Case No. 20-3469

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ZEHENTBAUER FAMILY LAND LP; HANOVER FARMS LP; EVELYN FRANCES YOUNG, Successor Trustee of Robert Milton Young Trust,

Plaintiffs-Appellants,

v.

TOTAL E&P USA, INC.; PELICAN ENERGY, LLC; JAMESTOWN RESOURCES, LLC

Defendants-Appellees.

On Appeal from the United States District Court
for the Northern District of Ohio, Case No. 4:15-cv-02449-BYP

CORRECTED[1] REPLY BRIEF OF PLAINTIFFS-APPELLANTS

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[1] This Corrected Reply Brief is revised only to reflect the Amended Caption pursuant to Doc. #47-1 and 47-2.

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I. OPENING STATEMENT

Contrary to what Defendants argue (at 4, 13, 39), the issue is not whether refined products that are sold downstream are chemically distinct from or more valuable than raw products extracted at the wellhead. This is a red herring. A royalty payment, which represents a lessor's fractional share of production from a lease, may be calculated at the wellhead or at any downstream point, depending on the lease terms. *Bluestone Nat. Res. II, LLC v. Randle*, --- S.W.3d ---, 2021 WL 936175, at *3 (Tex. Mar. 12, 2021).

Calculating a royalty at a downstream point does not make the leases "unworkable" as Defendants claim (at 19).[2] Gross royalty leases do exist, and the parties may contract as they see fit. Defendants are able to carry the burden of post-production costs on the lion's share of production - their working interest[3]. The issue is whether they also contractually carry the burden of post-production costs as to the Class's fractional share (17.5 - 20%) of the royalties.[4] Chesapeake

[2] There is no advantage of bargaining power by accumulated volumes as Defendants argue (at 7). Since the transaction is at the well, Total E&P USA ("TEPUSA") and Total Gas & Power North America ("TGPNA") are in the exact same position, either of whom would have to contract to gather and process the exact same gas.

[3] 80 - 82.5% of the oil and gas depending on the lease royalty percentage.

[4] TEPUSA's citation (at 14), 20) to Peter A. Lusenhop & John K. Keller, *Royalty Valuation and Post-Production Costs: The Competing Rules*, 36 E. Min. L. Found.

acknowledged at the oral argument in *Lutz v. Chesapeake Appalachia, LLC*, 71 N.E.3d 1010 (Ohio 2016), that the "at the well" rule did not apply to gross proceeds valuations. *See* Brief of Plaintiffs-Appellants, Doc. 27 at 25-26. The question here is whether the parties contracted for a valuation point at the wellhead or a downstream point.

II. <u>The Parties Contracted for a Gross Royalty</u>

The Class, through the Gross Royalty Leases, contracted for a downstream sales price by providing the royalty is based on gross proceeds, which is defined to include the total consideration paid for marketable by-products, marketed off the leased premises, and expressly prohibited deductions. *See* Comp. ¶¶ 15-17, RE 1-1, Page ID 19-20; Zehentbauer Lease, RE 1-1, Page ID 44; Hanover Farms Lease, RE 1-1, PageID 66; Young Lease, RE 1-1, PageID 88.

The affiliate sales provision provides that the royalty is to be based on a third-party arms-length transaction <u>without</u> any deductions or expenses. TEPUSA

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§ 22.02, can be disregarded because it ignores the language in the leases. Further, the authors themselves were actively representing lessees in seeking Ohio to adopt the "at the well" rule, which Ohio rejected. *See Lutz v. Chesapeake Appalachia, L.L.C.*, 2016-Ohio-7549, 148 Ohio St. 3d 524, 71 N.E.3d 1010 (listing John Keller as representing petitioner); *Bounty Mins., LLC v. Chesapeake Expl., LLC*, No. 5:17CV1695, 2019 WL 7048981 (N.D. Ohio Dec. 23, 2019) (listing Peter Lusenhop as representing defendants); *Henceroth v. Chesapeake Expl., L.L.C.*, No. 4:15CV2591, 2019 WL 4750661 (N.D. Ohio Sept. 30, 2019), aff'd sub nom. Henceroth v. Chesapeake Expl., LLC, 814 F. App'x 67 (6th Cir. 2020) (same); *Zehentbauer Fam. Land LP v. Chesapeake Expl., LLC*, No. 4:15CV2449, 2016 WL 3903386 (N.D. Ohio July 19, 2016) (same).

admits that it calculates the royalty based on "an arithmetic formula" that is "adjusted for TGPNA's costs of compression, dehydration, treating, gathering, fractionation, processing, and transportation" costs. Third para. of TEPUSA's answer to Interrogatory No. 10, RE 99-1, PageID 1133.

