IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF WEST VIRGINIA
Wheeling

DAVID L. KINNEY and **RAYMOND P. KINNEY**, individually and on behalf of a class of similarly situated persons,

Plaintiffs,

v.

Civil Action No. 5:15-CV-160
Judge Bailey

CNX GAS COMPANY, LLC and **NOBLE ENERGY, INC.**,

Defendants.

ORDER GRANTING DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT AND DENYING PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

I. Introduction

Pending before this Court are Plaintiffs' Motion for Summary Judgment [Doc. 53], Noble Energy, Inc.'s Motion for Partial Summary Judgment [Doc. 51], and Defendant CNX Gas Company, LLC's Motion for Partial Summary Judgment Regarding Phase I Legal Question [Doc. 55], all filed on May 19, 2017. The Motions have been fully briefed and are ripe for decision. For the reasons that follow, this Court grants the defendants' motions [Docs. 51 & 55] and denies plaintiffs' motion [Doc. 53].

II. Factual and Procedural History

Plaintiffs filed this putative class action Complaint in the Circuit Court of Marshall County on November 4, 2015. It was subsequently removed to this Court on December 9, 2015, based on CAFA jurisdiction. The Complaint contains three counts as follows:

declaratory judgment (Count 1); unjust enrichment (Count 2); and fraud (Count 3). [Doc. 1-1]. The named Plaintiffs, David L. Kinney and Raymond P. Kinney ("Kinney Plaintiffs"), entered into an Oil, Gas and Coalbed Methane Gas Lease with CNX in 2009 ("Kinney Lease") covering 69.129 acres of mineral interest owned by the Kinney Plaintiffs. [Doc. 1-1, at 2, ¶¶ 5-6]. The Kinney Lease contains provisions that expressly set forth the royalty owed to the Kinney Plaintiffs, and the specific costs that may be deducted therefrom:

> (Deep Formation Oil and Gas Royalty)
>
> 15% of the sales price received by Lessee for deep formation oil and gas owned by the Lessor and produced and sold from the Premises less an amount equal to $1.20 per MMBtu with respect to heating, sweetening, gathering, dehydrating, compressing, processing, manufacturing, transporting, trucking, marketing, blending, and other costs and expenses incurred by Lessee in marketing said oil and gas and all excise depletion, severance, privilege and production taxes that are now or hereafter levied, or assessed or charged on oil and gas owned by Lessor and produced from the Premises, which amount the parties are agreed will be presumed to be actually incurred and reasonable.
>
> (Shallow Formation Oil and Gas and Coalbed Methane)
>
> 12.5% of the sales price received by Lessee for shallow oil and gas and coalbed methane gas owned by Lessor and produced and sold from the Premises less an amount equal to $1.20 per MMBtu with respect to heating, sweetening, gathering, dehydrating, compressing, processing, manufacturing, transporting, trucking, marketing, blending, and other costs

> and expenses incurred by Lessee in marketing said coalbed methane gas and all excise, depletion, severance, privilege and production taxes that are not or hereafter levied, or assessed or charged on oil and gas owned by Lessor and produced from the Premises, which amount the parties are agreed will be presumed to be actually incurred and reasonable.

[Doc. 1-1 ¶¶ 5-6].

The Kinney Plaintiffs allege defendants improperly subtracted flat-rate deductions from royalty payments that were neither actual nor reasonable in contravention of the provisions quoted above. [Doc. 1-1, at 3, ¶ 12]. In fact, the Kinney Plaintiffs argue that any flat-rate post-production provision is illegal under West Virginia law and should be terminated from Plaintiffs' leases. [Doc. 1-1, at 8, ¶ 33]. The Kinney Plaintiffs' Complaint seeks the following relief:

> (1) That this court issue a declaration stating that the flat-rate post-production costs clauses are illegal under West Virginia law and must be terminated from all mineral rights contracts existing with the defendants;
>
> (2) That this Court issue a declaration stating that all flat-rate post production costs already subtracted from their royalty payments must be reimbursed by the defendants;
>
> (3) Punitive damages from the Defendants in order to punish them and deter them and other individuals and/or entities from engaging in similar conduct;
>
> (4) Compensatory and general damages in an amount within the jurisdiction of this Court to be determined by the jury;
>
> (5) Pre-judgment and post-judgment interest;

(6) Attorneys' fees and costs; and

(7) Any other specific or general relief as may become apparent as this matter progresses and such other relief as the Court deems proper.

[Doc. 1-1, at 9-10, ¶¶ 42-46, *ad damnum*].

