IN THE SUPREME COURT OF MISSISSIPPI

NO. 2009-CA-01794 T

PURSUE ENERGY CORPORATION	**APPELLANT**
VS.	
NANCY CAROL GARRETT ABERNATHY, ET AL.	**APPELLEES**

Certificate of Interested Persons

The undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representations are made in order that the justices of the Supreme Court and/or the judges of the Court of Appeals may evaluate possible disqualification or recusal.

Pursue Energy Corporation
(Appellant)

Paul H. Stephenson, III
William F. Ray
Watkins & Eager PLLC
Post Office Box 650
Jackson, Mississippi 39205
(Counsel for Appellant)

G. David Garner
Post Office Box 789
Raleigh, Mississippi 39153
(Counsel for Appellant)

Nancy Carol Garrett Abernathy
Nancy G. Abernathy
Anne M. Ballantyne
Stephen P. Ballantyne
Black Warrior Minerals, Inc.
Erma Boyd
John L. Burwell, Jr.
John L. Burwell, Jr. Children's Trust
Laura Jean Garrett Butler
Mark C. Butler
Ralph C. Butler
Barbara Ann White O'Connell Byrd Trust
Doris F. Callender
Mary Mortimer Campbell Children's Trust #2
Chainco, Inc.
Homer Cummings
Sid Davis
Marie I. Fairchild LIT
Marie I. Fairchild Trust
W. R. Fairchild Construction
W. R. Fairchild Construction, LLC
Wiley Fairchild
Harrison S. Ford
Gary Darwin Garrett
Georgia L. Jenkins Glisson
Barbara Ann Cooper Haley
Erin Hargroder
Chris Hemeter Life Estate
W. D. Hilton
Carroll Ingram
Mary C. Jenkins
Velma R. Jenkins
Janet White Johnston
James T. Kendall
W. Baldwin Lloyd
A. W. Magruder
A. W. Magruder, Jr.
J. D. Mashburn and Wife
James D. Mashburn
(Appellees)

Marie McKay Mashburn
Edwin D. Moore
Glenn G. Mortimer
Glenn G. Mortimer, Jr.
Glenn G. Mortimer, Jr. L/E
Mortimer Group
Piney Woods School
Robert S. Pirtle
Lottie Dent Potter
Mary Helen Garrett Shealy
R. H. Sims, Jr.
Rudy H. Sims, Jr. and Larry A. Sims
James B. Sykes, Jr.
Barbara Walters Thompson, MD
Grady Hamilton Vaughn
Miriam H. Whitsett
Wirt A. Yerger
(Appellees)

C. Victor Welsh, III
Pittman Germany Roberts & Welsh, L.L.P.
Post Office Box 22985
Jackson, Mississippi 39225-2985
(Counsel for Appellees)

Marcus M. Wilson
Bennett Lotterhos Sulser & Wilson, P.A.
Post Office Box 98
Jackson, Mississippi 39205-0098
(Counsel for Appellees)

Respectfully submitted,

Paul H Stephenson III

Paul H. Stephenson, III
Attorney of Record for Appellant

Table of Contents

Table of Contents

Table of Contents

Page

Table of Authorities

Page

Cases:

Table of Authorities

Page

Cases:

Table of Authorities

Table of Authorities

Page

Cases:

Statutes and Rules:

Statement of Issues

The issues presented for review are as follows:

(1) Whether the Chancery Court erred in finding defendant/appellant Pursue Energy Corporation ("Pursue"), as a mineral lessee and sour gas well operator, was liable to plaintiffs for increased royalties or other well revenue payments on poisonous sour gas produced from wells operated by Pursue. This issue includes

(A) Whether in calculating payments to plaintiffs, Pursue's deducted fee for processing the sour gas beyond the wellhead must be limited to recoupment of actual operating expenditures and capital investment, preventing Pursue from making a "profit" for its services as a commercial sour gas plant owner and operator; and

(B) Whether the "profit" portion of Pursue's fee is not chargeable to well revenue interest owners even though

(i) the amount of royalty due under the apposite mineral leases is based on an "at the well" valuation of poisonous sour gas;

(ii) the plaintiffs would realize no economic value from gas production associated with their mineral interests but for the processing of their produced gas; and

(iii) the plaintiffs offered no evidence that the processing fee is too high, or that anyone would process the gas for less than Pursue's fees, and Pursue proved its charges as plant owner/operator were below those charges of comparable sour gas processors - - resulting in above-market revenue payments to plaintiffs and other well revenue interest owners.

In the alternative,

(2) Whether the Chancery Court erred in failing to apply *res judicata* to bar the claims of some 80% of the plaintiffs, whose identical claims were previously denied in a federal court action against Pursue's predecessor-in-interest, and the federal court's judgment (which applied Mississippi law) involved the same claims and legal theories, and the same leases, wells, processing plant,

processing fee, and calculations as this proceeding.

(3) Whether the Chancery Court erred in finding the relationship between these plaintiff mineral lessors and Pursue to be "fiduciary."

(4) Whether the Chancery Court erred in finding hypothetically that punitive damages could have been awarded, and erred in awarding attorneys' fees to plaintiffs based on that finding.

(5) Whether the Chancery Court erred in its award of prejudgment interest.

(6) Whether the Chancery Court erred in failing to apply the statute of limitations to bar some of the claims of the plaintiffs.

Statement of the Case

I. The Nature of the Case.

This case is a dispute between a group of natural gas well interest owners (the "Plaintiffs")[1] and their mineral lessee, Pursue Energy Corporation ("Pursue"). The natural gas in issue contains over 30% hydrogen sulfide and is therefore highly poisonous, "sour" gas which is unusable at the well and indeed lethal in its natural state. Therefore, the toxic gas must be processed to obtain "sweet" methane gas appropriate for sale and commercial use. Natural gas processing is commonly performed either by third parties who are strangers to the lease and are uninvolved in the gas production, *or* by working interest owner lessees who are involved under the lease in gas production operations at the well and in further commerce. Pursue is both a working interest owner/well operator and processing plant

---

[1] Plaintiffs' well interests are not limited to "royalty." Some Plaintiffs also own "overriding royalty" interests and others also own "working interests" in the subject gas production. (T. 396-98.)

owner/operator. Pursue thus acts in two distinct capacities.

Plaintiffs claim Pursue owes them increased revenue payments. The dispute is over the amount of the fee Pursue, as plant owner, charges to the proportionate interests of working interest, royalty, overriding royalty and other interest owners for processing the poison sour gas. The Plaintiffs contend Pursue can only include actual operating expenses in the processing fee; they maintain Pursue as plant owner/operator is not entitled to any return on its capital in the processing plant or to a profit from its high risk activities in processing the lethal, environmentally dangerous sour gas. The Plaintiffs' position is contrary to applicable lease provisions that royalty and other revenue payments under the lease should be calculated based on the value of gas at the well. Their position also directly conflicts with a binding final federal court judgment interpreting Mississippi law involving Pursue's predecessor-in-interest, the same leases, the same wells, the same processing plant and some 80% of these plaintiff owners. The Chancery Court has misconstrued the leases, erroneously disregarded the prior federal court action and otherwise erred in limiting Pursue's processing fee to only actual out-of-pocket operating expenses.

II. Course of Proceedings and Disposition in Court Below.

In 1995 Pursue, a producer and processor of sour gas in Rankin County, purchased additional Simpson and Rankin County sour gas reserves, nine producing wells, and a sour gas processing plant. Thereafter, Pursue processed the combined sour gas production from both its own original wells and the acquired wells through the acquired plant.

The Piney Woods Country Life School and 36 other Plaintiffs commenced this action in December 2000. The complaint, and the December 2001 amended complaint which added 12 more owners as plaintiffs, sought (i) an accounting concerning gas production revenue payments, (ii) reimbursement of alleged excess gas plant processing charges, and (iii) creation of a common fund for distribution of underpayments. (R. E. 57-60.) The Plaintiffs complain that Pursue deducted unreasonably high gas processing charges in calculating the payments due them in amounts substantially in excess of those charged by Pursue's predecessor-in-interest, Shell Oil Company ("Shell"). (R. E. 57.)

After extensive discovery and unsuccessful attempts by the Plaintiffs to join all Pursue royalty owners as plaintiffs, the case proceeded to trial in February 2002. The Chancery Court took the case under advisement. On September 20, 2002 and before a decision was rendered, Pursue filed a petition for business reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Mississippi. The filing of the bankruptcy petition automatically stayed the Plaintiffs' state court action. On June 16, 2003, the Bankruptcy Court lifted the automatic stay to allow the Chancery Court to rule on Plaintiffs' claims for underpayments but did not allow entry of a final judgment. (R. 177.)

