WRITTEN TESTIMONY

OF

Gateway Royalty

BEFORE THE HOUSE ENERGY AND NATURAL RESOURCES COMMITTEE

Substitute House Bill 152 – Opponent Testimony

Thursday, June 24, 2021

Chris Oldham, President

Larry Oldham, Senior Advisor and Manager

Robert C. Sanders, General Counsel

Chairman Stephens, Vice Chairman Stewart, Ranking Member Weinstein and all members of the Committee. We thank the Committee for the careful attention it is giving this vitally important piece of legislation. We appreciate the time many of you spent meeting with us individually in the past few weeks, and we have been inspired by your dedication to serving the public good.

By way of background, Gateway manages family entities that invest in oil and gas production by buying a portion of the mineral owner's royalty interest. To date, Gateway has acquired interests in 1,466 horizontal wells across the eight counties currently in Ohio's Utica Shale field. As a result, Gateway receives monthly royalty payments from eleven oil and gas operators.

Gateway supports unitization of mineral estates, as this allows for the efficient development of Ohio's rich oil and gas reserves. Gateway also supports provisions in the substitute bill that accelerate unitization approval by the Ohio Department of Natural Resources (page 2 in the attached exhibits).

Gateway believes, however, that **the sub bill needs to be improved** in order to provide unleased mineral owners with a fair royalty and bonus payment.

First, although the sub bill provides for a royalty on the "gross proceeds," that language does **not prevent operators from deducting costs**. Operators often deduct costs from so-called "gross proceeds" royalties using (1) sales to marketing affiliates and (2) "market enhancement" clauses. We will explain these two mechanisms today, but the key point to remember is that operators cannot use those mechanisms to deduct costs from a "gross proceeds" lease if the royalty language recommended by Gateway is included in the sub bill. To prevent deductions, the royalty must be a percentage of **"the gross proceeds paid by the first unaffiliated buyer in an arms-length transaction with no deduction of any costs, including, but not limited to, the costs of gathering, compressing, processing, dehydrating, separating, transporting and marketing."**

Second, the sub bill provides for a royalty percentage of **only 1/8th (12.5%)** of the gross sale price, yet the norm since the beginning of the Utica shale boom in 2010 is between 16-20%. Since the quality and types of oil and gas reserves vary from unit to unit, a fair market royalty percentage for a given unit is the **average royalty**

percentage of all leases in the unit. We believe that the unleased mineral owner should not have the highest, or the lowest, royalty percentage, but the average. This would put the unleased mineral owner in parity with his or her neighbors.

Third, the sub bill provides for a one-time bonus payment to the unleased mineral owner of 50% of the market rate for bonuses. The bonus should be the **average bonus per acre paid for all acres in the unit under leases in their primary term**, excluding acreage held by production.

Fourth and finally, the sub bill allows an operator to file an application for forced pooling if it has only 65% of the acres in the proposed unit under lease. The operator should be required to have at least **85% of the acreage under lease before filing an application for forced pooling**. This will require the operator to negotiate with more landowners, which will create a more accurate market value for calculating the royalty percentage and the amount of the bonus. It is not burdensome for operators to lease 85% of the acreage in a proposed unit before filing an application for forced pooling. In fact, they **routinely lease approximately 87% of the acreage**, as shown in the Table titled **"Analysis of All Horizontal Forced Pooled Units Filed in the Ohio Utica Shale as of April 2021"** (pages 3, 4, 5 and 6 in the attached exhibits).

These four changes to sub H.B. 152 are included in Gateway's redline to the sub bill.

These recommended changes to the sub bill would benefit not only mineral owners who are forced-pooled, but also unleased mineral owners who will be negotiating leases in the future. **As Gateway knows too well, operators sometimes use the threat of forced pooling to try to coerce mineral owners into accepting unfavorable lease terms rather than be forced-pooled under worse terms later.** Unless the sub bill provides the fair market value royalty and bonus recommended by Gateway, the threat of forced pooling will **depress the value on mineral estates of all unleased mineral owners in Ohio for generations to come.**

This devaluation of mineral estates hits Ohioans who are among the most impoverished in the state. The table titled **"Ohio Utica Shale Demographics"** (page 7 in the attached exhibits) shows the poverty rate, average per capita income and average household income of people living in the eight Ohio counties in the Utica shale field. The average per capita income in these counties is approximately $27,000 per year and the average household income is typically below $50,000. The income levels in all eight counties in the Utica field are in the lower half of all 88 counties in Ohio. In many cases, the only significant asset owned by landowners in these counties is their mineral estate.

The cost deductions taken from the royalties paid to these hard-pressed Ohioans is staggering. Gateway has created a table titled **"Overview of Post Production Costs**

by Operator" (page 8 in the attached exhibits) from the actual royalty revenue checks it receives each month from the eleven operators that pay it royalties. The table shows the average percentage of the gross sales price that each operator deducts in "post-production costs" (costs incurred between the well and the point of sale). At the high end, Encino deducts on average **57% of the gross sales price**. On the low end, Equinor and Rice deduct on average **13%** of the gross sale price. The average among all eleven operators is **28%** of the gross sale price.

The revenues that the operators generate from these wells are also staggering. The 8/8^{ths} revenues that the eleven operators have generated from 1,466 wells in which Gateway owns an interest are **$13.3 billion**. From the $13.3 billion, the eleven operators have deducted $464.1 million of post-production deductions from the mineral owners' assumed 1/8 royalty interest. One of the top four operators by revenue, Encino, has generated 8/8ths revenue of **$1.1 billion since May 1, 2019** from 650 wells in which Gateway owns a royalty interest. Encino deducted **$82.3 million from the mineral owners' assumed 1/8th royalty interest share.** The large per-well revenues received by operators allows them to recover the approximately $7.0 million they invest in the drilling and completion of each well in as little as 9 months.

The financial statements of the operators reveal the enormous revenues they are generating. Although several operators declared bankruptcy in recent years, most notably Chesapeake and Gulfport, these bankruptcies were largely due to prolific spending and mismanagement. As operators gain greater knowledge on how to efficiently, and economically, extract oil and gas production from the Utica shale, their growing bottom-line numbers attest to their success.

The operators' financials reveal that, in some cases, the operator's parent company also owns, or has an interest in, the midstream companies that are paid the costs deducted from the royalties. The parent company therefore makes money on both ends. The operator pays less royalties by deducting costs and the midstream company banks the costs deducted.

An example cost deductions paid to midstream companies owned by the operator's parent is found on the website of Ascent Resources at https://ascentresources.com/investors. Ascent's website includes the "Management's Discussion and Analysis and Consolidated Financial Statements as of December 31, 2020 and 2019 and for the Years Ended December 31, 2020, 2019 and 2018 for Ascent Resources Utica Holdings, LLC." Ascent Resources Utica Holdings, LLC is a large operator owned by EMG and First Reserve, who reported in its Consolidated Statements of Operations (page 9 in the attached exhibits) that "Gathering, processing and transportation expenses" were $919.986 million,

$856.126 million, and $658.117 million for the years ended 2020, 2019 and 2018, respectively. Also, in its Notes to Consolidated Financial Statements, **"Note 8. Related Party Transactions"** (page 10 in the attached exhibits) states, "In the normal course of our business, we have entered into certain business relationships with entities in which EMG or First Reserve have control or significant influence through their equity investments. These relationships include agreements for the sale of our NGL [Natural Gas Liquids] production and the gathering, processing and transportation of our natural gas and NGL production." Ascent further explains in "Note 8. Related Party Transactions," that "We also incurred gathering, processing and transportation expenses associated with these agreements of $623.7 million, $607.8 million and $463.9 million during the years ended December 31, 2020, 2019 and 2018, respectively."

