

IN THE SUPREME COURT OF OHIO

REGIS F. LUTZ, et al.,

Plaintiffs/Respondents,

vs.

CHESAPEAKE APPALACHIA, L.L.C.,

Defendant/Petitioner.

Supreme Court Case No. 15-0545

On Review of Certified Question
from the United States District Court,
Northern District of Ohio, Eastern
Division

Dist. Case No. 4:09-cv-2256

**BRIEF OF SAM JOHNSON, ZEHENTBAUER FAMILY LAND LP,
HANOVER FARMS LP, AND BOUNTY MINERALS, LLC *AMICI CURIAE*
NOT FILED IN SUPPORT OF ANY PARTIES**

William G. Williams (0013107),
(COUNSEL OF RECORD)
Scott M. Zurakowski (0069040),
Gregory W. Watts (0082127),
Aletha M. Carver (0059157),
KRUGLIAK, WILKINS, GRIFFITHS
& DOUGHERTY CO., L.P.A.
4775 Munson Street NW/PO Box 36963
Canton, Ohio 44735-6963
Phone: (330) 497-0700/Fax: (330) 497-4020
bwilliams@kwgd.com;
szurakowski@kwgd.com; gwatts@kwgd.com;
acarver@kwgd.com

Dennis E. Murray, Jr. (0038509),
MURRAY & MURRAY CO., L.P.A.
111 East Shoreline Drive
Sandusky, Ohio 44870
Phone: (419) 624-3126
Fax: (419) 624-0707
*Attorneys for Amici Curiae Sam Johnson,
Zehentbauer Family Land LP, Hanover Farms
LP, and Bounty Minerals, LLC*

Daniel T. Donovan (0067833),
(COUNSEL OF RECORD)
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
Phone: (202) 879-5000
Fax: (202) 879-5200

John K. Keller (0019957),
Vorys, Sater, Seymour and Pease LLP
52 East Gay Street
Columbus, Ohio 43215
Phone: (614) 464-6400
Fax: (614) 464-6350

Kevin C. Abbott (0091504),
Nicolle R. Snyder Bagnell (0091442),
Reed Smith LLP
225 Fifth Avenue
Pittsburgh, Pennsylvania 15222
Phone: (412)288-3804
Fax: (412) 288-3063
*Attorneys for Petitioner Chesapeake
Appalachia, L.L.C.*

James Lowe (0002495),
(COUNSEL OF RECORD)
Lowe Eklund & Wakefield Co., LPA
1660 Skylight Office Tower
Cleveland, Ohio 44113-1454
Phone: (216) 781-2600/Fax: (216) 781-2610
jlowe@lewlaw.com

Robert C. Sanders (PHV Pending),
Law Office of Robert C. Sanders
12051 Old Marlboro Pike
Upper Marlboro, Maryland 20772
Attorneys for Respondents Regis F. Lutz, et al.

O. Judson Scheaf III (0040285),
(COUNSEL OF RECORD)
Ben L. Pfefferle III (0024297),
McDonald Hopkins LLC
250 West Street, Suite 550
Columbus, Ohio 43215
Phone: (614) 458-0025

Michael W. Wise (0046694),
Adam C. Smith (0087720),
McDonald Hopkins LLC
600 Superior Avenue, East, Suite 2100
Cleveland, Ohio 44114
Phone: (216) 348-5400
Fax: (216) 348-5474
*Attorneys for Amici Curiae
Gulfport Energy Corp. and The Ohio Oil and
Gas Association*

Bruce M. Kramer (PHV-4489-2015),
McGinnis, Lochridge & Kilgore
711 Louisiana Street, Suite 1600
Houston, Texas 7702
Amicus Curiae

Lija Kaleps-Clark (0086445),
(COUNSEL OF RECORD)
Director of Land and Legal Services
NGO Development Corporation, Inc.
1500 Granville Road
Newark, Ohio 43058-4970
Phone: (740) 348-1212
Fax: (740) 344-2054
*Attorneys for Amici Curiae Ohio Oil and Gas
Association, Artex Oil Company, Eclipse
Resources I, L.P., EnerVest Operating, L.L.C.,
Hess Ohio Developments, LLC, Hilcorp
Energy Company, HGO Development
Corporation, Inc., Rex Energy Corporation,
and Sierra Resources, LLC*

L. Bradford Hughes (0070997),
(COUNSEL OF RECORD)
Christopher J. Baronzzi (0078109),
Porter Wright Morris & Arthur LLP
41 South High Street
Columbus, Ohio 43215-6194
Phone: (614)227-1915
Fax: (614) 227-2100
bhughes@porterwright.com;
cbaronzzi@porterwright.com

Matthew A. Haynie (PHV-7475-2015),
American Petroleum Institute
1220 L Street, N.W.
Washington, D.C. 2005
Phone: (202) 682-8000
HaynieM@api.org
*Attorneys for Amicus Curiae
The American Petroleum Institute*

TABLE OF CONTENTS

	<u>PAGE</u>
TABLE OF AUTHORITIES.....	ii
I. INTERESTS OF <i>AMICI CURIAE</i>	1
II. LAW AND ARGUMENT.....	6
<u>Proposition of Law No. 1</u> : Because the Court has long recognized, under the <i>Harris</i> decision, that oil and gas leases are contracts, the Court should apply the basic rules of contract interpretation and not adopt a general rule applicable to all lease forms to determine whether Respondents’ royalty is to be calculated based on “net proceeds” or “gross proceeds.”	6
A. Application of contract interpretation to oil and gas leases.....	6
B. Analysis of post-production costs in the context of “net proceeds” vs. “gross proceeds”	8
C. Ohio law has applied the contract analysis proposed by <i>Amici Curiae</i>	11
D. In leases where the implied covenant to market production has not been waived, such as those of <i>Amici Curiae</i> , as part of a contract interpretation analysis courts should interpret the royalty language in light of the lessee’s duty to market when determining whether post-production costs can be deducted from royalty.	14
III. CONCLUSION	15
PROOF OF SERVICE.....	17
APPENDIX	
Affidavit of Gregory W. Watts.....	Exhibit A

TABLE OF AUTHORITIES

PAGE

CASES

<i>Am. Chem. Soc. v. Leadscope, Inc.</i> , 10th Dist. Franklin No. 04AP-305, 2005-Ohio-2557	7
<i>Am. Energy Serv., Inc. v. Lekan</i> , 75 Ohio App. 3d 205, 598 N.E.2d 1315 (5th Dist.1992)	14
<i>Aultman Hosp. Assoc. v. Community Mut. Ins. Co.</i> , 46 Ohio St.3d 51, 544 N.E.2d 920 (1989)	7
<i>Busbey v. Russell</i> , 10 Ohio C.C. 23 (1898)	11, 12, 13
<i>Cleveland Elec. Illum. Co. v. City of Cleveland</i> , 37 Ohio St.3d 50, 524 N.E.2d 441 (1988)	7
<i>Employers' Liability Assur. Corp. v. Roehm</i> , 99 Ohio St. 343, 124 N.E. 223 (1919).....	7
<i>Harris v. Ohio Oil Co.</i> , 57 Ohio St. 118, 48 N.E. 502 (1897).....	2, 6
<i>Henderson-Achert Lithographic Co. v. John Shillito Co.</i> , 64 Ohio St. 236, 60 N.E. 295 (1901)	7
<i>Heritage Resources, Inc. v. Nationsbank</i> , 939 S.W.2d 118 (Tex.1996).....	8
<i>Holdeman v. Epperson</i> , 111 Ohio St.3d 551, 2006-Ohio-6209, 857 N.E.2d 583	7
<i>Mauger v. Positron Energy Res., Inc.</i> , 5th Dist. Morgan No. 14A0001, 2014-Ohio-4613.....	14
<i>Moore v. Adams</i> , 5th Dist. Tuscarawas No. 2007AP090066, 2008-Ohio-5953.....	14
<i>Schmidt v. Texas Meridian Resources, Ltd.</i> , 4th Dist. Washington No. 94CA12, 1994 WL 728059 (Dec. 30, 1994).....	12, 13
<i>Skivolocki v. East Ohio Gas Co.</i> , 38 Ohio St.2d 244, 313 N.E.2d 374 (1974)	7
<i>Sunoco, Inc. v. Toledo Edison Co.</i> , 129 Ohio St.3d 397, 2011-Ohio-2720, 953 N.E.2d 285	7
<i>Westfield Ins. Co. v. Galatis</i> , 100 Ohio St.3d 397, 2003-Ohio-5849, 797 N.E.2d 1256.....	8
<i>White Co. v. Canton Transportation Co.</i> , 131 Ohio St. 190, 2 N.E.2d 501 (1936)	13

Wood v. TXO Prod. Corp., 854 P.2d 880 (Okla.1992)..... 14

Yoder v. Artex Oil Co., 5th Dist. Guernsey No. 14 CA 4, 2014-Ohio-5130 14

OTHER AUTHORITIES

Anderson, *Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically?* (Part 1), 37 Nat. Resources J. 547 (1997).....8, 12

TREATISES

8 Williams & Meyers, *Manual of Oil and Gas Terms* (2014).....6

I. INTERESTS OF AMICI CURIAE

Amici Curiae, Sam Johnson, Zehentbauer Family Land LP, Hanover Farms LP, and Bounty Minerals, LLC, are Ohio property mineral owners who have entered into oil and gas leases or are successor lessors, with oil and gas producers, for the development of their mineral interests. *Amici Curiae*, along with thousands of other lessors whose property is located in ten eastern Ohio counties, signed oil and gas leases under a lease form known as the “Krugliak” or “Williams” Lease. This lease form was entered into with Chesapeake, or its predecessors, and involved tens of thousands of mineral acres. Over 100,000 net mineral acres were leased under the Williams Lease. In addition, other Ohio lease groups utilized the Williams Lease, including the royalty provisions, which lease form was negotiated, drafted, intended, and accepted by the parties to have customized language to be a “gross” royalty provision, with no post-production deductions.

The certified question the Court is asked to determine is whether Ohio follows the “at the well” rule or some version of the “marketable product” rule. The issue underlying the certified question is which party bears the burden of post-production costs (those costs associated with transporting, processing, compressing, and treating oil, gas, associated hydrocarbons, and by-products thereof into marketable form). In essence, the parties before the Court seek a determination whether the royalties to be paid the lessors are based on the gross proceeds (without deduction of post-production costs) or the net proceeds (after the deduction of post-production costs). The “at the well” rule would allow the deduction of post-production costs resulting in a net royalty. The “marketable product” rule would not allow the deduction of post-production costs resulting in a gross royalty.

Amici Curiae's position is that it is not necessary for the Court to adopt either “rule,” but instead to apply the basic rules of contract interpretation based on the lease language before the Court. Over 100 years ago, the Court foretold of the danger of adopting one law over another when determining the rights and remedies of the parties under an oil and gas lease. The Court explained that “the law applicable to one form of lease may not be, and generally is not, applicable to another and different form.” *Harris v. Ohio Oil Co.*, 57 Ohio St. 118, 129, 48 N.E. 502 (1897). The Court recognized that oil and gas leases are contracts and the rules of contract construction apply to determine their meaning. *Id.* The Court should not ignore the *Harris* decision and adopt an austere rule that disregards all but a few of the words contained in a negotiated royalty provision because the parties’ intent can only be determined when the royalty provision is read in its entirety.

Further, the Court should follow the basic rules of contract interpretation to determine whether the payment of royalty was intended to be based on the net proceeds or gross proceeds paid for the oil, gas, associated hydrocarbons, and marketable by-products produced from the leased premises. It is a court’s duty to give language in an agreement the meaning the parties intended it to have, and not apply a one-rule-fits-all analysis that may rewrite the meaning of a royalty lease provision giving it a meaning not intended by the parties. There is no reason for this Court to apply the “at the well” rule to a lease to determine whether a lessee may deduct post-production costs resulting in a net royalty where the lease specifically addresses whether deductions are allowed and whether the royalty is to be based on gross proceeds.