TEPUSA's Transaction Confirmation provides the price is the netback price less all fixed costs under all Downstream Agreements.

Contract Price: The Contract Price for the sale and purchase of Gas at each Delivery Point shall be equal to the weighted average of the "Average Monthly Netback Price" and the "Average Daily Netback Price" at such Delivery Point, plus any net additional liquids value, if any, less the fixed costs incurred under all Downstream Agreements (including reservation and demand fees) expressed in U.S. Dollars per MMBtu for the total Contract Quantity at such Delivery Point.

Transaction Confirmation, RE 172-4, PageID 5450. Downstream Agreements is defined to mean all post-production costs.

Schedule "2" – Downstream Agreements. "Downstream Agreements" means all agreements relating to the compression, dehydration, gathering, transportation, treating, fractionation or processing of Gas sold and purchased under this Transaction Confirmation. Schedule "2" shall be revised from time to time as mutually agreed by the parties.

Id., PageID 5451. However, the Gross Royalty Leases provide for payment based on that sales price but without deductions.

What the lease requires: arms-length price (x) without any deductions or expenses (y) = royalty (z)

$$x = z$$

What TEPUSA does: arms-length price (x) minus costs of compression, dehydration, treating, gathering, fractionation, processing, and transportation (y) = royalty (z)

$$x \neq z$$

The provision does not say without deduction of lessee's costs, it says without deduction of any costs. TEPUSA is expressly calculating the "price" by deducting costs, which the lease provision prohibits.

Further, the affiliate sales provision has to be read in conjunction with the rest of the royalty provision providing for payment based on "gross proceeds." See Brief of Plaintiffs-Appellants at 11-19; see also *Bounty Mins., LLC v. Chesapeake Expl., LLC*, No. 5:17CV1695, 2019 WL 7171353, at *10 (N.D. Ohio Dec. 23, 2019) (stating when construing the affiliate sales language, the court cannot ignore the rest of the royalty provision, but, rather, must give effect to the entirety of all the language read in conjunction with the whole paragraph). While Appellants disagree with the outcome in the *Bounty* case (discussed below in Section III(A)), Appellants do agree that sales to unaffiliated bona fide purchasers and affiliated entities should both have the same valuation point.

The dictionary definition of "gross" means income exclusive of deductions, and is the opposite of "net." Brief of Plaintiffs-Appellants at 12. Gross proceeds entitle "the lessor to a royalty payment unburdened by postproduction costs." *Bluestone*, at *2. This is consistent with the leases' definition of "gross proceeds" which includes payment for "marketable by-products." Brief of Plaintiffs-Appellants at 12-13. Specific words were included for a reason (i.e., without any deductions, total consideration, off the leasehold, marketable by-products). There was no reason to include these terms if the intent of all parties was a net royalty.

The district court's conclusion to value the gas at the wellhead ignores the lease language that the royalty was to be based upon gross proceeds paid to lessee for the gas marketed off the leased premises and that "for purposes of this lease", "gross proceeds" was specifically defined to mean the total consideration paid for oil, gas, associated hydrocarbons, and marketable by-products produced from the leased premises without deductions of any kind.

The District Court's interpretation impermissibly rewrites the lease by deleting important for bargained terms, rendering them meaningless:

> Gas Royalty. To pay to the Lessor TWENTY percent (20.0%) royalty ~~based upon the **gross proceeds** paid to the lessee for the gas marketed and used off the leased premises, including casinghead gas or other gaseous substance, and produced from each well drilled thereon,~~ computed at the wellhead from the sale of such gas substances so sold by Lessee in an arms-length transaction to an unaffiliated bona fide purchaser, or if the sale is to an affiliated of Lessee, the price upon which royalties are based shall be comparable to that which could be obtained in an arms-length transaction (given the quantity and quality of the gas available for sale from the leased premises and for a similar contract term) ~~**and without any deductions or expenses**~~. ~~For purposes of this Lease, **"gross proceeds" means the total consideration paid for oil, gas, associated hydrocarbons, and marketable by-products produced from the leased premises without deductions of any kind** except as provided in paragraph 44.~~

Young Lease, RE 1-1, PageID 88.