The excessive cost deductions taken by operators have caused many mineral owners to insist on "gross proceeds" royalties. As a result, gross proceeds leases have become more prevalent in recent years. Notwithstanding, operators often continue to take cost deductions through the two mechanisms mentioned earlier — sales to marketing affiliates and by "market enhancement" clauses. Both tactics lull unsuspecting mineral owners into believing their royalties will be cost free. Mineral owners are rightly shocked, angered and embittered when they learn that, notwithstanding the "gross proceeds" language, the operator takes large deductions that whittle their royalties down to almost nothing.

Under the **affiliate sale mechanism**, sometimes referred to as **"two-step marketing"** (page 11 in the attached exhibits), the operator sells the well production to a marketing affiliate at the well. The marketing affiliate processes the production and sells it in downstream markets. The price that the marketing affiliate pays the operator is the price paid to the marketing affiliate in the downstream sale, **less all costs incurred between the well and the downstream sale.** When the mineral owner protests, the operator argues that it "takes no deductions" and pays the royalty on the "gross price" it receives from the marketing affiliate, even though post-production costs were already netted out of the true gross sale price paid by the first unaffiliated buyer in the downstream sale.

The "**market enhancement" clause mechanism** (page 12 in the attached exhibits) is equally deceptive. The lease provides for a royalty on "gross proceeds" with no deduction of any costs needed to make the oil and gas "marketable," including, but not limited to, "the costs of gathering, storing, separating, treating, dehydrating, compressing, processing, transporting, and marketing." The lease then has a **"however" clause** that says that costs that "enhance the value of a marketable product" can be deducted from the royalties. The operator then deducts **all post**

production costs, including the list of costs the lease just stated would **not** be deducted. When the mineral owner protests, the operator argues that the oil and gas was in "marketable condition" the moment it was produced at the well head and that all costs incurred thereafter are deductible.

Disturbingly, market enhancement clauses have begun to appear in forced pooling orders issued by the Ohio Department of Natural Resources ("ODNR"). **Prior to February 13, 2018**, the orders simply provided for a royalty on the **"gross proceeds,"** as shown in excerpt of an application on page 14 of the attached exhibits. **Beginning February 13, 2018**, ODNR's orders have included market enhancement clauses in the form of a new "definition" for "gross proceeds" (page 15 in the attached exhibits). Gateway met with representatives of ODNR last week and asked how and why market enhancement clauses came to be added to ODNR forced pooling orders. The representatives had no answer (page 16 in the attached exhibits).

The fact that ODNR itself is imposing market enhancement clauses on unleased mineral owners underscores why it is essential that the sub bill include the royalty language recommended by Gateway. Otherwise, ODNR will likely continue to burden unleased mineral owners with market enhancement clauses. Sadly, it is now painfully evident that unleased mineral owners need protection not only from operators, but from ODNR itself.

Gateway believes that ODNR's forced pooling orders issued since February 13, 2018 are patently unfair to the unleased mineral owners because of the inclusion of market enhancement clauses. Accordingly, Gateway recommends the sub H.B. 152 be **retroactive to February 13, 2018**. Gateway's redline to the sub bill includes a provision that makes the royalty and bonus provisions retroactive to that date.

The original version of H.B. 152 would have required unleased mineral owners who are forced pooled to accept a royalty of 1/8th (12.5%) of the "net proceeds." The substitute bill changes the royalty to 1/8th (12.5%) of the "gross proceeds," which suggests that **the sponsors now correctly recognize that the royalties to be cost free**. As just explained, however, "gross proceeds" language in the sub bill does **not accomplish the sponsors' objective** of ensuring that the royalties will be cost free because affiliate sales and market enhancement clauses allow operators to deduct costs despite "gross proceeds" language. The only way the mineral owner will be protected from cost deductions is by the royalty language that Gateway recommends be included in the sub bill. The royalties must be the mineral owner's percentage (in this case the average percentage of all leases in the unit) of the **"gross proceeds paid by the first unaffiliated buyer in an arms-length transaction with no deduction of any costs, including, but not limited to, the costs of gathering, compressing,**

processing, dehydrating, separating, transporting and marketing" (page 13 in the attached exhibits)**.**

The changes to Sub Bill 152 recommended by Gateway are imminently fair and reasonable. The royalties to unleased mineral owners should not be burdened with cost deductions, the royalty percentage should be the average of all leases in the unit, the bonus should be the average of all leases in the unit, and the operator should not be permitted to file an application for forced pooling until 85% of the acreage in the proposed unit are under lease (page 17 in the attached exhibits).

The world-class oil and gas reserves in Ohio provide an unprecedented opportunity to mineral owners and operators alike. Neither should be unfairly enriched at the expense of the other, however. With the changes proposed by Gateway, sub H.B. 152 will strike the right balance in the interests of all parties.

Gateway thanks the Committee again for its diligent attention to this important bill. We stand ready to assist you in any way we can as you continue your deliberations.

Respectfully submitted,

Chris Oldham
President

Larry Oldham
Senior Advisor and Manager

Robert C. Sanders
General Counsel

EXHIBITS TO
WRITTEN TESTIMONY
OF

Gateway Royalty

BEFORE THE HOUSE ENERGY AND NATURAL RESOURCES COMMITTEE

Substitute House Bill 152 – Opponent Testimony

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Sub. H.B. No. 152

Benefits of the Bill if Gateway Recommendations are accepted

OPERATORS

- **Acceleration of timing for unitization approval from the Ohio Department of Natural Resources.**

EXISTING LEASED MINERAL OWNERS

- **Improvement in the timing of development for mineral owners who have already been leased.**

UNLEASED MINERAL OWNERS

- **Provision of fair and equitable gross royalty and upfront bonus money.**

Analysis of all Horizontal Forced Pooled Units (FPUs) Filed in the Ohio Utica Shale as of April 2021

Analysis of all Horizontal Forced Pooled Units (FPUs) Filed in the Ohio Utica Shale
Based on all Permits as of April 2021

