

Like Winning the Lottery? A Look at a Pennsylvania Supreme Court Decision Relating to Marcellus Shale Royalties

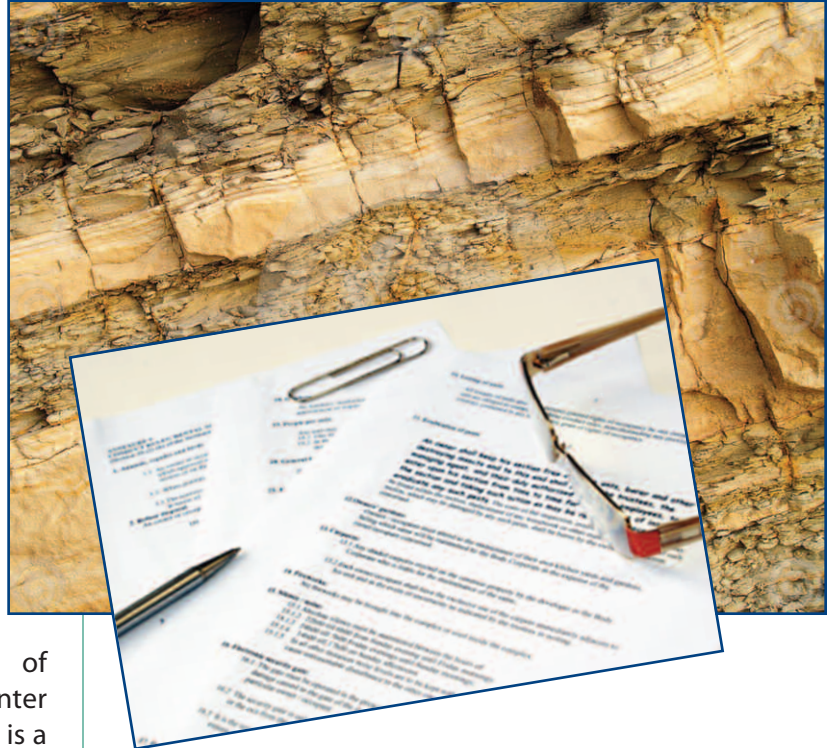
By Amy L. Vanderveen, Esq.



Two years ago, many people in Western Pennsylvania had never heard of the Marcellus Shale... or any shale for that matter. However, the terms "Marcellus Shale," "landmen" and "royalties," have become as familiar to residents of Pennsylvania as the cold winter weather. The Marcellus Shale is a

black shale that underlies much of Pennsylvania, New York, Ohio and West Virginia and contains approximately 363 trillion cubic feet of recoverable gas. With the recent development of new technologies, the east coast has seen an explosion in horizontal drilling. In addition to decreasing the United States' dependence on foreign energy, estimates predict that over the next decade, the Marcellus Shale may have the economic impact of \$13.5 billion in Pennsylvania alone. However, as with any other boon, landowners must be careful entering into leases with gas companies, as the incentives are often too good to be true.

Currently, Pennsylvania is inundated with "landmen," employees of the oil and gas companies sent to landowners to develop lease agreements giving them the right to drill from the landowner's mineral estate. Such leases typically include per-acre signing bonuses and an agreed-to royalty payment if the well produces natural gas. At first glance, many of these contracts appear to be lucrative; however, in order to avoid being misled, it is important for landowners to seek outside advice before entering into any oil and gas lease. Although concerns relating to royalty and bonus payments are only beginning to emerge, the Pennsylvania Supreme Court recently addressed the issue of whether certain oil and gas leases were valid even though they



subtracted post-production costs from the calculation of the landowners' natural gas royalties. *Kilmer v. Elexco Land Servs.*, 990 A.2d 1147 (Pa. 2010).

In *Kilmer*, several landowners ("Landowners") sought to invalidate leases they signed before the Marcellus Shale rush drove up neighboring land values. Upon receiving less in royalties than anticipated, the Landowners sued ElexCo Land Services Inc. and Southwest Energy Production Co. ("Gas Companies"), contending that the Gas Companies' method of calculating royalties violated the Guaranteed Minimum Royalty Act ("GMRA"), 58 P.S. § 33. The GMRA

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Delay Damages in High/Low Scenario

by Michael L. Magulick

Finally a decision by Pennsylvania Appellate Court that includes common sense. Pennsylvania Superior Court in *Thompson v. TJ Whipple Construction Company*, 985 A.2d 221, in a case of first impression, decided that the Plaintiff who entered into a high/low verdict agreement and receives a verdict in excess of the agreed upon high is not entitled to delay damages pursuant to Rule 238 of the Pennsylvania Rules of Civil Procedure.



