IN THE

Supreme Court of Virginia

RECORD NO. 131590

SWORDS CREEK LAND PARTNERSHIP,

Appellant,

v.

DOLLIE BELCHER, *et al.*
and
PAUL RICHARDSON, *et al.*,

Appellees.

REPLY BRIEF OF APPELLANT

Eric D. Whitesell (VSB No. 17631)
GILLESPIE, HART, ALTIZER & WHITESELL, P.C.
126 East Main Street
Post Office Box 718
Tazewell, Virginia 24651
(276) 988-5525 - Telephone
(276) 988-6427 - Facsimile
ghaw@verizon.net

Blair M. Gardner (WVSB No. 8807)
Admitted pro hac vice
Lee Adair Floyd (WVSB No. 11823)
Admitted pro hac vice
Alvin L. Emch (WVSB No. 1125)
Admitted pro hac vice
JACKSON KELLY PLLC
Post Office Box 553
Charleston, West Virginia 25322
(304) 340-1146 - Telephone
(304) 340-1272 - Facsimile
bgardner@jacksonkelly.com
lafloyd@jacksonkelly.com
aemch@jacksonkelly.com

Counsel for Appellant

LANTAGNE LEGAL PRINTING 801 East Main Street Suite 100 Richmond, Virginia 23219 (804) 644-0477
A Division of Lantagne Duplicating Services

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

INTRODUCTION 1

I. Production of the CBM Can Only Be Accomplished by Entering Swords Creek's Property 2

II. The Surface Owners' "Double Royalty" Theory Is Wholly Unsupported 4

III. The Surface Owners are Estopped from Claiming They Did Not Maintain a Principal-Agent Relationship With CNX 8

IV. This Court Should Employ A Constructive Trust to Equitably Divide the Escrowed Royalties 9

CONCLUSION 10

TABLE OF AUTHORITIES

Cases

Burke v. Southern Pac. R. Co.,
234 U.S. 669 (1914) 10

Chandler v. Kelly,
149 Va. 221, 141 S.E. 389 (1928) 9

Cooper v. Cooper,
249 Va. 511, 457 S.E.2d 88 (1995) 10

Harrison-Wyatt v. Ratliff,
267 Va. 549, 593 S.E.2d 234 (2004) 7, 10

Johnson v. Powhatan Mining Co.,
127 Va. 352, 106 S.E. 703 (1920) 8

Kan. Natural Gas Co. v. Bd. of Comm'rs of Nesho Cnty.,
75 Kan. 335, 89 P. 750 (1907) 3

Murphy v. Holiday Inns, Inc.,
216 Va. 490, 219 S.E.2d 874 (1975) 8

Ohio Oil Company v. Sharp,
135 F.2d 303 (10th Cir. 1943) 2

Sanchez v. Medicorp Health System,
270 Va. 299, 618 S.E.2d 331 (2005) 9

Title Ins. Co. of Richmond, Inc. v. Howell,
158 Va. 713, 164 S.E. 387 (1932) 9

Statutes

Va. Code § 45.1-361.21 3
Va. Code § 45.1-361.22 ..... 4, 5
Va. Code § 45.1-361.15 7

INTRODUCTION

Appellant Swords Creek Land Partnership ("Swords Creek") respectfully submits this Reply to the Brief of Appellees Dollie Belcher and Paul Richardson ("Surface Owners"). As discussed in Swords Creek's Opening Brief, the circuit court's judgment is erroneous and should be reversed because its ruling disregarded Swords Creek's exclusive right to access the coal seams necessary for CBM production. The Surface Owners admit that as the owner of the coal seams Swords Creek is entitled to charge for access to them. Surface Owners' Resp. at 7–8. They admit that Swords Creek entered into a "private lease with CNX" authorizing CNX to access Swords Creek's coal seams and extract the CBM in return for payment of a royalty for the CBM produced. *Id.* at 4–5. It is undisputed that the Surface Owners' claim to royalties depends completely on the CBM having been extracted from Swords Creek's coal seams located beneath the surface of the land. Despite these conceded facts, the Surface Owners insist that Swords Creek is entitled to nothing for allowing access to and disturbance of its coal seams.

This conclusion is unjust and cannot be correct. Virginia courts have routinely recognized that the coal estate is real property that includes the

absolute right to dispose of all CBM within the coal; coal owners therefore must have at least some rights to the CBM produced from their property.

