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NO. 14-0302

In the Supreme Court of Texas

CHESAPEAKE EXPLORATION, L.L.C., ET AL.
Petitioners,

v.

MARTHA ROWAN HYDER, ET AL.
Respondents.

Appeal from the Fourth Court of Appeals
at San Antonio, Texas

BRIEF OF AMICI CURIAE IN OPPOSITION TO MOTION FOR REHEARING

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INTEREST OF THE *AMICI CURIAE*

This brief is filed on behalf of the following amici:

The City of Fort Worth

The Fort Worth Housing Finance Corporation

The Fort Worth Local Development Corporation

The Fort Worth Independent School District

Tarrant County College District

J.C. Pace, Ltd.

Traders Village, Ltd.

J. C. Pace III, Trustee

Alexandra Pace Schneider, Trustee

Jennifer Leigh Pace, Trustee

Leigh S. Taylor, Trustee

Sarah Louis Sykes, Trustee

The Amici are lessors under more than 250 oil and gas leases where Petitioner Chesapeake Exploration, LLC ("Chesapeake"), and Total E&P (USA), Inc. ("Total") and, in some cases, Dorchester Resources, a company formed and controlled by Chesapeake's former CEO, Aubrey McClendon, are each lessees. The Amici have filed suits to recover unpaid royalties. In most cases, Chesapeake has contended that *Heritage Resources* permits it to disregard covenants

precluding sales to affiliates and that specify the lessees are to pay royalty free of all post-production costs. This brief is paid for by the Amici. In this regard, the Amici were surprised to see that briefs filed by the Texas Independent Producers & Royalty Owners Association ("TIPRO") and Unit Corporation do not disclose that the same attorney and law firm that submitted the briefs on behalf of TIPRO and Unit Corporation also represent Total in most, if not all, cases brought by royalty owners against Chesapeake and Total for underpayment of royalties due under Barnett Shale leases, including the Amicis' cases. Although Total is not a named party to the Hyder proceeding, it is a significant working interest owner in the Hyder lease, and therefore undoubtedly has an interest in the positions advanced by Chesapeake as operator of the Hyder lease. In short, the "amici" briefs of TIPRO and Unit Corporation should be treated as submissions by Chesapeake, as the operator of Total's interests in the Barnett Shale.

SUMMARY OF THE ARGUMENT

This Court has never held that a lessee should be permitted to ignore terms of an oil and gas lease that expressly require the lessee to pay royalties (or here, an overriding royalty) free of post-production costs. This is particularly true when, as in this case, Chesapeake and Total have sought to use arranged "wellhead sales" to their affiliates to manipulate the point at which market value is to be determined. Chesapeake and Total have done so for no reason other than to try to burden non-working interest owners with post-production costs the lease expressly states the lessees must bear. This Court should not use rules of contract construction to allow Chesapeake to use the initial *Heritage* opinion as a trump card to erase from the Hyders' lease express promises that were intended to have meaning and purpose by claiming those promises should be judicially declared as "surplusage."[1]

ARGUMENT

I. THE COURT SHOULD NOT REWRITE CONTRACTS

Contract law rests on "the bedrock principle" that when a court is faced with construing a contract it should strive, whenever possible, to interpret it from the

[1] Motion for Rehearing at 4–6, 10–12 (arguing that "gross production" means "value at the wellhead," thereby triggering *Heritage* and rendering "cost-free" without any meaning or effect) [hereinafter "Motion"].

document's four corners.[2] And a court should try to determine what the original parties intended:

> As a fundamental matter, Texas law recognizes and protects a broad freedom of contract. We have repeatedly said that "if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice."[3]

One aspect of this freedom is the freedom to "bargain for mutually agreeable terms and allocate risks as they see fit."[4]

To give life to this foundational freedom, Texas courts hearing contract disputes strive, first and foremost, to determine and give effect to the parties' intentions as expressed in the written document.[5] Texas courts have held fast to the

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[2] *See Smith v. Liddell*, 367 S.W.2d 662, 665 (Tex. 1963) (noting that, when contract is unambiguous, "this court must give to the instrument the legal effect resulting from a construction of the language contained within the four corners of the instrument"); *Utica Nat. Ins. Co. of Texas v. Am. Indem. Co*., 141 S.W.3d 198, 208 n.9 (Tex. 2004) (Hecht, J., dissenting) (noting that an approach to contract interpretation "where judges divine the parties' reasonable expectations and then rewrite the contract accordingly, is contrary to the bedrock principle of American contract law that parties are free to contract as they see fit, and the courts are to enforce the agreement as written absent some highly unusual circumstance, such as a contract in violation of law or public policy") (quoting *Wilkie v. Auto–Owners Ins. Co*., 664 N.W.2d 776, 782 (Mich. 2003)).