To the extent the Court adopts either the “at the well” or “marketable product” rule, it should be expressly limited to the specific royalty provision(s) before the Court, which are particularly concise:

- The royalties to be paid by Lessee are * * * (b) on gas, including casinghead gas or other gaseous substance, produced and sold or used off the premises or for the extraction of gasoline or other product therefrom, 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.
- Lessee to receive the field market price per thousand cubic feet for one-eighth (1/8) of all gas marketed from the premises.
- Lessee covenants and agrees to deliver to the credit of the Lessor, as royalty, free of cost, in the pipeline to which the wells drilled by the Lessee may be connected the equal one-eighth part of all Oil and/or Gas produced and saved from said leased premises.

Amici Curiae's royalty language in the Williams Lease is more robust and clear. It provides, in relevant part:

ROYALTIES. The Lessee covenants and agrees:

a. **Oil Royalty.** To pay the Lessor * * * royalty based upon the gross proceeds paid to the Lessee from the sale of oil, including without limitation other liquid hydrocarbons or their constituents and products thereof recovered from the leased premises.

b. **Gas Royalty.** To pay to the Lessor * * * royalty based upon the **gross proceeds** paid to 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 affiliate 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 44.¹

(Emphasis added.) (Affidavit of Gregory W. Watts, attached hereto as Exhibit A, and identified as Exhibit 1.)

Paragraph 44 only allowed deductions for lessor's proportionate share of ad valorem taxes:

AD VALOREM TAXES. Lessor and Lessee each shall pay their respective share of all Ad Valorem taxes, Lessor's share to be equal to the percentage of royalty paid to Lessor. Despite anything to the contrary, Lessee shall be responsible for all severance taxes associated with production of oil and gas under this Lease. Lessee agrees to pay for any CAUV recoupment incurred by Lessor as a result of Lessee's operations under this Lease, but any such payment shall be based only upon the acreage actually disturbed by Lessee.

Because Ohio precedent views oil and gas leases as contracts and applies the basic rules of contract interpretation to lease terms, a court must give meaning, if possible, to all words contained in an agreement. A royalty provision may specifically provide for a gross royalty, prohibiting any deductions or expenses (including post-production costs) from the payment of royalty to the lessors.

For example, *Amici Curiae's* royalty provision requires the Lessee to pay a royalty based on gross proceeds, which term is specifically defined in the gas royalty provision, and means "without deductions of any kind." The parties clearly intended that the royalty be based on gross proceeds and the only expenses that may be deducted are Lessors' prorated share of tax. Chesapeake's blanket one-size-fits-all "at the well" approach, if allowed to apply to

¹ Krugliak, Wilkins, Griffith & Dougherty, Co., L.P.A. ("Krugliak" or "KWGD") represented multiple lease groups that entered into oil and gas leases with Chesapeake. The different lease groups had royalty language which was substantially similar. Representative examples are attached to the Affidavit of Gregory W. Watts, attached hereto as Exhibit A, and identified as Exhibits 2 through 4.

leases such as those entered into by *Amici Curiae*, would essentially allow the lessee to rewrite the parties' oil and gas lease from one for a gross royalty based on gross proceeds (without deduction of post-production costs) to a net royalty based on net proceeds (after the deduction of post-production costs).

Finally, as found by other state courts that have adopted a version of the "marketable product" rule, the existence of an implied covenant to market also impacts whether post-production costs may be deducted when calculating royalty. Under general contract law, a party bears the burden or cost of his own performance. Ohio case law recognizes the implied covenant to market, and if present in an oil and gas lease, under the rules of contract interpretation,² should be considered when determining whether the lessee's cost of performance (post-production costs to transform the leasehold products into marketable form) can be deducted from a lessor's royalty, resulting in a net royalty. Producers who have drilled in Ohio's Utica shale play will continue to generate revenue from the oil and gas owned by the lessors. The Utica shale play produces, on average, more daily mcf of natural gas and measured natural gas liquids than most other unconventional shale plays in the nation.

For these reasons, *Amici Curiae* respectfully ask the Court to refrain from adopting a general rule applicable to all lease forms, and use established rules of contract construction to interpret only those royalty provisions directly before the Court. Furthermore,

² Furthermore, the previous Ohio lease forms utilized by historical and traditional Ohio based producers (production primarily from Clinton Formation) did not address net or gross proceeds for royalty; however, Ohio producers almost always paid gross proceeds without passing post-production costs on to lessors. Ohio lessees for over 100 years paid for transportation, processing, compression, and marketing out of their proceeds and after payment to lessors of the royalty based on the gross proceeds. See Chesapeake's Preliminary Memorandum in Support of Acceptance of Certified Question, p. 5 (stating "[t]he apportionment of post-production costs is a relatively recent development *** [for many years, producers sold gas at the wellhead *** [and there were] no post-production costs incurred by the producer"); Brief of *Amicus Curiae* Ohio Oil and Gas Association, et. al., p. 10 ("However, for most producers, there were no post-production costs incurred under the old pipeline system and thus no post-production costs deductions for purposes of royalty valuation.").

this Court should find that the entire terms of a lease must be weighed prior to determining the royalty payments as “gross proceeds” or “net proceeds” of the total revenue.

II. LAW AND ARGUMENT

Proposition of Law No. 1: Because the Court has long recognized, under the *Harris* decision, that oil and gas leases are contracts, the Court should apply the basic rules of contract interpretation and not adopt a general rule applicable to all lease forms to determine whether Respondents’ royalty is to be calculated based on “net proceeds” or “gross proceeds.”

A contract analysis requires the Court to review the language of the royalty provision, give meaning to all of the language contained therein, and determine the parties’ intent when they entered into the lease. The Court should focus on the royalty provision in its entirety and frame the issue as whether royalties are to be paid on “net proceeds” or “gross proceeds.” A court should not use “at the well” language to determine whether a lessee can deduct post-production costs and pay a net royalty if the lease specifically addresses whether the royalty is to be “gross” or “net” and whether any deductions are allowed.

Payment of a royalty based on “net proceeds” means post-production costs may be deducted in calculating royalties because this term “implies that the parties intended to make deductions to account for costs[.]” 8 Williams & Meyers, *Manual of Oil and Gas Terms*, at 646 (2014). Conversely, if the language of the royalty provision is based on “gross proceeds,” which means “the total monies and other consideration accruing to an oil and gas lease for the disposition of the oil,” then post-production costs may not be passed along to lessors. *Id.*, at 458. Net proceeds expressly contemplate deductions, gross proceeds do not.

A. Application of contract interpretation to oil and gas leases

Under the general rules of contract construction, contracts should be construed so as to give effect to the intention of the parties. *Aultman Hosp. Assoc. v. Community Mut. Ins.*

Co., 46 Ohio St.3d 51, 53, 544 N.E.2d 920 (1989) citing *Employers' Liability Assur. Corp. v. Roehm*, 99 Ohio St. 343, 124 N.E. 223 (1919), syllabus; *Skivolocki v. East Ohio Gas Co.*, 38 Ohio St.2d 244, 313 N.E.2d 374 (1974), paragraph one of the syllabus. This is the cardinal purpose for judicial examination of any written instrument. *Id.* Courts will give effect to the parties' expressed intentions when, following negotiations, the parties make mutual promises which are integrated into an unambiguous written contract, duly signed by them. *Id.*, citing *Henderson-Achert Lithographic Co. v. John Shillito Co.*, 64 Ohio St. 236, 252, 60 N.E. 295 (1901). "Intentions not expressed in the writing are deemed to have no existence and may not be shown by parol evidence." *Id.*

Interpreting a contract requires a court to give meaning to every word and not overlook the existence of certain words. *Am. Chem. Soc. v. Leadscope, Inc.*, 10th Dist. Franklin No. 04AP-305, 2005-Ohio-2557, ¶ 34, citing *Cleveland Elec. Illum. Co. v. City of Cleveland*, 37 Ohio St.3d 50, 524 N.E.2d 441 (1988), paragraph three of the syllabus. In interpreting a contract, courts are to give effect to the intent of the parties and to examine the contract as a whole and presume that the intent of the parties is reflected in the language of the contract. *Sunoco, Inc. v. Toledo Edison Co.*, 129 Ohio St.3d 397, 2011-Ohio-2720, 953 N.E.2d 285, ¶ 37. Where contractual language is unambiguous, a court must apply the language as written, without resort to methods of construction or interpretation, and may not, in effect, create a new contract by finding an intent not expressed by the contract's clear language. *Holdeman v. Epperson*, 111 Ohio St.3d 551, 2006-Ohio-6209, 857 N.E.2d 583, ¶ 12.

Commentators, such as Professor Owen Anderson, argue that "royalty clauses, being both executory and anticipatory in nature, should be construed as a whole, in light of current market realities, and not narrowly construed by isolating certain words or phrases and

ignoring general intent.” Anderson, *Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically?* (Part 1), 37 Nat. Resources J. 547, 549 (1997). In other words, the “at the well” approach is too rigid because it places too much emphasis on the words “at the well,” rather than placing the emphasis on the parties’ intent, where it belongs.

Further, a court is not permitted to alter a lawful contract by imputing an intent contrary to that expressed by the parties. *Westfield Ins. Co. v. Galatis*, 100 Ohio St.3d 397, 2003-Ohio-5849, 797 N.E.2d 1256, ¶12. *Amici Curiae’s* Williams Leases specifically provides lessors’ royalty is to be based on “gross proceeds,” and that “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.” Application of the “at the well” rule to *Amici Curiae’s* Williams Lease would ignore the express language of the parties’ intent that royalties are to be based on gross proceeds, not net proceeds, and be without deductions of any kind.

B. **Analysis of post-production costs in the context of “net proceeds” vs. “gross proceeds”**

Parties to an oil and gas lease are free to agree to any type of royalty calculation methodology. *Heritage Resources, Inc. v. Nationsbank*, 939 S.W.2d 118, 122 (Tex.1996). Consistent with applying a contract analysis to a lease’s royalty provision is the determination of whether the royalty provision language provides for the payment of a royalty based on “gross proceeds” or “net proceeds.”

As discussed above, the issue underlying the certified question is which party bears the burden of post-production costs. As Chesapeake acknowledges in its Merit Brief, “[t]here is no dispute in this case that the producer bears all of the costs of drilling a well and

bringing the gas to the wellhead. These costs * * * are known as ‘production’ costs.’ ” (Chesapeake’s Merit Brief, p. 3). Since there is no dispute that “production” costs cannot be deducted from the lessors’ royalty, the difference between “gross proceeds” and “net proceeds” is whether post-production costs can be deducted from the lessors’ royalty. Application of Chesapeake’s proposed “at the well” rule to *Amici Curiae* would allow post-production costs resulting in lessors’ royalty being calculated on “net proceeds,” resulting in a net royalty, in direct contravention of the express intent of the parties that the royalty be paid on “gross proceeds,” without deductions of any kind.

Amici Curiae’s gas royalty language provides:

ROYALTIES. The Lessee covenants and agrees:

* * *

b. **Gas Royalty.** To pay to the Lessor * * * royalty based upon the **gross proceeds** paid to 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 affiliate 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.

(Emphasis added.) (Affidavit of Gregory W. Watts, attached hereto as Exhibit A, and identified as Exhibit 5.)

Conversely, Chesapeake’s standard Ohio form “Paid-Up Oil and Gas Lease” provides:

PAYMENTS TO LESSOR. In addition to the bonus paid by Lessee for the execution hereof, Lessee covenants to pay Lessor, proportionate to Lessor's percentage of ownership, as follows:

* * *

(B) ROYALTY: For all oil and gas substances that are produced and sold from the leased premises, Lessor shall receive as its royalty one-eighth (1/8) of the **sales proceeds actually received by Lessee from the sale of such production, less this same percentage share of all post production costs, as defined below**, and less this same percentage share of all production, severance and ad valorem taxes. **As used in this provision, post production costs shall mean (i) all losses of produced volumes (whether by use as fuel, line loss, flaring, venting or otherwise) and (ii) all costs actually incurred by Lessee from and after the wellhead to the point of sale, including, without limitation, all gathering, dehydration, compression, treatment, processing, marketing and transportation costs incurred in connection with the sale of such production.** For royalty calculation purposes, Lessee shall never be required to adjust the sales proceeds to account for the purchaser's costs or charges downstream from the point of sale. Lessee may withhold Royalty payment until such time as the total withheld exceeds fifty dollars (\$50.00).