I. Production of the CBM Can Only Be Accomplished by Entering Swords Creek's Property

CBM is unique. It is a distinct form of natural gas that is found only within a coal seam. There is no single right or ownership interest (other than complete fee simple title with no severance) that can alone authorize everything necessary for the production of CBM. Rather, in order to produce CBM, an operator must be authorized to use a "bundle" of rights and interests, each of which is necessary if CBM is to be reduced to actual possession and certain of which are jointly owned and must be cooperatively shared by more than one entity. These include:

- the rights to access, disturb, and build structures on the surface as necessary to conduct exploration and production;
- the right to access and conduct extraction operations directly and wholly within the coal seam (this right, Swords Creek respectfully submits, belongs exclusively to the owner of the coal seam);
- and, finally, the right to reduce the CBM to possession (a right owned by CNX as the lessee of Swords Creek's CBM and the operator pursuant to the Gas Act).

See, e.g., *Ohio Oil Company v. Sharp*, 135 F.2d 303, 307 (10th Cir. 1943).

The requirement that all of these property rights and interests be respected and protected infuses both Virginia common law and the Gas Act, and presents an impenetrable obstacle to the Surface Owners' claim that they alone should receive the royalties generated by CNX's CBM production. As with any gas, absolute title to CBM does not and cannot vest until the CBM is reduced to actual possession (i.e. "captured"). *Kan. Natural Gas Co. v. Bd. of Comm'rs of Nesho Cnty.*, 75 Kan. 335, 335, 89 P. 750, 752 (1907). The record indisputably shows that the recovery and possession of CBM occurred (and could only occur) by entry into and disturbance of the real property exclusively owned by Swords Creek—the coal. Only Swords Creek could grant that right of entry and this gives rise to its interest in the CBM.

An award of royalties can only follow a determination that one possesses a legally cognizable economic interest in the CBM. The Gas Act affirms this legal conclusion. As the Surface Owners note, the Gas Act provides that under a pooling order a "gas owner" may lease its interest in the well, participate as an operator, or act as a non-participating operator. Va. Code § 45.1-361.21.C.7. The next section of the Gas Act provides specifically for CBM units in which a "conflicting claimant" identified by the well operator is "deemed" to lease its interest by default if no election is

made to participate in the unit. Va. Code § 45.1-361.22.6.

A "deemed lessor," however, does not attain the legal status of an owner of the CBM by the mere administrative action of the Board's pooling order as stated by the Surface Owners. The Gas Act is explicit that the right to ownership and an award of all or a portion of the royalties only arises upon "a final legal determination of ownership." Va. Code § 45.1-361.22.6. The same section of the Gas Act describes the three means—judicial adjudication, arbitral award, or commercial agreement of the parties involved—by which such "legal" entitlement may be determined. Va. Code § 45.1-361.22.5. Thus, the right to a royalty arises from one's legally recognized economic interest in the CBM. The label attached to each conflicting claimant's interest as a "gas" or "coal" owner does nothing either to affix or sever the right of the holder of the interest to receive a royalty.

II. The Surface Owners' "Double Royalty" Theory Is Wholly Unsupported

For the first time in this litigation, the Surface Owners' Response suggests a disastrous "double royalty" theory of recovery that, to our knowledge, has never been recognized by any jurisdiction. Although they took care not to explicitly define the mechanics of this recovery, presumably the Surface Owners are suggesting that this Court should make the CBM well operator liable for <u>two</u> royalties: (1) a one-eighth royalty

payable to the Surface Owners and (2) an additional one-eighth royalty payable to Swords Creek. In advancing this theory, the Surface Owners readily acknowledge that Swords Creek is entitled to the payment of royalty in return for granting access to its coal seams for the purpose of producing CBM, thus implicitly conceding that the circuit court erred in concluding otherwise. They propose that this Court retroactively impose a second one-eighth royalty upon CNX in an attempt to secure all of the royalty escrowed under the Gas Act to them, and thereby avoid the just and logical result of dividing the one-eighth royalty equitably among the parties whose "rights and interests" had to be acquired in order to produce the CBM.

