

Oil and Gas, Natural Resources, and Energy Journal


Volume 3 | Number 3
The 2017 Survey on Oil & Gas

September 2017

West Virginia

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Recommended Citation

Andrew Graham, *West Virginia*, 3 OIL & GAS, NAT. RESOURCES & ENERGY J. 849 (2017),
<http://digitalcommons.law.ou.edu/onej/vol3/iss3/25>

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ONE J

Oil and Gas, Natural Resources, and Energy Journal

VOLUME 3

NUMBER 3

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 July 1, 2016, and June 30, 2017. Part II of this Article will discuss common law developments in both state and federal courts in West Virginia and Part III will discuss statutory developments in both enacted and proposed legislation.

II. Judicial Developments

The West Virginia Supreme Court of Appeals has been relatively busy over the last year deciding issues related to oil and gas development in the state. This section will first discuss the oil and gas cases decided by West Virginia’s highest court. Next, it will examine a decision issued by the United States District Court for the Northern District of West Virginia.

A. West Virginia Supreme Court of Appeals

Leggett v. EQT

In *Leggett v. EQT Production Co.*, the West Virginia Supreme Court of Appeals answered certified questions from the United States District Court for the Northern District of West Virginia regarding whether post-production costs may be deducted from royalty calculations under West Virginia’s flat-rate royalty statute.¹ Specifically, the questions certified to the Supreme Court of Appeals by the federal district court were as follows:

1. Does *Tawney v. Columbia Natural Resources, L.L.C.*, 219 W. Va. 266, 633 S.E.2d 22 (2006), which was decided after the enactment of West Virginia Code § 22-6-8, have any effect upon the Court’s decision as to whether a lessee of a flat-rate lease, converted pursuant to West Virginia Code § 22-6-8, may deduct post-production expenses from his lessor’s royalty, particularly

1. 800 S.E.2d 850 (W. Va. 2017).

with respect to the language of '1/8 at the wellhead' found in West Virginia Code § 22-6-8(e)?

2. Does West Virginia Code § 22-6-8 prohibit flat-rate royalties only for wells drilled or reworked after the statute's enactment and modify only royalties paid on a per-well basis where permits for new wells or to modify existing wells are sought, or do the provisions of West Virginia Code § 22-6-8 abrogate flat-rate leases in their entirety?²

The plaintiffs owned a fractional interest in the oil and gas in a tract of land subject to an oil and gas lease that provides for a flat-rate royalty, rather than a royalty based upon a fraction of the production of gas.³ In 1982, the West Virginia Legislature enacted a statute that provides that a permit to drill or rework a well on an oil and gas lease that includes a flat-rate royalty will not be issued unless the lessee agrees to pay the lessor "no less than one-eighth 'of the total amount paid to or received by or allowed to [the lessee] *at the wellhead* for the oil or gas so extracted, produced or marketed[.]'"⁴ In 2001, the court held, in *Wellman v. Energy Resources, Inc.*, that "the lessee must bear all costs incurred in exploring for, producing, marketing, and transporting the [oil or gas] to the point of sale" if the lease provides for royalty based on the proceeds received by the lessee.⁵ In 2006, the court held, in *Tawney v. Columbia Natural Resources, LLC*, that "[l]anguage in an oil and gas lease that provides that the lessor's 1/8 royalty . . . is to be calculated 'at the well,' 'at the wellhead,' or similar language, or that the royalty is 'an amount equal to 1/8 of the price, net all costs beyond the wellhead,' or 'less all taxes, assessments, and adjustments' is ambiguous and, accordingly, is not effective to permit the lessee to deduct from the lessor's 1/8 royalty any portion of the costs incurred between the wellhead and the point of sale."⁶

Citing the court's prior decisions in *Wellman* and *Tawney*, the oil and gas owners argued that the lessee could not deduct post-production costs when calculating royalty under the flat-rate royalty statute because of the "at the

2. *Id.* at 854.

3. *Id.* at 853.

4. *Id.* (emphasis in original).

5. *Id.* at 858 (citing *Wellman v. Energy Res., Inc.*, 557 S.E.2d 254, 256 (W. Va. 2001)).