A. The Chancery Court's October 7, 2003 "Ruling: Memorandum Opinion."

On October 7, 2003, the Chancery Court issued a "Ruling: Memorandum Opinion" (R. E. 13) finding that Plaintiffs had been underpaid. While finding Pursue's plant operating expenses between 1996 and 2001 "to be fair and reasonable," the Chancery Court concluded charges in excess of actual operating expenses were not recoverable by Pursue. (R. E. 13.) The Court determined that notwithstanding Pursue's investment purchase in Shell's gas processing plant through which all the subject sour gas was processed and the risks encountered by Pursue in plant operation, it "would not be fair and equitable" to charge the Plaintiffs any monetary amount above reimbursement of plant operating expenditures. (R. E. 14.) The Chancery Court did not address the value of Pursue's gas processing function, and made no reference to undisputed evidence that Pursue's processing fee was well below market rates. The Court rejected Pursue's assertion of res judicata based on the final decision in *The Piney Woods Country Life School, et al. v. Shell Oil Company*[2] which addressed plant processing charges associated with sour gas production from the same wells, processed through the same plant, and involving many of the same owners and lease contracts. The Chancery Court stated it "considered the prior Shell Oil case that was litigated in Federal Court which approved similar costs in that case, however at the time that case was filed the capital investment, it appears to this Court, were not and had not been recovered by Shell." (R. E. 14.)

The Court awarded prejudgment interest at 6% per annum on the amount of

---

[2] *The Piney Woods Country Life School, et al. v. Shell Oil Co.*, 539 F. Supp. 957 (S.D. Miss. 1982), *aff'd in part, rev'd in part*, 726 F.2d 225 (5th Cir. 1984), *cert. denied*, 471 U.S. 1005 (1985); *on remand*, No. J74-0307(W) (S.D. Miss. April 24, 1989), *aff'd in part, rev'd in part*, 905 F.2d 840 (5th Cir. 1990); *on remand*, 1995 WL 917482 (S.D. Miss. 1995), *aff'd in part*, 116 F.3d 478 (5th Cir. 1997); *on remand*, 170 F. Supp. 2d 675 (S.D. Miss. 1999), *aff'd*, 218 F.3d 744 (5th Cir. 2000) (Exhs. 32-37 I.D.) (the "*Piney Woods* Case").

underpayments. (R. E. 13.) No findings were made as to alleged claims for previously unpled punitive damages[3] or attorneys' fees in light of the limitations imposed by the Bankruptcy Court referral.

B. The Chancery Court's January 30, 2008 "Ruling."

Following the Chancery Court's October 7, 2003 Ruling: Memorandum Opinion addressing alleged underpayments, the Bankruptcy Court again lifted the automatic stay to enable the Chancery Court to conduct proceedings on the Plaintiffs' claims for punitive damages and attorneys' fees. On January 30, 2008, the Chancery Court issued a "Ruling" denying Plaintiffs' punitive damage claim but awarding attorneys' fees. (R. E. 15.) The Court found the relationship between the Plaintiffs, as mineral interest lessors, and Pursue, as mineral interest lessee, to be fiduciary. It determined "payments were made to the owners of the plant from profits made from the operations of the plant" which were not "allowable" under the leases. (R. E. 15-17.) The Court found the existence of leases negotiated by a handful of mineral owners, contractually allowing them to pay lower processing charges than the overwhelming majority of other owners, made Pursue's "actions malicious." (R. E. 17.) Opining punitive damages "could" have been awarded, the Court concluded an attorneys' fees award was appropriate to avoid an "unjust enrichment" of Pursue and "unfair reduction" of payments. (R. E. 17-18.) Based on the time expended by the Plaintiffs' counsel and a

---

[3] Plaintiffs' amended complaint did not contain any claim for punitive damages. (R. E. 57-60.) Plaintiffs filed only a purported "notification of intent to pursue claim for punitive damages." (R. 124.)

$250 per hour rate, the Court awarded fees of 40% of the actual damages awarded the Plaintiffs in the October 7, 2003 Ruling: Memorandum Opinion. (R. E. 18-19.)

In lifting the automatic stay the second time, the Bankruptcy Court did not authorize entry of final judgment by the Chancery Court. Consequently, no final or appealable judgment was entered.

C. The Chancery Court's October 2, 2009 Order and Final Judgment.

On June 10, 2009 the Bankruptcy Court again lifted the stay to allow the Chancery Court to address any remaining issues in the case and enter final judgment. Dissatisfied with the Chancery Court's October 2003 finding of 6% per annum prejudgment interest, the Plaintiffs sought an award of interest under *Miss. Code Ann.* § 53-3-39 (Rev. 2003) at 8%, compounded annually. (R. 745.) The Chancery Court denied the request for interest under § 53-3-39 and again awarded interest on royalty underpayments at 6% per annum (simple) from 1996 to 2001 but also awarded interest at 6% compounded annually after December 31, 2001 through entry of judgment. (R. E. 20, 28-29.) The Chancery Court also awarded post-judgment interest on all monetary amounts owed at 6% per annum (simple). (R. E. 23.)

Final judgment was entered on October 2, 2009. (R. E. 22.) Pursue filed its notice of appeal on October 26, 2009. (R. 1196.) The Plaintiffs filed a notice of cross-appeal on November 2, 2009. (R. 1199.)

III. Statement of Facts.

A. The Leases.

The leases in issue contain gas royalty provisions calling for payments based upon the value of production "at the well." For example, Plaintiff James B. Sykes, Jr. ("Sykes") executed a lease in favor of Pursue's predecessor-in-interest that contains the following royalty clause:

> The royalties to be paid by Lessee are: . . . (b) on gas, including casinghead gas or other gaseous substance, produced from said land and sold or used off the premises or in the manufacture of gasoline or other product therefrom, the market value *at the well* of [three-sixteenths] of the gas so sold or used, provided that on gas sold *at the wells* the royalty shall be [three-sixteenths] of the amount realized from such sale.

(Exh. 14 ¶ 3.) (Emphasis added).

As lessor, Sykes (and the other similarly situated Plaintiffs) own minerals in the acreage described in their leases. In the leases taken by Pursue and its predecessor, the lessors conveyed to the lessee the right to develop the minerals lying under the described acreage in return for which the lessor was to be paid a contractually agreed royalty. Possessed of the contractual right to own and develop the minerals, a mineral lessee may be called a "working interest" owner. Having contractually conveyed his rights to develop in return for rights to receive royalty payments from his lessee, the mineral lessor may be called a royalty owner.[4] Natural gas as it is produced at the well may require processing to obtain a merchantable product. Where gas production must be processed, the working interest

---

[4] Other types of well revenue interests exist. For example, in some instances a mineral lessee may elect to assign his rights to develop the acreage and in return receive an "overriding royalty" payable under the assigned mineral leases. (Exh. 12.) Regardless of the types of interest owned by any Plaintiff, the processing fee is calculated on the same basis. (T. 396-98.)

owner lessee may or may not be the processing plant owner. (T. 111, 190-91, 348-50, 514-15.) Regardless, according to the leases in this matter, the lessee must pay royalty based on the value of the gas *at the well*; royalty payments under these leases are not based on the value of processed gas at the tailgate of a processing plant.[5]

B. Shell's Production and Processing of Sour Gas and the *Piney Woods* Case.

Proper factual understanding of this controversy between the Plaintiffs and Pursue requires an appreciation of prior gas field development, production and processing efforts by Shell as well as Shell's associated royalty payment practices. Such appreciation includes recognition of the *Piney Woods* Case (*supra* at 5 n.2).

Shell began drilling in the Thomasville area in Rankin County, Mississippi in the late 1960s. It discovered "sour" gas extremely high in hydrogen sulfide at great depths under unprecedented temperatures and pressures. Shell confronted multiple technological challenges associated with drilling for and producing the highly poisonous gas. Drilling and development efforts by Shell involved several well blowouts. Further, when production was achieved, the high concentrations of poisonous hydrogen sulfide in the raw gas stream required that the production be processed to secure clean methane gas appropriate for commercial use ("sweet gas"). The need for gas processing presented Shell as a sour gas producer with essentially two alternatives: (i) it could contract with a third party to build a processing plant to either buy the sour gas production outright or process the sour gas for a

[5] Out of approximately 1,800 leases addressing gas production from the subject fields, there are only 10 or 12 that contractually prohibit or limit gas processing charges. (T. 589-90.)

fee to obtain sweet gas and extract elemental sulfur; or (ii) rather than contract with a third party, Shell could build and operate, at substantial risk and extensive financial investment, the processing plant itself, thereby becoming a sour gas processor in addition to being the sour gas producer. Shell chose the second alternative, building and operating its own processing plant which became known as the "Thomasville Plant." (T. 24-26, 190-91, 514-15.)

Gas processing costs are recouped by plant owners from working interest, royalty and other well interest owners in a variety of ways. For example, some plant owners are compensated with a percentage of the sales proceeds from one or more of the end products. Others receive a fee based on a fixed rate per Mcf[6] of gas processed. (T. 501, 503, 516, 517, 521, 524, 525.) Shell, as owner and operator of the Thomasville Plant, charged a processing fee to well revenue interest owners pursuant to two formulae under which the plant owner/operator retained a portion of end product sales proceeds to cover plant investment, operating expenditures, and processing operation profit. One formula applied to sour gas processing to obtain sweet gas, and the other applied to sour gas processing to recover elemental sulfur. Both formulae sought to assure not only recovery of operating expenditures but also receipt of a return on plant investment or profit similar to those commonly commanded by a third-party processing plant owner/operator. (*Piney Woods* Case, Exh. 33 I.D. at 446-48, 488; 539 F. Supp. at 963-64.)

[6] "Mcf" is the abbreviation for a thousand cubic feet, a common volumetric measurement for gas.