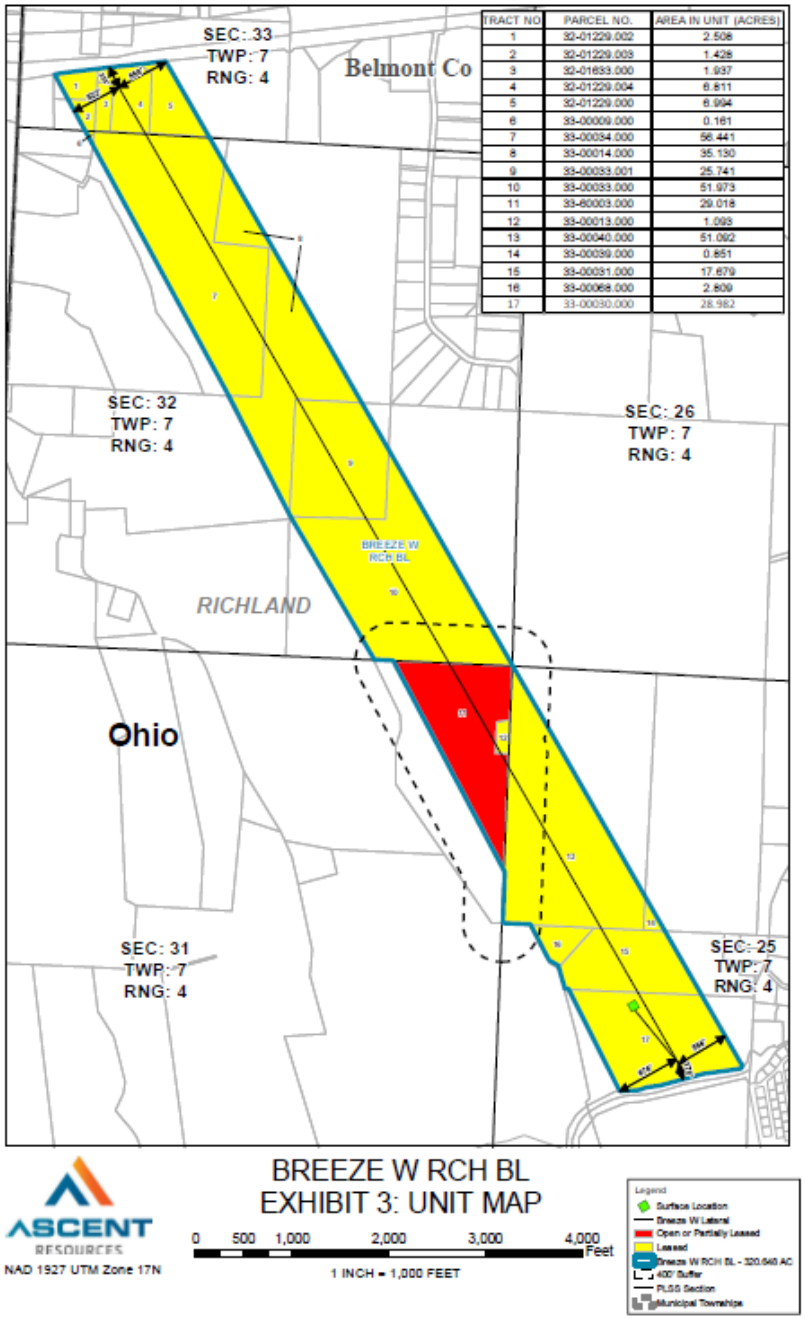
County	Number of Operators per County	Total Number of FPU Applications Filed	Total Number of Acres in all FPUs	Average Number of Acres per FPU	Average Number of Tracts in FPUs	Average Tract Size in Acres	% of Mineral Acres Leased when FPU was filed	% Royalty Disclosed by Operator in FPU Application
Belmont	6	89	49,932	561	79	7.06	88.78%	ND
Carroll	1	8	7,507	938	160	5.88	76.63%	17%
Columbiana	2	4	2,064	516	48	10.93	81.43%	17%
Guernsey	4	15	11,411	761	77	9.91	84.45%	ND
Harrison	4	28	20,410	729	65	11.23	86.79%	17-19%
Jefferson	4	44	25,246	573	85	6.73	88.58%	17-19%
Monroe	6	78	47,369	607	50	12.16	89.79%	ND
Noble	3	6	4,449	742	57	13.09	89.31%	ND
Grand Total		272	168,388	619	72	8.64	88.11%	

Ascent Resources Forced-Pooled Unit Application Oct 9, 2020 filing date

Breeze W RCH BL Unit
Belmont County

326.69 acres
17 tracts
90% leased
? Net Revenue
? Royalty Owners

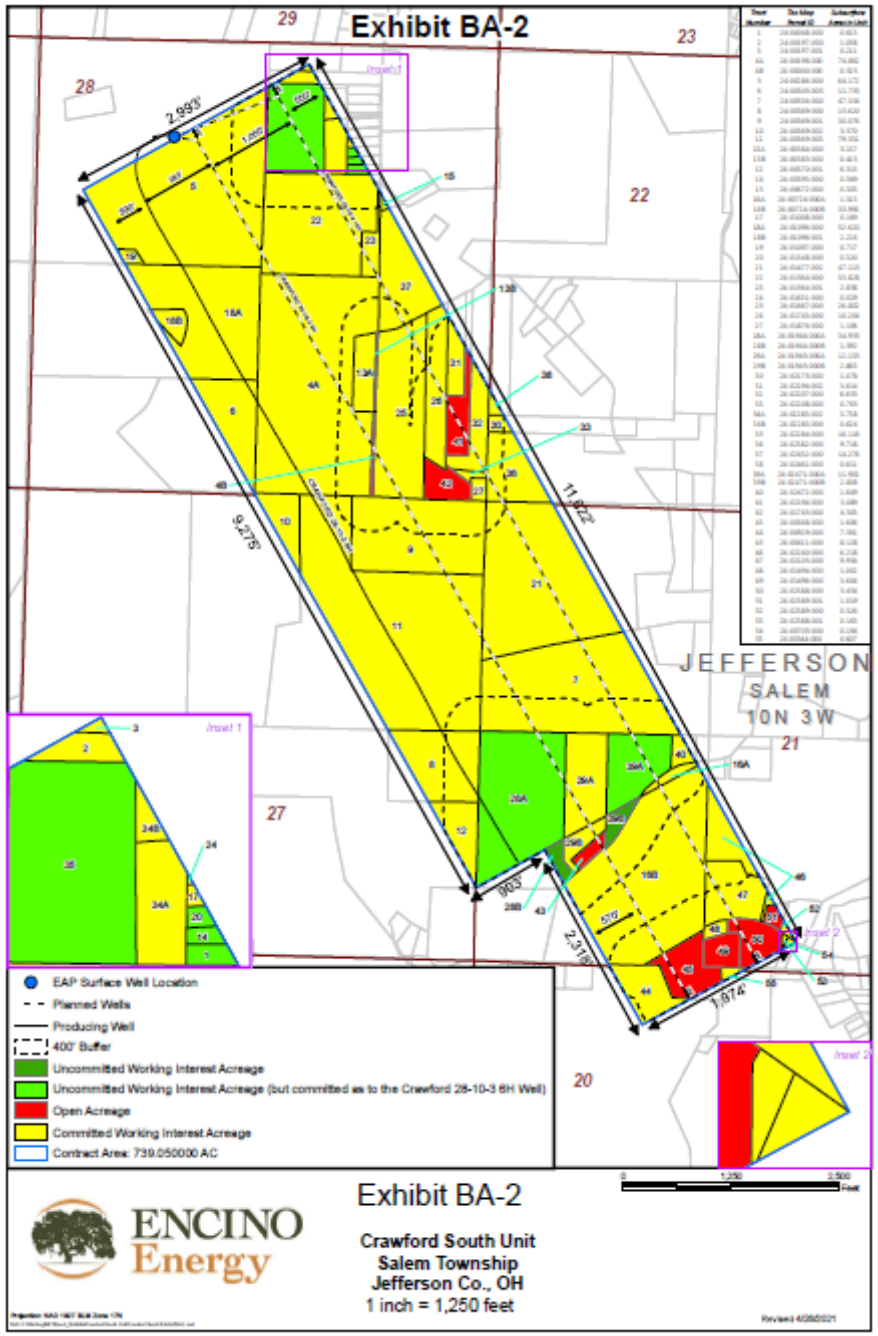
Note: This was the example used in testimony by Proponent, Matt Hammond, on April 15, 2021.