[3] *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 95–96 (Tex. 2011) (quoting *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653, 664 (Tex. 2008)).

[4] *Gym-N-I Playgrounds, Inc. v. Snider*, 220 S.W.3d 905, 912 (Tex. 2007).

[5] *See RSUI Indem. Co. v. The Lynd Co*., 466 S.W.3d 113, 118 (Tex. 2015), *reh'g denied* (Sept. 11, 2015) ("When construing a contract, our primary concern is to ascertain the intentions of the parties as expressed in the document.") (citing *Amedisys, Inc. v. Kingwood Home Health Care*, LLC, 437 S.W.3d 507, 514 (Tex. 2014); *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996) (citing *Sun Oil Co. v. Madeley*, 626 S.W.2d 726, 727–28 (Tex. 1981) and

principle that "where the language is plain and unambiguous, courts must enforce the contract as made by the parties, and cannot make a new contract for them, nor change that which they have made under the guise of construction."[6] This Court has therefore said that its analysis of a contract begins with the contract's express language.[7] Courts should give "effect to *all the provisions* of the contract so that none will be rendered meaningless."[8] And if, when viewed in light of the surrounding circumstances, the lease remains susceptible to more than one reasonable interpretation, then the meaning should be determined by adopting the construction more favorable to the lessor[9] and not by a court's picking and

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McMahon v. Christmann, 157 Tex. 403, 303 S.W.2d 341, 344 (1957)); *see also Sonat Exploration Co. v. Cudd Pressure Control, Inc.*, 271 S.W.3d 228, 235 (Tex. 2008) ("Enforcing contracts according to their own terms satisfies the relevant policies of the forum, enhances certainty, predictability, and uniformity of result, and facilitates commerce and relations with other states and nations.").

[6] *E. Texas Fire Ins. Co. v. Kempner*, 27 S.W. 122 (Tex. 1894); *see Am. Mfrs. Mut. Ins. Co. v. Schaefer*, 124 S.W.3d 154, 162 (Tex. 2003) ("[W]e may neither rewrite the parties' contract nor add to its language."); *Royal Indem. Co. v. Marshall*, 388 S.W.2d 176, 181 (Tex. 1965) ("Courts cannot make new contracts between the parties, but must enforce the contracts as written.").

[7] *El Paso Field Servs., L.P. v. MasTec N. Am., Inc.*, 389 S.W.3d 802, 805–06 (Tex. 2012) (citing *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 333 (Tex. 2011)); *see Progressive County Mut. Ins. Co. v. Kelley*, 284 S.W.3d 805, 807 (Tex. 2009) ("The starting point of this analysis is the instrument itself.").

[8] *Seagull Energy E&P, Inc. v. Eland Energy, Inc.,* 207 S.W.3d 342, 345 (Tex. 2006) (citation and internal quotation marks omitted).

[9] *See, e.g., Stanolind Oil & Gas Co. v. Newman Bros. Drilling Co*., 305 S.W.2d 169, 176 (Tex. 1957) ("[I]t appears to be the settled rule in this state that of two or more equally reasonable constructions of which the language of an oil and gas lease is susceptible the one more favorable to the lessor will be allowed to prevail." (quoting *Zeppa v. Houston Oil Co*., 113 S.W.2d 612, 615 (Tex. App.—Texarkana 1938, writ. ref'd))); *Yturria v. Kerr-McGee Oil & Gas Onshore, LLC*, 291 F. App'x. 626, 631 (5th Cir. 2008) ("If, after applying the pertinent rules of

choosing which provisions are to be enforced and which may be ignored under the sophistry that a negotiated term is "surplusage."