In 1974, the Piney Woods Country Life School and 40 other Plaintiffs in this action[7] sued Shell in a class action challenging Shell's practices for calculating and making royalty payments for interests in sour gas (the *Piney Woods* Case). These plaintiffs, like the Plaintiffs here, contended that Shell was not entitled to receive a return on plant investment (or "profit") as part of the plant processing fee. The *Piney Woods* district court rejected such contentions, and denied all royalty owner claims related to gas processing charges (Exh. 32 I.D. at 437; Exh. 33 I.D. at 439, 446-48, 456-61, 488; 539 F. Supp. at 963-65, 969-73.) The Fifth Circuit affirmed Shell's right to charge a processing fee to royalty owners. The appellate court found record support for finding the charges reasonable but elected to leave the issue of reasonableness open for further consideration by the district court since the case was otherwise being remanded. (Exh. 34 I.D. at 496; Exh. 35 I.D. at 514-16; 726 F.2d at 240-41.)[8]

[7] The 41 Plaintiffs in this action who were also plaintiffs in the *Piney Woods* Case or are successors-in-interest to them are as follows: Ann Mortimer Ballantyne, Stephen P. Ballantyne, Black Warrior Materials, Inc., Erma Boyd, Erin Hargroder (Brumfield), John L. Burwell, Jr. Children's Trust, John Burwell, Jr., Mark C. Butler, Ralph C. Butler, Barbara Byrd Trust, Doris R. Callender, Chainco, Inc., Homer N. Cummings, Sid Davis, Marie I. Fairchild Life Insurance Trust, W. R. Fairchild Construction Company LLC, Wiley Fairchild, Mary Jane Field, Georgia L. Jenkins Glisson, Barbara Ann Cooper Haley, W. D. Hilton, Carroll H. Ingram, Mary C. Jenkins, Velma R. Jenkins, Janet White Johnston, James T. Kendall, W. Baldwin Lloyd, A. W. Magruder, Jr., J. D. Mashburn, Marie McKay Mashburn, Glenn G. Mortimer, III, Mary Mortimer Campbell Children's Trust, The Piney Woods Country Life School, Robert S. Pirtle, Lottie Dent Potter, R. H. Sims, Jr., Barbara Walters Thompson, Gary Hamilton Vaughn, Bruce A. Walters, Miriam Hilton Whitsett and Wirt Yerger. (Exh. 44.)

[8] In making its record for res judicata purposes, Pursue sought to introduce into evidence the relevant judgments and opinions in the *Piney Woods* Case. The Chancery Court declined admission into evidence and received the judgments and opinions for identification. Hereafter as to the published opinions, citation will be to the reporters. Unreported judgments and the 1989 unreported district court opinion will be continually referenced by exhibit number.

On remand the district court expressly incorporated its prior determinations that Shell's processing costs were reasonable and emphasized there had been no showing in either trial that Shell's "processing costs in any manner outweigh the value added to the processing of raw gas into salable sweet gas." (Exh. 36 I.D. at 518; Exh. 37 I.D. at 547-48; Memo. Opin. at 29-30.) There was no appeal of the district court's 1989 findings that all of Shell's processing costs were reasonable. Final judgment was entered on those claims in 1989. (Exh. 36 I.D.)

C. Pursue's Production and Processing of Sour Gas Before It Acquired Shell's Leases, Wells, and Plant.

Pursue commenced sour gas development activities in the Thomasville area in 1978. Pursue drilled a successful discovery well in 1979 and drilled additional wells in the 1980s with varying degrees of success. Pursue tried to negotiate a processing contract with Shell for the processing of Pursue-controlled sour gas at Shell's Thomasville Plant, but Shell refused. Pursue Gas Processing and Petrochemical Company ("PGPP") therefore built a plant to process the sour gas produced from Pursue-operated wells. (T. 110-11, 348.)

The processing fee originally charged by PGPP had two main components consisting of (i) actual operating costs plus (ii) a fixed fee based on plant inlet volumes of sour gas and long tons of elemental sulfur recovered. PGPP invoiced all well interest owners for their proportionate shares of the processing fees for sour gas produced from wells serving PGPP's plant. (T. 349-50.)

D. Pursue's Acquisition of Shell's Gas Reserves and Processing Plant.

In 1992 or 1993 Pursue made an unsolicited offer to purchase Shell's sour gas wells, hydrocarbon reserves, gathering system and processing plant for approximately $55 to $60 million. Shell responded that it had no interest in selling its Thomasville sour gas-related properties at any price. In late 1994 or early 1995, however, Shell contacted Pursue to determine whether Pursue remained interested in purchasing Shell's Thomasville sour gas assets. Shell had reportedly been instructed by its parent company, Royal Dutch Shell, to divest its onshore United States properties of any assets that involved high environmental risk, which implicated the Thomasville sour gas wells and facilities. Consequently, Shell put up for sale not only its Thomasville Plant and related wells and gathering facilities, but also a number of other Shell U. S. properties involving hydrogen sulfide gas. Based on its own declining sour gas production rates, Pursue assessed its own operations and equipment, evaluated Shell's properties and elected to make an offer to purchase them. (T. 112-14, 562-67.)

Pursue ultimately offered Shell $28,130,000 for Shell's Thomasville Plant and the associated sour gas wells, reserves, leases, gathering system and related facilities. Shell accepted the monetary offer without making a counteroffer but demanded broad protection from legal and environmental liabilities arising after the sale. A substantial portion of the purchase negotiations were dedicated to contractual indemnity provisions for legal and environmental risks, since both parties recognized such matters as a significant component of the consideration given for transfer of Shell's assets. (T. 114-18, 567-69.)

The parties agreed on a lump-sum purchase price for all acquired assets. However, for tax purposes, Shell also required an allocation of the monetary purchase price between the sour gas wells and inherent reserves and the processing plant. (T. 118-21.) Pursue made the allocation in accordance with commonly applied methodologies for projection of equipment values, future gas production and associated cash flows. (T. 421-33.) As a result of its allocation analyses, Pursue booked an initial 1995 capital investment in Shell's Thomasville Plant of $14,943,000. (T. 353.)

E. Pursue's Gas Processing and Charges After Acquisition of Shell's Properties.

Pursue's acquisition of Shell's sour gas wells and reserves substantially increased Pursue's production of sour gas. The number of Pursue-operated wells increased from four to 13 wells. Pursue prudently and necessarily elected to process all sour gas production through the former Shell plant. The original Pursue plant could not have processed all the increased volumes of production. It was also more expensive to operate the Pursue plant on a per Mcf of sour gas basis than it was to operate the Shell plant. (T. 121-22, 569-71.) No longer having a need for its plant, Pursue dismantled and retired it in an environmentally proper manner. (T. 122, 195.)

In addition to deciding which processing plant to use, Pursue as plant owner/operator also had to adopt an approach for charging processing costs to all of the well interest owners who shared the revenues from sales of sweet gas and elemental sulfur plant products. Pursue essentially had three alternatives: (i) implement Shell's processing fee approach for all sour gas; (ii) apply the higher processing fee historically used for the four Pursue-operated wells to production from all 13 wells; or (iii) create a new processing fee. (T. 123, 572.)

Pursue chose Shell's processing fee approach for multiple sound reasons. Using Shell's established fee lowered the fee for all well owners when compared to the fee Pursue owners had paid for sour gas processed at PGPP's plant. Even the previous Shell owners' fees were reduced, due to economies of scale occasioned by combining gas production from Pursue's and Shell's wells. Utilization of PGPP's processing cost formula would have resulted in a higher processing fee than Shell's formula. Shell's processing formulae included an equitable cap which precluded the plant owner/operator from retaining more than 60% of end product revenues as the processing fee regardless of volume of sour gas plant throughput and declines in end product prices. PGPP's formula contained no such cap which had in the past resulted in processing fees approaching and even exceeding end product revenues. On balance, Pursue believed Shell's gas processing formula resulted in a processing charge that was extremely fair and reasonable for all owners. Further, under the *Piney Woods* Case, Shell's gas processing formula was a judicially sanctioned approach particularly appropriate for implementation by Pursue as Shell's successor-in-interest. (T. 122-25, 390-93, 407, 572-73.)

F. Higher Industry Charges for Sour Gas Processing.

Between 1996 and 2001, the time period addressed by the trial in this matter, the undisputed evidence established that Pursue's processing fee was much lower than the average of comparable sour gas processing charges of other sour gas processors, as follows:

	Pursue Charges (per sour gas Mcf)	Average Charges of Other Sour Gas Processors (per sour gas Mcf)
1996	$ .80	$ 1.50
1997	$ .91	$ 1.60
1998	$ .85	$ 1.70
1999	$ 1.00	$ 1.90
2000	$ 1.18	$ 2.10
2001	$ 1.07	$ 2.25

(Exhs. 57, 75.)

Thus, Pursue's annualized processing fee ranged from a 1996 low of $.80 per sour gas Mcf to a high in 2000 of $1.18 per sour gas Mcf. During this same time period the average of comparable sour gas processing fees charged by other sour gas processors ranged from a 1996 low of $1.50 per sour gas Mcf to a high in 2001 of $2.25 per sour gas Mcf. Between 1996 and 2001 Pursue's sour gas processing charges were thereby approximately one-third to one-half less than those received by other sour gas processors. (Exhs. 57, 74-77; T. 518-34.) The Plaintiffs offered no evidence that anyone would process the subject sour gas for less than what Pursue charged.