(Emphasis added.) (Attached to the Affidavit of Gregory W. Watts, attached hereto as Exhibit A, and identified as Exhibit 5.)

Clearly, *Amici Curiae's* Williams Lease providing for "gross proceeds," "without deductions of any kind," is quantitatively different from Chesapeake's standard Ohio form lease royalty provision which expressly allows for deductions of post-production costs. However, Chesapeake's one-size-fits-all "at the well" rule would treat these leases identically, resulting in the deduction of post-production costs and a payment based on net proceeds, not gross proceeds. Such a result is not in accord with the parties' express intent and must be rejected.

Chesapeake and their *Amici* even acknowledge that their proposed "at the well" rule would be inapplicable to leases such as *Amici Curiae's*, which specifically address the

calculation of royalty (based on gross proceeds) and prohibit deductions. See Chesapeake's Merit Brief, p. 5 (wherein it concedes that post-production costs are shared "*unless the lease explicitly says otherwise*" (emphasis added.)); Brief of *Amicus Curiae* Bruce M. Kramer, p. 5 ("references to the terms 'well' or 'wellhead' have, *in the absence of other express, contrary language*" (emphasis added.)); Brief of *Amicus Curiae* American Petroleum Institute, p. 7 ("[w]hen an oil and gas lease provides royalty is to be calculated based on value 'at the well,' * * * lessee is allowed to allocate to the lessor "his or her *pro rata* share of post-production costs, "unless such allocation of costs is expressly prohibited in the lease."). As Chesapeake and its *Amici* acknowledge, language prohibiting any deductions and providing for royalties based on "gross proceeds" trumps any reference to at the well or wellhead, which do not in and of themselves reference or specify any allowed deductions.

C. **Ohio law has applied the contract analysis proposed by *Amici Curiae*.**

Ohio courts called upon to determine royalty issues have, in the past, applied a contract analysis. In *Busbey v. Russell*, 10 Ohio C.C. 23 (1898), the court interpreted a royalty provision to determine whether royalty was to be paid on "net proceeds" or "gross proceeds." The oil royalty clause provided that "one-eighth part of all the oil produced and saved was * * * to be delivered to the lessor, free of expense into tanks, or into pipe lines to his credit." *Id.* at 26. The gas royalty clause provided that if wells produced gas in sufficient quantities to justify marketing, the lessor "should be paid at the rate of one-eighth income dollars per year for such well so long as the gas therefrom should be sold." *Id.*

The court acknowledged that "income" may mean net or gross income. *Id.* at 25. However, the instrument to be construed was not of a commercial character between merchants, and therefore, the question was not to be determined by strict commercial usage, but by

principles that take into consideration how and by whom the term was used, in determining the meaning of the parties in the use of that term. *Id.* Looking at it in that light, the court determined that it was clear the parties intended gross income, not net. *Id.* at 26. The court stated it is a matter of common observation that royalties on minerals are assessed on the marketable amount produced and it is fair to infer that when the lessor in this instance stipulated for one-eighth of the income from the gas produced and sold, he intended, and it was understood to be, one-eighth of the gross income or receipts from the sale, and the stipulation as to the oil, the court thought, placed it beyond question. *Id.* at 26-27. The court concluded:

It was impracticable to deliver one-eighth of the gas itself to the lessor as was to be done with the oil, and it seems reasonable that he would stipulate for the same proportion of the receipts from the marketed gas, instead of running the risk of no substantial return for the gas by reason of bad financial management and wasteful expenditures on the part of the lessees.

Id.

As noted by one commentator, “[t]his case recognizes that the proper calculation of royalty depends upon the wording of the applicable royalty clause and * * * the *Busbey* court emphasizes that *royalty clauses should not be construed by isolating and defining specific words, but by construing the entire royalty provision as a whole.*” (Emphasis added.) Anderson, 37 Natural Resources J. at 593.

In *Schmidt v. Texas Meridian Resources, Ltd.*, 4th Dist. Washington No. 94CA12, 1994 WL 728059 (Dec. 30, 1994), the court applied a contract interpretation to determine whether post-production transportation costs may be deducted against royalty payments. *Id.* at *3. In doing so, the court declined to apply “a rigid interpretation of * * * royalty provisions” and instead applied “more traditional principles of law reserved for such instruments [*i.e.* contract interpretation].” *Id.* In *Schmidt*, all of the leases under review “provided for payment of

a 1/8 royalty interest in oil and gas proceeds” to the lessor. *Id.* at *2-*3. In making royalty payments, Republic did not deduct post-production transportation costs associated with moving the gas from wellhead to pipeline. *Id.* at *1. Subsequently, Republic transferred its leasehold interests to Texas Meridian Production Co., Ltd. and immediately began deducting post-production transportation costs from the royalty payments. *Id.*

The lessors commenced an action seeking an accounting of proceeds on the basis that post-production costs should not have been deducted and should be reimbursed to them. *Id.* The trial court agreed and awarded damages in excess of \$10,000. *Id.* On appeal, the court of appeals explained that “[o]il and gas leases * * * are contracts and are subject to certain fundamental contract principles. It is well settled law that a party may waive the terms of a written contract by words *or conduct*. *White Co. v. Canton Transportation Co.* (1936), 131 Ohio St. 190 at paragraph two of the syllabus.” (Emphasis sic.) *Id.* at *5. The court of appeals affirmed the trial court’s decision concluding that because the course of conduct between the original parties (the original lessee and the lessors) did not involve the deduction of post-production costs, the ability to do so was waived. *Id.* at 6. Therefore, the subsequent deductions by Texas Meridian were not contemplated by the original parties to the lease and were improper. *Id.* at *7.

The *Busbey* and *Schmidt* decisions support *Amici Curiae’s* argument that the Court should apply the basic rules of contract interpretation, rather than a rigid one-size-fits-all rule, to answer the certified question because this approach is consistent with Ohio precedent.

D. **In leases where the implied covenant to market production has not been waived, such as those of *Amici Curiae*, as part of a contract interpretation analysis courts should interpret the royalty language in light of the lessee's duty to market when determining whether post-production costs can be deducted from royalty.**

In addition to the language contained in the royalty provision, other provisions of the lease may impact the issue of post-production costs. Since the 1800s, courts have recognized the existence of implied covenants in oil and gas leases, including the covenant to market. *Yoder v. Artex Oil Co.*, 5th Dist. Guernsey No. 14 CA 4, 2014-Ohio-5130, ¶ 45. *See also Moore v. Adams*, 5th Dist. Tuscarawas No. 2007AP090066, 2008-Ohio-5953, ¶¶ 31-36 (“There are several generally recognized implied covenants in oil and gas leases and these include the following * * * the covenant to market the product.”); *Am. Energy Serv., Inc. v. Lekan*, 75 Ohio App. 3d 205, 215, 598 N.E.2d 1315 (5th Dist.1992) (same); *Mauger v. Positron Energy Res., Inc.*, 5th Dist. Morgan No. 14A0001, 2014-Ohio-4613, ¶ 66 (same).

States that have adopted the “marketable product” rule rely on the implied covenant to market production, which is implied in all oil and gas leases, unless specifically waived by the parties. Under this approach, a lessee may only deduct costs after the production has been placed in a marketable condition. *Wood v. TXO Prod. Corp.*, 854 P.2d 880, 882 (Okla.1992). This is consistent with contract law that a party with a duty must bear the costs of performing that duty. (*See Lutz’s Preliminary Memorandum on Certified Question*, p. 12).

Chesapeake is well aware of the implied covenant to market, the effect it can have on the lessee’s obligations, and how to waive the covenant. Chesapeake’s standard lease form does just that, providing: “LEASE DEVELOPMENT. There is no implied covenant to drill, prevent drainage, further develop or market production within the primary term or any extension of term of this Lease.” (*See Affidavit of Gregory W. Watts*, attached hereto as Exhibit A,

identified as Exhibit 5.) However, where the implied covenant to market production has not been waived, courts should interpret the royalty language in light of this specific covenant.³

III. CONCLUSION

The Court has been asked to adopt a rigid rule based on one isolated phrase “at the well” to address the propriety of deducting post-production costs. However, the rules of construction and this Court’s precedent precludes the need to adopt a “rule.” Instead, the Court only needs to apply the basic rules of contract interpretation in analyzing whether post-production costs should be deducted by Chesapeake in calculating royalty. Such a determination is governed by the parties’ intent, as specifically negotiated, drafted, intended, and accepted, as to whether the royalties owed under the lease are to be paid based on the “gross proceeds” (without deduction of post-production costs) or “net proceeds” (after the deduction of post-production costs).

This proposed “gross proceeds” versus “net proceeds” analysis should govern the interpretation concerning the allowance of post-production costs. Since there is no dispute that “production” costs cannot be deducted from the lessors’ royalty, the difference between “gross proceeds” and “net proceeds” will necessarily turn on whether post-production costs can be deducted from the lessors’ royalty. Chesapeake and their *Amici* even acknowledge their proposed “at the well” rule is inapplicable despite those three words if the lease specifically addresses the calculation (based on gross proceeds) or prohibits deductions.

Such interpretation guards against courts rewriting royalty provisions based on a “rule” rather than on the meaning the parties intended to give the provision considering all of the

³ Many Williams Leases included an express covenant to market. See Affidavit of Gregory W. Watts, attached hereto as Exhibit A, and identified as Exhibits 1 and 4, ¶ 40 (“Lessee shall *** market any saleable products produced on the leased premises as may be necessary to fully develop the leased premises.”)

language contained in it. Clearly, Chesapeake could have included language in *Amici Curiae's* leases specifically allowing post-production deductions as they did in their standard lease form, rather than agreeing that royalties would be based on gross proceeds without deductions of any kind. Imposition of Chesapeake's proposed rule would render *Amici Curiae's* royalty provision entirely meaningless and no different than Chesapeake's own standard lease form. Such a result must be rejected.

Amici Curiae respectfully request that this Court reject applying a rigid "at the well" rule generally to all leases, and to the extent the Court does adopt such a rule, expressly limit it to the specific leases before the Court on the certified question. Furthermore, this Court should find that the entire terms of a lease must be weighed prior to determining the royalty payments as "gross proceeds" or "net proceeds" of the total revenue.