Encino Energy Forced-Pooled Unit Application April 6, 2021 filing date

Crawford South Unit
Jefferson County

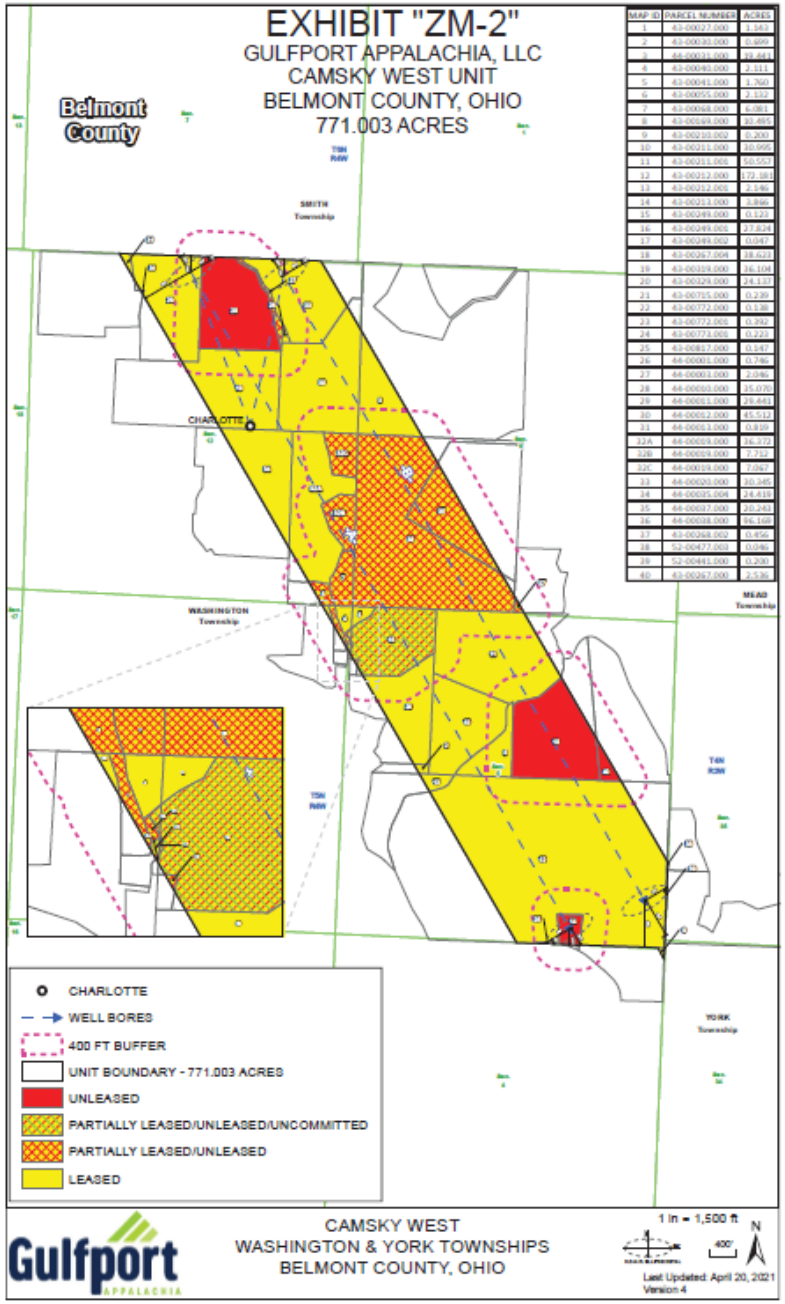
739.05 acres
55 tracts
86% leased
83% Net Revenue
17% Royalty Owners



Gulfport Energy Forced-Pooled Unit Application
April 21, 2021 filing date

Camsky West Unit
Belmont County

771.00 acres
40 tracts
85.6% leased
? Net Revenue
? Royalty Owners



Ohio Utica Shale Demographics (1)

The 8 counties in the Ohio Utica Shale field have poverty rates ranging from 11.3% to 17.1%, and based on income, rank from a high of 47th to a low of 81st out of 88 counties. On a theoretical basis, the average mineral ownership per person is 6.8 mineral acres. (2)

OHIO UTICA SHALE DEMOGRAPHICS (1)								
8 COUNTIES IN THE OHIO UTICA SHALE			INCOME OF EACH COUNTY			SIZE OF EACH COUNTY		
County	Population	Poverty Rate	Per Capita Income *Ohio Average $31,552*	Median Household Income *Ohio Average $56,602*	Rank out of 88 Counties	Area Square Miles	Total Possible Mineral Acres	Theoretical Avg Mineral Acres per person in County (2)
Belmont	67,006	11.6%	$27,580	$50,904	64th	532	340,563	5.1
Carroll	26,914	11.3%	$29,518	$55,267	47th	395	252,550	9.4
Columbiana	101,883	13.2%	$26,489	$48,345	70th	532	340,410	3.3
Guernsey	38,875	15.5%	$24,742	$45,917	74th	522	334,240	8.6
Harrison	15,040	14.5%	$24,940	$49,689	73rd	402	257,498	17.1
Jefferson	65,325	17.1%	$26,391	$46,581	63rd	408	261,331	4.0
Monroe	13,654	14.0%	$26,476	$45,289	81st	456	291,661	21.4
Noble	14,424	14.2%	$24,440	$46,897	67th	398	254,726	17.7
TOTAL	343,121					3,645	2,332,979	6.8

(1) Data provided by www.census.gov and was calculated using the 2015-2019 American Community Survey that incorporates data over the previous five years to reach an acceptable estimate of data until the 2020 Census numbers are released.

(2) The theoretical average mineral acres per person in the County includes all mineral owners, large and small, including Ohio Department of Transportation and nature preserves.

Overview of Post-Production Deductions by Operator
on 1,466 producing Utica wells in which Gateway Royalty owns a royalty interest

Total Producing Wells 1Q 2021		Operator	Number of Wells	8/8ths Gross Revenue	Post-Production Deductions (Deducts) Average % of Gross Revenue [1]	Highest % of Gross Revenue [2]	8/8ths Deducts	1/8th deducted from Royalty Owners
855		EAP Ohio (Encino-CHK)	650	$ 1,148,856,756	**57%**	**95%**	$ 658,583,269	**$ 82,322,909**
0	[3]	EAP Ohio (Encino-new)	28	177,031,912	**49%**	**71%**	86,962,806	10,870,350
7		SWN (Triad)	3	5,658,520	**44%**	**44%**	2,497,763	312,220
620		Ascent	140	2,696,295,551	**40%**	**61%**	1,069,656,849	**133,707,106**
47		CNX	8	84,015,182	**30%**	**38%**	25,503,693	3,187,962
223		Antero	22	478,511,903	**26%**	**47%**	125,522,398	15,690,300
206		SWN (Eclipse)	47	679,103,555	**26%**	**40%**	173,972,341	21,746,543
40		R E Gas Dev	40	398,145,995	**26%**	**38%**	102,930,795	12,866,349
401		Gulfport	295	3,580,786,350	**25%**	**50%**	890,404,916	**111,300,614**
59		XTO	30	421,697,694	**24%**	**35%**	101,109,055	12,638,632
51		Equinor	11	121,430,364	**13%**	**20%**	16,815,301	2,101,913
140		Rice (EQT)	192	3,466,619,918	**13%**	**38%**	459,152,337	57,394,042
2,649		**TOTAL**	**1,466**	**$ 13,258,153,700**	**28%**	**95%**	**$ 3,713,111,523**	**$ 464,138,940**

[1] This shows Deducts as a percentage of Gross Revenue per Operator and in Total.
Average % of Gross Revenue = 8/8ths Deducts divided by 8/8ths Gross Revenue.
In Total, the weighted average for Deducts as a percentage of Gross Revenue for all 1,466 wells is 28%.

[2] This shows the highest Deducts as a percentage of Gross Revenue, per Operator, which was for certain wells (not for all wells per Operator). As shown, EAP Ohio (Encino-CHK) had Deducts as high as 95% of Gross Revenue on certain wells.