Whether they are independent third parties or also natural gas producers, processing plant owners within the industry expect a return on equity, or profit, commensurate with the risks encountered. Thus, mere dollar-for-dollar recoupment of actual plant investment is only a part of what sound business practice dictates should be recovered, for a reasonable return on risk capital or profit component is also necessary. Pursue's return on its investment in the

Shell Thomasville Plant since 1995 has been appreciably below those returns common in the industry for investments of comparable risks. (T. 310-12, 481-90, 498-503, 511, 518, 538-41.)

Plaintiffs offered no evidence addressing market prices for sour gas processing. Instead they attacked Pursue for its profit. Likewise, Plaintiffs offered no evidence about what constitutes a reasonable return on equity, or profit, associated with the processing of sour gas. Their expert did testify, however, that sour gas production and processing involve considerable risks. This Plaintiffs' expert also necessarily acknowledged that the processing plant, which could have been built and operated by a third party instead of Shell or Pursue, was a valuable asset which substantially enhanced the wellhead value of the sour gas. (T. 189-94.) Since the sour gas has absolutely no monetary value unless it is processed, the commercial value of the processed products creates a substantial enhancement of wellhead value which plainly exceeds the operating expenditure-related processing costs. Mere dollar-for-dollar recoupment of plant investment alone with no profit or return on risk capital provides no compensation for operation risks and is simply not prudent business practice.

Summary of the Argument

The obligation to pay royalty arises under lease contracts requiring royalty payments based on an "at the well" determination. The gas "at the well" is poisonous, lethal sour gas not usable in the condition in which it comes to the surface at the well. Processing of the sour gas at substantial cost and risk to Pursue is required to obtain commercially marketable, environmentally safe natural gas and elemental sulfur. The sour gas is effectively worthless without processing. The sour gas processing which occurs away from the well adds substantially to the value of the sour gas "at the well."

The Plaintiffs do not dispute the necessity of sour gas processing, that sour gas processing is a high risk enterprise, that the processing plant owner/operator may charge all well revenue interest owners a reasonable fee for the necessary sour gas processing, or that the controlling "at the well" lease royalty provision permits a working interest owner lessee who is also the processor to require owners under those leases to share in reasonable processing charges. The Plaintiffs do dispute, however, their obligation to share in a processing fee which includes a profit on plant operations for Pursue not as lessee but as processing plant owner/operator, regardless of whether the fee is lower than market rates. The Plaintiffs, as did the Chancery Court, have misconstrued the controlling "at the well" lease provision, just as they ignore business and marketing realities justifying a return or profit for the high risk operation of a valuable sour gas processing plant.

The Plaintiffs' position directly conflicts with *The Piney Woods Country Life School v. Shell Oil Company* court decision applying Mississippi law to deny the identical claims of 41 of the Plaintiffs in this proceeding. Indeed, the claims of these 41 Plaintiffs here involve the same leases, the same wells, the same processing plant, the same processing fee and Pursue's predecessor-in-interest as defendant. Consequently, the Chancery Court erred in not finding that such claims are barred by res judicata.

The Plaintiffs bore the burden of proof in this case. Yet they offered no evidence addressing reasonable processing costs. They simply claim that as a matter of law a lessee acting in the distinct capacity as a gas processor/processing plant owner cannot receive a return on investment, risk capital charge or profit for processing poison gas to render it safe and marketable.

Nowhere did the Plaintiffs suggest, nor can they, that any sour gas processor would have charged less than Pursue. To the contrary, Pursue irrefutably established that Pursue's processing charges were one-third to one-half less than the charges of other sour gas processors. Pursue's processing charges thus substantially understate the value added to the unprocessed sour gas and substantially overstate the value of the gas at the well, leading to above-market payments for owner interests including royalties. There has been no underpayment of royalty or any other revenue interests in Pursue's wells.

Alternatively, if royalty underpayments are found to have occurred, the Chancery Court's determination that punitive damages "could have been awarded" on this record is manifestly wrong. Among other things, Pursue's lowering of processing charges after the Shell acquisition, good faith reliance on the *Piney Woods* Case, and processing charges substantially below market preclude all conclusory suggestions of egregious or malicious conduct. The Chancery Court plainly erred in attaching significance to the negotiation of different leases with less than 1% of all royalty owners as the purported evidence of "malicious actions."

The Chancery Court's award of attorneys' fees cannot stand in the absence of any basis on which to award punitive damages. The Court's award of prejudgment interest is likewise erroneous given the absence of a liquidated claim or bad faith conduct.

The claims of original Plaintiffs accruing three years before December 2000 are time-barred as are the claims of parties added to the amended complaint which accrued more than three years before December 2001.

Argument

I. The Claims of The Piney Woods Country Life School and 40 Other Plaintiffs Are Barred by Res Judicata.

The threshold issue on appeal is whether the sour gas processing costs shared by the Plaintiffs may exceed actual operating expenses after the processing plant owner has received revenues sufficient to pay for the plant. This issue has already been conclusively resolved as to The Piney Woods Country Life School and 40 other Plaintiffs ("Piney Woods School Plaintiffs"). The *Piney Woods* Case to which these Plaintiffs were parties involved the same leases, the same wells, the same processing plant and the same processing fee in issue in this action. The court held that processing fees received by Shell, a working interest owner lessee who also owned the processing plant, may include a return-on-investment profit component as a risk capital charge. As Shell's successor-in-interest, Pursue uses Shell's processing fee. The claims of the Piney Woods School Plaintiffs that Pursue's processing charges were excessive because Shell's Thomasville Plant had "paid out" are therefore barred by res judicata.[9]

A. The requirements for application of res judicata are well established.

This Court has set forth the requirements for application of res judicata on a number of occasions as follows:

> "[F]our identities must be present before the doctrine of res judicata will be applicable: (1) identity of the subject matter of the action, (2) identity of the cause of action, (3) identity of the parties to the cause of action, and (4) identity of the quality or character of a person against whom the claim is made. Where these four identities are present, the parties will be prevented from relitigating all issues tried in the prior lawsuit, as well as all matters which should have been litigated and decided in the prior suit."

Deere & Company v. First National Bank of Clarksdale, 12 So. 3d 516, 522 (Miss. 2009) (quoting *Hogan v. Buckingham*, 730 So. 2d 15, 17 (Miss. 1998)). *See EMC Mortgage Corp. v. Carmichael*, 17 So. 3d 1087, 1090 (Miss. 2009) (applying four identities to bar action, noting prior judgment must be final judgment on merits, and recognizing "'res judicata is fundamental to the equitable and efficient operation of the judiciary and "reflects the refusal of the law to tolerate a multiplicity of litigation"'").

B. The four required identities of actions for application of res judicata are present.

Each identity for application of res judicata clearly exists here as shown below.

First, the subject matter of the two actions is identical. In both actions the subject

[9] The applicability of res judicata is a question of law. Hence, review is *de novo*. *E.g.*, *Lowrey v. Lowrey*, 25 So. 3d 274, 285 (Miss. 2009) ("chancellor's conclusions of law reviewed *de novo*").

matter includes payments of royalty to the same plaintiffs, under the same mineral leases or contracts, on sour gas production from the same wells, processed through the same plant, with the same processing fee charged by the plant owner who was also a working interest owner lessee.

The district court in the *Piney Woods* Case described the subject matter of that action as follows:

> Piney Woods Country Life School, Ridgway Management, Inc. and other named plaintiffs brought the instant action, individually and on behalf of a putative class designated as all royalty owners in the Thomasville, Piney Woods and Southwest Piney Woods fields, and other contiguous fields located in Rankin County, Mississippi, whose natural gas is being, has been and/or will be processed through Shell Oil Company's Thomasville Plant Facility. By their complaint, Plaintiffs challenge the propriety of royalty payments made by Defendant, Shell Oil Company (hereinafter referred to as "Shell"), on natural gas produced from five units in the Thomasville, Piney Woods, and Southwest Piney Woods fields.

539 F. Supp. at 959-60.

The Plaintiffs' complaint makes clear the identity of subject matters as they assert the following:

> 51. During the late 1960s and early 1970s, Shell Oil Company leased mineral rights in Rankin and Simpson Counties and began drilling and developing sour gas wells. Shell also built the Thomasville plant which it used to process the sour gas stream into two marketable products, methane, which is also known as natural gas, and sulfur.
>
> 52. Ultimately, Shell discovered and developed four sour gas fields: Thomasville, Piney Woods, Southwest Piney

> Woods and Harrisville. Shell processed the gas from all four fields at its Thomasville plant.
>
> 53. During the late 1970s or early 1980s, Pursue Energy leased minerals in Rankin and Simpson Counties and began to drill additional wells in each of the four fields discovered by Shell.
>
> 54. Pursue built the processing plant to process its sour gas production, just as Shell had done.
>
> 55. Each month during the 1980s and 1990s both Pursue and Shell produced sour gas, processed it and sold methane and sulfur. Before paying the royalty owners for their royalty share of production, both companies deducted substantial sums for processing charges.
>
> 56. On or about January 1, 1996, Shell sold to Pursue all of its interests in the four fields it had discovered in Rankin and Simpson Counties, including its interest in leases and all production and production-related facilities.
>
> 57. After acquiring the Shell interests, Pursue was the principal owner of production and facilities in the four fields. It became the operator of all wells in the fields and both processing plants.
>
> 58. Pursue chose to terminate operations of its plant and began processing the sour gas production from all wells through Shell's Thomasville plant.
>
> 59. Since Pursue bought Shell out and gained complete control, it has deducted more than 50% of the royalty owners' share of revenue for processing charges even though, at times, Shell had deducted 25% or less for processing the same gas at the same plant.