This lawsuit involved an injury sustained by Douglas Thompson as a result of the negligence of employees of TJ Whipple Construction Company. Prior to trial, the parties entered into a high/low verdict agreement. The agreement was memorialized in writing by letter from counsel for Plaintiff to counsel for TJ Whipple Construction Company. It read "This will confirm that my client has agreed to accept Selective Insurance Company's offer of a high/low agreement. The high will be \$1,000,000 and the low will be \$250,000. If the jury should award more than \$1,000,000 then Mr. Thompson would receive \$1,000,000. If the jury would award less than \$250,000 or it should be a defense verdict, Mr. Thompson would receive \$250,000." There was no reference to delay damages in the correspondence.

The case was tried in August of 2007. The jury returned a verdict in favor of the Plaintiff and against TJ Whipple Construction Company in the amount of \$1,017,041.67. As per the agreement, the award was reduced to \$1,000,000. Subsequently, counsel for Plaintiff filed a Petition for Delay Damages in the amount of \$84,842.04. Counsel for TJ Whipple Construction Company filed an Answer denying that his client or its insurance carrier was required to pay delay damages.

The request for delay damages was denied by the trial court. The decision was appealed by Plaintiffs to the Pennsylvania Superior Court. After briefing and argument, the Superior Court affirmed the trial court decision. They reasoned that the high/low verdict agreement is a contract/settlement agreement which must be strictly construed. The written agreement when analyzed in

conjunction with the legal principle that delay damages become a part of the jury verdict supports their conclusion that delay damages were not recoverable. It distinguished this lawsuit from the decision in *LaRue v. McGuire*, 885 A.2d 549, which permitted delay damages in which the parties stipulated that in the event of a verdict in favor of the Plaintiff, any award would be limited to \$15,000 in exchange for Plaintiff's ability to enter into evidence the medical records of the Plaintiff without the burdensome cost of deposing the medical experts. In that case, the Superior Court held that the capped amount of damages did not necessarily preclude an award for delay damages, but any amount of delay amounts awarded must be calculated based upon the \$15,000 cap and not on the amount awarded by the jury. They reasoned that the stipulation in *LaRue* is not comparable to a negotiated settlement agreement since the unilateral decision by the Plaintiff in *LaRue* to take advantage of a procedural device designed to expedite the admissibility of evidence is "hardly comparable to a negotiated settlement reached in contemplation of a maximum upper limits of available insurance coverage."

In this case, the court discounted Plaintiff's argument that it cannot be inferred from the plain meeting of the contract that the \$1,000,000 cap was inclusive of delay damages. They reasoned that the high/low agreement is a tool commonly utilized in litigation which guarantees Plaintiff a minimal recovery while limiting the Defendant's potential exposure. The parties entering into the high/low agreement are free to craft them in terms that are mutually acceptable. The addition of delay damages renders the high/low agreement useless for litigation purposes.

The decision does not address the issue of whether delay damages are permissible when the jury returns a verdict that is less than the ceiling. However, based upon their review of the decisions from other jurisdictions, I would assume that they would permit delay damages if there is a damage verdict below the agreed upon floor or if the verdict is less than the agreed upon ceiling. However, I doubt that they would permit the delay damages to exceed the agreed upon ceiling. If the jury returned a defense verdict, my analysis would suggest that the Plaintiff would not be entitled to delay damages since there is nothing upon which to calculate interest.

If you have any questions or would like to discuss this issue or any other issue related to personal injury litigation, please feel free to contact me at (412) 566-2970 or mmagulick@waymanlaw.com. ♦

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governs leases entered into by Pennsylvania landowners and gas companies who seek to drill into the Marcellus Shale deposits. In order to protect landowners, the GMRA requires that the leases guarantee the lessor “at least one-eighth royalty of all oil, natural gas or gas of other designations removed or recovered from the subject real property.” Claiming their leases violated this provision of the GMRA, the Landowners filed for declaratory judgment seeking to void their leases. The Landowners contended that because the Gas Companies subtracted post-production costs from the calculation of their royalties, they did not receive the required one-eighth royalty. However, the trial court granted summary judgment in favor of the Gas Companies and denied the Landowners’ Motion for Summary Judgment. The Landowners timely filed an appeal in the Superior Court. However, because more than seventy suits were on hold pending the outcome of the appellate litigation in this case, the Gas Companies asked the Supreme Court to exercise extraordinary jurisdiction to speed the resolution of this purely legal question of first impression, which was granted.