/s/ William G. Williams

William G. Williams (0013107),
(COUNSEL OF RECORD)
Scott M. Zurakowski (0069040),
Gregory W. Watts (0082127),
Aletha M. Carver (0059157), of
KRUGLIAK, WILKINS, GRIFFITHS
& DOUGHERTY CO., L.P.A.
4775 Munson Street NW/PO Box 36963
Canton, Ohio 44735-6963
Phone: (330) 497-0700/Fax: (330) 497-4020
bwilliams@kwgd.com; szurakowski@kwgd.com;
gwatts@kwgd.com; acarver@kwgd.com

Dennis E. Murray, Jr. (0038509),
MURRAY & MURRAY CO., L.P.A.
111 East Shoreline Drive
Sandusky, Ohio 44870
Phone: (419) 624-3126
Fax: (419) 624-0707

*Attorneys for Amici Curiae Sam Johnson,
Zehentbauer Family Land LP, Hanover Farms LP,
and Bounty Minerals, LLC*

PROOF OF SERVICE

I hereby certify that a copy of the foregoing was served by Ordinary U.S. Mail
this 22nd day of September 2015 upon:

James Lowe
Lowe Edlund & Wakefield Co., LPA
1660 West Second Street
610 Skylight Office Tower
Cleveland, OH 44113-1454

Robert C. Sanders
Law Office of Robert C. Sanders
12051 Old Marlboro Pike
Upper Marlboro, MD 20772

Daniel T. Donovan
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 2005

John K. Keller
Vorys, Sater, Seymour and Pease LLP
52 East Gay Street
Columbus, OH 43215

Kevin C. Abbott
Nicolle R. Snyder Bagnell
Reed Smith LLP
225 Fifth Avenue
Pittsburgh, PA 15222

O. Judson Scheaf III
Ben L. Pfefferle III
McDonald Hopkins LLC
250 West Street, Suite 550
Columbus, Ohio 43215

Michael W. Wise
Adam C. Smith
McDonald Hopkins LLC
600 Superior Avenue, East
Suite 2100
Cleveland, OH 44114

Bruce M. Kramer
McGinnis, Lochridge & Kilgore
711 Louisiana Street
Suite 1600
Houston, TX 77002

Lija Kaleps-Clark
Director of Land and Legal Services
NGO Development Corporation, Inc.
1500 Granville Road
Newark, OH 43058-4970

L. Bradford Hughes
Christopher J. Baronzzi
Porter Wright Morris & Arthur LLP
41 South High Street
Columbus, Ohio 43215-6194

Matthew A. Haynie
American Petroleum Institute
1220 L Street, N.W.
Washington, D.C. 20005

/s/ William G. Williams

William G. Williams (0013107),
(COUNSEL OF RECORD)

Scott M. Zurakowski (0069040),

Gregory W. Watts (0082127),

Aletha M. Carver (0059157), of
KRUGLIAK, WILKINS, GRIFFITHS

& DOUGHERTY CO., L.P.A.

*Attorneys for Amici Curiae Sam Johnson,
Zehentbauer Family Land LP, Hanover Farms LP,
and Bounty Minerals, LLC*

IN THE SUPREME COURT OF OHIO

REGIS F. LUTZ, et al.,

Plaintiffs/Respondents,

vs.

CHESAPEAKE APPALACHIA, L.L.C.,

Defendant/Petitioner.

Supreme Court Case No. 15-0545

On Review of Certified Question from
the United States District Court,
Northern District of Ohio, Eastern
Division

Case No. 4:09-cv-2256

AFFIDAVIT OF GREGORY W. WATTS

Affiant, Gregory W. Watts, being duly sworn and cautioned, for his Affidavit, states
as follows:

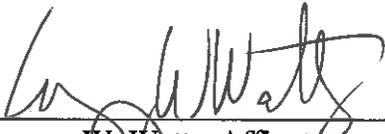
1. My name is Gregory W. Watts, and I am one of the attorneys involved in leasing thousands of acres using the “Krugliak” or “Williams” Lease.
2. I am over the age of 18 and have personal knowledge of the matters testified to in this Affidavit.

EXHIBIT A

3. Attached hereto as Exhibits 1, 2, 3, and 4 are true and accurate copies of various versions of the "Gas Royalty" provisions used in the "Krugliak" or "Williams" Lease in leases entered into with Ohio Buckeye Energy, L.L.C., Chesapeake Exploration, L.L.C., and Chesapeake Appalachia, L.L.C.

4. To the best of Affiant's knowledge, attached hereto as Exhibit 5 is a true and accurate copy of Chesapeake Exploration, L.L.C.'s standard Ohio form "Paid-Up Oil and Gas Lease" from September 2014

Further, Affiant saith naught.



Gregory W. Watts, Affiant

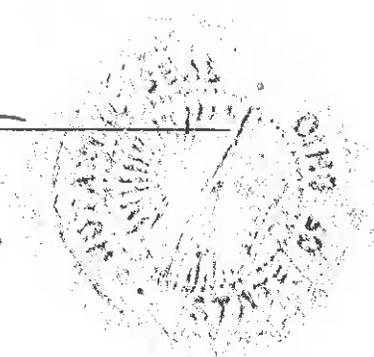
STATE OF OHIO, COUNTY OF STARK, SS:

Sworn to before me and subscribed in my presence at Canton, Ohio, this 22nd day of September 2015.



Notary Public

Aletha M. Carver, Attorney at Law
Notary Public, State of Ohio
My Commission has no exp. date
Under Section 147.03 R.C.
Recorded in Carroll County



materials and minerals reserved hereby, as long as it does not interfere with the rights and privileges granted Lessee herein and the contemplated oil and gas well operations.

5. **TERM.** This Lease shall continue in force and the rights granted hereunder be quietly enjoyed by the Lessee during the primary term of five (5) years from the effective date of this Lease, the date entered on page one, (hereafter the "Primary Term") and so much longer thereafter as oil or gas are produced on the leased premises or lands pooled or unitized herewith, in paying quantities or for as long as Lessee is conducting operations for oil and gas. A well shall be deemed to be producing in paying quantities if said revenue from production produces a profit over operating costs, without regard to any capital costs to drill or equip the well, and has production in amounts in excess of those set forth in O. R.C. Section 1509.062(A)(2). The Lessee shall be deemed to be conducting operations for oil or gas, if the Lessee is conducting operations as defined in paragraph 14.

6. **OPTION TO RENEW.** Lessee is hereby given the option to extend by renewal the Primary Term of this Lease for one five (5) year period. This option may be exercised by Lessee at any time before the expiration of this Lease by notifying Lessor in writing of Lessee's intent to exercise its option and simultaneously therewith paying to Lessor prior to said expiration of this Lease a lease bonus to Lessor in an amount equal to 110% the original signing bonus per acre paid to Lessor by Lessee under this Lease. Such payment shall be based upon the net acres, then covered by this Lease and not at such time being maintained by other provisions hereof. Except as otherwise provided in this Lease, if Lessee does not elect to exercise its option to renew, this Lease shall terminate at the end of the five (5) year Primary Term.

7. **SPUD FEE.** A one-time spud fee of FIFTEEN THOUSAND DOLLARS (\$15,000.00) shall be paid to Lessor at the commencement of drilling of the first horizontal well from a pad site which is located upon leased premises. Two Thousand Dollars (\$2,000.00) shall be paid for each a vertical well pad which is located upon the leased premises.

8. **NO DELAY RENTAL.** Lessor shall not receive any delay rental payment since this is a paid-up in advance lease.

9. **ROYALTIES.** The Lessee covenants and agrees:

a. **Oil Royalty.** To pay to the Lessor SEVENTEEN AND ONE HALF percent (17.5%) royalty based upon the gross proceeds paid to Lessee from the sale of oil,

including without limitation other liquid hydrocarbons or their constituents and products thereof recovered from the leased premises.

b. Gas Royalty. To pay to the Lessor SEVENTEEN AND ONE HALF percent (17.5%) royalty based upon the gross proceeds paid to 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 affiliate 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.

c. Lessee shall pay to the Lessor royalty on any monetary settlement received by Lessee from any breach of contract by Lessee's purchaser relating to the marketing, pricing, purchasing, or taking of oil or gas production from the leased premises.

d. All royalties that may become due hereunder shall commence to be paid on the first well completed on the leased premises within one hundred twenty (120) days after the first day of the month following the month during which any well is completed and commences production into a pipeline for sale of such production. On each subsequent well, royalty payments must commence within ninety (90) days after the first day of the month following the month during which any well is completed and commences production into a pipeline for sale of such production. Thereafter, all royalties on oil shall be paid to Lessor on or before the last day of the second month following the month of production, and all royalties on gas shall be paid to Lessor on or before the last day of the third month following the month of production. Each royalty payment shall contain a statement showing the name of the purchaser, the volume of production purchased, and said price paid. Any sums not paid by Lessee when due shall bear interest at the rate of one and one-half percent (1.5%) per month.

assignee of this Lease, or an interest holder therein, agrees to indemnify and hold harmless Indemnitees in the same manner provided above. Each assignee of the Lessee, or any interest therein, agrees to indemnify and hold harmless the Indemnitees as if said assignee were party to this Lease when executed. Such indemnity shall apply, but not be limited to, to any claim arising out of operations conducted under or pursuant to this Lease, howsoever caused. The provisions of this paragraph shall survive the termination of this Lease.

40. **REASONABLE DEVELOPMENT.** If oil or gas, are discovered on the leased premises subject to this Lease, Lessee shall develop the leased premises as a reasonable and prudent operator and exercise due diligence in drilling such additional well or wells and market any saleable products produced on the leased premises as may be necessary to fully develop the leased premises. Lessee shall protect the oil and gas in and under the leased premises from drainage by wells on adjoining or adjacent tracts or leases, including but not limited to those held by the Lessee or any Affiliate of Lessee. If oil or gas should be produced in paying quantities from a well on adjacent acreage that is draining any acreage of the leased premises that is not pooled or unitized with that well or already within a producing well Unit or pooled production Unit, Lessee shall within six (6) months after the earlier of: (1) notice from the Lessor of such producing well or (2) Lessee's knowledge of such well having been drilled, begin in good faith and pursue diligently operations leading to the drilling of an offset well and such well shall be drilled to such depth as may be necessary to prevent drainage of the leased premises, and Lessee shall use all means necessary in a good faith effort to make such well produce oil or gas in paying quantities. Any well with a casing passing within six hundred (600) feet of the leased premises shall be presumed to be draining the leased premises. Lessee may rebut this presumption only with evidence acceptable to Lessor. The requirements of this paragraph shall be subject to the rules and regulations of

is engaged in by Lessor and to avoid damage to any survey monuments/pins. In the event that such intrusion cannot be avoided, Lessee shall compensate either Lessor or any tenant (but not both) for the damage at current market value for the projected yield at full maturity as well as any additional survey costs to replace survey monuments/pins.

44. **AD VALOREM TAXES.** Lessor and Lessee each shall pay their respective share of all Ad Valorem taxes, Lessor's share to be equal to the percentage of royalty paid to Lessor. Despite anything to the contrary, Lessee shall be responsible for all severance taxes associated with production of oil and gas under this Lease. Lessee agrees to pay for any CAUV recoupment incurred by Lessor as a result of Lessee's operations under this Lease, but any such payment shall be based only upon the acreage actually disturbed by Lessee.

45. **HYDRAULIC FRACTURING.** Lessee represents and warrants that during any hydraulic fracturing process it will not use kerosene, benzene, toluene, xylene, and formaldehyde or any harmful carcinogens or other agents believed to cause cancer for the purposes of fracturing or pumping the same into any formation under the leased premises and Lessee will provide Lessor with all Material Safety Data Sheets (MSDS) available for any chemicals used by Lessee in its hydraulic fracturing process on the leased premises..

46. **RECLAMATION CLAUSE.** Lessee shall restore the leased premises to as near as possible original condition within ninety (90) days after well completion; however in the case of a multi-well pad location, within ninety (90) days after the completion of the final well completed from the pad location, weather permitting. Original condition shall include, but not be limited to, reseeding any areas that were kept in grass or pasture, removal of all debris, equipment and personal property (except such

3. **TERM.** This lease shall continue in force and the rights granted hereunder be quietly enjoyed by the Lessee during the primary term of five (5) years and so much longer thereafter as oil or gas or their constituents are produced on the leased premises or lands pooled or unitized herewith, in paying quantities or for as long as Lessee is conducting operations in search for oil and gas. In connection therewith, (i) a well shall be deemed to be capable of production in paying quantities if it has the capacity to produce a profit over operating costs, without regard to any capital costs to drill or equip the well, or to deliver the oil or gas to market, and (ii) the Lessee shall be deemed to be conducting operations in search of oil or gas, or their constituents, if the Lessee is conducting operations as defined in paragraph 8. A one-time spud fee of **FIFTEEN THOUSAND DOLLARS (\$15,000.00)** shall be paid to Lessor at the commencement of drilling of the first horizontal well from a pad site which is located upon leased premises. A spud fee of **TWO THOUSAND DOLLARS (\$2,000.00)** shall be paid to Lessor at the commencement of drilling of each vertical well drilled from a well site which is located upon leased premises. A well shall be deemed commenced upon the spudding of the well.

