Oil and Gas Alert: Supreme Court of Ohio Declines to Answer Certified Questions on Whether Ohio Follows the 'At The Well' Rule for Post-Production Costs

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In an opinion published yesterday, the Supreme Court of Ohio declined to answer a certified question from the Northern District of Ohio regarding whether Ohio follows the "at the well" rule or the "marketable product" theory with respect to post-production costs, leaving it up to the federal court to interpret the parties' contracts under traditional cannons of contract construction. In declining to adopt a universal rule, the Supreme Court of Ohio reaffirmed the long-held principle that oil and gas leases are contracts and, therefore, "the rights and remedies of the parties are controlled by the specific language of their lease agreement[.]" *Lutz v. Chesapeake Appalachia, L.L.C.*, Slip Opinion No. 2016-Ohio-7549, ¶ 2. Consequently, the Court declined to answer the question of law submitted.

Click here to read the decision.

Background

The underlying case involves a putative class action in which the plaintiffs (landowner-lessors) claim that defendant (lessee) underpaid their gas royalties under the terms of their respective leases. The leases of the named plaintiffs have three varieties of royalty clauses:

1. 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 used or used, provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale.
2. Lessee to receive the field market price per thousand cubic feet for one-eighth (1/8) of all gas marketed from the premises.
3. 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.

The Northern District certified the following question to the Supreme Court of Ohio:

Does Ohio follow the "at the well" rule (which permits the deduction of post-production costs) or does it follow some version of the "marketable product" rule (which limits the deduction of post-production costs under certain circumstances)?

The question was certified on April 1, 2015.

THE DECISION

On November 2, 2016, the Supreme Court of Ohio declined to answer the certified question. The Court began its opinion by citing the well-settled principle that "[u]nder Ohio law, an oil and gas lease is a contract that is subject to the traditional rules of contract construction." *Lutz*, 2016-Ohio-7549, ¶ 2. It then recited the traditional canons of contract construction under Ohio law—that contracts are to be interpreted as to carry out the intent of the parties and, where the language is ambiguous, extrinsic evidence is admissible to ascertain that intent. *Id.* at ¶ 9.

The Court explained that:

1. If the language of the leases is ambiguous, it could not give effect to the parties' intent because there was no extrinsic evidence before the Court; and
2. If the language of the leases is not ambiguous, the Northern District should be able to interpret the leases without its assistance.

Consequently, the Supreme Court of Ohio dismissed the cause as it related to the certified question. As a result, the case will proceed in the Northern District of Ohio.

QUESTIONS

If you have any questions about the Supreme Court of Ohio's decision, please contact: Gregory Russell (614.464.5468), Peter A. Lusenhop (614.464.8263), or Steven A. Chang (614.464.5484).