In an opinion authored by Justice Baer, the [Supreme] Court acknowledged that the developments in drilling technologies and the proximity of the Marcellus Shale to the east coast energy markets has created a surge of interest in drilling in the area, forcing gas companies to offer more lucrative lease terms than they have in the past.

In an opinion authored by Justice Baer, the Court acknowledged that the developments in drilling technologies and the proximity of the Marcellus Shale to the east coast energy markets has created a surge of interest in drilling in the area, forcing Gas Companies to offer more lucrative lease terms than they have in the past. As the term “royalty” is not defined in the GMRA, the Landowners rejected the Gas Companies’ argument that the term has developed a technical meaning in the oil and gas industry, and instead argued the Court should rely upon its ordinary definitions. According to the Landowners,

the relevant determination should be the price at the point of sale, regardless of where the sale was made or the cost of getting to product from the wellhead to the point of sale. The Gas Companies, however, contended that the plain language of the GMRA provides that the relevant point of reference is the moment the gas is removed from the ground, or is in the wellhead. After considering both arguments, the Court held that it was required to interpret the valuation point which was most consistent with the language of the Statute. In finding for the Gas Companies, the Court explained that the Statutory Construction Act instructed it to reject the common definition of “royalty” in favor of the definition it has acquired in the oil and gas industry. The Court noted that although the industry definition of “royalty” is not subject to the costs of production, post-production costs are typically deducted in the calculation of landowners’ royalties. Thus, the Court held that the GMRA should be read to permit the calculation of royalties at the wellhead, as provided by the net-back method provided in the leases. Therefore, the Court affirmed the trial court’s grant of summary judgment in favor of the Gas Companies.

At first glance, it appears that *Kilmer* favors oil and gas companies by permitting them to pay lower royalties to landowners by allowing for the subtraction for post-production costs. However, landowners need not fear, such outcomes can be avoided with proper legal guidance and through careful lease negotiations with the oil and gas companies. As the Marcellus Shale gas deposits have been in existence for approximately 400 million years, it is clear that they are not going anywhere soon. Therefore, landowners pursued by landmen should take their time and seek legal advice before signing away their mineral rights. Then, and only then, they can rest, assured that they are sharing in at least one-eighth of the Marcellus Shale royalties’ pie (plus bonuses, which are another story).

For any questions concerning the Marcellus Shale, please feel free to contact Amy L. Vanderveen at avanderveen@waymanlaw.com. ❖

WAYMAN, IRVIN & MCAULEY, LLC
The logo for Wayman, Irvin & McAuley, LLC features the letters 'W', 'I', and 'M' in a large, bold, serif font. A stylized ampersand (&) is positioned between the 'I' and 'M', with its top loop overlapping the 'I' and its bottom loop overlapping the 'M'. The entire logo is rendered in a dark green color.

The Firestorm of the Barrick Case

by Kate J. Fagan

On September 16, 2010, the Pennsylvania Superior Court issued an Opinion, authored by the Honorable Judith F. Olsen, in the case of *Carl and Brenda Barrick vs. Holy Spirit Hospital of the Sisters of Christian Charity, individually and doing business as Holy Spirit Hospital, Sodexho Management, Inc., Sodexho Operations, LLC and Linda J. Lawrence*. The issuance of this Opinion to the legal community started a firestorm of events which caused serious concern for both the plaintiffs' and the defense bar.



The case involved a hospital cafeteria patron who filed suit against the hospital and others after sustaining injuries when a chair collapsed beneath him at the hospital cafeteria. As a result of the litigation and before the subsequent trial, the hospital had served a subpoena on the plaintiff's treating physician which sought the complete medical file including correspondence between the plaintiff's counsel and the physician. The treating physician had been designated by the plaintiff to be his expert witness at trial.

As a result of the subpoena, the plaintiff claimed that the correspondence as between his attorney and the physician was protected by attorney-work product privilege. Argument was held before the trial court, and a subsequent agreement as between the parties ended in the trial court conducting an *in camera* review of the correspondence as contained in the physician's file so that the trial court could determine whether or not that material was privileged.