At any time prior to the expiration of the original primary term hereof, Lessee may extend such term for an additional five (5)-year period equal to the primary term by paying to the Lessor a lease signing bonus in an amount equal to the original signing bonus plus ten percent (10%) per acre for such lease extension for a second five (5)-year term.

4. **NO DELAY RENTAL.** Lessor shall not receive any delay rental payment since this is a paid-up in advance lease.

5. **ROYALTIES.** The Lessee covenants and agrees:

a. **Oil Royalty.** To pay Lessor seventeen and one half percent (17.5%) royalty based upon the gross proceeds paid to Lessee from the sale of oil recovered from the leased premises valued at the purchase price received for oil prevailing on the date such oil is run into transporter trucks or pipelines.

b. **Gas Royalty.** To pay to the Lessor seventeen and one half percent (17.5%) royalty based upon the gross proceeds paid to 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 affiliate 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 except for Lessee

to deduct from Lessor's royalty payments Lessor's prorated share of any tax, severance or otherwise, imposed by any government body. 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.

c. Lessee shall pay to the Lessor royalty on any monetary settlement received by Lessee from any breach of contract by Lessee's purchaser relating to the marketing, pricing, purchasing, or taking of oil or gas production from the leased premises.

d. All royalties that may become due hereunder shall commence to be paid on the first well completed on the leased premises within one hundred twenty (120) days after the first day of the month following the month during which any well is completed and commences production into a pipeline for sale of such production. On each subsequent well, royalty payments must commence within ninety (90) days after the first day of the month following the month during which any well is completed and commences production into a pipeline for sale of such production. Thereafter, all royalties on oil shall be paid to Lessor on or before the last day of the second month following the month of production, and all royalties on gas shall be paid to Lessor on or before the last day of the third month following the month of production. Each royalty payment shall contain a statement showing the name of the purchaser, the volume of production purchased, and said price paid. Any sums not paid by Lessee when due shall bear interest at the rate of 1.5 percent per month.

e. Lessee further grants to Lessor or Lessor's designee the right at Lessor's expense, to examine, audit, copy or inspect books, records, and accounts of Lessee pertinent to the purpose of verifying the accuracy of the reports and statements furnished to Lessor, and for checking the amount of payments lawfully due the Lessor under the terms of this agreement; however, such audit rights shall be limited to not more than one audit every two (2) years and shall not extend to any periods which are more than two (2) years prior to the date of such audit notice. In exercising this right, Lessor shall give reasonable notice to Lessee of its intended audit and such audit shall be conducted during normal business hours at the office of Lessee at the sole cost and expense of lessor. However, if the amount of deficiencies in royalty payments revealed by the audit equal or exceed 125% of the cost and expense of the audit, then the Lessee shall bear the cost and expense of the audit and all monies due shall be payable within 30 days of the final determination of the amounts due.

6. **PAYMENTS.** All money due under this lease shall be paid to the Lessor by check made payable to the order of Lessor and mailed to the address set forth above until delivery to the

lands pooled/unitized therewith is used for the underground storage of gas, or for the protection of stored gas, or (v) if prescribed payments are made, or (vi) if Lessee's operations are delayed, postponed or interrupted as a result of any coal, stone or other mining or mining related operation under any existing and effective lease, permit or authorization covering such operations on the leased premises or on other lands affecting the leased premises, such delay will automatically extend the primary or secondary term of this oil and gas lease without additional compensation or performance by Lessee for a period of time equal to any such delay, postponement or interruption.

If there is any dispute concerning the extension of this Lease beyond the primary term by reason of any of the alternative mechanisms specified herein, the payment to the Lessor of the prescribed payments provided below shall be conclusive evidence that the Lease has been extended beyond the primary term.

EXTENSION OF PRIMARY TERM. Lessee has the option to extend the primary term of this Lease for one additional term of three (3) years from the expiration of the primary term of this Lease; said extension to be under the same terms and conditions as contained in this Lease. Lessee may exercise this option to extend this Lease if on or before the expiration date of the primary term of this Lease, Lessee pays or tenders to the Lessor or to the Lessor's credit an amount equal to the initial consideration given for the execution hereof. Exercise of this option is at Lessee's sole discretion and may be invoked by Lessee where no other alternative of the Lease Term clause extends this Lease beyond the primary term.

NO AUTOMATIC TERMINATION OR FORFEITURE.

(A) **CONSTRUCTION OF LEASE:** The language of this Lease (including, but not limited to, the Lease Term and Extension of Term clauses) shall never be read as language of special limitation. This Lease shall be construed against termination, forfeiture, cancellation or expiration and in favor of giving effect to the continuation of this Lease where the circumstances exist to maintain this Lease in effect under any of the alternative mechanisms set forth above. In connection therewith, (i) a well shall be deemed to be capable of production if it has the capacity to produce a profit over operating costs, without regard to any capital costs to drill or equip the well, or to deliver the oil or gas to market, and (ii) the Lessee shall be deemed to be conducting operations in search of oil or gas, or their constituents, if the Lessee is engaged in geophysical and other exploratory work including, but not limited to, activities to drill an initial well, to drill a new well, or to rework, stimulate, deepen, sidetrack, frac, plug back in the same or different formation or repair a well or equipment on the Leasehold or any lands pooled/unitized therewith (such activities shall include, but not be limited to, performing any preliminary or preparatory work necessary for drilling, conducting internal technical analysis to initiate and/or further develop a well, obtaining permits and approvals associated therewith and may include reasonable gaps in activities provided that there is a continuous of activities showing a good faith effort to develop a well or that the cessation or interruption of activities was beyond the control of Lessee, including interruptions caused by the acts of third parties over whom Lessee has no control or regulatory delays associated with any approval process required for conducting such activities).

(B) **LIMITATION OF FORFEITURE:** This Lease shall never be subject to a civil action or proceeding to enforce a claim of termination, cancellation, expiration or forfeiture due to any action or inaction by the Lessee, including, but not limited to making any prescribed payments authorized under the terms of this Lease, unless the Lessee has received written notice of Lessor's demand and thereafter fails or refuses to satisfy or provide justification responding to Lessor's demand within 60 days from the receipt of such notice. If Lessee timely responds to Lessor's demand, but in good faith disagrees with Lessor's position and sets forth the reasons therefore, such a response shall be deemed to satisfy this provision, this Lease shall continue in full force and effect and no further damages (or other claims for relief) will accrue in Lessor's favor during the pendency of the dispute, other than claims for payments that may be due under the terms of this Lease.

PAYMENTS TO LESSOR. In addition to the bonus paid by Lessee for the execution hereof, Lessee covenants to pay Lessor, proportionate to Lessor's percentage of ownership, as follows:

(A) **DELAY RENTAL:** To pay Lessor as Delay Rental, after the first year, at the rate of five dollars (\$5.00) per net acre per year payable in advance. The parties hereto agree that this is a Paid-Up Lease with no further Delay Rental and/or Delay in Marketing payments due to Lessor during the primary term hereof.

(B) **ROYALTY:** To pay Lessor as Royalty, less all taxes, assessments, and adjustments on production from the Leasehold, as follows:

1. **OIL:** To deliver to the credit of Lessor a Royalty equal to one-eighth (1/8) of the net revenue realized by Lessee for all oil and any constituents thereof produced and marketed from the Leasehold, less the cost to transport, handle, separate, meter, treat, process and market the oil.

2. **GAS:** To pay Lessor an amount equal to one-eighth (1/8) of the net revenue realized by Lessee for all gas and the constituents thereof produced and marketed from the Leasehold, less the cost to transport, gather, dehydrate, compress, market, meter, treat and process the gas and any losses in volumes to point of measurement that determines the revenue realized by Lessee. Lessee may withhold Royalty payment until such time as the total withheld exceeds fifty dollars (\$50.00).

(C) **DELAY IN MARKETING:** In the event that Lessee drills a well on the Leasehold or lands pooled/unitized therewith that is awaiting completion (such as hydraulic fracture stimulation), or that Lessee deems to be capable of production, but does not market producible gas, oil, or their constituents therefrom and there is no other basis for extending this Lease, Lessee shall pay after the primary term and until such time as marketing is established (or Lessee surrenders the Lease) a Delay in Marketing payment equal in amount and frequency to the annual Delay Rental payment, and this Lease shall remain in full force and effect to the same extent as payment of Royalty.

(D) **SHUT-IN:** In the event that production of oil, gas, or their constituents is interrupted and not marketed for a period of twelve (12) months, and there is no producing well on the Leasehold or lands pooled/unitized therewith, Lessee shall thereafter, as Royalty for constructive production, pay a Shut-in Royalty equal in amount and frequency to the annual Delay Rental payment until such time as production is re-established (or Lessee surrenders the Lease) and this Lease shall remain in full force and effect. During Shut-in, Lessee shall have the right to rework,

EXHIBIT "A"

This Exhibit "A" is attached to and made a part of that Certain Oil and Gas Lease dated June 29th, 2011, by and between Kari L. Thomas and Hejga C. Thomas, as Lessor, and Chesapeake Exploration, L.L.C., as Lessee. If any of the following provisions conflict with or are inconsistent with the printed provisions or terms of this Lease, the following provisions shall control.

USE OF PROPERTY

Restriction of Surface Activity

Lessee shall not have the right to place any well pad within Five Hundred (500) Feet nor conduct any surface activity within Five Hundred (500) Feet of any residential structure nor within Three Hundred (300) Feet of any permanent structure existing at the time of Lessee's operations and being utilized by Lessor on the leased premises without the express written consent of the Lessor. Examples of existing permanent structures being utilized are barns, pole buildings and garages. Existing permanent structures are not intended to include any dilapidated structures not fit for common use.

Location Approval

Location of any well, access roads, pipelines routes, tank batteries, compressor, or other facilities shall be approved by Lessor or one of their representatives in writing prior to location thereof. Such approval shall not be unreasonably withheld, conditioned, or delayed. Upon receipt of Lessee's written site-location approval request, Lessor shall have fourteen (14) days from the date of said correspondence to approve in writing or to advise Lessee in writing of Lessor's disapproval of a specific location(s) associated with Lessee's site plan and to provide Lessee with an alternate location(s) that is deemed to be reasonable, economically feasible and at a legal location pursuant to all applicable rules and regulations. Lessor's failure to notify Lessee of written approval of said site plan or to provide Lessee with written objection and an alternate location(s) within fourteen (14) days shall constitute Lessor's approval of the proposed site location.

Surface Damage Clause

Provided that Lessor is the current surface owner of the affected lands at the time of Lessee's surface operations, Lessee agrees to pay Twenty-Five Thousand Dollars and 00/100 (\$25,000.00) as a supplemental surface damage payment for each pad site built on the herein described leased premises. Multiple wells may be drilled from a single drill site pad located on the surface of the leased premises. In the event Lessee physically and materially disturbs more than twenty (20) acres for any drill site pad, Lessor shall be compensated at the rate of Three Thousand Dollars and 00/100 (\$3,000.00) for each net acre so disturbed in excess of twenty (20) acres.

Surface Restoration Clause

It is agreed and understood that the Lessee shall repair any material damage resulting from Lessee's operations to the surface of said premises and restore the surface as nearly as practicable to the condition in which said land existed at the time of the commencement of drilling operations upon above described land. This work shall be completed within a reasonable amount of time after all cessation of the drilling operations upon the said lands. This work shall be done at the sole expense of the Lessee.

Pipeline - No Foreign Gas

Any pipelines constructed pursuant to the terms of this lease shall be for transporting oil and/or gas from a well(s) drilled on the leased premises or lands pooled therewith unless the prior written consent of Lessor is obtained.

Pipeline - Flow Depth

When requested in writing by Lessor prior to the laying of pipeline, Lessee shall bury the pipeline a minimum depth of 36 inches below ground level, measured from the top of the pipe, where possible.