(R. E. 56, 57.) Discovery proceeded and the trial was conducted based on the complex and intertwined yet identical relationship between Shell's and Pursue's practices. (E.g., T. 26-32, 42-58, 121-26, 569-76.)

Second, the causes of action are also identical. The causes of action in the *Piney Woods* Case included the allegation that "Shell has, and is, improperly charging royalty owners for processing their share of the production from the subject fields at its Thomasville Plant." 539 F. Supp. at 960. The district court depicted payment of processing costs to the Thomasville Plant as being "accomplished by equations which compute a 'plant-lease split of the residue gas and sulphur revenues.'" *Id.* at 963. The district court recognized the plant costs included a return on investment. *Id.* at 964. In 1982 the district court's final judgment denied the Piney Woods School Plaintiffs' "claim for damages and injunctive relief from alleged *improper and excessive* charges made against their royalty interests for Shell's *gathering system, gas and sulfur plants*, and pipeline to Yazoo City." (Exh. 32 I.D.) In 1989 the district court after the second trial affirmed and supplemented that 1982 finding in concluding Shell's processing costs were reasonable. 1989 Memo. Opin. at 29-30 (Exh. 37 I.D.).

The Plaintiffs here expressly asserted a cause of action in Count II of their complaint based on Pursue allegedly "deducting excessive and unreasonable sums of money from the royalty owners' share of sales proceeds without justification or explanation." (R. E. 58.) They requested the Chancery Court to (i) order Pursue payment of all excessive amounts retained from their royalty owner share of production and (ii) enjoin Pursue from charging excessive processing costs in the future. (R. E. 59-60.) Pursue calculated the processing costs to be paid to the plant using the same equations used in the *Piney Woods* Case. (Exh. 7; T. 57-58, 572-73.)

Third, the parties to the cause of action are identical for res judicata purposes. The Piney Woods Country Life School was the lead named plaintiff and class representative in the *Piney Woods* Case. The 41 Plaintiffs previously identified (*supra* at 11 n.7) were either identified members of the certified class or successors-in-interest to class members. (539 F. Supp. at 960 n.1; Exh. 44; T. 303-04.) Each lease litigated in the *Piney Woods* Case having been assigned to Pursue in 1995, Pursue is successor-in-interest to Shell. Parties in privity satisfy the "identity of parties" requirement. *E.g.*, *EMC Mortgage Corp.*, 17 So. 3d at 1090-91; *Jenkins v. Terry Investments, LLC*, 947 So. 2d 972, 978 (Miss. App. 2006) (successors in interest in privity for res judicata purposes).

Fourth, the "identity of the quality or character" of Shell as the defendant in the *Piney Woods* Case and Pursue as defendant in this action is identical. Both were lessees under the same mineral leases who owned the same processing plant and as plant owners/operators charged the same processing fee to the same people, on the same basis.

C. The Chancery Court misinterpreted the *Piney Woods* Case.

The Chancery Court erroneously rejected Pursue's assertion of res judicata based on a misunderstanding of the *Piney Woods* Case. The Chancery Court stated: "The Court further considered the prior Shell Oil case that was litigated in Federal Court which approved similar costs, however at the time that case was filed the capital investment, it appears to this Court, were not and had not been recovered by Shell." (R. E. 14.)[10] The *Piney Woods* Case allowed a processing fee that included a profit even after recoupment of capital investment. The question of whether capital investment had been recovered or the plant had been "paid for" is not the issue. The determinative issue is whether a plant processing fee shared by royalty and other interest owners can include charges beyond operating costs and investment recovery. The *Piney Woods* Case plainly holds that charges exceeding actual operating and investment costs are permissible, as the court approved a processing fee providing a return on investment and the realization of such a profit. (539 F. Supp. at 963-65, 969-73; Exh. 32 I.D.; 1989 Memo. Opin. at 29-30; Exh. 37 I.D. at 547-48.)

Res judicata conclusively applies on this record. All claims of the Piney Woods School Plaintiffs are thereby barred.

II. Pursue's Processing Costs Are Not Excessive.

The Plaintiffs' claim is that Pursue's processing costs are excessive. The sole alleged basis for the allegation is that Pursue (through the related PGPP) fully recovered its investment in the original Pursue plant and Shell fully recovered its investment in the Thomasville Plant. The Plaintiffs thus claim any processing fee resulting in a payment in

---

[10] The Chancery Court's statement that it "considered" the *Piney Woods* Case indicates the Court viewed the judgments in the case to be before it though the Court had declined to admit them into evidence. The Court could have taken judicial notice of the judgments under Mississippi Rule of Evidence 201 without allowing the judgments and opinions to be marked for identification. This Court, too, may take judicial notice of such judgments. If this Court were to require actual admission of the judgments and opinions into evidence, Pursue asserts the Chancery Court clearly erred in not doing so.

excess of actual operating expenditures after recovery *of* plant investment is excessive.[11] As explained above, this claim is barred by res judicata as to the Piney Woods School Plaintiffs. With respect to the relatively few remaining Plaintiffs[12] (and in the alternative as to the Piney Woods School Plaintiffs), the claim is meritless under the subject leases and on this record.[13]

A. The lease requisite "at the well" valuation necessitates recognition of processing costs in excess of actual expenses.

"[T]he specification in the leases that royalty is computed 'at the well' controls." *Piney Woods*, 726 F.2d at 240.[14] "At the well" requires determination of "the value of the gas at the moment it seeks to escape the wellhead." *Freeland v. Sun Oil Co.*, 277 F.2d 154, 159 (5th Cir. 1960) (cited with approval in *Piney Woods*, 539 F. Supp. at 971-72, 726 F.2d at 240.) Where a market exists for gas at the well or the gas is sold at the well, that sales market establishes value at the well. Where there is no market for the gas because processing is required, the value added by processing must be recognized and deducted from plant end

[11] It should also be noted that Pursue did not recover its 1995 investment and incremental investments in the Shell Thomasville Plant on an undiscounted dollar-for-dollar basis until 2000. (Exh. 51.)

[12] According to the amended complaint: Nancy G. Abernathy, Laura G. Butler, Harrison Ford, Gary Garrett, Mrs. L. B. (Chris) Hemeter, Edwin Dyer Moore, Mary Helen Shealy and James B. "Rusty" Sykes, Jr.

[13] The Chancery Court's erroneous interpretation of the leases raises a question of law. Accordingly, review is *de novo*.

[14] This Court has not explicitly addressed this issue. The *Piney Woods* Case applied Mississippi law. Furthermore, the Plaintiffs' claim is not that no processing charges are allowable but that Pursue's processing charges are excessive. (R. E. 58-60; T. 150-51, 166-68.) The Plaintiffs' acknowledgment that Pursue may charge a reasonable processing fee rests on the necessary recognition of the controlling "at the well" provision.

product values to determine value realized at the well. *Piney Woods*, 726 F.2d at 240-41.

Because the subject gas "at the well" is highly poisonous sour gas, the Plaintiffs' industry expert ("Gazzier") acknowledged the wells cannot produce without a plant. (T. 193-94.) He did not investigate, however, the value of sour gas at the well without or before processing. Rather, Gazzier questioned whether the gas could be valued without a processing plant; he characterized the sour gas at the well as of "very limited commercial value" and readily assumed a "significant increase [to the value at the well] as a result of the valuable processing function." (T. 196-97.) Gazzier further agreed that the substantial value added to wellhead value through processing would be realized whether a third party built and operated the processing plant or the gas producer (Shell or Pursue) built and operated the plant. (T. 190-91.) The value at the well on which royalty is to be based would obviously be no different whether the lessee/producer or a third party is the processor.

The *Piney Woods* Case is certainly not the only case recognizing that a working interest owner lessee who owns and operates the processing plant can require its royalty owners to share in a processing fee including a return on investment, risk capital charge or profit. *See Scott Paper v. Taslog, Inc.*, 638 F.2d 790, 799 (5th Cir. 1981) (court approved method of determining value at the well by deducting from sales revenue the costs of processing and return on investment); *Armstrong v. Skelly Oil Co.*, 55 F.2d 1066, 1068 (5th Cir. 1932) (lessee-operator of gasoline extracting plant "entitled to deal with the lessor the same as a stranger would have done," including receiving return on investment). Likewise, other courts have applied the same methodology for determining wellhead value where the working interest owner lessee is contracting with a third party processor. *See Ashland Oil, Inc. v. Phillips Petroleum Co.*, 554 F.2d 381, 388 (10th Cir. 1975) (plant owner obligated to pay lessee producer value for gas at well entitled to return on investment in determination of wellhead value); *Freeland*, 277 F.2d at 155 (royalty owners required to bear pro rata share of third party processor's fee).