On October 16, 2009, the trial court entered an Order which granted the enforcement of the subpoena, and directed the physician, who was acting both as the treating physician and as the expert witness, to turn over the requested correspondence and e-mails. Following that Order, an Appeal was filed with the Pennsylvania Superior Court, and the documents at issue were certified to that court under seal.

The Superior Court was faced with an issue it deemed to be of first impression. That issue was whether or not the court below erred by ordering Mr. Barrick's treating physician, who also would testify as an expert witness, to disclose letters

and emails between himself and the attorney for the Barricks that addressed strategy as to how to frame the physician's expert opinions. Further, it should be noted that all treatment records of Mr. Barrick were disclosed to the defendants and their counsel. The documents and e-mails went solely to the interaction as between counsel and the physician.

After reviewing the matter, the Pennsylvania Superior Court determined that the attorney-work product privilege was not sacrosanct, "particularly where it has become relevant to an issue in the pending action."

After reviewing the matter, the Pennsylvania Superior Court determined that the attorney-work product privilege was not sacrosanct, "particularly where it has become relevant to an issue in the pending action". The court found that the defendants were entitled to discover the substance of the facts and opinions to which the expert would be expected to testify, as well as the grounds on which those opinions were based. They found that the correspondence between the plaintiff's attorney and the physician was highly relevant, and therefore would be discoverable, and potentially can be used at trial. Obviously, that written and electronic correspondence could provide for interesting cross-examination of the physician witness, and serve to embarrass, potentially, counsel for the Barricks.

The court further reasoned that the weight and veracity of the physician's ultimate conclusions and opinions would be challenged at trial, and therefore, the defendants and their



counsel were entitled to discover the extent, if any, to which the plaintiffs' attorney may have influenced or impacted the physician's opinion.

The issuance of the *Barrick* opinion caused grave concern in plaintiff and defense counsel throughout the Commonwealth of Pennsylvania. Attorneys, who represent either side, often correspond or email treating physicians or other experts giving information which may contain the attorney's impressions of the facts in the case, as well as other impressions that the attorney wishes to impart to a potential expert for consideration in his or her review of the entire matter. Those impressions or thoughts of the attorney, arguably, should be protected by the Pennsylvania Rules of Civil Procedure, notably Pa.R.C.P. §4003.3. Concerns also arose with regard to potential discovery of correspondence or information sent to experts who ultimately may not give testimony at trial, nor be called upon to write any opinion or prepare any report. Additional concerns were raised with regard to whether or not "expert exclusion" would occur, or efforts would be made to tie up numerous experts so that they would be unavailable to opposing parties because of the particular nature of correspondence and input from counsel.

As a result of this concern, professional organizations across the Commonwealth sought to see whether or not there was any way to intercede with regard to this Opinion. The Opinion, upon its issuance, became substantive law, and could impact thousands of cases currently before both the Common Pleas and Appellate Courts. Professional groups with members whose interests lay on both sides of the Bar expressed their concern as to just how the Court's decision could impact existing cases, and those to be filed in the future. Suggestions were offered to go so far as to redraft and change the existing Rules of Civil Procedure to offer protection of the communication as between counsel and potential experts, whether that expert would be called upon to offer a report or opinion, or testify at any trial or other proceedings.

After due consideration, the Superior Court has withdrawn the *Barrick* decision, and granted the Application for *En Banc* reargument which was filed on behalf of the defendant/appellants on September 27, 2010. A panel of nine (9) Pennsylvania Superior Court Judges was impaneled with the Honorable Correale F. Stevens presiding as the President Judge of the panel. Pursuant to the Order of the Superior Court, an *en banc* argument was held on April 5, 2011, and decision by the Court is pending. ♦

Pa. Attorney-Client Privilege a Two Way Street

by Colleem M. Aracri

The Pennsylvania Supreme Court recently decided the issue of whether, and to what degree, the attorney-client privilege attaches to attorney-to-client communications, in *Gillard v. AIG Ins. Co.*, 2011 Pa. LEXIS 393 (Pa. Feb. 23, 2011). The case involved a bad faith claim, in which the Plaintiff sought all of the documents from the file of the law firm representing AIG in the underlying litigation. AIG withheld and redacted some documents, arguing they were protected under the attorney client privilege. The Plaintiff motioned to compel production of the withheld and redacted documents, arguing that the attorney-client privilege is very narrow, and applies only to communications the client initiates, not to all communication between the client and attorney.