No Compression on Leased Premises

Other than those necessary for the production and transportation of products produced from the Leased Premises or lands pooled or unitized therewith, it is agreed and understood that compression facilities will not be placed on the leased premises, unless written consent is provided by the Lessor, which consent shall not be unreasonably withheld, delayed or conditioned. Lessee agrees that the leased premises described herein will not be used as a central processing facility. Where compression facilities, temporary or permanent, are used upon the premises, Lessee shall take all reasonable efforts to minimize the noise associated with the same.

Commencement of operations shall be defined as Lessee having secured a drilling permit from the State and further entering upon the herein described premises with equipment necessary for the preparing of a well pad or commencing other activities necessary for the spudding of a well to be drilled. Once commenced, and upon expiration of the primary term of this lease or any extension thereof, said operations shall not lapse for a period of greater than ninety (90) consecutive days prior to the completion of the well.

Shut-In

It is understood and agreed that this lease may not be maintained in force for a continuous period of time longer than thirty-six (36) consecutive months, or sixty (60) cumulative months after the expirations of the primary term or any extension hereof solely by the provision of the shut-in royalty clause. The shut-in status of any well shall persist only so long as it is necessary to correct, through the exercise of good faith and due diligence, the condition giving the rise to the shut-in of the well.

Shut-In Royalty

If a well capable of producing oil or gas within a drilling unit containing any portion of the Leasehold premises is shut-in for a period greater than one-hundred and twenty (120) days in any calendar year, then Lessee shall pay to Lessor a shut-in royalty equal to Twenty Five (\$25) Dollars for each net acre of this Lease contained within said drilling unit. Said Shut-In Royalty shall be due and owing to Lessor within ninety (90) days following any shut-in period of greater than one-hundred and twenty (120) days.

Pooled Production Unit Limit

In the event Lessee desires to pool or unitize the leased premises with other lands and there is no spacing order previously established by a governmental or regulatory body, Lessee shall not have the right to form a production unit larger than 1,280 acres for any horizontal well, and Lessee shall not have the right to form a production unit larger than 60 acres for any vertical well. Lessee shall provide any unitized Lessor with a written unitization plan within thirty (30) days of the recording of the unit designation.

Push Clause

If the Leasehold covered by this Oil and Gas Lease covers more than sixty (60) net acres and more than sixty percent (60%) of the Leasehold covered by this Oil and Gas Lease is not included in the production unit established by Lessee, this Lease shall automatically terminate two (2) years ("Extended Term") after the expiration of the primary term or any extension provided herein, insofar and only insofar as to all Leasehold outside a production unit established by Lessee for a well, provided if the Lessee, its successors or assigns shall be engaged in operations for the drilling, completing or testing of a new well or wells or the drilling, completing, testing, or deepening of an existing well or wells on the leased premises or on lands with which said Leasehold or a portion hereof have been included in a production unit, then this Oil and Gas Lease shall continue in full force and effect until such drilling, completing, testing or deepening operations have been completed.

ROYALTY

Royalty Payments Clause

Lessee shall pay to Lessor free of cost, a royalty equal to Seventeen and Five-Tenths percent (17.50%) of the gross proceeds received by Lessee for the sale of all oil, gas or related hydrocarbons produced and sold from the Leased Premises. It is understood and agreed that to the extent Lessee sells oil, gas or related hydrocarbons to an affiliate, the price upon which royalty shall be based shall be the greater of: a) the price paid by the affiliate; or b) the price that would have been received from a sale to an unaffiliated third party under a sales arrangement for like quantity, quality, term and at the same point of sale to the affiliate.

MISCELLANEOUS

Arbitration Clause

Any questions concerning this Lease or performance there under shall be ascertained and determined by three disinterested arbitrators, one thereof to be appointed by Lessor, one by the Lessee and third by the

revenue from production produces a profit over operating costs, without regard to any capital costs to drill or equip the well, and has production in amounts in excess of those set forth in O. R.C. Section 1509.062(A)(2). The Lessee shall be deemed to be conducting operations for oil or gas, if the Lessee is conducting operations as defined in paragraph 14.

6. OPTION TO RENEW. Lessee is hereby given the option to extend by renewal the Primary Term of this Lease for one three (3) year period. This option may be exercised by Lessee at any time before the expiration of this Lease by notifying Lessor in writing of Lessee's intent to exercise its option and simultaneously therewith paying to Lessor prior to said expiration of this Lease a lease bonus to Lessor in an amount equal to 110% the original signing bonus per acre paid to Lessor by Lessee under this Lease. Such payment shall be based upon the net acres, then covered by this Lease and not at such time being maintained by other provisions hereof. Except as otherwise provided in this Lease, if Lessee does not elect to exercise its option to renew, this Lease shall terminate at the end of the five (5) year Primary Term.

7. SPUD FEE. A one-time spud fee of FIFTEEN THOUSAND DOLLARS (\$15,000.00) shall be paid to Lessor at the commencement of drilling of the first horizontal well from a pad site which is located upon leased premises. Two Thousand Dollars (\$2,000.00) shall be paid for each a vertical well pad which is located upon the leased premises.

8. NO DELAY RENTAL. Lessor shall not receive any delay rental payment since this is a paid-up in advance lease.

9. ROYALTIES. The Lessee covenants and agrees:

a. Oil Royalty. To pay to the Lessor TWENTY percent (20%) royalty based upon the gross proceeds paid to Lessee from the sale of oil, including without limitation other liquid hydrocarbons or their constituents and products thereof recovered from the leased premises so sold by Lessee in an arms-length transaction to an unaffiliated bona fide purchaser, or if the sale is to an affiliate 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 said products 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, gaseous substances, and marketable by-products produced from the leased premises without deductions of any kind except as provided in paragraph 44.

b. Gas Royalty. To pay to the Lessor TWENTY percent (20%) royalty based upon the gross proceeds paid to 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 affiliate 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, gaseous substances, and marketable by-products produced from the leased premises without deductions of any kind except as provided in paragraph 44.

c. Lessee shall pay to the Lessor royalty on any monetary settlement received by Lessee from any breach of contract by Lessee's purchaser relating to the marketing, pricing, purchasing, or taking of oil or gas production from the leased premises.

d. All royalties that may become due hereunder shall commence to be paid on the first well completed on the leased premises within one hundred twenty (120) days after the first day of the month following the month during which any well is completed and commences production into a pipeline for sale of such production. On each subsequent well, royalty payments must commence within ninety (90) days after the first day of the month following the month during which any well is completed and commences production into a pipeline for sale of such production. Thereafter, all royalties on oil shall be paid to Lessor on or before the last day of the second month following the month of production, and all royalties on gas shall be paid to Lessor on or before the last day of the third month following the month of production. Each royalty payment shall contain a statement showing the name of the purchaser, the volume of production purchased, and said price paid. Any sums not paid by Lessee when due shall bear interest at the rate of one and one-half percent (1.5%) per month.

10. **AUDIT RIGHTS.** Lessee further grants to Lessor or Lessor's designee the right at Lessor's expense, to examine, audit, copy or inspect books, records, and accounts of Lessee pertinent to the purpose of verifying the accuracy of the reports and statements furnished to Lessor, and for checking the amount of payments lawfully due the Lessor under the terms of this agreement; however, such audit rights shall be limited to not more than one audit every two (2) years and shall not extend to any periods which are more than two (2) years prior to the date of such audit notice. In exercising this right, Lessor shall give reasonable notice to Lessee of its intended audit and such audit shall be conducted during normal business hours at the office of Lessee at the sole cost and expense of lessor. However, if the amount of deficiencies in royalty payments revealed by the audit equal or exceed one hundred and twenty five percent (125%) of the cost and expense of the audit, then the Lessee shall bear the cost and expense of the audit and all monies due shall be payable within thirty (30) days of the final determination of the amounts due.

11. **PAYMENTS.** All money due under this Lease shall be paid to the Lessor by check made payable to the order of Lessor and mailed to the address set forth above until delivery to the Lessee of notice of change of ownership or notice of change of address as hereinafter provided. Such payment or tender of any payment due under this Lease and

37. HUNTING AND FISHING PROHIBITED. Lessee agrees that its employees, agents, subcontractors, and independent contractors shall have no right to and are prohibited from discharging any firearms, hunting trapping or fishing on the leased premises. Any person found to have violated this provision may be denied further access to the leased premises for any purpose. Furthermore, Lessor retains the right for Lessor, his successors, assigns and invitees to discharge firearms, fish trap and hunt anywhere on the leased premises.

38. NOTICE OF OPERATIONS AND AGENCY ACTIONS. Lessee shall give Lessor advance written notice of the spud date, commencement and completion of drilling or other wellbore completion operations, temporary abandonment, and plugging and final abandonment of any well on the leased premises or in a drilling Unit which contains all or a portion of the leased premises. Such notice shall be provided or delivered to Lessor no less than three (3) business days prior to such an event. Lessee shall give Lessor written notice of any hearings or actions, whether by a governmental agency or a court, affecting the leased premises; such notice shall be provided or mailed to Lessor within five (5) business days following the date that Lessee learns of same.

39. INDEMNITY. Lessee and its successors and assigns, shall defend, indemnify, release and hold harmless Lessor and Lessor's heirs, successors, representatives, agents and assigns ("Indemnitees"), from and against any and all claims, liabilities, judgments, demands and causes of action for injury (including death) or damages and losses to persons or property arising out of, incidental to or resulting from the operations of or under the terms of this Lease, or due to, Lessee or Lessee's servants, agents, employees, guests, licensees, invitees or independent contractors, and from and against all costs and expenses incurred by Indemnitees by reason of any such liabilities, claims, acts of God, force majeure, regulatory or environmental issues, damages or loss of any property, injuries or death, including attorneys' fees, fines, penalties, interests, costs, and losses; and each assignee of this Lease, or an interest holder therein, agrees to indemnify and hold harmless Indemnitees in the same manner provided above. Each assignee of the Lessee, or any interest therein, agrees to indemnify and hold harmless the Indemnitees as if said assignee were party to this Lease when executed. Such indemnity shall apply, but not be limited to, to any claim arising out of operations conducted under or pursuant to this Lease, howsoever caused. The provisions of this paragraph shall survive the termination of this Lease.

40. REASONABLE DEVELOPMENT. If oil or gas, are discovered on the leased premises subject to this Lease, Lessee shall develop the leased premises as a reasonable and prudent operator and exercise due diligence in drilling such additional well or wells and market any saleable products produced on the leased premises as may be necessary to fully develop the leased premises. Lessee shall protect the oil and gas in and under the leased premises from drainage by wells on adjoining or adjacent tracts or leases, including but not limited to those held by the Lessee or any Affiliate of Lessee. If oil or

44. AD VALOREM TAXES. Lessor and Lessee each shall pay their respective share of all Ad Valorem taxes, Lessor's share to be equal to the percentage of royalty paid to Lessor. Despite anything to the contrary, Lessee shall be responsible for all severance taxes associated with production of oil and gas under this Lease. Lessee agrees to pay for any CAUV recoupment incurred by Lessor as a result of Lessee's operations under this Lease, but any such payment shall be based only upon the acreage actually disturbed by Lessee.

45. HYDRAULIC FRACTURING. Lessee represents and warrants that during any hydraulic fracturing process it will not use kerosene, benzene, toluene, xylene, and formaldehyde or any harmful carcinogens or other agents believed to cause cancer for the purposes of fracturing or pumping the same into any formation under the leased premises and Lessee will provide Lessor with all Material Safety Data Sheets (MSDS) available for any chemicals used by Lessee in its hydraulic fracturing process on the leased premises..

46. RECLAMATION CLAUSE. Lessee shall restore the leased premises to as near as possible original condition within ninety (90) days after well completion; however in the case of a multi-well pad location, within ninety (90) days after the completion of the final well completed from the pad location, weather permitting. Original condition shall include, but not be limited to, reseeded any areas that were kept in grass or pasture, removal of all debris, equipment and personal property (except such equipment necessary for Lessee's ongoing operations) which Lessee or Lessee's agents brought onto the leased premises, restoring the original grade of the leased premises, replacement of any structures disturbed or removed by Lessee, including but not limited to drainage systems, fencing, livestock watering systems and irrigation systems, however the well site pad(s) and access road(s) may remain for normal and customary operational purposes, although Lessee will use best efforts to minimize the size of the well pad after drilling is completed. Lessee has one (1) year from the drilling of a dry hole or the cessation of production, unless extended under paragraph 15 if applicable, to remove all equipment and casing and plug the well or in the case of a multi-well pad location, after the cessation of production from the final producing well, and restore the land to as near as possible to original condition.