B. Pursue's processing costs understate the value added beyond the well to the sour gas.

The Plaintiffs bore the burden to prove that Pursue's deduction of allegedly excessive processing costs understated the value of the sour gas at the well, and thus caused underpayment to Plaintiffs. *Piney Woods*, 905 F.2d at 845 ("Under Mississippi law, the royalty owners, as plaintiffs, bear 'the burden of going forward with sufficient evidence to prove [their] damages by a preponderance of the evidence.'"); *TXG Intrastate Pipeline Co. v. Grossnickle*, 716 So. 2d 991, 1016 (Miss. 1997) (plaintiff bore burden of proof to establish market value of gas, citing *Piney Woods* Case). Yet, the Plaintiffs made no such effort beyond the blanket assertion in the teeth of the *Piney Woods* Case that no charge above operating expenses after plant "payout" is permissible. Since they did not prove the value of the gas at the wellhead, they could not prove their payments were too low.

The notion that a third-party plant owner would construct and operate the high risk sour gas processing plant in return for only reimbursement of its operating costs and mere recovery *of* plant investment without any return *on* capital or profit is preposterous. The Plaintiffs offered no evidence of wellhead value. They wholly failed to address processing costs charged by other sour gas processors. They presented nothing on which a court could find the processing costs excessive or that Pursue's processing costs deductions understated wellhead value.

Pursue did address sour gas processing costs through an expert eminently qualified in gas processing, gas plant operations and gas plant economics, including sour gas plants and also including charges made by plant owners, operators, producers and shared by royalty and other revenue interest owners. (T. 513.) Possessed of a wealth of pertinent experience (T. 495-513), Pursue's expert Richard Jones ("Jones") investigated the reasonableness or alleged excessiveness of Pursue's processing charges under the leases. (T. 518-26.) Jones found the charges to be reasonable, indeed finding them considerably less (1/3 to 1/2) than the industry average for sour gas processing costs. (*Supra* at 16.) (Exhs. 74-77; T. 526, 533-34.) Jones further emphasized Pursue's return on its investment in the Shell Thomasville Plant is well below the return commonly demanded and realized for industry investments with similar risks. (*Supra* at 16.) (T. 538-41.)

The Chancery Court erroneously failed to recognize Pursue's processing fee was well below market as was Pursue's return on its investment in the Thomasville Plant. *See Piney Woods*, 726 F.2d at 239 (comparable sales market analysis a method by which wellhead value at gas may be determined). Further, the Court compounded its error by disregarding Pursue's 1995 investment of $14,943,000 in Shell's Thomasville Plant and subsequent additional plant investments. (Exh. 51; T. 538-40.)[15]

C. The Chancery Court's erroneous denial of processing charges above actual operating expenses reflects a basic misunderstanding of the relationships among the lessor, lessee, and plant owner.

The Chancery Court sought to justify its award of relief based on processing charges above actual operating expenses as follows:

> In reaching this conclusion, the Court finds that the original Pursue plant at the time of the purchase of the Shell facility had been paid in full. That the Shell facility was purchased together with the wells that Shell owned and that this purchase benefited both the mineral owners who had leased their minerals as well as the lessee and operator of said leases. This Court recognizes, as shown by the testimony, that there were risks that were taken by Pursue in operating said plant, however the mineral owners who had leased their minerals were having minerals depleted from their mineral reserves that were not going to be replaced and to charge these owners for any additional charge would not be fair and equitable.

(R. E. 13-14.)

That the original Pursue plant had been "paid in full" when Pursue purchased Shell's Thomasville Plant has nothing to do with the reasonableness of processing charges for operation of the Thomasville Plant. Pursue made investments in and bore all the operating risks in both plants, not the Plaintiffs, and not some third party venture capitalist. Pursue's purchase and operation of Shell's Thomasville Plant benefited not only Pursue but also other working interest owner lessees, royalty owner lessors and other owners of well revenue

[15] Even under a recovery of investment or plant payout theory allowing no profit, no damages would be awardable for production before 2000 when payout occurred.

interests. Pursue's investment, and Pursue's acceptance of substantial risk to operate the plant, speak emphatically to the reasonableness of Pursue's processing charges.

The Chancery Court's finding that charges above actual operating expenditures "would not be fair and equitable" because the Plaintiffs' minerals were being depleted misapprehends the lessor-lessee-plant owner relationships. Under the leases, the lessors conveyed the right to develop the minerals to Pursue as lessee. The consideration for that conveyance is the contracted-for-royalty. Development of the minerals necessitated construction and operation of a processing plant and associated gathering/transportation facilities by a third party or Pursue at significant risks (which the Chancery Court appeared to recognize). The plant operating risks are borne by Pursue as plant owner like any third-party plant owner; they are not borne by the Plaintiffs, the working interest owner lessees or other well revenue interest owners. In addition to being contractually permissible, there is nothing unfair or inequitable about charges above actual expenditures.

Pursue's processing costs understate the value added by processing. Deducting only those costs from sales revenues overstates the value of sour gas at the well. There is no underpayment of royalty or any other revenue interest under such circumstances.

III. Punitive Damages Could Not Have Been Awarded On This Record.

The Chancery Court stopped short of actually awarding punitive damages. The Court engaged, however, in a faulty analysis to find a hypothetical basis for punitive damages in order to justify the Court's misguided award of attorneys' fees. The record plainly does not support a punitive damages award under established case law. The punitive damages hearing in the bifurcated proceedings indisputably provides no evidentiary basis for punitive damages. The Plaintiffs offered no evidence at that hearing beyond purported proof of the monetary amount of alleged actual damages, Pursue's financial condition including net worth, and efforts expended by counsel in suing Pursue. (T. 643-725.) Nor does the evidence at the February 2002 actual damages hearing substantiate a finding of entitlement to punitive damages or an award of attorneys' fees.

A. The narrow parameters under which punitive damages may be awarded are well defined.

The burden on the Plaintiffs to prove a claim for punitive damages under the well-established pronouncements of this Court is a heavy one indeed. "To qualify for punitive damages in a breach of contract case, a plaintiff must prove by a preponderance that the breach was the result of an intentional wrong or that a defendant acted maliciously or with reckless disregard of the plaintiff's rights." *Hamilton v. Hopkins,* 834 So. 2d 695, 703 (Miss. 2003). Plaintiffs "must demonstrate a willful or malicious wrong or the gross, reckless disregard for the rights of others" to support a punitive award. *Paracelsus Health Care Corp. v. Willard,* 754 So. 2d 437, 442 (Miss.1999). "Punitive damages are only appropriate in the most egregious cases so as to discourage similar conduct and should only be awarded in cases where the actions are extreme." *Id.*

No punitive damages can be awarded without a deliberate intent to do wrong. Punitive damages apply to wrongs "which, besides the violation of a right or the actual damages sustained, imports insult, fraud, or oppression and not merely injuries but injuries inflicted in the spirit of wanton disregard for the rights of others." *Neider v. Franklin,* 844 So. 2d 433, 438 (Miss. 2003).

"The facts must be highly unusual as punitive damages are only awarded in extreme cases. . . . There must be ruthless disregard for the rights of others, so as to take the case out of the ordinary rule." *Gamble v. Dollar General Corp.*, 852 So. 2d 5, 15 (Miss. 2003). "'[T]here is no right to an award of punitive damages and such damages are to be awarded only in extreme cases.'" *Doe v. Salvation Army*, 835 So. 2d 76, 79 (Miss. 2003).

Moreover, in disputes involving contract interpretation and rules of law, punitive damages are not appropriate unless the defendant willfully breaches an *established* duty. "[This] Court, *in cases of first impression*, has refused to award punitive damages even though its ultimate decision was against [defendant]." *Murphree v. Federal Ins. Co.*, 707 So. 2d 523, 534 (Miss. 1997) (emphasis added). *See Harrison v. Allstate Ins. Co.*, 662 So. 2d 1092, 1095 (Miss. 1995) (case of first impression could not support punitive damages award). No Mississippi case has ever limited a mineral lessee's right to calculate royalty or other well revenue interest payments by charging a processing fee in excess of operating expenses after plant payout; and as previously emphasized, the *Piney Woods* Case *allowed* such charges.

B. The record precludes any finding of Pursue conduct sufficient to warrant punitive damages.

At every turn the evidence shows Pursue acted in good faith in conformance with its reasonable understanding of its contractual rights under the leases. Both the rationale for and the effect of Pursue's use of the Shell processing formula preclude any finding of maliciously willful, wanton or egregious conduct. For example and as previously explained:

(1) Pursue recognized post-acquisition operations would predominantly involve the former Shell properties as contrasted with the pre-acquisition Pursue properties. In particular, Pursue necessarily used Shell's Thomasville Plant and dismantled its own plant.

(2) Pursue is Shell's assignee and successor-in-interest. Pursue stepped into the shoes of Shell.

(3) The *Piney Woods* Case involved the same former Shell properties (leases, wells, plant) purchased by Pursue. The very same formula selected by Pursue to make processing charges was reviewed and approved in the *Piney Woods* Case, including approval of a return on investment or equity after the processing plant was paid for. Pursue expected, and could reasonably expect, the *Piney Woods* Case to guide Pursue's obligations.

(4) Pursue knew use of PGPP's processing costs methodology would have resulted in charges higher than the Shell formula.

(5) Pursue reasonably believed using the Shell formula meant below-market rates for processing would be charged, which in addition to the assurance provided by court approval of the formula, militated against creation of a new processing fee approach.