In this proceeding, the Court focused on the following clause:

> Lessee shall, within sixty (60) days from the date of first production from each off-lease well, convey to Lessors a perpetual, cost-free (except only its portion of production taxes) overriding royalty of five percent (5.0%) of gross production obtained from each such well payable to Lessors . . . .[10]

Applying the above rules of contract construction, the Court rationally observed that, because an overriding royalty by definition is free of *production* costs, the only way to give the term "cost-free" meaning is to conclude that it refers to post-production costs.[11]

In its motion, however, Chesapeake attempts to convince this Court to ignore specially negotiated terms using a "the sky is falling" argument. Chesapeake criticizes the Court for failing to carefully consider the issues ("the Court's opinion is wrong, and its rushed decision should be corrected").[12] Chesapeake then suggests the Court's decision will somehow lead to an ineffective

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construction, the lease remains subject to two or more equally reasonable interpretations, Texas cases counsel that we adopt the interpretation more favorable to the lessor.") (citing *Zeppa*, 113 S.W.2d at 615; *Champlin Petroleum Co. v. Ingram*, 560 F.2d 994, 998 (10th Cir. 1977); *Freeman v. Samedan Oil Corp.*, 78 S.W.3d 1, 7 (Tex. App.—Tyler 2001, pet. granted, judgm't vacated w.r.m.); *Sirtex Oil Indus., Inc. v. Erigan*, 403 S.W.2d 784, 788 (Tex. 1966)).

[10] Lease at 5, ¶10.

[11] Opinion at 7, 9.

[12] Motion at 3.

and inefficient oil and gas industry.[13] For example, Chesapeake contends the phrase "gross production" should actually mean the overriding royalty must be paid using a *Heritage* netback calculation "at the well"—even though doing so would allow Chesapeake to ignore a provision precluding wellhead sales to its affiliate.

II. *HERITAGE* SHOULD NOT BE USED TO TREAT NEGOTIATED LEASE LANGUAGE AS "SURPLUSAGE"

Chesapeake and its industry supporters argue that *Heritage* established a new paradigm for lease interpretation that permits Texas courts to disregard unambiguous language as "surplusage" when a lessee claims to sell gas at the wellhead at a price that is calculated using a "net back" method.

The primary message of *Heritage* is that the actual language used *in the lease* controls.[14] Justice Baker found first that, as used in the *Heritage* leases, "market value at the well" was the starting point.[15] And he concluded that wellhead market value can be determined by subtracting reasonable post-production costs from the market value at a downstream point of sale.[16] Justice

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[13] *Id.*

[14] 939 S.W.2d at 121. *See* Opinion at 10 ("*Heritage Resources* holds only that the effect of a lease is governed by a fair reading of its text.").

[15] 939 S.W.2d at 122.

[16] *Id.* Justice Baker noted that the "most desirable method" for determining market value is to use comparable sales, and that the "net back" method is only used when information about comparable sales is not available. *Id.*

Baker also noted there was a conflicting no-deductions clause that appeared to prohibit deductions for post-production costs.[17] He resolved the conflict through his reading of the no-deductions clause ("there shall be no deduction *from the value of the Lessor's Royalty*").[18] Because the leases described the "value of the Lessor's royalty" as the "market value at the well," and because in his view, the "market value at the well" necessarily includes deductions from post-production costs, there were no other post-production costs to be deducted after "the value of the Lessor's Royalty" had been determined.[19] In her concurring opinion, Justice Owen wrote that "[t]here is little doubt that at least some of the parties to these agreements subjectively intended the [no-deductions] phrase to have meaning."[20] But, she concluded, "the use of the words 'deductions from the value of the Lessor's royalty' is circular in light of this and other courts' interpretation of 'market value at the well.'"[21] In other words, in her view, the no-deductions language did not define or describe how the royalty would be valued. Rather, she

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[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] 939 S.W.2d 118, 130 (Owen, J., concurring).