47. RESEEDING. All reseeded shall be done with suitable grasses selected by Lessor and installed by Lessee during a planting period selected by Lessor. Reseeding shall be performed in a manner to place the leased premises as close as possible to its pre-drilling condition. In the absence of direction from the Lessor, no reseeded (except for borrow pits) will be required on any existing access roads. It shall be the duty of Lessee to insure that a growing ground cover is established upon the disturbed soils and Lessee shall reseed as necessary to accomplish that duty. Lessee shall inspect disturbed areas at such times as Lessor shall reasonable request in order to determine the growth of ground cover and/or noxious weeds, and Lessee shall reseed ground cover and control noxious weeds from time to time to the extent necessary to accomplish its obligations hereunder. Lessee recognizes that this shall be a continuing obligation and Lessee shall

**PAID-UP
OIL AND GAS LEASE**

Lease No. _____

10/13 - OH

This Lease made this 30th day of September, 2014, by and between _____

_____ hereinafter collectively called "Lessor" and Chesapeake Exploration, L.L.C., an Oklahoma limited liability company, P.O. Box 18496, Oklahoma City, OK, 73154-0496, hereinafter called "Lessee".

WITNESSETH, that for and in consideration of Ten Dollars (\$10.00) and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, and of the mutual covenants and agreements hereinafter set forth, the Lessor and Lessee agree as follows:

LEASING CLAUSE. Lessor hereby leases exclusively to Lessee all the oil and gas (including, but not limited to coal seam gas, coalbed methane gas, coalbed gas, methane gas, gob gas, occluded methane/natural gas and all associated natural gas and other hydrocarbons and non-hydrocarbons contained in, associated with, emitting from, or produced/originating within any formation, gob area, mined-out area, coal seam, and all communicating zones), and their liquid or gaseous constituents, whether hydrocarbon or non-hydrocarbon, underlying the land herein leased, together with such exclusive rights as may be necessary or convenient for Lessee, at its election, to explore for, develop, produce, measure, and market production from the Leasehold, or from other lands, using methods and techniques which are not restricted to current technology, including, without limitation, the right to conduct geophysical and other exploratory tests; to drill, maintain, operate, cease to operate, plug, abandon, and remove wells; to use or install roads over and across the Leasehold for use in development of the Leasehold or other lands, electric power and telephone facilities, water impoundments, and to construct pipelines with appurtenant facilities, including data acquisition, compression and collection facilities for use in the production and transportation of products from the Leasehold or from other lands across the Leasehold, to use oil, gas, and non-domestic water sources, free of cost, to store gas of any kind underground, regardless of the source thereof, including the injecting of gas therein and removing the same therefrom; to protect stored gas; to operate, maintain, repair, and remove material and equipment; to use and occupy the subsurface of the Leasehold for the drilling of a wellbore(s) for use in development of the Leasehold or other lands.

DESCRIPTION



LEASE TERM. This Lease shall remain in force for a primary term of five (5) years from 12:00 A.M. September 30, 2014 (effective date) to 11:59 P.M. September 29, 2019 (last day of primary term) and shall continue beyond the primary term as to the entirety of the Leasehold if any of the following is satisfied: (i) operations are conducted on the Leasehold or lands pooled/unitized therewith in search of oil, gas, or their constituents, or (ii) a well deemed by Lessee to be capable of production is located on the Leasehold or lands pooled/unitized therewith, or (iii) oil or gas, or their constituents, are produced from the Leasehold or lands pooled/unitized therewith, or (iv) if the Leasehold or lands pooled/unitized therewith is used for the underground storage of gas, or for the protection of stored gas, or (v) if prescribed payments are made, or (vi) if Lessee's operations are delayed, postponed or interrupted as a result of any coal, stone or other mining or mining related operation under any existing and effective lease, permit or authorization covering such operations on the leased premises or on other lands affecting the leased premises, such delay will automatically extend the primary or secondary term of this oil and gas lease without

48503.OHCA

additional compensation or performance by Lessee for a period of time equal to any such delay, postponement or interruption.

If there is any dispute concerning the extension of this Lease beyond the primary term by reason of any of the alternative mechanisms specified herein, the payment to the Lessor of the prescribed payments provided below shall be conclusive evidence that the Lease has been extended beyond the primary term.

EXTENSION OF PRIMARY TERM. Lessee has the option to extend the primary term of this Lease for one additional term of five (5) years from the expiration of the primary term of this Lease; said extension to be under the same terms and conditions as contained in this Lease. Lessee may exercise this option to extend this Lease if on or before the expiration date of the primary term of this Lease, Lessee pays or tenders to the Lessor or to the Lessor's credit an amount equal to the initial consideration given for the execution hereof. Exercise of this option is at Lessee's sole discretion and may be invoked by Lessee where no other alternative of the Lease Term clause extends this Lease beyond the primary term.

NO AUTOMATIC TERMINATION OR FORFEITURE.

(A) CONSTRUCTION OF LEASE: The language of this Lease (including, but not limited to, the Lease Term and Extension of Term clauses) shall never be read as language of special limitation. This Lease shall be construed against termination, forfeiture, cancellation or expiration and in favor of giving effect to the continuation of this Lease where the circumstances exist to maintain this Lease in effect under any of the alternative mechanisms set forth above. In connection therewith, (i) a well shall be deemed to be capable of production if it has the capacity to produce a profit over operating costs, without regard to any capital costs to drill or equip the well, or to deliver the oil or gas to market, and (ii) the Lessee shall be deemed to be conducting operations in search of oil or gas, or their constituents, if the Lessee is engaged in geophysical and other exploratory work including, but not limited to, activities to drill an initial well, to drill a new well, or to rework, stimulate, deepen, sidetrack, frac, plug back in the same or different formation or repair a well or equipment on the Leasehold or any lands pooled/unitized therewith (such activities shall include, but not be limited to, performing any preliminary or preparatory work necessary for drilling, conducting internal technical analysis to initiate and/or further develop a well, obtaining permits and approvals associated therewith and may include reasonable gaps in activities provided that there is a continuum of activities showing a good faith effort to develop a well or that the cessation or interruption of activities was beyond the control of Lessee, including interruptions caused by the acts of third parties over whom Lessee has no control or regulatory delays associated with any approval process required for conducting such activities).

(B) LIMITATION OF FORFEITURE: This Lease shall never be subject to a civil action or proceeding to enforce a claim of termination, cancellation, expiration or forfeiture due to any action or inaction by the Lessee, including, but not limited to making any prescribed payments authorized under the terms of this Lease, unless the Lessee has received written notice of Lessor's demand and thereafter fails or refuses to satisfy or provide justification responding to Lessor's demand within 60 days from the receipt of such notice. If Lessee timely responds to Lessor's demand, but in good faith disagrees with Lessor's position and sets forth the reasons therefore, such a response shall be deemed to satisfy this provision, this Lease shall continue in full force and effect and no further damages (or other claims for relief) will accrue in Lessor's favor during the pendency of the dispute, other than claims for payments that may be due under the terms of this Lease.

PAYMENTS TO LESSOR. In addition to the bonus paid by Lessee for the execution hereof, Lessee covenants to pay Lessor, proportionate to Lessor's percentage of ownership, as follows:

(A) DELAY RENTAL: To pay Lessor as Delay Rental, after the first year, at the rate of five dollars (\$5.00) per net acre per year payable in advance. The parties hereto agree that this is a Paid-Up Lease with no further Delay Rental and/or Delay in Marketing payments due to Lessor during the primary term hereof.

(B) ROYALTY: For all oil and gas substances that are produced and sold from the leased premises, Lessor shall receive as its royalty one-eighth (1/8) of the sales proceeds actually received by Lessee from the sale of such production, less this same percentage share of all post production costs, as defined below, and less this same percentage share of all production, severance and ad valorem taxes. As used in this provision, post production costs shall mean (i) all losses of produced volumes (whether by use as fuel, line loss, flaring, venting or otherwise) and (ii) all costs actually incurred by Lessee from and after the wellhead to the point of sale, including, without limitation, all gathering, dehydration, compression, treatment, processing, marketing and transportation costs incurred in connection with the sale of such production. For royalty calculation purposes, Lessee shall never be required to adjust the sales proceeds to account for the purchaser's costs or charges downstream from the point of sale. Lessee may withhold Royalty payment until such time as the total withheld exceeds fifty dollars (\$50.00).

(C) DELAY IN MARKETING: In the event that Lessee drills a well on the Leasehold or lands pooled/unitized therewith that is awaiting completion (including, without limitation, hydraulic fracture stimulation), or that Lessee deems to be capable of production, but does not market producible gas, oil, or their constituents therefrom and there is no other basis for extending this Lease, Lessee shall pay after the primary term and until such time as marketing is established (or Lessee surrenders the Lease) a Delay in Marketing payment equal in amount and frequency to the annual Delay Rental payment, and this Lease shall remain in full force and effect to the same extent as payment of Royalty.

(D) SHUT-IN: In the event that production of oil, gas, or their constituents is interrupted and not marketed for a period of twelve (12) months, and there is no producing well on the Leasehold or lands pooled/unitized therewith, Lessee shall, after the primary term, as Royalty for constructive production, pay a Shut-in Royalty equal in amount and frequency to the annual Delay Rental payment until such time as production is re-established (or Lessee surrenders the Lease) and this Lease shall remain in full force and effect. During Shut-in, Lessee shall have the right to rework, stimulate, or deepen any well on the Leasehold or to drill a new well on the Leasehold in an effort to re-establish production, whether from an original producing formation or from a different formation. In the event that the production from the only producing well on the Leasehold is interrupted for a period of less than twelve (12)

months, this Lease shall remain in full force and effect without payment of Royalty or Shut-in Royalty.

(E) **DAMAGES:** Lessee will remove unnecessary equipment and materials and reclaim all disturbed lands at the completion of activities, and Lessee agrees to repair any damaged improvements to the land and pay for the loss of growing crops or marketable timber.

(F) **MANNER OF PAYMENT:** Lessee shall make or tender all payments due hereunder by check, payable to Lessor, at Lessor's last known address, and Lessee may withhold any payment pending notification by Lessor of a change in address. Payment may be tendered by mail or any comparable method (e.g., Federal Express), and payment is deemed complete upon mailing or dispatch. Where the due date for any payment specified herein falls on a holiday, Saturday or Sunday, payment tendered (mailed or dispatched) on the next business day is timely.

(G) **CHANGE IN LAND OWNERSHIP:** Lessee shall not be bound by any change in the ownership of the Leasehold until furnished with such documentation as Lessee may reasonably require. Pending the receipt of documentation, Lessee may elect either to continue to make or withhold payments as if such a change had not occurred.

(H) **TITLE:** If Lessee receives evidence that Lessor does not have title to all or any part of the rights herein leased, Lessee may immediately withhold payments that would be otherwise due and payable hereunder to Lessor until the adverse claim is fully resolved. Lessor represents and warrants that there is no existing oil and gas lease which is presently in effect covering the Leasehold.

(I) **LIENS:** Lessee may at its option pay and discharge any past due taxes, mortgages, judgments, or other liens and encumbrances on or against any land or interest included in the Leasehold; and Lessee shall be entitled to recover from the debtor, with legal interest and costs, by deduction from any future payments to Lessor or by any other lawful means. In the event the leased lands are encumbered by a prior mortgage, then, notwithstanding anything contained herein to the contrary, Lessee shall have the right to suspend the payment of any royalties due hereunder, without liability for interest, until such time as Lessor obtains at its own expense a subordination of the mortgage in a form acceptable to Lessee.