6. *Id.* (citing *Tawney v. Columbia Natural Res., LLC*, 633 S.E.2d 22, 30 (W. Va. 2006)).

wellhead” language used in the statute.⁷ However, the court reasoned that the most equitable definition of “at the wellhead” as used in the flat-rate royalty statute is to “deduct the post-production costs from the ‘value-added’ downstream price in an effort to replicate the statutory wellhead value.”⁸ If a company does deduct from a lessor’s royalty, the costs must be reasonable, and the deduction must be supplemented by an appropriate accounting of the lessee’s costs.⁹ Costs are reasonable so long as they “enhance the value of an already marketable product;” this is a determination that the court ultimately leaves to the fact-finder.¹⁰

Gastar Exploration, Inc. v. Contraguerro

In *Gastar Exploration, Inc., v. Contraguerro*, the West Virginia Supreme Court of Appeals held that an oil and gas lease could be pooled without the consent or ratification of the owners of a non-participating royalty interest (“NPRI”) and reversed and remanded a circuit court’s decision to invalidate the pooling of an oil and gas lease where the owners of an NPRI had not consented to pooling.¹¹ The court reaffirmed that West Virginia does not follow the cross-conveyance theory of pooling, but rather follows the contract theory of pooling.¹²

In 1933, two sisters acquired an undivided one-half interest in and to the oil and gas within and underlying a tract of land containing 105.9 acres.¹³ In 1946, they conveyed the right to lease the oil and gas, together with the right to receive delay rentals, to John Wenzel.¹⁴ Ultimately, Wenzel’s interest in the oil and gas was acquired by PPG Industries, Inc., who granted an oil and gas lease to Gastar Exploration USA, Inc. in 2011.¹⁵ Gastar created the Wayne/Lily Unit in 2012 when it pooled part of the PPG lease with other leases; Gastar did not obtain the consent of the NPRI owners prior to pooling the PPG lease into the Wayne/Lily Unit and the NPRI owners did not ratify the unit after its creation.¹⁶ The NPRI owners sued in the Circuit Court of Marshall County, West Virginia, asking the circuit court to determine the royalties payable to them from the

7. *See Leggett*, 800 S.E.2d at 862.

8. *Id.* at 866.

9. *See id.* at 868 (citation omitted).

10. *Id.*

11. 800 S.E.2d 891 (W. Va. 2017).

12. *Id.* at 900-01.

13. *Id.* at 894.

14. *Id.*

15. *Id.* at 895.

16. *Id.* at 895-96.

Wayne/Lily Unit.¹⁷ The NPRI owners also alleged that Gastar did not have the right to pool the PPG lease without their consent.¹⁸ Relying on Texas case law that pooling creates a cross-conveyance of royalty interests, the circuit court declared the Wayne/Lily Unit to be invalid because the NPRI owners had not consented to the pooling of the PPG lease.¹⁹

The West Virginia Supreme Court of Appeals reversed the circuit court's decision and held that West Virginia does not follow the cross-conveyance theory of pooling—which is followed in Texas, Mississippi, Illinois, and California—but rather follows the contract theory of pooling.²⁰ In a cross-conveyance jurisdiction, such as Texas, all owners in a pool acquire an “undivided ownership interest with other individuals and entities by cross-conveying across the entire tract,”²¹ whereas in a contract theory state, such as West Virginia, pooling creates a consolidation of contractual and financial interests, but does not create a joint ownership interest. The court reasoned that under the cross-conveyance theory, the NPRI owners would be granted a right to make decisions on pooling, even though they own no part of the executive right in the oil and gas estate; giving an NPRI owner such rights would run counter to the nature of an NPRI.²²

Mountain Valley Pipeline, LLC v. McCurdy

In *Mountain Valley Pipeline, LLC v. McCurdy*, the West Virginia Supreme Court of Appeals held that a private company has no right of eminent domain to enter and survey land pursuant to West Virginia Code § 54-1-3 and West Virginia Code § 54-1-1 if the private company's purpose for entering the land is not for a public use.²³ Mountain Valley Pipeline, LLC (“MVP”) was in the process of seeking approval to construct and operate a pipeline from Wetzel County, West Virginia, to Pittsylvania County, Virginia, called the Mountain Valley Pipeline (the “Pipeline”).²⁴ MVP would not directly own the gas being transported through the Pipeline; however, affiliates of MVP would own nearly ninety-five percent of the gas being transported through the Pipeline.²⁵ The Pipeline will

17. *See id.* at 896.