In fact, despite TEPUSA's repeated omissions in its brief, the affiliate sale language ends with "and without any deductions or expenses." It would make no sense if TEPUSA could deduct postproduction costs in an affiliate sale, if they could not deduct postproduction costs in a sale to an unaffiliated third party. This would result in a windfall to Total who could use an intercompany transfer to do what they were previously prohibited from doing.

The third party sale language and the affiliate sale language are not unrelated to each other because of the use of the word "or". The affiliate sale contractual language supplements the gross proceeds paid royalty language by requiring the gross proceeds paid to be based on bona fide third party arms-length transactions, which are not circumvented by affiliate sales.

The leases expressly contemplate payment of royalties based on the gross proceeds from the finished "marketable by-products" (natural gas, ethane, butane, propane, etc.).

TEPUSA wants to interpret the "without any deductions" lease language as meaning no deductions for only its post-production costs from the price it receives from its affiliate, TGPNA, who takes the post-production deductions, not TEPUSA. However, again, this ignores the affiliate clause language, the purpose behind it, and the fact that TEPUSA's formula used to calculate the price includes the deductions of the postproduction costs. The lease says "without any deductions", and TEPUSA's method to calculate the price *includes deductions*.

A. **<u>The Texas Supreme Court Recently Held "at the well" Valuation Point Inherently Conflicts with Gross Proceeds Language which Moves the Valuation Point for the Calculation of Royalties to the Downstream Sale Point.</u>**

On March 12, 2021, in *Bluestone Nat. Res. II, LLC v. Randle*, the Texas Supreme Court had the opportunity to clarify the effect of gross proceeds language in an oil and gas lease including a valuation point "at the mouth of the well." 2021 WL 936175, *1. The issue in the case was whether the mineral lease permits the deduction of postproduction costs from the sales proceeds before royalties are computed. *Id.* The Texas Supreme Court held a provision requiring computation based on gross value inherently conflicts with a computation based on value received "at the mouth of the well." *Id.* "The former is a gross-proceeds equivalent from which postproduction costs may not be deducted, and the latter is a net-proceeds equivalent that contemplates deductions." *Id.*

A royalty payment may be calculated at the wellhead or any downstream point depending on the lease terms. *Id.* at *3. The basic structure of a royalty provision is that it has three components: (i) the royalty fraction or percent; (ii) the yardstick, e.g., market value, proceeds, price; and (iii) the location for measuring the yardstick, at the well, at the point of sale. *Id.* at *4. In *Bluestone*, the lessors maintained that "gross value received" is equivalent to gross proceeds and is selfinclusive of both the yardstick and the valuation point, with "received" referring to the proceeds actually obtained at the point of sale and "gross" meaning without deductions. *Id.*

If the amount realized is not expressly specified to be net or gross, "at the well" language can result in an at the well valuation point which functions as a net-proceeds calculation, giving the lessee the right to subtract postproduction costs from downstream sales proceeds. *Id.* at *6. When used in conjunction with "amount realized" language, "at the well" is as much a valuation method as it is a valuation point. *Id.* at *7. However, when proceeds are valued in "gross," the valuation point is necessarily the point of sale because that is where the gross is realized or received. *Id.* Royalties "computed on gross amounts" means "royalties are paid based on point-of-sale proceeds without deduction of postproduction costs." *Id.*

The lessee in *Bluestone* (like TEPUSA here) argued the lease's gross value term can be melded with an "at the well" valuation point to produce a net-proceeds calculation. *Id.* The Texas Supreme Court rejected that viewpoint, stating "we cannot agree because "gross" and "net" terms do not peaceably coexist." *Id.* "[J]oinder of the terms 'gross proceeds" and 'at the well' gives rise to 'an inherent conflict' that renders a royalty clause ambiguous." *Id.* (internal citations omitted). The Texas Supreme Court explained that is so because "at the well" is a net-proceeds equivalent that contemplates deductions while gross proceeds "indicates just the opposite." *Id.*