(J) **CHARACTERIZATION OF PAYMENTS:** Payments set forth herein are covenants, not special limitations, regardless of the manner in which these payments may be invoked. Any failure on the part of the Lessee to timely or otherwise properly tender payment can never result in an automatic termination, expiration, cancellation, or forfeiture of this Lease. Lessor recognizes and acknowledges that oil and gas lease payments, in the form of rental, bonus and royalty, can vary depending on multiple factors and that this Lease is the product of good faith negotiations. Lessor hereby agrees that the payment terms, as set forth herein, and any bonus payments paid to Lessor constitute full consideration for the Leasehold. Lessor further agrees that such payment terms and bonus payments are final and that Lessor will not seek to amend or modify the lease payments, or seek additional consideration based upon any differing terms which Lessee has or will negotiate with any other lessor/oil and gas owner.

(K) **PAYMENT REDUCTIONS:** If Lessor owns a lesser interest in the oil or gas than the entire undivided fee simple estate, then the rentals (except for Delay Rental payments as set forth above), royalties and shut-in royalties hereunder shall be paid to Lessor only in the proportion which Lessor's interest bears to the whole and undivided fee.

UNITIZATION AND POOLING. Lessor grants Lessee the right to pool, unitize, or combine all or parts of the Leasehold with other lands, whether contiguous or not contiguous, leased or unleased, whether owned by Lessee or by others, at a time before or after drilling to create drilling or production units either by contract right or pursuant to governmental authorization. Pooling or unitizing in one or more instances shall not exhaust Lessee's pooling and unitizing rights hereunder, and Lessee is granted the right to change the size, shape, and conditions of operation or payment of any unit created. Lessor agrees to accept and receive out of the production or the revenue realized from the production of such unit, such proportional share of the Royalty from each unit well as the number of Leasehold acres included in the unit bears to the total number of acres in the unit. Otherwise, as to any part of the unit, drilling, operations in preparation for drilling, production, or shut-in production from the unit, or payment of Royalty, Shut-in Royalty, Delay in Marketing payment or Delay Rental attributable to any part of the unit (including non-Leasehold land) shall have the same effect upon the terms of this Lease as if a well were located on, or the subject activity attributable to, the Leasehold. In the event of conflict or inconsistency between the Leasehold acres ascribed to the Lease, and the local property tax assessment calculation of the lands covered by the Lease, or the deeded acreage amount, Lessee may, at its option, rely on the latter as being determinative for the purposes of this paragraph.

FACILITIES. Lessee shall not drill a well on the Leasehold within 200 feet of any structure located on the Leasehold without Lessor's written consent. Lessor shall not erect any building or structure, or plant any trees within 200 feet of a well or within 25 feet of a pipeline without Lessee's written consent. Lessor shall not improve, modify, degrade, or restrict roads and facilities built by Lessee without Lessee's written consent.

CONVERSION TO STORAGE. Lessee is hereby granted the right to convert the Leasehold or lands pooled/unitized therewith to gas storage. At the time of conversion, Lessee shall pay Lessor's proportionate part for the estimated recoverable gas remaining in any well drilled pursuant to this Lease using methods of calculating gas reserves as are generally accepted by the natural gas industry and, in the event that all wells on the Leasehold and/or lands pooled/unitized therewith have permanently ceased production, Lessor shall be paid a Conversion to Storage payment in an amount equal to Delay Rental for as long thereafter as the Leasehold or lands pooled/unitized therewith is/are used for gas storage or for protection of gas storage; such Conversion to Storage payment shall first become due upon the next ensuing Delay Rental anniversary date. The use of any part of the Leasehold or lands pooled or unitized therewith for the underground storage of gas, or for the protection of stored gas will extend this Lease beyond the primary term as to all rights granted by this Lease, including but not limited to production rights, regardless of whether the production and storage rights are owned together or separately.

DISPOSAL AND INJECTION WELLS. Lessor hereby grants to Lessee the right to drill wells and/or re-enter existing wells, including necessary location, roadway and pipeline easements and rights of way, on any part of the Leasehold or lands pooled or unitized therewith for the disposal and/or injection into any subsurface strata, other than a potable water strata, of air, gas, brine, completion and production fluids, waste water and any hydrocarbon related substances from any source, including, but not limited to wells on the Leasehold or lands pooled or unitized therewith or from properties and lands outside the Leasehold or lands pooled or unitized therewith, and to conduct all operations as may be required, for so long as necessary and required by Lessee for purposes as herein provided. If, at the expiration of the primary term, Lessee is disposing and/or injecting into any subsurface strata underlying the Leasehold or lands pooled or unitized therewith or conducting operations for such disposal and/or injection and this lease is not being maintained by any other provision contained herein and no other payments are being made to Lessor as prescribed hereunder, Lessee shall pay to Lessor the sum of one thousand dollars (\$1,000.00) per year, proportionately reduced to Lessor's ownership in the Leasehold and surface as it bears to the full and undivided estate, beginning on the next anniversary date of this Lease and said payment and term of this Lease, insofar as to terms and provisions contained herein applicable to disposal and injection wells, shall continue annually thereafter for so long as necessary and required by Lessee for purposes as herein provided and until all disposal and/or injection wells located on the Leasehold or on lands pooled or unitized therewith are plugged and abandoned. Lessor agrees that if required by Lessee, regulatory agency or governmental authority having jurisdiction, Lessor shall enter a separate Disposal and Injection Agreement with Lessee for the purposes as herein provided.

TITLE AND INTERESTS. Lessor hereby warrants generally and agrees to defend title in the Leasehold and covenants that Lessee shall have quiet enjoyment hereunder and shall have benefit of the doctrine of after acquired title. Should any person having title to the Leasehold fail to execute this Lease, the Lease shall nevertheless be binding upon all persons who do execute it as Lessor.

LEASE DEVELOPMENT. There is no implied covenant to drill, prevent drainage, further develop or market production within the primary term or any extension of term of this Lease. There shall be no Leasehold forfeiture, termination, expiration or cancellation for failure to comply with said implied covenants. Provisions herein, including, but not limited to the prescribed payments, constitute full compensation for the privileges herein granted.

COVENANTS. This Lease and its expressed or implied covenants shall not be subject to termination, forfeiture of rights, or damages due to failure to comply with obligations if compliance is effectively prevented by federal, state, or local law, regulation, or decree, or the acts of God and/or third parties over whom Lessee has no control.

RIGHT OF FIRST REFUSAL. If at any time within the primary term of this Lease or any continuation or extension thereof, Lessor receives any bona fide offer, acceptable to Lessor, to grant an additional lease which will take effect upon expiration of this Lease ("Top Lease") covering all or part of the Leasehold, Lessee shall have the continuing option by meeting any such offer to acquire a Top Lease on equivalent terms and conditions. Any offer must be in writing and must set forth the proposed Lessee's name, bonus consideration and royalty consideration to be paid for such Top Lease, and include a copy of the lease form to be utilized reflecting all pertinent and relevant terms and conditions of the Top Lease. Lessee shall have fifteen (15) days after receipt from Lessor of a complete copy of any such offer to advise Lessor in writing of its election to enter into an oil and gas lease with Lessor on equivalent terms and conditions. If Lessee fails to notify Lessor within the aforesaid fifteen (15) day period of its election to meet any such bona fide offer, Lessor shall have the right to accept said offer. Any Top Lease granted by Lessor in violation of this provision shall be null and void.

ARBITRATION. In the event of a disagreement between Lessor and Lessee concerning this Lease or the associated Order of Payment, performance thereunder, or damages caused by Lessee's operations, the resolution of all such disputes shall be determined by arbitration in accordance with the rules of the American Arbitration Association. Arbitration shall be the exclusive remedy and cover all disputes, including but not limited to, the formation, execution, validity and performance of the Lease and Order of Payment. All fees and costs associated with the arbitration shall be borne equally by Lessor and Lessee.

ENTIRE CONTRACT. The entire agreement between Lessor and Lessee is embodied herein and in the associated Order of Payment (if any). No oral warranties, representations, or promises have been made or relied upon by either party as an inducement to or modification of this Lease.

TITLE CURATIVE. Lessor agrees to execute consents, affidavits, ratifications, amendments, permits and other instruments as Lessee may request to carry out the purpose of this lease, including without limitation, applications necessary to obtain driveway entrance permits, and approvals of drilling or production units which Lessee may seek to form pursuant to governmental authorization.

SURRENDER. Lessee, at any time, and from time to time, may surrender and cancel this Lease as to all or any part of the Leasehold by recording a Surrender of Lease and thereupon this Lease, and the rights and obligations of the parties hereunder, shall terminate as to the part so surrendered; provided, however, that upon each surrender as to any part of the Leasehold, Lessee shall have reasonable and convenient easements for then existing wells, pipelines, pole lines, roadways and other facilities on the lands surrendered.

SUCCESSORS. All rights, duties, and liabilities herein benefit and bind Lessor and Lessee and their heirs, successors, and assigns.

FORCE MAJEURE. All terms, provisions and express or implied covenants of this Lease shall be subject to all applicable laws, rules, regulations and orders. If Lessee is unable, in its sole discretion, to effectively accomplish the purposes and objectives of this Lease or to exercise its rights hereunder because of such laws, rules, regulations or orders, or if drilling, reworking, production or other operations hereunder, or Lessee's fulfillment of its obligations hereunder are prevented or delayed by such laws, rules, regulations or orders, or by inability to obtain

necessary permits, equipment, services, material, water, electricity, fuel, access or easements, or by fire, flood, adverse weather conditions, war, sabotage, rebellion, insurrection, riot, strike or labor disputes, or by inability to obtain a satisfactory market for production or failure of purchasers or carriers to take or transport such production, or by any other cause not reasonably within Lessee's control, then this Lease shall not terminate, in whole or in part, because of such inability, prevention or delay, and, at Lessee's option, the period of such inability, prevention or delay shall be added to the term hereof. Lessee shall not be liable in damages for breach of any express or implied covenants of this Lease for failure to comply therewith, if compliance is prevented by, or failure is the result of any applicable laws, rules, regulations or orders or operation of force majeure. If this Lease is the subject matter of any lawsuit, arbitration proceeding, or other action, then this Lease shall not expire during the pendency of such lawsuit, arbitration proceeding, or other action, or any appeal thereof, and the period of the lawsuit, arbitration proceeding, or other action, and any appeal thereof, shall be added to the term of this Lease.

SEVERABILITY. This Lease is intended to comply with all applicable laws, rules, regulations, ordinances and governmental orders. If any provision of this Lease is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the remaining provisions shall survive and continue in full force and effect to the maximum extent allowed by law. If a court of competent jurisdiction holds any provision of this Lease invalid, void, or unenforceable under applicable law, the court shall give the provision the greatest effect possible under the law and modify the provision so as to conform to applicable law if that can be done in a manner which does not frustrate the purpose of this Lease.

COUNTERPARTS. This Lease may be executed in one or more counterparts, each of which will be deemed to be an original copy of this Lease and all of which, when taken together, will be deemed to constitute one and the same agreement.

See attached Exhibit 'A' which is unrecorded.

IN WITNESS WHEREOF, Lessor hereunto sets hand and seal.

(Seal)

Document prepared by: Chesapeake Exploration, L.L.C., P.O. Box 18496, Oklahoma City, OK 73154-0496

ACKNOWLEDGMENT

STATE OF _____)
COUNTY OF _____) SS:

On this, the _____ day of _____, 20____, before me a notary public, the undersigned officer, personally appeared _____, known to me (or satisfactorily proven) to be the person(s) whose names(s) is/are subscribed to the within instrument, and acknowledged that he/she/they executed the same for the purposes therein contained.

IN WITNESS WHEREOF, I here unto set my hand and official seal.

My Commission Expires: _____

Signature/Notary Public: _____

Name/Notary Public (print): _____

Recorder: Return to Chesapeake Exploration, L.L.C., P.O. Box 18496, Oklahoma City, OK 73154-0496