18. *Id.*

19. *Id.* at 897 & n.10.

20. *Id.* at 899-901.

21. *Id.* at 899.

22. *Id.* at 900-01.

23. 793 S.E.2d 850 (W. Va. 2016).

24. *Id.* at 852.

25. *Id.* at 853

transport gas, mostly produced in West Virginia, to two points: the Transco Pool located in Pittsylvania County, Virginia, which will provide service to the entire east coast of the United States; and the Columbia WB pipeline, which is another transportation pipeline.²⁶ The gas transported in the Pipeline would be delivered to Roanoke Gas Company, which serves consumers in Virginia.²⁷ At the time of this case, no agreements had been reached that would provide any of the gas being transported by the Pipeline to West Virginia consumers.²⁸ There was no evidence that natural gas producers not affiliated with MVP, or any West Virginia consumers, would benefit from MVP's pipeline and the gas it would transport.²⁹

In October, 2014, MVP submitted a request to the Federal Energy Regulatory Commission to initiate the necessary process leading to an application for the issuance of a certificate of public convenience and necessity for the Pipeline.³⁰ In order to complete the application process, MVP needed to survey land for the proposed route of its pipeline.³¹

Bryan and Doris McCurdy (the "McCurdys") own three tracts of land in Monroe County, West Virginia, containing about 185 acres total, which are along the proposed route of MVP's pipeline.³² The Pipeline would cross all three tracts of land and come near the McCurdys' barn and their residence.³³ An agent of MVP contacted the McCurdys in February 2015 and requested access to their property to conduct necessary surveys to complete MVP's application process.³⁴ The McCurdys declined to consent to the surveys.³⁵ MVP sent a letter shortly thereafter providing notice of its intention to take legal action to obtain access to the property pursuant to West Virginia Code § 54-1-3, which states in part that "[a]ny incorporated company . . . invested with the power of eminent domain under [chapter 54], . . . may enter upon lands for the purpose of . . . surveying. . . ."³⁶ The McCurdys sued MVP for an injunction prohibiting MVP from entering

26. *Id.*

27. *Id.*

28. *Id.*

29. *See id.* at 861.

30. *Id.* at 853.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.* & n.3; *see also* W. VA. CODE ANN. § 54-1-3 (West 2017).

their property, and the circuit court granted preliminary and permanent injunctions.³⁷ MVP appealed.³⁸

The court analyzed who would benefit from the Pipeline in making its determination because, as the circuit court found, the right of eminent domain may only be exercised in the State of West Virginia for the use and benefit of West Virginians.³⁹ MVP was not regulated as a utility in West Virginia and there was no evidence that any West Virginia consumers or natural gas producers who were not affiliated with MVP would benefit from the Pipeline.⁴⁰ The primary purpose of the Pipeline was to deliver gas to the Transco pool, which would then be distributed to consumers outside of West Virginia.⁴¹ Accordingly, the court held that the Pipeline did not serve the public use; therefore, MVP may not exercise the right of eminent domain, pursuant to West Virginia Code § 54-1-3 and § 54-1-1, for the purpose of entering the McCurdys' property to conduct a survey.⁴²

Poulos v. LBR Holdings, LLC

At issue in *Poulos v. LBR Holdings, LLC* was whether the reservation of “the oil and gas” in a 1938 deed intended to include coalbed methane gas.⁴³ The West Virginia Supreme Court of Appeals highlighted the longstanding challenges that courts have faced when considering the ownership of coalbed methane and was not persuaded that it should adopt a bright-line rule on the issue.⁴⁴ Instead, the court chose to continue reviewing the issue of ownership of coalbed methane on a fact-based, case-by-case approach.⁴⁵

In *Poulos*, the court agreed with the circuit court as to the sufficiency of the evidence to find that coalbed methane was not a valuable resource at the time of the deed in 1938, stating that coalbed methane was “well known, and it was commonly considered a deadly hazard for which the general custom and usage was to get rid of it.”⁴⁶ The court sided with the coal owner in this case and held that the grantors of the 1938 deed did not intend to reserve the coalbed methane by their reservation of “the oil and gas”

37. *McCurdy*, 703 S.E.2d at 853.

