<sup>41</sup> These funds are intended to stabilize staffing levels at the WVDEP by

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35. *Id.* at 205.

36. *Id.* at 206 (citing *Tawney v. Columbia Nat. Res., LLC*, 633 S.E.2d 22, 30 (W. Va. 2006)).

37. *Id.*

38. *Id.* at 208.

39. *Id.*

40. *Id.* at 209.

41. See S.B. 404, 85th Leg., Reg. Sess. (W. Va. 2021).

raising an additional \$1.3 million.<sup>42</sup> This bill is effective as of June 16, 2021.<sup>43</sup>

*House Bill 2581*

House Bill 2581 modifies the process for the valuation of natural resources property and establishes an alternate method of appeal of proposed valuation of natural resources property. This bill was effective as of April 10, 2021.<sup>44</sup>

*B. Regulatory Changes*

*Senate Bill 160*

This bill authorizes a rule change, Title 110 Series 13GG, made by the Department of Revenue that codifies the procedures and methodology for the Downstream Natural Gas Manufacturing Investment Tax Credit passed in 2020.<sup>45</sup>

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42. Hartman Harman Cosco Public Policy Strategists, *Debriefing the 2021 WV Legislative Session – Oil and Gas* (May 13, 2021), <https://h2cstrategies.com/2021/05/13/debriefing-the-2021-wv-legislative-session-oil-gas/>.

43. See S.B. 404, 85th Leg., Reg. Sess. (W. Va. 2021).

44. See H.B. 2581, 85th Leg., Reg. Sess. (W. Va. 2021).

45. See S.B. 160, 85th Leg., Reg. Sess. (W. Va. 2021).