Like the lessee in *Bluestone*, TEPUSA's interpretation of the lease results in an inherent conflict that this Court, like the Texas Supreme Court, should reject. The only logical explanation is to apply the "computed at the wellhead" language to calculating the volume of gas and oil produced (rather than as a valuation point), which gives meaning to every phrase and word in the royalty provision, omitting nothing as meaningless or surplusage, as required by Ohio law. *Van Ligten v. Emergency Servs., Inc.*, 2012 WL 2517552, at *6 (Ohio Ct. App. June 29, 2012) (quoting *Affiliated FM Ins. Co. v. Owens-Corning Fiberglas Corp.*, 16 F.3d 684, 686 (6th Cir. 1994).

However, if TEPUSA's interpretation is applied, then it renders the royalty clause in inherent conflict rendering it ambiguous, requiring reversal of the District Court's decision and consideration of the evidence the District Court failed to consider. *See* Brief of Plaintiffs-Appellants at 21-27.

B. <u>Computed at the Wellhead refers to the Volume of Gas Produced</u>

As set forth above, computed at the wellhead does not refer to the valuation point, which is already described by the gross proceeds language to be the downstream sales price on the marketable by-products. If computed at the wellhead referred to the valuation point, then the lease would refer to two opposite and conflicting valuation points – one of which expressly prohibits postproduction deductions, and one of which that expressly contemplates them.

Rather, computed at the wellhead refers to the volume of gas upon which the Class's royalty is to be calculated. Appellants agree with TEPUSA (at 35) that "computed at the wellhead" must modify some noun in the royalty clause. However, that noun is the gas produced from the well (i.e. volume), which language immediately precedes the language computed, rather than the gross proceeds language which occurs earlier in the sentence.

> To pay to the Lessor TWENTY percent (20.0%) royalty based upon the **gross proceeds** paid to the lessee **for the gas** marketed and used off the leased premises, including casinghead gas or other gaseous substance, and **produced** from each well drilled thereon, computed at the wellhead

Young Lease, RE 1-1, PageID 88.

Therefore, "computed at the wellhead" refers to volume and modifies the words gas marketed and used, a perfectly natural requirement given the royalties will be calculated by multiplying the price (gross proceeds) times the volume (gas produced).[5] "Specifying that the volume on which a royalty is due must be determined at the wellhead says nothing about whether the overriding royalty must bear postproduction costs." *Chesapeake Expl., L.L.C. v. Hyder*, 483 S.W.3d 870, 874 (Tex. 2016).

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[5] Gas volumes produced at the wellhead have the volumes measured by a meter at the wellhead.

TEPUSA argues (at 36) that it makes no sense to say the volume or amount of gas was computed. However, TEPUSA's beef example seems to undermine that point. TEPUSA argues (at 36-37) that "it is the amount due to the grocery store (the sales price) that is "computed from" the weight of the beef at the time of sale, when multiplied by the price per pound." In their example, the weight of the beef would be equivalent to the volume of gas – and it is the royalties owed to the lessor (grocery store bill) that is computed from volume of gas (weight of the beef). TEPUSA's position that it makes no sense to compute volume is further undercut by its admission that volume is critical and must be computed (at 37) stating "the value of a given shipment of gas – is based on its volume."

If that wasn't enough, TEPUSA then reverses itself and admits (at 38): "**Volume must be computed in all of these transactions**." (emphasis added). Appellants agree. Volume must be computed. And that is what the royalty provision addresses – computing the volume of gas produced from the well.

As stated above, if computed at the wellhead refers to a valuation point rather than the volume of gas produced, then the lease contains an inherent conflict and are ambiguous. *See Bluestone, supra*.