(6) Pursue's implementation of the Shell formula resulted in reduced processing costs for everyone; i.e., both former Shell royalty owners and original Pursue royalty owners previously paid more per Mcf of sour gas.

(7) Pursue's charges have been one-third to one-half below market.

(*Supra* at 7-17.)

The inherent fairness of Pursue's charges compared with sour gas processing market rates and Shell's court-approved charges is thus clear. The Plaintiffs did not even try to establish someone else would have charged less than Pursue to process the gas, foreclosing any suggestion of egregious Pursue conduct.

C. The Chancery Court misconstrued the law and the record in finding a basis for punitive damages.

The Chancery Court's Ruling as to hypothetical punitive damages is flawed from the outset. Without citation of any case law the Chancery Court found the relationship between the Plaintiffs as mineral lessors and Pursue as mineral lessee to be fiduciary. This Court has never found a fiduciary relationship arises under an oil and gas lease between a mineral lessee and royalty owner.[16] None exists as the relationship is contractual under which the lessee acts with due regard for the rights of both its lessors and itself, and not as a fiduciary. *See Nygaard v. Getty Oil Co.*, 918 So. 2d 1237, 1241-42 (Miss. 2005) (relationship between *overriding royalty owner* and successor-in-interest lessee not "trust relationship" but "purely contractual").

The Plaintiffs' complaint does not even allege a fiduciary relationship; the Plaintiffs

---

[16] Nor, for example, has Texas, a jurisdiction with a substantially developed body of oil and gas law. *See Stinnett v. Colorado Interstate Gas Co.*, 227 F.3d 247, 253 (5th Cir. 2000) (no fiduciary relationship under oil and gas lease as fiduciary relationship is "'extraordinary,'" "'not [to] be lightly created,'" and generally not found in "arms-length contractual relationships, even among trusting friends"). *HECI Exploration Co. v. Neel*, 982 S.W.2d 881, 888 (Tex. 1998) ("Texas law has never recognized a fiduciary relationship between a lessee and royalty owners.").

allege only that Pursue owed them "a duty of utmost good faith and fair dealing." Insertion of the word "utmost" before "good faith" does not convert this duty of good faith into a fiduciary duty. Such an alleged duty is no different from the duty arising under all contracts. *See, e.g., Ferrara v. Walters*, 919 So. 2d 876, 883 (Miss. 2005) ("all contracts carry inherent covenant of good faith and fair dealing").

The Chancery Court's finding of a fiduciary relationship "based [solely] on the fact that the leasehold interest conveyed by the owners of the minerals were generally from individual landowners of the minerals who relied on Pursue for the mining of these minerals" is plainly deficient. The finding represents nothing more than a presumption that the Plaintiffs expected Pursue to perform its contractual obligations. The record does not support a speculative inference that the Plaintiffs justifiably reposed trust and confidence in Pursue (in most instances the successor-in-interest to the initial lessees) believing they had some special relationship with Pursue. *See, e.g., Burgess v. Bankplus*, 830 So. 2d 1223, 1227-28 (Miss. 2002) (normal business relationship pursuant to contract such as debtor-creditor and mortgagor-mortgagee does not establish fiduciary relationship absent extraordinary circumstances where *both* parties understand "'special trust and confidence has been [justifiably] reposed'"). [17]

The Chancery Court's recitation of the history of sour gas production in explaining its "punitive" Ruling substantially misconstrues the record. Pursue neither invested $30

[17] The Plaintiffs called only two plaintiffs to testify. Their testimony does not contain even a conclusory suggestion of facts imposing a fiduciary relationship. (T. 135-68.)

million in its prior plant nor imposed an additional 60% "surcharge" to recover such an initial cost. Pursue did pay in "the neighborhood of $30 million" for Shell's Thomasville properties in 1995, including $14,943,000 allocated at that time to the plant. (*Supra* at 12-14.) Pursue imposed no "surcharge" on the Plaintiffs after the acquisition from Shell. (Shell's formula contained a 60% cap that limited payments for processing to a maximum of 60% of end product revenues. This was a limitation on what the interest owners in Shell's wells, and ultimately also interest owners in Pursue's wells, could be charged for gas processing, not an additional "surcharge" imposed on them for deduction from their well revenue.)

The Chancery Court appears to have emphasized the following:

> It should be further noted that substantial payments were made to the owners of the plant from profits made from the operations of the plant. Therefore, the owners of the royalty paid not only costs but profits. Nowhere in the leases would this or should this be allowable.

(R. E. 17.)

These findings again fundamentally misapprehend the relationships among the royalty owner lessors, working interest owner lessees, other revenue entitled well owners and plant owners. To suggest that the plant owner cannot make a "profit" merely because it is also a lessee ignores not only the *Piney Woods* Case but also obvious business realities. The payments made to the plant owners were not made just by the royalty owners; working interest owner lessees and other well interest owners in addition to Pursue likewise made the same payments. (T. 99-100, 396-98.) Regardless of whether the plant owner is also a working interest owner or is an independent third party, its right to a reasonable return on equity or a reasonable "profit" affects the determination of the value of the sour gas at the well just as much as any out-of-pocket cost expenditure.

Nor do Pursue's "royalty payment stubs" remotely evidence bad faith conduct. The Chancery Court acknowledged the stubs disclosed processing charges were being made but then stated that Pursue did not put the Plaintiffs "on notice so that they could challenge or question these costs." (R. E. 17.) Of course, 41 of the Plaintiffs had long been "on notice" regarding processing charges practices as parties in the *Piney Woods* Case. Regardless, disclosure of the types and amounts of the charges was made to all Plaintiffs and other interest owners, month after month, year after year, providing obvious and ample opportunities to question the costs.[18]

The Chancery Court further erred in attaching significance to the circumstance "that some of the people who were knowledgeable in [oil and gas] matters were, in fact, charged a less amount." (R. E. 17.) The record reflects that the "some of the people" equals 10 or 12 persons out of more than 1,800 well revenue interest owners. The Court's conclusion that the existence of these very few different lease arrangements "meant that the remaining royalty owners were charged a greater proportion of the costs that were recovered" is also wrong. An individual royalty owner's share of the processing costs is determined by *his*

[18] For example, Plaintiff Sykes testified Pursue had not given him "any accounting for [the] deduction amount" shown on the royalty check stubs, but quickly added "in all fairness, I have not asked for it, that I remember." (T. 140.)

proportionate ownership interest as applied to the total volume of sour gas processed. Costs paid by others do not affect what a particular individual pays. Further, every lease was individually negotiated between a willing lessor and a willing lessee. There is no requirement of universally equal lease terms.

Without explanation the Chancery Court concludes Pursue's conduct was "willful and intentional" apparently to suggest Pursue acted in bad faith. (R. E. 17.) Yet nothing about the Court's recitation of evidence, including the Court's misapprehension of it, demonstrates egregious conduct or bad faith. Plaintiff Owner Sykes testified that the lease provisions increasing his royalty from the standard one-eighth to three-sixteenths, and reducing the lease term from 10 years to five years, were "negotiated things"; Sykes testified that he "actively participated in negotiating the terms of [his] lease" with Pursue's predecessor-in-interest. (T. 153-54.)[19] For the Court to find that a few people successfully negotiated a lower processing charge constitutes "malicious" conduct as to the Plaintiffs, or royalty owners generally, is clearly erroneous. Among other things, the inference that only those leases were "negotiated" is grossly speculative and unfounded on the limited record created by the Plaintiffs.

IV. There Being No Basis for Punitive Damages, Attorneys' Fees Were Wrongly Awarded.

[19] Moreover, the numerous working interest owners in addition to Pursue who shared in the end product proceeds include Plaintiffs in this action who are both working interest and royalty owners; these Plaintiffs as working interest owners paid royalty to their lessors under leases which neither prohibited nor reduced processing charges. (T. 396-98.)

The absence of a basis for punitive damages requires the Chancery Court's award of attorneys' fees be set aside. "'Mississippi follows the American rule regarding attorney fees: unless a statute or contract provides for imposition of attorney fees, they are not recoverable. . . . When there is no contractual provision or statutory authority providing for attorney fees, they may not be awarded as damages unless punitive damages are also proper.'" *Huggins v. Wright,* 774 So. 2d 408, 412-13 (Miss. 2000) (quoting *Century 21 Deep South Prop., Ltd. v. Corson*, 612 So. 2d 359, 375 (Miss.1992). "Repeatedly, the Court has followed the American Rule that when there is no contractual provision or statutory authority providing for attorney's fees, they may not be awarded as damages unless punitive damages are proper as well." *Willard v. Paracelcus Health Care Corp*., 681 So. 2d 539, 544 (Miss. 1996).[20] A court can award attorneys' fees in lieu of punitive damages, but only when the defendant's conduct *would support* punitive damages. *Check Cashers Express, Inc. v. Crowell,* 950 So. 2d 1035, 1043 (Miss. App. 2007).