[21] *Id.*

declared it only prohibited deductions "from the value of Lessor's royalty" *after* that value had been determined.[22]

As this Court noted in its Opinion, the subsequent procedural history of the *Heritage* decision underscores that its outcome was tied to the unique, circular no-deductions clause at issue in that case.[23] On rehearing, former Justice Gonzalez (joined by now Governor Abbott, now Senator Cornyn, and former Justice Spector) appropriately noted that at the end, there was a 4 to 4 split on the merits of the case. Those four Justices emphasized a point lost on Chesapeake: "the Court will examine and consider the entire instrument so that none of the provisions will be rendered meaningless."[24] They further noted that *Heritage* has "very limited precedential value and controls only [that] case."[25] It is also significant that the original opinion drew numerous complaints that the Court had elevated one term to render another term "surplusage." Importantly, a number of oil and gas law experts have criticized *Heritage* to the extent it sanctions judicial selection and enforcement of selected lease provisions to the exclusion of others.[26]

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[22] *Id*. at 122; *id.* at 130–31 (Owen, J., concurring) ("As long as 'market value at the well' is the benchmark for valuing the gas, a phrase prohibiting the deduction of post-production costs *from that value* does not change the meaning of the royalty clause." (emphasis added)).

[23] Opinion at 9 & n.25.

[24] *Heritage*, 960 S.W.2d at 619 (Gonzalez, J., dissenting on motion for rehearing).

[25] *Id*. at 620.

[26] *See, e.g.*, Robert C. Bledsoe & Michael E. Curry, A New Look at "The Ten Most Regrettable Oil and Gas Decisions Ever Issued by the Texas Supreme Court," Adv. O. & G.

III. THE HYDERS' LEASE UNAMBIGUOUSLY EXCLUDES POST-PRODUCTION COSTS FROM THE GAS AND OVERRIDING ROYALTIES

Moreover, the Hyders' lease is easily distinguished from the lease in *Heritage*. First, neither the royalty nor the overriding royalty clauses value the amount to be paid based on "market value at the well." Second, the Hyders' overriding royalty language prohibits deductions *when determining the value of the override* in the first instance. It does not include "circular" language that arguably only prohibits deductions *after* the value is established. And third and very importantly, unlike the leases in *Heritage*, the Hyder lease contains a no-affiliate-sale clause that prohibits sales by a lessee to any "entities affiliated with Lessee in any way."[27]

Course, State Bar of Texas (Sept. 2010); Rachel M. Kirk, *Variations in the Marketable-Product Rule from State to State*, 60 OKLA. L. REV. 769, 770 (2007) (citing *Heritage* in support of statement that it "remains unclear [in Texas] what language the courts will deem sufficient to allocate [post-production] costs"); Bruce M. Kramer, *Interpreting the Royalty Obligation by Looking at the Express Language: What A Novel Idea?*, 35 TEX. TECH L. REV. 223, 263 n.162 (2004) (commenting that *Heritage*'s holding is "interesting because there was express language in the royalty clause not allowing certain deductions to be made"); Edward B. Poitevent, II, *Post-Production Deductions from Royalty*, 44 S. TEX. L. REV. 709, 730 (2003) (noting that the *Heritage* court's decision to treat the no-deduction clause of the lease as "surplusage" "is puzzling given that the royalty clause was the result of bargaining between two sophisticated parties").

[27] Lease at 2, ¶5.

A. The No-Affiliates Sale Clause Supports the Conclusion That "Cost-Free" Means Free of Post Production Costs To The Point of A Sale To An Unaffiliated Party

Chesapeake's motion for rehearing accuses the majority of "ignoring the law."[28] Chesapeake argues that the Court first should "have decided the point at which the overriding 'gross-production royalty' was to be paid. . . . That inquiry would have identified only one location—at the well."[29] Chesapeake then states:

> This overriding royalty is a gross-production royalty that is paid on the volumes and values to be determined at the wellhead. The Lessee [Chesapeake Exploration] sells the gas at the well [to Chesapeake Energy Marketing], and the buyer [Chesapeake Energy Marketing] later sells the gas to third parties after the buyer has incurred post-production expenses to enhance the value of the gas.[30]

However, the Hyder's lease prohibits that course of conduct:

> **Lessee shall not sell hydrocarbons to entities owned in whole or in part by Lessee or to entities affiliated with Lessee in any way, without the express written consent of Lessors.**[31]

This provision unmistakably precludes a lessee's efforts to claim to sell gas at the wellhead to an affiliate in order to avoid lease terms specifying that the lessee will bear post-production costs. Transactions between related companies are

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[28] Motion at p. 3.