III. <u>The Cases Relied on by TEPUSA are Clearly Distinguishable</u>

A. <u>Bounty Minerals v. Chesapeake Expl., L.L.C.</u>

Bounty Minerals L.L.C. v. Chesapeake Expl., L.L.C., et al, No. 5:17-cv-01695-PAB, 2019 WL 7171353 (N.D. Ohio December 23, 2019) (Doc. #192) is distinguishable from the issues raised in this case, which were waived in *Bounty*. Unlike in *Bounty*, Appellants are advancing an interpretation of the gross proceeds language in the lease, which requires the Defendants to bear all post-production costs. No such argument was made by Bounty Minerals, who wholly ignored the relevant lease language in *Bounty*.

In *Bounty*, Chesapeake argued the lease provided for a valuation point "at the wellhead." 2019 WL 7171353, at *8. Bounty Minerals argued the reference to the wellhead was not "germane to this matter," and didn't apply to affiliate sales (essentially conceding that it applied to non-affiliate sales). *Id.*

The district court noted that Bounty Minerals does not challenge the use of the "at the well" rule (which would allow post-production costs to be deducted) and "the Court deems that issue waived and does not address it herein." *Id.* at *12, fn. 12. Since the at the well rule applied to unaffiliated sales (as waived by Bounty Minerals), the Court noted that the key issue was then whether the phrase "computed at the wellhead" applied to both sales to (1) unaffiliated bona fide purchasers and (2) affiliated entities such as CEMLLC. *Id.* at *10. The Court held that ignoring the language as urged by Bounty Minerals when looking at affiliate sales was problematic because it creates uncertainty regarding the valuation of royalties based on affiliate sales. *Id.* at *11. "Even assuming that Bounty Minerals' literal construction of the sentence at issue had some merit, it would lead to the incongruous result that sales to unaffiliated entities (i.e., arms-length transactions) would result in lower royalties than sales to affiliates. Accordingly, the Bounty court determined that the leases at issue created only one valuation point for both unaffiliated and affiliated sales: "at the wellhead." *Id.* at *12. It was undisputed in *Bounty* that a lease containing royalty language referring to "at the well" unambiguously allows for the deduction of post-production costs, and "*Bounty Minerals does not contest*" this. *Id.* at *15 (citing *Cunningham Property Management Trust v. Ascent Resources-Utica*, *LLC*, 351 F.Supp.3d 1056, 1062 (S.D. Ohio 2018)) (emphasis added).

Bounty completely failed to explain, and as a result the district court failed to consider, whether the word "computed" in the phrase "computed at the wellhead" referenced a volumetric measurement concerning the volume or amount of gas upon which the royalty should be computed, as opposed to the market value of the gas at the wellhead. Bounty waived that issue. "As Bounty Mineral does not challenge the use of the 'at the wellhead' rule, the *Court deems that issue waived and does not address it herein*." *Id.* at *12, footnote 12 (emphasis added).

Conversely, Appellants have consistently and repeatedly contested Defendants' argument regarding the valuation point. See Plaintiffs' Motion for Partial Summary Judgment, RE 168-1, PageID 4957-4972; Plaintiffs' Memorandum in Opposition to Total E&P USA, Inc.'s Cross-Motion for Summary Judgment and Plaintiffs' Reply in Support of Plaintiffs' Motion for Partial Summary Judgment as to All Defendants, including Total E&P USA, Inc., RE 183, PageID 5903-5920; Plaintiffs' Memorandum in Opposition to Chesapeake Defendants' Motion for Summary Judgment, Joined in by Jamestown Resources,, L.L.C and Pelican Energy, L.L.C., and Plaintiffs' Reply in Support of Plaintiffs' Motion for Partial Summary Judgment as to All Defendants, including Chesapeake Defendants, Jamestown Resources,, L.L.C and Pelican Energy, L.L.C., RE 184, PageID 5928-5950, 5952-5953.

Therefore, any analysis contained within *Bounty* in relation to the "at the wellhead" royalty language is completely inapplicable to Appellants' leases and arguments in this case.