38. *Id.* at 854.

39. *Id.* at 862.

40. *Id.* at 860-61 & n.8.

41. *Id.* at 861 & n.9.

42. *See id.* at 863.

43. 792 S.E.2d 588 (W. Va. 2016).

44. *Id.* at 597.

45. *Id.*

46. *Id.* at 603.

because coalbed methane was not valuable and was generally considered “a hazard and a nuisance” at the time of the deed.⁴⁷

Anderson v. Jones

In *Anderson v. Jones*, the West Virginia Supreme Court of Appeals held that a deed conveyed to parties not named as grantees in a deed were entitled to a part of the royalty interest in the oil, but for only as long as the original grantee owned the oil and gas within and underlying the land and had a right to execute leases for the same.⁴⁸

In this case, Cordelia A. Jones conveyed two tracts of real estate to L. Oliver Jones in a deed dated August 1, 1912.⁴⁹ This deed contained the following provision:

It is expressly understood and agreed, that in case oil is found and produced in paying quantities from said land hereby conveyed that the following named children and heirs at law of Z.T. Jones, now deceased shall have[,] own[,] and possess the usual one-eighth (1/8) thereof or what is commonly known as royalty, jointly and in common, and that said royalty shall be owned and held in common by said heirs, to wit:

Flora B. Lamp, A. Fulton Jones, Emma C. McCullough, Mary D. Jones, William P. Jones, Vesta Nichols, and L. Oliver Jones, grantee herein, share and share alike to them their heirs and assigns; But the said L. Oliver Jones shall have the exclusive right to make execute and deliver all such oil and gas leases upon said lands and to receive all rentals and bonuses on account of said leasing in his own right without having to account in any manner to his co-owners in said royalty.⁵⁰

Harold Rex Anderson, Jr., and Harold Rex Anderson, III, (the “Andersons”) acquired the interest of L. Oliver Jones.⁵¹ The Andersons sued to quiet title to the property, claiming that they were the exclusive owners of the surface, as well as the oil and gas interests in the property.⁵² They argued that the children of Cordelia A. Jones (with the exception of L. Oliver Jones) were “strangers to the title” and were not conveyed any

47. *Id.* at 604.

48. No. 15-0460, 2016 WL 6756803 (W. Va. Nov. 15, 2016).

49. *Id.* at *1.

50. *Id.*

51. *See id.* at *2.

52. *Id.*

portion of the property because their names did not appear in the conveyance portion of the deed and only appeared in the “reservation clause” or “exception clause” of the deed.⁵³ The respondents argued that, following the modern trend in property law, it was the intent of Cordelia A. Jones to grant them an interest in the oil and gas and sufficient intent existed to convey an interest to them.⁵⁴ The circuit court held that the 1912 deed conveyed oil and gas to the children of Cordelia A. Jones, in equal shares, and that they are the current oil and gas owners.⁵⁵

The West Virginia Supreme Court of Appeals reversed the decision of the circuit court.⁵⁶ The court looked to the plain language of the document.⁵⁷ The court found that the deed clearly conveyed the two tracts of land, including the oil and gas in place, to L. Oliver Jones.⁵⁸ Interestingly, the court came to the unusual conclusion that the deed effectively conveyed a one-eighth royalty of oil found and produced in paying quantities to the heirs of Cordelia A. Jones, who were not mentioned in the conveyance portion of the deed.⁵⁹ The court’s decision centered on the language contained in the deed regarding L. Oliver Jones’ “exclusive right to make execute and deliver all such oil and gas leases upon said lands.”⁶⁰ The court held that the royalty interest of the heirs of Cordelia A. Jones was completely contingent upon L. Oliver Jones executing leases and was only effective for as long as L. Oliver Jones owned the property.⁶¹ Therefore, once L. Oliver Jones no longer owned the property and could not execute leases for the property, then the heirs of Cordelia A. Jones no longer had a right to receive a royalty on oil produced from the property.⁶²

DWG Oil & Gas Acquisitions, LLC v. Southern Country Farms, Inc.