A one-fourth "double royalty" theory is neither supported by the Gas Act or the common law. The Gas Act plainly states that when there are conflicting claims of ownership to CBM, the Virginia Gas and Oil Board ("Board") shall "cause to be established an escrow account into which the payment for costs or proceeds attributable to the conflicting interests shall be deposited and held for the interest of the claimants." Va. Code § 45.1-361.22.2. Subsequently, "the gas well operator shall deposit into the escrow account one-eighth of all proceeds attributable to the conflicting interests." Va. Code § 45.1-361.22.4. The Gas Act explicitly provides for a singular one-eighth royalty and nothing more. Any suggestion to the

contrary is not supported by the law of Virginia.

Moreover, both Swords Creek and the Surface Owners are lessors (and claimants), the former by its actual lease entered in 1991 and the latter provisionally by reason of the statute. JA 107-26, 512-31. Depending upon this Court's construction of the coal severance deed, the Surface Owners may have an interest in the CBM once liberated, but the critical right to enter and disturb the coal seams in order to actually recover the CBM was acquired from Swords Creek. Collectively, this bundle of legal interests comprise the complete economic interest in the CBM for which CNX has escrowed a one-eighth royalty with the Board.

Swords Creek's lease royalty was not paid to Swords Creek—it is included in the escrowed sums. Its lease was entered into after the Gas Act was amended to cover CBM production and development. The Swords Creek lease explicitly references the Gas Act—including its provisions regarding pooling and the payment of contested royalties into escrow—and subordinates the operation of the lease to the Act. JA 116-17, 521-22. The lease's recitation of a one-eighth royalty simply coincides with the one-eighth royalty provided for by the statute. JA 110, 515. The legal rights Swords Creek alone possesses in its coal seams (including the exclusive right to access them and the absolute right to dispose of the CBM within

them) are indispensable for the successful recovery of the CBM, and support the award of all CBM royalties to Swords Creek. Like the Surface Owners, Swords Creek is subject to the Board's pooling orders. As the undisputed CBM lessee pursuant to the Gas Act, CNX owns the CBM once produced, and as the well operator it acts as the agent of both the Surface and Coal Owners. In order to distribute the royalties, CNX is only required to know who to pay and how much.

Coalbed methane is one single substance, which comprises a separate mineral estate. *Harrison-Wyatt v. Ratliff*, 267 Va. 549, 593 S.E.2d 234 (2004). Under the Gas Act, longstanding property law decisions, and common sense, CBM capture and recovery is subject to one royalty. The creation by this Court of an entirely new, statutorily unsupported, retroactive requirement that well operators pay a one-fourth royalty (one-eighth to coal owners and one-eighth to the Surface Owners) for producing CBM would sound the death knell of CBM production in Virginia. This outcome would achieve exactly the opposite of the Gas Act's objective, which is to encourage the production and recovery of CBM. Va. Code § 45.1-361.15. Swords Creek is confident that this Court will not entertain this fanciful theory.

III. The Surface Owners are Estopped from Claiming They Did Not Maintain a Principal-Agent Relationship With CNX

Similarly, in their Response the Surface Owners deny that they have committed any act which "breached the covenants of general warranty and quiet possession," and assert that they are mere bystanders to CNX's production of the CBM at issue. The Surface Owners may not have it both ways. They cannot simultaneously claim an entitlement to CBM royalties generated by CBM production and at the same time deny their agency relationship with the CBM producer.[1]

There can be no doubt that an actual agency relationship exists between the Surface Owners and CNX. As the Surface Owners have acknowledged, their status as "deemed" lessors under the Gas Act created a contract between them and CNX. Surface Owners' Resp. at 6. The Surface Owners now claim the benefit of CNX's actions on their behalf under that contract, i.e. the production of CBM and the escrowed royalties. *Murphy v. Holiday Inns, Inc.*, 216 Va. 490, 492, 219 S.E.2d 874, 876 (1975) ("Actual agency is a consensual relationship. . . . When an agreement, considered as a whole, establishes an agency relationship, the parties

---

[1] In the parlance of the common law one cannot "approbate and reprobate," under the same transaction or instrument, meaning that one cannot simultaneously claim the advantage of a favorable provision while simultaneously denying an unfavorable term. *Johnson v. Powhatan Mining Co.,* 127 Va. 352, 106 S.E. 703, 706 (1920).

cannot effectively disclaim it by formal 'consent.'"). Neither does it matter if there is no written document which describes the principal-agent relationship, although the Gas Act itself arguably does so. *Chandler v. Kelly*, 149 Va. 221, 231, 141 S.E. 389, 392 (1928).