[3] The 1Q 2021 producing wells for EAP Ohio (Encino-new) are included in the 855 wells for EAP Ohio (Encino-CHK).

Example of "Payment of Cost Deductions by Operators to Midstream Affiliates"

Selected information from Ascent Resources Utica Holdings, LLC
2020 Consolidated Financial Statements
Page 27 – Consolidated Statements of Operations

ASCENT RESOURCES UTICA HOLDINGS, LLC
CONSOLIDATED STATEMENTS OF OPERATIONS

($ in thousands)	Year Ended December 31, 2020	2019	2018
Revenues:			
Natural gas	$ 1,258,594	$ 1,589,099	$ 1,444,368
Oil	138,723	241,521	133,786
NGL	118,224	148,639	109,221
Commodity derivative (loss) gain	(19,167)	441,139	(90,881)
Total Revenues	1,496,374	2,420,398	1,596,494
Operating Expenses:			
Lease operating expenses	78,430	72,606	50,163
Gathering, processing and transportation expenses	919,986	856,126	658,117
Production and ad valorem taxes	37,495	34,167	23,362
Exploration expenses	104,230	124,477	156,450
General and administrative expenses	63,825	61,027	63,794
Acquisition expenses	—	—	9,407
Natural gas and oil depreciation, depletion and amortization	733,450	702,414	500,773
Depreciation and amortization of other assets	3,568	3,239	3,912
Total Operating Expenses	1,940,984	1,854,056	1,465,978
(Loss) Income from Operations	(444,610)	566,342	130,516
Other (Expense) Income:			
Interest expense, net	(134,213)	(109,114)	(92,227)
Change in fair value of contingent payment right	(6,518)	—	—
Change in fair value of embedded derivative	—	5,026	18,865
Losses on purchases or exchanges of debt	(6,037)	—	(62,233)
Other income	1,867	3,711	683
Total Other Expense	(144,901)	(100,377)	(134,912)
Net (Loss) Income	$ (589,511)	$ 465,965	$ (4,396)

Example of "Payment of Cost Deductions by Operators to Midstream Affiliates"

Selected information from Ascent Resources Utica Holdings, LLC
2020 Consolidated Financial Statements
Page 45 – Footnote 8

ASCENT RESOURCES UTICA HOLDINGS, LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

8. Related Party Transactions

Gas Gathering, Firm Transportation, Processing and Commodity Sales Agreements

In the normal course of our business, we have entered into certain business relationships with entities in which EMG or First Reserve have control or significant influence through their equity investments. These relationships include agreements for the sale of our NGL production and the gathering, processing and transportation of our natural gas and NGL production. The NGL revenues recognized under such agreements were $67.0 million, $104.8 million and $79.9 million during the years ended December 31, 2020, 2019 and 2018, respectively. As of December 31, 2020 and 2019, we had accounts receivable – natural gas, oil and NGL sales of $9.5 million and $21.2 million, respectively, due from these purchasers. We also incurred gathering, processing and transportation expenses associated with these agreements of $623.7 million, $607.8 million and $463.9 million during the years ended December 31, 2020, 2019 and 2018, respectively. As of December 31, 2020 and 2019, we had $96.6 million and $96.1 million of payables, respectively, due to companies associated with these agreements, which are presented as other current liabilities on the consolidated balance sheets. For information regarding the credit support requirements due to certain related parties, see Note 9, *Pipeline Commitments*.

Long-Term Debt

In connection with the Exchange, we issued $12.0 million in aggregate principal amount of 2025 Second Lien Term Loans and $8.6 million in aggregate principal amount of 2027 Notes to certain existing equity holders and their designated affiliates. As of December 31, 2020, $8.6 million in aggregate principal amount of 2025 Second Lien Term Loans and $0.3 million in aggregate principal amount of 2027 Notes were held by certain related parties.

Example of Operators' Self-Dealing Sales to Affiliates

"Two-Step Marketing"

- **Operator sells the products to a marketing affiliate at the well under a "gross proceeds" lease.**
- **The marketing affiliate processes the products and sells them in downstream markets.**
- **The price paid to the operator by the marketing affiliate is the price received in the downstream sale, less all costs incurred between the well and the downstream sale.**
- **When the mineral owner protests, the operator argues that it "takes no cost deductions" and pays the royalty on the "gross price" it receives from its marketing affiliate.**

Example of Operators' Self-Dealing Market Enhancement

"Market Enhancement"

- The Lease provides for a royalty on "gross proceeds" with no deduction of costs needed to make the oil and gas marketable".
- The Lease then says costs can be deducted if they enhance the value of an already "marketable" product.
- The operator then deducts all costs incurred between the well and the downstream sale.
- When the mineral owner protests, the operator argues that the oil and gas was in "marketable condition" at the well and that all costs between the well and the downstream sale enhanced the value of an already marketable product.
- Under this reasoning that oil and gas is "marketable" at the well, there is never any post-production cost that is not deductible.

Example of Market Enhancement Clause

It is agreed between the Lessor and the Lessee that, notwithstanding any language herein to the contrary, all oil, gas or other proceeds accruing to the Lessor under this lease shall be paid without deduction for, directly or indirectly, any post production costs, including but not limited to, the costs of producing, gathering, storing, separating, treating, dehydrating, compressing, processing, transporting, and marketing the oil, gas and other products produced hereunder to the extent such costs are necessarily incurred to transform the product into a marketable form; provided, however, any such costs which result in enhancing the value of already marketable oil, gas or other products may be deducted from Lessor's share of production proceeds. so long as such costs are reasonable and do not exceed the value of the enhancement obtained by incurring such costs.

Gateway Royalty's Recommended Essential Language for a Gross Proceeds Royalty

"A royalty equal to [a percentage] of the gross proceeds paid by the first unaffiliated buyer in an arms-length transaction with no deduction of any costs, including, but not limited to, the costs of gathering, compressing, processing, dehydrating, separating, transporting and marketing."

This prevents cost deductions using:

- **Sales to Affiliates**
- **"Market Enhancement" Clauses**

ODNR Order by the Chief "Gross Proceeds" prior to February 13, 2018

January 19, 2018

Order No. 2018-13

To: Chesapeake Exploration, LLC

Re: Application for Unitization
Surratt Unit
Belmont and Guernsey Counties, Ohio

Definitions:

No definition was given for "gross proceeds" in this Order by the Chief, or any previous orders prior to this date. The definition for "gross proceeds" first appeared in the next Order by the Chief on February 13, 2018 (see next slide).

Plan for Unit Operations

9) c) Each unleased mineral owner shall receive a monthly cash payment equal to a one-eighth (1/8) landowner royalty interest calculated on **gross proceeds**. Allocation of the one-eighth (1/8) landowner royalty shall be based on the unit participation of each unleased mineral owner's tract. Chesapeake shall make royalty payments to all royalty interest owners at the same time.

ODNR Order by the Chief
"Market Enhancement" beginning February 13, 2018

February 13, 2018

Order No. 2018-14

To: Chesapeake Exploration, LLC

Re: Application for Unitization
Pickens Unit
Harrison County, Ohio

Definitions:

13) "Gross Proceeds" means a share of the gross production of oil, gas, condensate, and natural gas liquids free of any and all cost of producing, gathering, storing, separating, treating, dehydrating, compressing, processing, transporting, marketing, or pipeline construction and maintenance. "Gross proceeds" does not include costs that result in enhancing the value of marketable oil, gas, condensate, natural gas liquids, or other products to receive a better price so long as the costs are the actual costs of such enhancement and an unleased mineral rights owner's pro rata part of such cost is less than the amount of the enhanced value of the product.