In *DWG Oil & Gas Acquisitions, LLC v. Southern Country Farms, Inc.*,⁶³ the West Virginia Supreme Court of Appeals decided a case in which DWG Oil & Gas Acquisitions, LLC (“DWG”) claimed an ownership interest by way of language contained in a deed that conveyed the property “[s]ubject,

53. *Id.* (internal quotations omitted).

54. *Id.*

55. *Id.*

56. *Id.* at *4.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. 796 S.E.2d 201 (W. Va. 2017).

however, to all the reservations as contained in or referred to in [a prior] deed.”⁶⁴

DWG made an effort to purchase the oil and gas within and underlying a tract of land located in Franklin District, Marshall County, West Virginia, based on a title report indicating that the heirs of P.P. Campbell, Sr., (“Campbell, Sr.”) were the owners of the oil and gas.⁶⁵ Southern Country Farms, Inc. claimed that A.B. Campbell acquired the oil and gas interest and it ultimately passed to his heirs and then to Southern Country Farms.⁶⁶ The court looked at the language contained in three deeds, described in the Court’s opinion as Campbell Deed #1, Campbell Deed #2, and Campbell Deed #3.⁶⁷

In Campbell Deed #1, dated April 10, 1908, Campbell, Sr., conveyed to P.P. Campbell, Jr. (“Campbell, Jr.”), a tract of land containing 146 acres and a tract of land containing 20 acres, excepting and reserving therefrom “Fifty acres on West side of 146 acre tract also reserving therefrom all the coal oil and Gas with permission to sell, lease, release, and operate the same[.]”⁶⁸ Campbell, Sr., then conveyed to himself and A. B. Campbell, in trust for Laura C. McHenry, by a deed dated April 10, 1908, the fifty acre tract previously excepted and excepted therefrom the interest in the coal, oil, and gas.⁶⁹

In Campbell Deed #2, dated May 27, 1913, Campbell, Jr., conveyed the same 146 acres and 20 acres back to Campbell, Sr., “subject to the exceptions and reservations set forth in [deed bearing date the 10th day of April, 1908], reference being here made to said deed and record for more particular description of said exceptions and reservations[.]”⁷⁰

In Campbell Deed #3, dated June 5, 1913, Campbell, Sr., conveyed to A. B. Campbell the 146 acres and 20 acres, and said deed was made “[s]ubject, however, to all the reservations as contained in or referred to in [the deed dated the 27th day of May, 1913].”⁷¹

DWG argued that the reservation language contained in Campbell Deed #3 was effective to reserve the oil and gas unto Campbell, Sr., and that it remained vested in Campbell, Sr., until his death, at which time title passed

64. *Id.* at 204.

65. *Id.* at 203.

66. *Id.*

67. *See id.* at 202-04.

68. *Id.* at 204-05 (emphasis and internal quotations omitted).

69. *See id.* at 203.

70. *Id.*

71. *Id.* at 204.

to his heirs and ultimately to DWG.⁷² Southern Country Farms asserted title through Campbell Deed #3, arguing that A. B. Campbell acquired title to the surface and to the oil and gas within and underlying the property because there was no new reservation contained in Campbell Deed #3.⁷³

The circuit court held that Southern Country Farms was the rightful owner of the oil and gas based on two constructions of the exception and reservation language set forth in Campbell Deed #1.⁷⁴ First, the circuit court determined that if Campbell, Sr., retained the oil and gas in Campbell Deed #1, then that conveyance was a conveyance of the surface only and when Campbell, Jr., conveyed the property back to Campbell, Sr., the surface and oil and gas interests merged.⁷⁵ Consequently, when Campbell, Sr., conveyed the property to A. B. Campbell, he conveyed it in fee simple.⁷⁶ The circuit court's alternative construction of the language examined whether the language set forth in Campbell Deed #1 was a reservation of the oil and gas in only the fifty acre tract on the west side of the subject parcel; if that was the case, then Campbell, Sr., would have reserved no interest in the remainder of the 146 acres and the 20 acres, and the oil and gas would have been conveyed to A. B. Campbell because there were no prior reservations regarding that oil and gas interest.⁷⁷