[29] Motion at 2.

[30] Motion at 10.

[31] Lease at 2, ¶5 (emphasis supplied).

inherently suspect.[32] As Professors Smith and Weaver correctly note, sales to affiliates raise questions because of the risk that a lessee and its affiliate will inflate post-production costs to unfairly charge the lessee while the lessee's share of the costs may be shifted through internal accounting.[33] To prevent the gamesmanship Chesapeake has used to avoid its promise to bear post-production gathering and transportation costs, parties such as the Hyders have insisted upon terms that prohibit affiliate transactions. A wellhead sale to an affiliate is not a "sale" authorized by the lease and must be disregarded when calculating the royalty. Chesapeake has admitted this in other proceedings.

Chesapeake acknowledged the effect of a no-affiliates-sale clause before the Fifth Circuit in *Potts v. Chesapeake Exploration, LLC*.[34] There, the royalty clause required royalties be paid on "the market value at the point of sale of ¼ of the gas so sold or used."[35] During oral argument, Chesapeake was asked by Judge Smith about a provision in the *Potts* lease specifying that all royalties would be "free of all costs and expenses related to . . . marketing of oil and gas production from the

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[32] *See Parker v. TXO Prod. Corp.*, 716 S.W.2d 644, 646 (Tex. App.—Corpus Christi 1986, no writ) (noting that sale of gas from operator to its subsidiary was "inherently suspect"); 1 Ernest E. Smith & Jacqueline Lang Weaver, *Texas Law of Oil and Gas* § 4.6[C], at 4-76 (2d ed., Matthew Bender 2015).

[33] 1 Smith & Weaver, *supra*, at 4-76–77; *id.* § 4.6[E], at 4-82–83.

[34] *Potts v. Chesapeake Exploration, L.L.C.,* No. 13-10601 (5th Cir.).

[35] *Potts v. Chesapeake Exploration, L.L.C.*, 760 F.3d 470, 471 (5th Cir. 2014).

lease including…costs of compression, dehydration, treatment and transportation”:[36]

> Well, normally when we interpret contracts, we try to give effect to every provision of the contract. So can you explain to us what purpose **this**, again, **lengthy sentence** serves in this contract, **which again is a – is a custom made contract under *Heritage*** for the specific agreement that was reached here, give – give effect to the notwithstanding sentence as it affects what happened here.[37]

Chesapeake responded:

> If, for instance, the point of sale was at a different point downstream, then you could give effect to that notwithstanding clause.
>
> **If Potts and West had negotiated for and included a no-affiliate sale – that is, you may not sell my gas to an affiliate – then, wherever the next point of sale is in the chain of commerce as this gas moves downstream towards the burner tip, then there would be a practical effect for this no-deductions clause set out in the lease.**
>
> **But the lease that we have**, in this instance, **does not contain a prohibition on sales to affiliates**. It does not contain a requirement that the gas be sold off the leased premises. **It doesn’t contain any provisions like that to move Potts off of the *Heritage* default position**.[38]

The *Potts* lease did *not* contain a “no-affiliate-sale” clause. But to avoid giving effect to the no-deductions clause in *Potts*, Chesapeake highlighted the

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[36] *Id*. at 471–72.

[37] Audio Recording of Oral Argument by Chesapeake, March 11, 2014, at http://www.ca5.uscourts.gov/OralArgRecordings/13/_13-10601_3-11-2014.mp3 from 31:06 to 31:39 (last visited Nov. 5, 2015).

[38] *Id*. from 31:39 to 32:36.

significance of a no-affiliate sale clause to make the point that when a lease does preclude affiliate sales, that clause moves the point of sale to the point where the gas is first sold to an unaffiliated party. Chesapeake's admission also confirms that Chesapeake must bear post-production costs to that point of sale.

Hence, the point of sale for all purposes of the Hyders' lease is "the next point of sale in the chain of commerce as the gas moves from the wellhead towards the burner tip." It cannot be the wellhead—as claimed by Chesapeake.