Plan for Unit Operations
(This language remains the same as the January 19, 2018, Order No. 2018-13 (see previous slide.)

9) c) Each unleased mineral owner shall receive a monthly cash payment equal to a one-eighth (1/8) landowner royalty interest calculated on **gross proceeds**. Allocation of the one-eighth (1/8) landowner royalty shall be based on the unit participation of each unleased mineral owner's tract. Chesapeake shall make royalty payments to all royalty interest owners at the same time.

Governor Mike DeWine's office arranged for Gateway Royalty to meet with representatives of the ODNR on Tuesday, June 15, 2021.

Gateway asked the ODNR representatives why the ODNR added a definition of "gross proceeds" using market enhancement language in Orders by the Chief beginning on February 13, 2018?

The ODNR representatives had no answer to this question.

Sub. H.B. No. 152 – Gateway's Recommendations

GATEWAY'S RECOMMENDATIONS

The following recommendations would be **Fair and Equitable** and would represent **Fair Market Value** to both the mineral owner and the Operator.

1. Operator must own/control a **minimum of 85%** of all mineral acres in the proposed Forced Pooled Unit vs. the 65% currently proposed by the Bill.
   - **The average is 88% to date, based on the 272 Forced Pooled Unit applications filed thru April 2021, which have an average Forced Pooled Unit size of 619 acres consisting of 72 tracts with 8.64 acres per tract (see next slide).**
2. The unleased mineral owner's royalty interest should be the weighted average royalty the Operator has negotiated on all mineral acres leased within the Forced Pooled Unit when filed with the ODNR.
   - **The royalty should be cost free, defined as the "gross proceeds paid by the first unaffiliated third-party buyer in an arm's length transaction with no deduction of any costs."**
3. Bonus per net mineral acre to be paid to Mineral Owner **should be based on the average bonus** paid for all the Operator's leases that are within their primary term, excluding any acreage that is held by production.

COMMENT

- These recommendations would prevent the Operator from taking advantage of the Mineral Owner by not dealing in good faith leasing prior to filing the Forced Pooled Unit. **Gateway has experienced this tactic being used by Operators whereby Gateway has been threatened to either take the Operator's proposed net lease or get Forced Pooled.**

Gateway Management and General Counsel

Chris Oldham serves as a Manager of five Gateway Royalty entities, which have been successful in acquiring oil and gas minerals and royalties in the Ohio Utica Shale since 2012. In 2010, prior to founding the Gateway Royalty entities, Chris formed a $6 million land bank with oil industry friends and family to lease approximately 10,000 acres in a developing horizontal play. In less than 18 months, the acreage was sold for $28 million with a retained override.

Prior to 2010, Chris worked as a contract Landman primarily focused on the Barnett Shale in Tarrant County, Texas, with Dale Resources and then Chesapeake Energy. Dealing with local municipalities and thousands of mineral owners in an urban environment caused this to be a very complex leasing endeavor. He managed a team of 40 landmen with numerous responsibilities, including leasing, title curative, construction of drilling units, and staying ahead of Chesapeake's drilling schedule. Chris's experience with Chesapeake in the Barnett Shale is a significant example of his ability to successfully lead a team while handling complex projects. He gleaned knowledge on the inner workings of a major company in how it simultaneously handles land issues and drilling schedules. Chris learned the importance of managing the process through the development of a proprietary software database and carried this knowledge and expertise into the formation of his own companies.

Chris graduated from Midland High School in 2000 and was a member of the 1998 State Champion basketball team for 5A schools in Texas. He earned a BBA in Accounting and Finance from Texas Christian University in 2004. While attending TCU, Chris was President of his fraternity and was a finalist for Mr. TCU. He rode his bicycle from San Francisco, California to Washington, D.C. two consecutive summers as a participant in the "Journey of Hope", which was a 4,000-mile, cross-country bicycling event to raise money for people with disabilities. These events were sponsored by his fraternity's philanthropy, *Push America*, and Chris was the top fundraiser both years.

Chris resides in Fort Worth, Texas, with his wife, Kathryn, and their four children.

Larry C. Oldham serves as a Manager and Advisor of the Gateway entities, which were founded by Larry's son, Chris Oldham, and have been successful in acquiring oil and gas minerals and royalties in the Ohio Utica Shale since 2012. Additionally, Mr. Oldham serves as Manager of Oldham Properties, Ltd.; is an Operating Partner in Mountain Capital LLC, an energy private equity firm located in Houston, Texas; and is Lead Director and Chairman of the Audit Committee for HighPeak Energy, Inc. (NYSE: HPK), a public oil and natural gas company headquartered in Fort Worth, Texas.

Larry C. Oldham is the founder and former President and CEO of Parallel Petroleum LLC, an independent energy company headquartered in Midland, Texas, which is engaged in the acquisition, development and production of long-lived oil and gas properties, primarily in the Permian Basin.

Mr. Oldham founded Parallel Petroleum Corporation in 1979, took it public in 1980 for a total capitalization of $4 million. He served as an officer and director of the corporation until it was acquired thirty years later by Apollo Global Management in November 2009 for $483 million, with Mr. Oldham remaining as President. Apollo sold the company two years later in December 2011 to Samsung C&T Corporation for $772 million. Under Apollo's ownership and now under the Samsung's ownership, Parallel Petroleum LLC has maintained its footprint in the Permian Basin.

During his years at Parallel, some of the most notable property acquisitions were the 1984 acquisition of six Cambridge and Nail limited partnerships through a merger/combination for stock with a market cap of $10 million; the 1989 acquisition of the Page Field in Schleicher County; the 1991 acquisition of the West World field in Crockett County; the 1999 acquisition of all of Fina's West Texas assets for $96 million and subsequent sale to Energen Corporation in 2002 for $232 million; the 2001 acquisition of the Diamond M Canyon Reef Field in Scurry County; the 2002 acquisition of the Fullerton San Andres Field in Andrews County from Jerry Jones for $46.1 million; the 2004 acquisition of the Carm-Ann /N. Means Queen field in Andrews and Gaines Counties for a total consideration of $5.135 million; and the 2005 acquisition of the Harris San Andres field for a total consideration of $44.5 million.

In 1992, Parallel Petroleum was an early adopter of 3D seismic and drilled several Canyon Reef discoveries in Howard County and several discoveries in the Yegua/Frio Trend, onshore the Gulf Coast of Texas. In 2005, horizontal drilling was successfully implemented in the Wolfcamp formation in New Mexico and the Barnett Shale in Tarrant County Texas. In 2014, Parallel drilled its first of several horizontal wells in the Harris Field, which were large producing wells completed with engineered fracs. Parallel Petroleum was the forerunner of this highly successful completion technique.

Prior to Parallel's formation, Mr. Oldham was employed by Dorchester Gas Corporation from 1976 to 1979 and KPMG Peat Marwick, LLP during 1975 and 1976. He earned a BBA in Accounting from West Texas State University (now West Texas A&M University) in 1975 and was a 2012 Distinguished Alumni Award recipient. Mr. Oldham is a CPA and is a member of the Permian Basin Landman's Association and the Permian Basin Producers Association.

Larry and his wife, Sandra, reside in Midland, Texas. Their greatest joys are their two boys and daughters-in-law, Chris and Kathryn Oldham of Fort Worth and Dr. Cody and Cynthia Oldham of Midland, and their eight grandchildren. The Oldhams have been active members of the Midland Church of God since their arrival in Midland in 1978.