On January 6, 2017, after considering the Motion for Class Certification [Doc. 22] and hearing oral argument on the same, this Court conditionally certified the class as follows:

> Those West Virginia oil and gas mineral royalty interest owners whom have oil and gas mineral leases with CNX Gas Company, LLC and/or Noble Energy, Inc. which provide for the flat-rate deduction of post-production costs and whom have had post-production costs deducted from their royalty payments, but excluding those portions of leases where royalties are being paid into a coal bed methane escrow account.

[Doc. 37].

On February 16, 2017, this Court Ordered the parties to file dispositive motions regarding the "Phase I Issue," which asked whether the use of an oil and gas lease containing flat-rate deductions for post-production expenses is proper under West Virginia law [Doc. 44]. On May 19, 2017, the parties filed their respective motions for summary judgment as to the Phase I Issue [Docs. 51, 53 & 55]. Plaintiffs' Motion for Summary Judgment asserts the above Lease language is improper and unenforceable under West Virginia law, specifically under the framework of ***Wellman v. Energy Resources, Inc.***, 201 W. Va. 200, 557 S.E.2d 254 (2001), and ***Estate of Tawney v. Columbia Natural***

Resources, LLC, 219 W. Va. 266, 633 S.E.2d 22 (2006). Defendants, on the other hand, assert the subject Lease language (1) meets the three-part test set forth in ***Tawney***; (2) ***Wellman*** does not apply; and (3) West Virginia's recognition of the parties' freedom to contract precludes the application of the implied covenant-based ***Wellman*** decision. This Court agrees that the parties' freedom to contract precludes the relief sought by plaintiffs.

III. Rule 56 Motion for Summary Judgment Standard

Rule 56 of the Federal Rules of Civil Procedure provides that summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c); *see* ***Celotex Corp. v. Catrett***, 477 U.S. 317, 322 (1986). A genuine issue exists "if the evidence is such that a reasonable jury could return a verdict for the non-moving party." ***Anderson v. Liberty Lobby, Inc.***, 477 U.S. 242, 248 (1986). Thus, the Court must conduct "the threshold inquiry of determining whether there is the need for a trial – whether, in other words, there are any genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." ***Anderson***, 477 U.S. at 250.

Additionally, the party opposing summary judgment "must do more than simply show that there is some metaphysical doubt as to the material facts." ***Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.***, 475 U.S. 574, 586 (1986). That is, once the movant has met its burden to show absence of material fact, the party opposing summary judgment must then come forward with affidavits or other evidence demonstrating there is indeed a

genuine issue for trial. Fed. R. Civ. P. 56(c); ***Celotex Corp.***, 477 U.S. at 323-25; ***Anderson***, 477 U.S. at 248. "If the evidence is merely colorable, or is not significantly probative, summary judgment may be granted." ***Id***. at 249 (citations omitted).

When faced with cross-motions for summary judgment, a district court is not required to grant judgment as a matter of law for one side or the other; rather, the court must evaluate each party's motion on its own merits, taking care in each instance to draw all reasonable inferences against the party whose motion is under consideration. **Wright, Miller & Kane**, *Federal Practice and Procedure*: Civil 2d § 2720.

IV. Discussion

"In general, West Virginia contract law principles apply equally to the interpretation of leases. *See* ***Energy Dev. Corp. v. Moss***, 214 W. Va. 577, 591 S.E.2d 135, 143 (2003)." ***K&D Holdings, LLC v. Equitrans, L.P.***, 812 F.3d 333, 339 (4th Cir. 2015). "Clearly the question of whether or not these leases are ambiguous presents a question of law for the court to decide[.]" ***Moss***, 214 W. Va. 577, 585. While the general rule is that oil and gas leases will be liberally construed in favor of the lessor, this is so only when there is ambiguity as to the meaning of the lease terms. ***Id***. "Where the intent of the parties is clear, [the Supreme Court of Appeals of West Virginia] will not use the vehicle of interpretation to relieve one party of a bad bargain." ***Penchenik v. Baltimore & O.R. Co.***, 157 W. Va. 895, 205 S.E.2d 813, 815 (1974). Rather, where an otherwise valid lease "does not contravene some principle of law or public policy, it must stand and become operative as the deliberate act of the parties. 17 C.J.S. Contracts § 296, pages 702-707. It is not the right or province of a court to alter, pervert or destroy the clear meaning and

intent of the parties as plainly expressed in their written contract or to make a new and different contract for them." ***Cotiga Dev. Co. v. United Fuel Gas Co.***, 147 W. Va. 484, 492, 128 S.E.2d 626, 633 (1962)(internal citations omitted).