Admittedly, the overriding royalty language is in a separate paragraph. But it is unreasonable to suggest that a total prohibition on affiliate sales somehow does not apply to sales of gas from the "off-lease wells." Nothing in paragraph 10 provides that values are "to be determined at the wellhead." The Lease precluded affiliate sales for all purposes.

B. Paragraph 10's "Cost-Free" Clause Means What it Says

The overriding royalty provisions of the Hyders' lease do not contain a reference to the "value of the lessor's royalty." Rather, "cost-free" describes and defines the value of the overriding royalty, not costs deducted *after* the overriding royalty is valued.

At oral argument Justice Guzman asked Chesapeake, "Do overriding royalties normally bear production costs?"[39] Chesapeake responded "yes."[40] Chesapeake obviously did so to bolster its argument that "cost-free" was intended to refer to production costs and not post-production costs. Justices Boyd and Johnson followed up on Chesapeake's position. Chesapeake again told this Court that an overriding royalty is not free of production costs unless the phrase "cost-free" is added to the overriding royalty clause.[41] Chesapeake's statements illustrate that it will say whatever is expedient to avoid commitments it undertook in oil and gas leases.[42] The only interpretation that gives meaning and effect to every clause, including the "cost-free" language, is the one the Court has adopted—that the parties to the lease intended "cost-free" to include post-production costs.

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[39] Audio/Video Recording of Oral Argument by Chesapeake, March 24, 2015, at http://texassupremecourt.mediasite.com/mediasite/Play/824b6116443248669b6baf761d19eceb1d from 8:13 to 8:18 (last visited Nov. 5, 2015).

[40] *Id*. at 8:33 to 8:35.

[41] *See, e.g., id*. at 10:03 to 10:16 (Justice Boyd: "If the agreement said that you get an overriding royalty but did not say 'cost-free,' would you be responsible for the production costs?" Chesapeake: "I think that you have a good argument that you would be."); *id*. at 12:34 to 12:59 (Justice Johnson: "What if you only say – override – overriding – you have an overriding royalty, and that's all it says. Is your position that that means that the royalty is free of production costs, or is your position that the royalty is not free of production costs?" Chesapeake: "Our position is certainly that it is not free of production costs in that instance because you have to add the cost-free language . . . .").

[42] Just three weeks after oral argument, Chesapeake filed a letter withdrawing its argument and acknowledging that an overriding royalty does not bear production costs. (Letter Brief filed April 14, 2015.)

Chesapeake and its amici nevertheless contend this Court should distort the lease to hold that the override should bear post-production costs. They say this should be so because (1) other courts have found that "cost-free" language in other conveyances simply confirmed the law that overriding royalties do not bear production costs; (2) production taxes are not post-production costs; and (3) the phrase "gross production" actually means "net-back value at the well."[43] Chesapeake's construction departs from the plain and ordinary meaning of the words "cost-free" and "production."

First, Chesapeake argues that courts have held terms such as "cost-free overriding royalty" mean only "free of production costs" and should not be read to prohibit deduction of post-production costs.[44] But the cases cited to support that distorted interpretation concerned lease language identifying the specific "costs" that could not be deducted.[45] For example, the lease in *Delta Drilling Co. v. Simmons* said the override was "free and clear of *all cost of development*."[46] Similarly, *Martin v. Glass* said the override was "free and clear of all cost of *exploration, development, completion* and *operation*."[47]

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[43] Motion at 7–12.

[44] *Id*. at 11.

[45] *Id*. at 9.

[46] 338 S.W.2d 143, 147 (Tex. 1960) (emphasis added).

[47] 571 F. Supp. 1406, 1410 (N.D. Tex. 1983), *aff'd*, 736 F.2d 1524 (5th Cir. 1984) (emphasis added).

The Court correctly observed that the "general term 'cost-free' does not distinguish between production and postproduction costs and literally refers to all costs."[48] Simply put, the words "cost-free" should be given their ordinary, generally accepted meaning; "cost-free" is inclusive of both production and post-production costs.