Moreover, the Surface Owners are estopped from denying the "apparent or ostensible agency" created by their inclusion in the pooling order. Such an agency arises by operation of law and is established by the action of a principal—the Surface Owners—which would reasonably allow a third person to conclude that the agency exists. *Sanchez v. Medicorp Health System*, 270 Va. 299, 618 S.E.2d 331 (2005) ("[o]ne who permits another to hold himself out as agent and appears to acquiesce in that assumption of authority is bound thereby") (quoting *Title Ins. Co. of Richmond, Inc. v. Howell,* 158 Va. 713, 724, 164 S.E. 387, 391 (1932)). CNX acted as the Surface Owners' agent by producing CBM and the escrowed royalty pursuant to the "deemed" lease created between them by the Gas Act. Because the Surface Owners have a principal-agent relationship with CNX, they are estopped from alleging that they did not violate the general warranties of the severance deed.

IV. This Court Should Employ A Constructive Trust to Equitably Divide the Escrowed Royalties

To rectify the inequity of the circuit court's determination that the Surface Owners are entitled to all of the escrowed royalties without

compensating Swords Creek for access to its coal seams, the Court should employ a constructive trust to divide the proceeds. As stated it the third assignment of error, Swords Creek alleged a claim for unjust enrichment and requested relief in the form of a constructive trust. JA 269, 634; *Cooper v. Cooper*, 249 Va. 511, 517, 457 S.E.2d 88, 92 (1995) ("A constructive trust is appropriately imposed to avoid unjust enrichment of a party."). The circuit court erred in applying a *quantum meruit* standard that is typically utilized to resolve a claim for implied contract. JA 227 (finding that Swords Creek failed to assert "sufficient facts to state that there is an implication that [the Surface Owners] should have expected to pay [Swords Creek] for any benefit."). Regardless, the circuit court's reasoning is now refuted by the Surface Owners' admission that Swords Creek is entitled to payment for access to its coal seam. Surface Owners' Resp. at 7–8.

CONCLUSION

The issues of the parties' interests in CBM arising from the severance deed and the Gas Act present a "practical subject" which this Court must resolve "in a practical way." *Burke v. Southern Pac. R. Co.,* 234 U.S. 669, 679 (1914). Therefore, Swords Creek asks this Court to re-examine its decision in *Harrison-Wyatt* in light of the record made and arguments presented in these cases. If complete ownership of CBM—necessarily including all of the rights, responsibilities, and liabilities attaching to it—is to

be allocated under our law to one estate, then that estate is coal. If, however, this Court simply recognizes the obvious need to resolve this issue as authorized and contemplated under the Gas Act, then Swords Creek asks this Court to hold that fairness and justice under the circumstances demand that the economic benefits from the production of CBM be shared equally by Swords Creek and the Surface Owners.

Respectfully submitted,

Eric D. Whitesell

Eric D. Whitesell (VSB No. 17631)
GILLESPIE, HART, ALTIZER & WHITESELL, P.C.
126 East Main Street
Post Office Box 718
Tazewell, Virginia 24651
(276) 988-5525 - Telephone
(276) 988-6427 - Facsimile
ghaw@verizon.net

Blair M. Gardner (WVSB No. 8807)
Admitted pro hac vice
Lee Adair Floyd (WVSB No. 11823)
Admitted pro hac vice
Alvin L. Emch (WVSB No. 1125)
Admitted pro hac vice
JACKSON KELLY PLLC
Post Office Box 553
Charleston, West Virginia 25322
(304) 340-1146 – Telephone
(304) 340-1272 - Facsimile
bgardner@jacksonkelly.com
lafloyd@jacksonkelly.com
aemch@jacksonkelly.com

Counsel for Appellant

CERTIFICATE OF SERVICE

I hereby certify that, pursuant to Rule 5:26(e) of the Supreme Court of Virginia, on this 19th day of May 2014, I have caused fifteen (15) copies of this Reply Brief of Appellant, and one electronic copy (via CD) to be filed with the Clerk of the Supreme Court of Virginia, and that I have caused to be mailed, first class postage prepaid, three (3) copies of this Opening Brief of Appellant and one electronic copy (via CD) to Terrence Shea Cook, Post Office Box 507, Richlands, Virginia 24641 and Peter Glubiak, Post Office Box 27, King William, Virginia 23086.

Eric D. Whitesell

Eric D. Whitesell (VSB No. 17631)