Given the waiver by Bounty of arguments advanced by the Appellants in this case, the decision should not be relied upon. This conclusion is further supported by the *Bounty* Court's declining to consider the arguments raised by the Appellants, which were omitted or waived by Bounty, as set forth in an Amicus Curiae Memorandum Appellants attempted to file in that case. *See* 2019 WL

7171353, at *8; *Bounty Mins., LLC v. Chesapeake Expl., LLC*, No. 5:17CV1695, 2019 WL 7048981, at *1 (N.D. Ohio Dec. 23, 2019). In fact, Bounty asked the district court to strike the Zehentbauer Class motion to file their Amicus Memorandum because the Zehentbauer Class was really seeking to intervene to raise arguments not raised by any party. The district court agreed stating "… the Court finds that the Zehentbauer Class' proposed amicus briefing regarding its proposed construction of the lease royalty provisions is not appropriate under the circumstances presented. … Here, the Zehentbauer Class seeks to raise new legal theories and arguments that Bounty Minerals chose not to pursue and criticizes counsel for Bounty Minerals for its litigation strategy." 2019 WL 7048981, at *11.

B. *Lutz* and *Cunningham* involved Market Value at the Well Leases

In *Lutz v. Chesapeake Appalachia, LLC*, No. 4:09-CV-2256, 2017 WL 4810703, at *4 (N.D. Ohio Oct. 25, 2017), order clarified, No. 4:09CV2256, 2017 WL 9434016 (N.D. Ohio Nov. 13, 2017) (Lutz II), the district court found that Ohio would follow the at the well rule. The case involved several different leases, but the decision on partial summary judgment only addressed four of the leases in the case, which contained the following language:

> 3. The royalties to be paid by Lessee are: ... (b) on gas, ... produced from said land and sold or used off the premises ... the **market value at the well** of one-eighth of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale.... (emphasis added)

Based on the specific language in the lease before it, the district court concluded the Ohio Supreme Court would adopt the "at the well" rule. Although the court referred to it as adopting the "at the well" rule, it appears the court was imprecise and merely interpreted the lease provision before it as the Ohio Supreme Court had directed. The district court concluded that the parties' intent was that the location for valuing the gas for purposes of calculating the royalty was at the well. The Lutz lease was not a gross proceeds royalty lease. Rather, it was a "market value at the well" royalty lease. In that light, it is not surprising that the court found that "market value at the well" means market value at the well. Appellants' Gross Royalty Leases are clearly distinguishable as they include no "market value at the well" language.

Similarly, in *Cunningham Prop. Mgmt. Tr. v. Ascent Res. - Utica, LLC*, 351 F. Supp. 3d 1056, 1062 (S.D. Ohio 2018), the Southern District Court held that the lessor could not maintain a claim that the lessee breached the leases by taking post-production deductions from royalties. The case involves two leases from 1982 and 1983 which had identical royalty provisions, "[t]o pay to the Lessor, as royalty for the gas marketed and used off the premises and produced from each well drilled thereon, the sum of one-eighth (1/8) of **the wellhead price**." (emphasis added).

At the core of the dispute was the lease's "the wellhead price" language. Relying on the district court decision in *Lutz II*, that the issue can be put in terms of where the gas is to be valued for purposes of determining plaintiff's royalty payments, the district court found the language in *Lutz II* (market value at the well) materially indistinguishable from the language in the leases at issue (wellhead price), and therefore, for the same reasoning, dismissed the breach of contract claim as to this theory. Unlike this case, the leases did not provide for royalties based on gross proceeds without any deductions, which provides an alternative valuation point downstream.

C. *Henceroth* involved a Net Royalty Provision

The decision in Henceroth v. Chesapeake Expl., L.L.C., No. 4:15CV2591, 2019 WL 4750661, at *1 (N.D. Ohio Sept. 30, 2019), aff'd sub nom. Henceroth v. Chesapeake Expl., LLC, 814 F. App'x 67 (6th Cir. 2020), supports Appellants' position, not Defendants. While the district court granted summary judgment in favor of Chesapeake Exploration, the royalty lease language was not the royalty lease language found in the Zehentbauer Class leases. The Henceroth lease stated in pertinent part that the lessee was: "To pay Lessor an amount equal to one-eighth of the **net proceeds** realized by Lessee from the sale of all gas and the constituents thereof produced and marketed from the Leasehold." *Id.* at *1 (Emphasis added.) The Henceroth leases provided for the payment of a net royalty, not a gross royalty as in the Zehentbauer Class leases. Given the "net proceeds" language, the district court found that the use of the netback method to determine the net proceeds realized for the calculation of the royalties complied with the lease terms. *Id.* at *7 ("Defendant's motion presents the issue of whether CELLC paid royalties consistent with the Class Leases. The Court concludes that it did. Defendant paid 'one-eighth of the net proceeds realized.'"). This lease language was plain and unambiguous, as is the "gross proceeds language without deductions" language in the Zehentbauer Plaintiffs' leases. The use of the netback method was exactly what the parties negotiated for in section 5(b) of Henceroth leases. *Id.*