The West Virginia Supreme Court of Appeals upheld the circuit court's ruling that the ownership of the surface and the oil and gas in the subject property merged and became vested in Campbell, Sr.⁷⁸ Therefore, Campbell, Sr., conveyed fee simple title to the property to A. B. Campbell in Campbell Deed #3.⁷⁹ The court did not address the circuit court's alternative construction of Campbell Deed #1.⁸⁰

B. Federal Courts

In *Stern v. Columbia Gas Transmission, LLC*, the United States District Court for the Northern District of West Virginia found a right to pool leases through the granting clause and the secondary term of an oil and gas lease,

72. *Id.*

73. *See id.*

74. *Id.*

75. *Id.* at 205.

76. *Id.*

77. *See id.* at 204-05.

78. *Id.* at 207.

79. *Id.*

80. *Id.*

even though the lease did not contain an express pooling clause.⁸¹ At issue in *Stern* was whether the subject leases allowed for pooling or unitizing. The plaintiffs (the “Sterns”) alleged that pooling was not allowed in the subject leases and later refused to sign pooling modifications offered by Chesapeake Appalachia, LLC (“Chesapeake”).⁸² Without a signed pooling modification, Chesapeake filed a Declaration and Notice of Pooled Unit, which included parts of the Sterns’ property.⁸³ Subsequently a well was drilled and started producing gas.⁸⁴ The Sterns alleged that after the filing of this civil action, the lessee’s successor, SWN Production Company, LLC (“SWN”), filed an amended declaration of pooling which excluded the portion of the Sterns’ property that was included in the original declaration filed by Chesapeake.⁸⁵ The district court dismissed the main breach of contract claim regarding whether the leases allowed for pooling.⁸⁶

The court’s holding hinged on the language contained in the granting clauses and the secondary terms of the oil and gas leases. The granting clause of the Sterns’ leases granted to the lessees “all other rights and privileges necessary, incident to, or convenient for the operation of the [Sterns’ property], **alone and conjointly with other lands** for the production and transportation of oil and gas, and for the injection storage and withdrawal.”⁸⁷ The secondary term of leases provided that the leases shall be held as long as the Sterns’ property

or any portion thereof is operated by the [defendants], in search for or in production of oil or gas as long as such land is utilized by [the defendants] **alone or conjointly with neighboring lands** for either the storage of gas by injection, storage and removal of gas through well or wells operated on either the [Sterns’ property] or other adjoining or neighboring lands comprising a part of the same gas storage field, or for the protection of any gas stored in such storage field.⁸⁸

The court held that the phrase “alone or conjointly with neighboring lands” contemplates pooling or unitization because the lease can be

81. No. 5:15CV98, 2016 WL 7053702 (N.D. W. Va. Dec. 5, 2016).

82. *Id.* at *1.

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* at *2 (internal quotations omitted and emphasis in original).

88. *Id.* at *3 (emphasis in original).

extended “for any work done within a unit that includes the Sterns’ properties.”⁸⁹ Further, the court noted that the repeated use of that phrase in the two sections of the lease “reinforces the parties’ intent to grant pooling rights.”⁹⁰ The court rejected the argument that the subject leases cannot be read to allow for pooling because of a lack of an apportionment of royalties provision.⁹¹ The court found that an express provision regarding the apportionment of royalties is not needed, because it would provide the same royalty as a community lease, which would pay to the Sterns a royalty in proportion to the acreage of their tract of land contained in the unit.⁹²

The court also rejected the argument that pooling was not intended to be included in the original leases, because Chesapeake and SWN attempted to modify the leases to include pooling.⁹³ The court rejected this argument because it ultimately found the leases granted pooling and that any subsequent actions of the parties in performing the leases were irrelevant to the construction of the leases.⁹⁴

III. Statutory Developments

No bills related to oil and gas passed in West Virginia’s 83rd Legislative Session.

89. *Id.* at *3.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.* at *3.

94. *See id.* at *5.