There is no applicable statute or contractual provision authorizing attorneys' fees. An award of punitive damages would be improper. Thus, the Plaintiffs have no right to an

[20] *See also, e.g.*, *Hamilton,* 834 So. 2d at 700 (breach of real estate sales contract; reversing fee award; "if attorney's fees are not authorized by the contract or by statute, they are not to be awarded when an award of punitive damages is not proper."); *Kennedy v. Anderson*, 881 So. 2d 340, 348 (Miss. App. 2004) (easement dispute, reversing attorney fee award; "Unless there is a contractual provision or statutory authority providing for attorney fees, they may not be awarded as damages unless punitive damages are also proper.")

attorneys' fees award.[21]

V. There Being No Basis for Punitive Damages, Prejudgment Interest May Not Be Awarded.

In its 2003 opinion the Chancery Court found the Plaintiffs were entitled to prejudgment interest at 6% per annum on underpayments. (R. E. 13.) The Court reaffirmed that simple interest finding in 2009 as to underpayments through 2001, found interest should be compounded on underpayments after 2001, and denied interest on the attorneys' fees awarded. (R. E. 23, 28-29, 33-34.) The Chancery Court lacked the discretion to award prejudgment interest (simple or compound) and thereby erred.

The narrow circumstances under which prejudgment interest may be awarded absent contractual or statutory authorization have been plainly set forth by this Court on multiple occasions. As stated by the Court:

> "An award of prejudgment interest rests in the discretion of the awarding judge. Under Mississippi law, prejudgment interest may be allowed in cases where the amount due is liquidated when the claim is originally made or where the denial of a claim is frivolous or in bad faith. No award of prejudgment interest may rationally be made where the principal amount has not been fixed prior to judgment." *Coho Res. v. McCarthy*, 829 So. 2d 1, 19-20 (Miss. 2002) (quoting *Warwick v. Matheney*, 603 So. 2d 330, 342 (Miss. 1992)). *See also Tupelo Redev. Agency v.*

---

[21] This Court has recognized two narrow exceptions, not applicable here, justifying attorney fees' awards *as actual damages*, even absent contractual or statutory authority or malicious conduct: (i) "Where the wrongful act of the defendant has involved the plaintiff in litigation *with others*," and (ii) when an insurance company denies a claim without an arguable reason, but not maliciously (so-called "*Veasley*" damages). *Willard*, 681 So. 2d at 544-45 (emphasis added). The Court has expressly limited *Veasley* damages to "a problem peculiar to the insurance industry." *Id.* at 545.

Abernathy, 913 So. 2d 278, 286 (Miss. 2005).

Stockstill v. Gammill, 943 So. 2d 35, 50 (Miss. 2006).

Unquestionably, the amounts allegedly due were unliquidated when the Plaintiffs originally made their claims for an accounting and royalty underpayments. The Chancery Court made no finding that Pursue's use of a processing fee above actual operating expenditures was frivolous. In finding Plaintiffs entitled to punitive damages without awarding such damages, the Chancery Court said that Pursue's actions were "willful" and "intentional" because Pursue intended to do what it did. The Court found the actions "malicious" based on Pursue having negotiated for lower processing charges with a small handful of persons in the oil and gas business but not Plaintiffs. Assuming the Court's finding of "malice" is one of "bad faith," Pursue has shown above the Chancery Court clearly erred in such a determination. Hence, on this record there is neither a liquidated claim nor a bad faith denial of a claim.

The issue is whether prejudgment interest may be awarded in the undisputed absence of a liquidated claim and in the absence of record evidence on which a finding of frivolous or bad faith conduct can be sustained. Plainly, this Court's well-established precedent precludes any such award of prejudgment interest. *See*, *e.g.*, *Stockstill*, 943 So. 2d at 50 (including case authorities cited therein).

Alternatively, the Chancery Court erred in the assessment of prejudgment interest for the years 1996-2000 because these time periods precede the filing of the complaint. *Miss.*

Code Ann. § 75-17-7 (Rev. 2009), which affords the trial judge the discretion to award prejudgment interest where there is a liquidated claim or bad faith conduct, provides that the date from which interest may run can "in no event [be] prior to the filing of the complaint." *See Upchurch Plumbing, Inc. v. Greenwood Utilities Commission*, 964 So. 2d 1100, 1119 (Miss. 2007) (§ 75-17-7 applied to contract claim for liquidated amount); *American Fire Protection, Inc. v. Lewis*, 653 So. 2d 1387, 1392 (Miss. 1995) (under § 75-17-7 party possessed of liquidated claim "entitled to prejudgment interest from the date complaint is filed"). *But see Sentinel Industrial Contracting Corp. v. Kimmins Industrial Service Corp.*, 743 So. 2d 954, 971 (Miss. 1999) (awarding prejudgment interest from date of contract breach based on decision rendered long before amendment to § 75-17-7 which precluded running of interest before date of filing of complaint).[22]

VI. Claims Related To Payments To All Plaintiffs in 2006 and 2007 and Payments To Some Plaintiffs in 2008 Are Time-Barred.

Pursue both pled the statute of limitations (R. E. 73) and raised applicability of the statute at trial in conjunction with the Plaintiffs' introduction of exhibits including purported damages for time-barred claims. (T. 253, 256, 285, 287.) The Chancery Court's October 7, 2003 Ruling: Memorandum Opinion which addressed the Plaintiffs' right to compensatory damages for alleged underpayments says nothing about the applicability of the statute of

[22] Moreover, the Chancery Court abused its discretion in compounding interest at 6% in light of prevailing interest rates through the first 10 years of this decade. *See, e.g.*, constant maturity Treasury yields (often in range of 2% or below) utilized in federal court proceedings to award interest under 28 U.S.C. § 1961.

limitations to certain claims by the Plaintiffs. The Chancery Court erred in failing to apply the statute of limitations to claims accruing more than three years prior to the filing of the complaint and amended complaint.

The Plaintiffs' claims for underpayment of royalty under the leases constitute an action for breach of contract. The applicable statute of limitations is *Miss. Code Ann.* § 15-1-49 (Rev. 2003). *See Nygaard*, 918 So. 2d at 1240-41 (applying § 15-1-49(1) to claim for unpaid royalties). This statute provides in pertinent part for a three-year limitations period as follows: "All actions for which no other period of limitation is prescribed shall be commenced within three (3) years next after the cause of such action accrued, and not after."

Royalties and other production revenues are paid monthly by checks which, among other things, disclose (i) the total sales proceeds on which payments are based, (ii) the total processing fee being charged, (iii) the owner's decimal ownership interest in each respective well's sales proceeds, (iv) the owner's share of gross sales proceeds, (v) the owner's share of the processing fee, and (vi) the net payment being made to the owner based on deduction of the processing charges. (Exhs. 17, 18, 55; T. 146-47, 163-64, 394-98.) While the individual elements of the processing fee were not identified on the checks, the two owners who testified at trial necessarily acknowledged the obvious as they agreed the check stubs disclosed deductions were being made from their payments for processing charges about which they could have asked if they had so desired. (T. 140, 146-48, 163-65.) *See Nygaard*, 918 So. 2d at 1242 (royalty owner on notice had duty to investigate which commenced running of statute of limitations).

A cause of action for breach of contract accrues at the time of the alleged breach. *Young v. Southern Farm Bureau Life Ins. Co.*, 592 So. 2d 103, 107 (Miss. 1991) (citing with approval *Johnston v. Crisler*, 125 So. 724, 725 (Miss. 1930)). Thus, the Plaintiffs' claims for underpayments accrued monthly as payments were made. The complaint was filed on December 20, 2000 on behalf of 37 Plaintiffs. Twelve additional Plaintiffs were added when the amended complaint was filed on December 14, 2001. Therefore, all claims of the original Plaintiffs, and their successors-in-interest, based on payments made before December 20, 1997 are time-barred. All claims of the Plaintiffs added by the 2001 amended complaint, and their successors-in-interest, based on payments made before December 14, 1998 are also time-barred.

Conclusion

The Chancery Court's decision should be reversed and rendered. There has been no underpayment to Plaintiffs for royalty or any other revenue interest in Pursue's wells.

Further, the claims of the *Piney Woods* Case Plaintiffs are certainly barred by res judicata. No award of punitive damages, attorneys' fees or prejudgment interest can be made on this record. The claims accruing more than three years prior to the December 2000 filing of the original complaint and the claims of additional parties accruing more than three years prior to the amended complaint are time-barred.

This the 17th day of September, 2010.

Respectfully submitted,

PURSUE ENERGY CORPORATION

BY: Paul H Stephenson III

Paul H. Stephenson, III (MB [redacted]
William F. Ray (MB # [redacted]
G. David Garner (MB # [redacted]

ATTORNEYS FOR APPELLANT

OF COUNSEL:

Watkins & Eager PLLC
The Emporium Building
Suite 300, 400 E. Capitol Street
Jackson, Mississippi 39201
Telephone: (601) 965-1900

G. David Garner
124 Main Street
Raleigh, Mississippi 39153
Telephone: (601) 782-9090

CERTIFICATE OF SERVICE

The undersigned counsel for Appellant certifies that he has this day caused to be served a true and correct copy of the foregoing Brief of Appellant on the Chancery Court and counsel of record as follows:

By United States Mail

Honorable J. Larry Buffington
Chancellor
Post Office Box 924
Collins, Mississippi 39428

By Hand Delivery

C. Victor Welsh, III
Pittman Germany Roberts & Welsh, L.L.P.
410 South President Street
Jackson, Mississippi 39201

Marcus M. Wilson
Bennett Lotterhos Sulser & Wilson, P.A.
190 East Capitol Street
Suite 650
Jackson, Mississippi 39201

This the 17th day of September, 2010.

Paul H Stephenson III

PAUL H. STEPHENSON, III