Robert C. Sanders earned his law degree at the University of Baltimore, where he served as the Editor-in-Chief of the Law Review. After graduating from law school in 1986, he joined the Washington, D.C. firm of Clifford & Warnke where he worked with Clark Clifford, a former Secretary of Defense and advisor to four presidents, on a variety of high-profile cases, including a newspaper merger case successfully concluded in the U.S. Supreme Court. Rob later joined the Baltimore law firm of Shapiro & Olander as a litigation partner and continued to handle a variety of complex commercial disputes.

In 1998, Rob formed his own firm and began to concentrate on energy-related litigation, including a successful class action by natural gas marketers against an interstate pipeline company and various royalty underpayment cases on behalf of mineral owners in several states. Rob won a jury verdict in federal court in Pittsburgh on behalf of a class of 800 Pennsylvania mineral owners against Energy Corporation of America and successfully preserved that victory on appeal.

Rob is married with three adult children and two grandsons.

Reviewed As To Form By
Legislative Service Commission

Recommended Edits
To Sub. H.B. No. 152
from
Gateway Royalty LLC
June 24, 2021

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134th General Assembly
Regular Session
2021-2022

Sub. H.B. No. 152

A BILL

To amend section 1509.28 of the Revised Code to revise the law governing unit operation.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF OHIO:

Section 1. That section 1509.28 of the Revised Code be amended to read as follows:

Sec. 1509.28. (A) ~~The~~ As used in this section:

(1) "Bonus payment" means a payment for the execution of an oil and gas lease or a one-time payment made to a mineral owner who is required to participate in a unit pursuant to this Act.

(2) "Gross proceeds" means the 100% of the proceeds received on the sale of production of oil or gas in the first sale to an unaffiliated, third-party buyer in an arms-length transaction without deduction of any "post-production costs" as defined in section A(3) of this Act, but less a pro rata share of any taxes or government fees levied on, or as a result of, that production. ~~incurred between the wellhead and the point of sale, but less a proportionate share of any taxes or government~~

~~fees levied on or as a result of that production.~~

(3) "Post production costs" means all costs incurred between the wellhead and the first sale to an unaffiliated third-party buyer in an arms-length transaction, including, but not limited to, the costs of compressing, treating, separating, processing, dehydrating, gathering, storing, transporting and marketing.

(4) "Gross Royalty" means a share of the "gross proceeds" as defined in section A(2)of this Act.

(~~3~~5) "Net acres" means the pro rata undivided interest in oil and gas in a tract, expressed on an acreage basis and determined by multiplying an unleased mineral owner's percentage ownership interest in the oil and gas in a tract by the gross acreage of the tract.

(~~4~~6) "Non-operating working interest owner" means a working interest owner that is not the operator for the unit.

(~~5~~7) "Operational changes" means adjustments, amendments, or changes to any oil and gas operations, including, but not limited to, changes related to permitting, pad construction, pad location, drilling, completions, production, and workovers, within the unit.

~~(6) "Post-production costs" means all costs and expenses incurred between the wellhead and the point of sale, including, without limitation, the costs of any treating, separating,~~

~~dehydrating, processing, storing, gathering, transporting, compressing, and marketing.~~

~~(7) "Royalty" means a share of production that is free from the costs of production.~~

(8) "Unit order" means an order providing for unit operations.

(9) "Unleased mineral owner" means an owner of a fee mineral interest that is free of a lease or other instrument conveying all or any portion of the working interest in such rights to another.

(10) "Working interest" means an interest in oil or gas by virtue of a lease, operating agreement, fee title, or otherwise, including a carried interest, the owner of which, in the absence of a unit order, would have the right to drill and operate a well on one or more of the separately owned tracts comprising the unit and who is obligated to pay, either in cash or out of production, or otherwise, a portion of the unit expense.

(11) "Working interest owner" means a person who owns a working interest and who is not an unleased mineral owner.

(B)(1) An applicant who has obtained the consent of the owners of at least eighty~~sixty~~-five per cent of the land area overlying a pool or a part of a pool may submit an application for the operation as a unit of the entire pool or part of the pool to the chief of the division of oil and gas resources

management~~, upon the chief's own motion or upon application by the owners of sixty-five per cent of the land area overlying the pool, shall hold a hearing to consider the need for the operation as a unit of an entire pool or part thereof~~. In calculating the eighty~~sixty~~-five per cent, an owner's entire interest in each tract in the proposed unit area, including any divided, undivided, partial, fee, or other interest in the tract, shall be included to the fullest extent of that interest.

(2) The chief may make a motion, without application, for the operation as a unit of an entire pool or part of the pool.

(C) An ~~application by owners~~ applicant shall ~~be accompanied by a~~ include with the application for unit operation all of the following:

(1) A nonrefundable fee of ten thousand dollars~~ and by such~~;

(2) If desired by the applicant, a request that the hearing on the application be held remotely, as provided in division (D)(3) of this section;

(3) If desired by the applicant, a request that any trade secret, research, development, or commercial information separately designated and identified by the applicant be protected from disclosure;

(4) Any additional information ~~as~~ requested by the chief ~~may request~~.

(D)(1) The chief shall hold a hearing to consider the need for the operation as a unit of an entire pool or part thereof. Before the hearing, the chief shall notify interest holders located in the proposed unit of the date of the hearing by certified mail and by publishing notice twice in a newspaper of general circulation in the county or counties in which the unit is proposed to be located.

(2) The chief shall hold the hearing not more than sixty days after the date of the chief's motion under division (B)(2) of this section or the date the chief received the application for unit operation under division (B)(1) of this section, as applicable.

(3) Notwithstanding section 121.22 of the Revised Code, and, at the request of an applicant, the chief shall conduct the hearing electronically by teleconference, video conference, or any other similar electronic technology.

(4) The chief shall maintain the confidentiality of, and protect against the public disclosure of, information included in the application or presented at the hearing that identifies lease bonus and royalty terms applicable to an individual mineral interest owner within the proposed unit area unless the mineral interest owner consents to the disclosure of the information.

(5) If the applicant made a protection request under division (C)(3) of this section, both of the following apply:

(a) The trade secret, research, development, or commercial information shall not be included in the public record of the hearing, is not a public record subject to inspection or copying under section 149.43 of the Revised Code, and shall not be disclosed to the public.

(b) However, the chief may issue an order providing for the limited disclosure of trade secret, research, development, or commercial information to a person that owns a mineral rights interest in the proposed unit area only if the person requests it and the information will be used solely for the purpose of supporting or opposing the unit application at the hearing.

(E) The chief shall make an order providing for the unit operation of a pool or part thereof if the chief finds that such operation is reasonably necessary to increase substantially the ultimate recovery of oil and gas, and the value of the estimated additional recovery of oil or gas exceeds the estimated additional cost incident to conducting the operation. The chief shall issue the unit order not later than thirty days after the date of the hearing unless the chief denies the application by order within that thirty days.

(F) The unit order shall be upon terms and conditions that are just and reasonable and shall prescribe a plan for unit operations that ~~shall include~~ includes all of the following:

(1) A description of the unitized area, termed the unit area;

(2) A statement of the nature of the operations contemplated;

(3) An allocation to the separately owned tracts in the unit area of all the oil and gas that is produced from the unit area and is saved, being the production that is not used in the conduct of operations on the unit area or not unavoidably lost. The allocation shall be in accord with the agreement, if any, of the interested parties. If there is no such agreement, the chief shall determine the value, from the evidence introduced at the hearing, of each separately owned tract in the unit area, exclusive of physical equipment, for development of oil and gas by unit operations, and the production allocated to each tract shall be the proportion that the value of each tract so determined bears to the value of all tracts in the unit area.