With these principles in mind, this Court will turn its attention to the subject Lease terms. First, this Court finds the Lease is unambiguous. Accordingly, it must uphold the terms so long as they "do[] not contravene some principle of law or public policy." ***Cotiga***, 147 W. Va. at 492.

In ***Wellman***, the Supreme Court of Appeals noted that:

> [t]he rationale for holding that a lessee may not charge a lessor for 'postproduction' expenses appears to be most often predicated on the idea that the lessee not only has a right under an oil and gas lease to produce oil or gas, but he 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.

201 W. Va. at 264.

The Court noted that like the states that have adopted this position, "West Virginia holds that a lessee impliedly covenants that he will market oil or gas produced." ***Id***. at 265.

Based on this reasoning, the Court held 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.

Id., Syl. Pt. 4 (emphasis added).

The Court went on:

> If 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., Syl. Pt. 5 (emphasis added). *See also* ***id***. at 265.

Thus, ***Wellman*** held that a lease must state that deductions can be taken. *See* ***id.***, Syl. Pt. 4. ***Wellman*** also held – as the lease in that case did not state the parties' agreement as to what the deductions taken would be – that the deductions charged would need to be actually incurred and reasonable. *See* ***id.***, Syl. Pt. 5.

In ***Tawney***, the Court stated the rule in West Virginia regarding the lease language required to deduct post-production costs:

> Language in an oil and gas lease that is intended to allocate between the lessor and lessee the costs of marketing the product and transporting it to the point of sale must expressly provide that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, identify with particularity the specific deductions the lessee intends to take from the

> lessor's royalty (usually 1/8), and indicate the method of calculating the amount to be deducted from the royalty for such post-production costs.

219 W. Va. 266, Syl. Pt. 10.

Thus, there are three basic elements that must be "expressly provide[d]" in an unambiguous manner in order for a lessee to satisfy the requirements of ***Tawney***: (1) it must "expressly provide" the lessor will bear some part of the costs incurred between the wellhead and the point of sale; (2) it must "identify with particularity" the specific deductions the lessee intends to take; and (3) it must indicate the method of calculating the amount to be deducted from the royalty for such post-production costs. ***Id***. The subject royalty provision meets all of those elements in a plain and unambiguous manner.

The Lease expressly states that post production deductions can be taken. See, e.g., Lease, ¶ 3(a) ("less an amount equal to $1.20 per MMBtu"). The Lease then goes on to specifically identify the deductions that will be taken, listing the following: "heating, sweetening, gathering, dehydrating, compressing, processing, manufacturing, transporting, trucking, marketing, blending, and other costs and expenses incurred by lessee in marketing said oil and gas and all excise, depletion, severance, privilege and production taxes that are now or hereafter levied, or assessed or charged on oil and gas owned by Lessor and produced from the Premises . . .." See id. The Lease also expressly identifies the method of calculating the deductions: the deduction will be based on volume at $1.20 per MMBtu. See id. This language of the royalty provision clearly complies with ***Wellman*** and ***Tawney***.

Further, the Lease states no implied warranties or covenants can be read into it,

"including without limitation any covenants or conditions relating to the development of the Premises . . . ." Lease, ¶ 12. This disclaimer of implied covenants reinforces that the Lease was intended to abrogate West Virginia's general rule of implying a duty to market – exactly as ***Wellman*** and ***Tawney*** require. "This State's public policy favors freedom of contract, or the precept that a contract shall be enforced except when it violates a principle of even greater importance to the general public." Syl. Pt. 3 ***Wellington Power Corp. v. CNX Sur. Corp.***, 217 W. Va. 336, 614 S.E.2d 680 (2005).

Finally, and perhaps most importantly, the parties freely contracted that the flat-rate deductions are "actually incurred and reasonable." This Court will honor that language. Accordingly, this Court finds the unambiguous agreements in this matter satisfy all that the laws of the State of West Virginia require regarding such leases.

Conclusion

Therefore, for the reasons stated above:

1. Plaintiffs' Motion for Summary Judgment **[Doc. 53]** is **DENIED**;
2. Noble Energy, Inc.'s Motion for Partial Summary Judgment **[Doc. 51]** is **GRANTED**;
3. Defendant CNX Gas Company, LLC's Motion for Partial Summary Judgment Regarding Phase I Legal Question **[Doc. 55]** is **GRANTED**;
4. The Clerk is **DIRECTED** to enter Judgment in favor of the defendants; and
5. This matter is **ORDERED STRICKEN** from the active docket of this Court.

It is so **ORDERED**.

The Clerk is directed to transmit copies of this Order to all counsel of record herein.

DATED: August 24, 2017.