Second, Chesapeake is wrong that paragraph 10's express exclusion for "production taxes" should somehow serve as a segue to limit the meaning of "cost-free" to only costs of production. Whether production taxes are properly classified as a cost of production has nothing to do with whether the phrase "cost-free" should be limited to production costs. The reference to production taxes means just what it says, and nothing more—the Hyders must pay their share of production taxes.

Chesapeake claims post-production costs are "costs incurred after production *to enhance the value of the gas*."[49] Chesapeake therefore suggests that production taxes are a cost of production. Under Texas law, production costs are identified as "costs of development or operation."[50] But the taxes are not charged

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[48] Opinion at 7.

[49] Motion at 8 (emphasis added).

[50] *See Hurd*, 485 S.W.2d at 339 (noting that overriding royalties are free of "costs of development or operation").

until *after* the gas is produced and severed from the ground.[51] Therefore, taxes are not costs of development or operation, but are instead costs incurred after, or *post*, production.[52] Chesapeake's proposed definition of post-production costs is also flawed because it hinges on whether the costs "enhance the value of the gas." Whether a cost enhances the value of the gas is not easily answered. If Chesapeake's definition is made law, it will spawn further disputes over whether costs incurred after production enhance the value of the gas and therefore qualify as "post-production costs" that may or may not be charged under a given lease. And Chesapeake's erroneous classification of taxes is not supported by its dismissal as an "offhand comment" *Heritage*'s description of taxes as a post-production cost.[53]

Finally, Chesapeake's argument that the term "5% of gross production" requires that both volumes and values be determined at the wellhead is like Swiss cheese.[54] The Court correctly held that the phrase "gross production obtained from

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[51] TEX. TAX CODE ANN. § 201.001(6) (Vernon 2015) (defining "production" or "gas produced" as the "gross amount of gas taken from the earth . . ."); TEX. TAX CODE ANN. § 201.052(a) (Vernon 2015) (tax is imposed on "the market value of ***gas produced*** and saved in this state by the producer." (emphasis added)).

[52] *See* 3 Patrick H. Martin & Bruce M. Kramer, *Williams & Meyers, Oil and Gas Law* § 645.2, at 600–04 (2013) (describing "gas production and severance taxes" as among the "'subsequent to production' costs borne by nonoperating interests as well as by operating interests").

[53] Motion at 9 (citing *Heritage*, 939 S.W.2d at 122).

[54] *Id*. at 4–6, 10–11.

the well" speaks in terms of the *volume* of gas subject to royalty and not the "point at which the royalty is to be calculated."[55] Chesapeake urges the Court to judicially re-define "gross production" to mean "market value at the well." If this Court were to agree, it is obvious Chesapeake has the intent of extending such a ruling to the thousands of other leases it holds. But as the Court noted, "gross" ordinarily means "[u]ndiminished by deduction; entire,"[56] while Webster's defines "gross" as "an overall total *exclusive of deductions*."[57] "Production" can have several meanings, including the "act or process of producing," the "products of an oil or gas well," or the well itself.[58] The Court was correct in holding that, in the context of the Hyders' lease, the term "gross production obtained from the well" refers to the total volume of gas produced and on which royalty must be paid. Chesapeake's interpretation is neither credible nor reasonable. It distorts the commonly understood term "gross production" and renders "obtained from the well" meaningless.

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[55] Opinion at 7–8; Motion at 4.

[56] Black's Law Dictionary 818 (10th ed. 2014).

[57] Webster's Ninth New Collegiate Dictionary 538 (1989) (emphasis added).

[58] *See Amoco Prod. Co. v. Sea Robin Pipeline Co.*, 844 F.2d 1202, 1210 n.25 (5th Cir. 1988) ("The word 'production' is used in the oil and gas industry in several different but related senses.") (citing Williams & Meyers, *Oil and Gas Law (Manual of Terms)* 755 (1969)).

CONCLUSION

Chesapeake's motion is without merit and should be denied. Chesapeake should honor the commitments it accepted when it purchased the Hyder's lease from the original lessee.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief contains 4,498 words, excluding those portions exempted by Texas Rule of Appellate Procedure 9.4(i)(1), as determined using the word processing software's word count feature. This document was created using Microsoft Word, 14-point typeface, except for the footnotes, which are in 12-point typeface.

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