In other words, Plaintiff argued that the privilege is a "one-way street," not a "two-way street" as argued by AIG. The Plaintiff did concede, however, that certain communications from an attorney to a client could contain protected information that originated with the client, and would therefore be granted derivative protection, but noted that AIG was not requesting derivative protection. In their defense AIG argued that the purpose of the privilege is to promote candid disclosure and allow a free and open exchange between the attorney and his client.

Following *in camera* review in front of counsel, the court of common pleas found for the Plaintiff, adopting the "one-way street" perspective. The court grounded its ruling solely in the direction of the flow of information, disregarding the content within, implying that derivative protection did not exist. In its opinion under Rule of Appellate Procedure 1925, the court of common pleas did, however, allow for the possibility of derivative protection, but also noted that AIG was not requesting derivative protection.

On AIG's appeal, the Superior Court affirmed, holding that the privilege is strictly limited to communications from the client. The court recognized an allowance for derivative protection, but again it was noted that AIG was not seeking derivative protection, and their claim was denied.

In light of a divided decision in another case regarding the same issue, this appeal was selected to determine the scope of the attorney-client privilege in Pennsylvania. The precise

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issue on appeal was whether attorney-to-client communications were ever protected under the privilege.

AIG acknowledged the language of the applicable statute only included client to attorney communications, but argued that the statute was not meant to override the common law governing attorney-to-client communications. AIG's argument relied heavily on the historical acceptance of the privilege and the underlying policy justifications. AIG emphasized that confining the privilege to client-to-attorney communications would undermine the purpose of the privilege by inhibiting free and open communication. Additionally, AIG stated that focusing the privilege on the purpose of the communications, rather than just the flow, would better serve the overall interests of justice. Finally, they pointed out that strict limits on derivative protections are unrealistic, due to the relationship between client confidences and attorney advice. As such, AIG advocated that the privilege should extend to all communications from the attorney to the client.

The Plaintiff conceded that attorney-to-client communications are privileged if confidential client communications are intermixed, stressing that the common pleas court ruling allowed for derivative protection. The Plaintiff argued, however, that AIG did not request derivative protection. Plaintiff further argued against extending the privilege beyond close derivative protection, defining the allowance of any expansion as judicial interference with the legislative scheme. Plaintiff stated that strong policy concerns favored a narrow approach to the privilege. Furthermore, Plaintiff argued that an extension of the privilege would lead to more *in camera* reviews due to uncertainty of the scope, burdening the court.

The Supreme Court noted the inconsistent rulings of Pennsylvania courts regarding the scope of the attorney-client privilege. The court then recognized that the privilege does provide derivative protection. The court supported a broader range of derivative protection, stating that it did not believe that the legislature intended strict limits on derivative protection. The court acknowledged the potential for abuse of this privilege, but stated that existing practices were sufficient to provide necessary checks. Finally, the court stated definitively that in Pennsylvania, the attorney-client privilege operates in a two-way fashion to protect confidential client-to-attorney or attorney-to-client communications made for the purpose of obtaining or providing professional legal advice. ♦

WAYMAN WATCH

Mark Gesk and Amy Vanderveen were recently interviewed by Marissa Cicciolone, a Duquesne University School of Law student and staff writer for Juris Magazine. Ms. Cicciolone, Mark and Amy participated in a lengthy telephone conference regarding the impact of the Marcellus Shale on Southwestern Pennsylvania as well as several emerging issues related to the drilling. A portion of Mark and Amy's interview is included in Ms. Cicciolone's article, "Economic Growth at What Cost?: Shale Drilling's Risk of Disaster Outweighs Its Benefits" which appeared in the Fall 2010 Edition of Juris.

Kristen Lunz recently represented the firm at the DRI Annual Product Liability Conference in New Orleans in April.

Dale Forsythe and Scott Stephan recently presented "Marcellus Shale – New Risks for Existing Insureds" at the April 6-7, 2011 Claims Summit of the Pa. Association of Mutual Insurance Companies, in Gettysburg, Pa.

Scott Stephan and Dale Forsythe also represented the firm at the Pennsylvania Fraud Prevention Seminar in Hershey, Pa., April 25-26, 2011.

Congratulations to **Michael Magulick** and **Dale Forsythe** for selection for inclusion in *U.S. News and World Report* Best Lawyers in America for 2011, in Professional Malpractice Law for defendants. The firm is also included in Best Law Firms in America in Personal Injury and Professional Malpractice defense litigation.