This Court affirmed, also noting in addition to the net proceeds language that the royalty provision was "from the sale of all gas and the constituents thereof produced and marketed *from the Leasehold*." *Henceroth v. Chesapeake Expl., LLC*, 814 F. App'x 67, 69 (6th Cir. 2020). This Court stated that indicated that this all happens at the property ("from the Leasehold"), not downstream. *Id.* This is distinct from the present case in which the royalty is not to be net proceeds from sales "from the leasehold," but from gross proceeds for gas marketed and used *off* the leased premises, which is defined in the lease to include the total consideration paid for marketable by-products without deductions of any kind.

D. <u>The District Court Improperly Failed to Consider Material Evidence Regarding the Meaning of the Gross Royalty Leases.</u>

The District Court wrongly excluded evidence presented without any analysis, but only concluding the evidence was extraneous and was inadmissible. "Under Ohio law, the interpretation of written contract terms, including the determination of whether those terms are ambiguous, is a matter of law for initial determination by the court." *Savedoff v. Access Grp., Inc.*, 524 F.3d 754, 763 (6th Cir.2008) (citations omitted).

Contrary to TEPUSA's argument (at 47), Appellants are not trying to *contradict* the terms of the contracts. And as TEPUSA acknowledges, as long as Appellants are not trying to contradict the terms of the contract, parol evidence "is admissible to illuminate the circumstances under which the contract was executed, and to explain the intent of the parties as reflected in the contract." *Rhodes v. Rhodes Indus., Inc.*, 595 N.E.2d 441, 445-46 (Ohio Ct. App. 1991); see also *Savedoff*, 524 F.3d 754, 763 (extrinsic evidence is admissible to ascertain the intent of the parties when circumstances surrounding the agreement give special meaning to the plain language).

Clearly, the contemporary form leases the Class's Gross Royalty Leases were negotiated in place of shows the circumstances under which the contracts were executed and the party's intent. *See* Brief of Plaintiffs-Appellants at 23-26. This goes to the inclusion of the words "gross proceeds," "without deductions," and to what "computed at the wellhead" was intended to refer to – valuation point or volume.

More importantly, Chesapeake's own admission in the Christensen matter (which involved interpretation of the same royalty provision) were party admissions against interest that should have been relevant and admissible, and considered by the district court. *Id.* at 24. *TEPUSA does not contest this issue*.

Lastly, even assuming TEPUSA is correct on all fronts – that "computed at the wellhead" unambiguously refers to the valuation point, not the volume, and that all of the parol evidence attempts to contradict this valuation point and therefore would be inadmissible – *that itself would require reversal*. As set forth above, even Texas, an "at the well" state, acknowledges that "gross proceeds" and "at the well" language are incompatible. If "computed at the wellhead" means what TEPUSA advocates for (and the district court held), then the leases "joinder of the terms 'gross proceeds' and 'at the well' gives rise to 'an inherent conflict' that renders a royalty clause ambiguous." *Bluestone*, at *7 (internal citations omitted). And if ambiguous, the district court should have considered the parol evidence.

IV. CONCLUSION

For the reasons stated, the District Court's Decision should be reversed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing was filed electronically. Notice of this filing will be sent to all parties by operation of the Court's electronic system on this 20th day of May, 2021.

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(g)(1), I hereby certify that the foregoing Brief complies with the type-volume limitations in Federal Rule of Appellate Procedure 5(c)(1). According to the word count feature of Microsoft Word, the Brief contains 4,700 words, excluding the exempted parts under Rule 32. The Brief has been prepared in a proportionally spaced typeface using Times New roman in 14-point size.