(4) A provision for the credits and charges to be made in the adjustment among the owners in the unit area for their respective investments in wells, tanks, pumps, machinery, materials, and equipment contributed to the unit operations;

(5) A provision providing how the expenses of unit operations, including capital investment, shall be determined and charged to the separately owned tracts and how the expenses shall be paid;

(6) A provision~~, if necessary,~~ for carrying ~~or otherwise financing~~ the cost of any ~~person~~ non-operating working interest owner who ~~is unable~~ elects to be carried or who fails to meet

~~the person's~~ the non-operating working interest owner's financial obligations ~~in connection with~~ under the unit~~,~~ ~~allowing a reasonable interest charge for such service,~~ order, payable out of production and upon terms and conditions determined by the chief to be just and reasonable.

The terms and conditions shall include a non-participation charge in an amount of not less than one hundred and fifty~~three hundred~~ per cent of the amount carried, payable out of the non-operating working interest owner's share of production.

(7) A provision for the supervision and conduct of the unit operations, in respect to which each person shall have a vote with a value corresponding to the percentage of the expenses of unit operations chargeable against the interest of that person;

(8) The time when the unit operations shall commence, and the manner in which, and the circumstances under which, the unit operations shall terminate~~;~~. The unit order also shall include provisions authorizing the extension of these times by not less than twelve months and specifying the manner and circumstances under which an extension may be obtained without requiring an additional hearing.

(9) ~~Such additional provisions as are found to be appropriate for carrying on the unit operations, and for the protection or adjustment of correlative rights.~~ If the unit order addresses the interest owned by an unleased mineral owner,

a provision entitling the unleased mineral owner to elect one of the following not later than thirty days after the chief issues the unit order:

(a) To lease the unleased mineral owner's interests to the applicant under just and reasonable terms established at the hearing, including a royalty on ~~equal to one-eighth of~~ the gross proceeds received by the applicant on the sale of production, as "gross proceeds" is defined in this Act, in a percentage equal to the average royalty percentage in the oil and gas leases of the leased mineral owners in the unit, plus a bonus payment equal to the average bonus per acre paid to all leased mineral owners in the unit multiplied by the net acres contributed to the unit by the unleased mineral owner's interest; ~~fifty per cent of the current market rate for a bonus payment per acre within the proposed unit area at the time the application is made or the date of the chief's motion, as applicable, multiplied by the net acres contributed to the unit by the unleased mineral owner's interest;~~

(b) To participate in unit operations as a consenting party under the terms of the joint operating agreement attached to the application;

(c) To participate in unit operations as a non-consenting party under the terms of the joint operating agreement attached to the application, provided, however, that the non-participation charge applicable to the unleased mineral owner's

interest under the joint operating agreement shall be equal to two hundred per cent of the carried amounts, payable out of the unleased mineral owner's share of production.

If an unleased mineral owner does not make an election in the time specified in division (F)(9) of this section, the unleased mineral owner shall be deemed for all purposes to have elected the option specified in division (F)(9)(a) of this section.

(10) Such additional provisions as are found to be appropriate for carrying on the unit operations, and for the protection or adjustment of correlative rights.

~~(B)~~ (G) no unit order ~~of the chief providing for unit operations~~ shall become effective unless and until the plan for unit operations prescribed by the chief has been approved in writing by those owners who, under the chief's order, will be required to pay at least eighty~~sixty~~-five per cent of the costs of the unit operation, and also by the royalty or, with respect to unleased acreage, fee owners of eighty~~sixty~~-five per cent of the acreage to be included in the unit. If the plan for unit operations has not been so approved by owners and royalty owners at the time the unit order ~~providing for unit operations~~ is made, the chief shall upon application and notice hold such supplemental hearings as may be required to determine if and when the plan for unit operations has been so approved. If the owners and royalty owners, or either, owning the required

percentage of interest in the unit area do not approve the plan for unit operations within a period of six months from the date on which the unit order ~~providing for unit operations~~ is made, the order shall cease to be of force and shall be revoked by the chief.

~~An~~ (H) A unit order ~~providing for unit operations~~ may be amended by an order made by the chief, in the same manner ~~and subject to the same conditions~~ as an original unit order ~~providing for unit operations~~, provided that:

(1) If such an amendment affects only the rights and interests of the owners, the approval of the amendment by the royalty owners shall not be required.

(2) No such order of amendment shall change the percentage for allocation of oil and gas as established for any separately owned tract by the original order, except with the consent of all persons owning interest in the tract.

(3) No such order of amendment shall be required by the chief for either of the following:

(a) A change in the ownership of the interests included in the unit order when the unit boundaries do not change;

(b) Operational changes within the unit.

(I) The chief, by an order, may provide for the unit operation of a pool or a part thereof that embraces a unit area established by a previous unit order of the chief. Such an

order, in providing for the allocation of unit production, shall first treat the unit area previously established as a single tract, and the portion of the unit production so allocated thereto shall then be allocated among the separately owned tracts included in the previously established unit area in the same proportions as those specified in the previous unit order.

(J) Oil and gas allocated to a separately owned tract shall be deemed, for all purposes, to have been actually produced from the tract, and all operations, including, but not limited to, the commencement, drilling, operation of, or production from a well upon any portion of the unit area shall be deemed for all purposes the conduct of such operations and production from any lease or contract for lands any portion of which is included in the unit area. The operations conducted pursuant to the order of the chief shall constitute a fulfillment of all the express or implied obligations of each lease or contract covering lands in the unit area to the extent that compliance with such obligations cannot be had because of the order of the chief.

~~Oil~~ (K) Except as otherwise provided in the unit order, oil and gas allocated to any tract, and the proceeds from the sale thereof, shall be the property and income of the several persons ~~to whom, or to whose credit, the same are allocated or payable under the order providing for unit operations~~ entitled to share in that property and income in the same manner, in the

same proportions, and upon the same conditions, as they would have been entitled to had the order not been made by the chief, and with the same legal effect.

(L) No order of the chief or other contract relating to the sale or purchase of production from a separately owned tract shall be terminated by the unit order ~~providing for unit operations~~, but shall remain in force and apply to oil and gas allocated to the tract until terminated in accordance with the provisions thereof.

(M)~~Notwithstanding~~ (1) Except as otherwise provided in division (M)(2) of this section and notwithstanding divisions (A) to (H) of section 1509.73 of the Revised Code and rules adopted under it, the chief shall issue ~~an~~ a unit order for the unit operation of a pool or a part of a pool that encompasses a unit area for which all or a portion of the mineral rights are owned by the ~~department of transportation~~ state.

(2) Division (M)(1) of this section does not apply to a nature preserve, as defined in section 1517.01 of the Revised Code, that is owned or controlled by a state agency.

(N) No person shall undertake operations under the unit order on the surface of a tract owned by an unleased mineral owner without the written consent of the unleased mineral owner.

(O) Except to the extent that the parties affected so agree, no unit order ~~providing for unit operations~~ shall be construed to result in a transfer of all or any part of the

title of any person to the oil and gas rights in any tract in the unit area. All property, whether real or personal, that may be acquired for the account of the owners within the unit area shall be the property of such owners in the proportion that the expenses of unit operations are charged.

(P) Beginning on the effective date of this amendment, the chief shall not establish any new guidelines to administer and implement this section other than by rule adopted in accordance with Chapter 119. Of the Revised Code.

Section 2. That existing section 1509.28 of the Revised Code is hereby repealed.

Section 3. That this legislation shall be retroactive to February 13, 2018.