IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

A&B Campbell Family LLC, *et al.*, Plaintiffs, v. CHESAPEAKE ENERGY CORPORATION, *et al.*, Defendants.	No. 3:15-cv-0340-MEM **MEMORANDUM OF LAW IN SUPPORT OF CHESAPEAKE DEFENDANTS' JOINT MOTION TO DISMISS**

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

CASES **Page(s)**

STATUTES, RULES & REGULATIONS

OTHER AUTHORITIES

INTRODUCTION AND PROCEDURAL HISTORY

On February 17, 2015, Plaintiffs filed their original complaint, asserting antitrust and RICO claims against the Chesapeake and Access Defendants and common law claims against Chesapeake, Access, and additional Defendants. Each Defendant moved to dismiss and some Defendants moved to sever because they were named in contract-related claims only.

On July 18, 2015, Plaintiffs filed the Amended Complaint, in which Plaintiffs now allege much different and much broader antitrust and RICO claims against all ten Defendants, based upon alleged joint venture activities among subsets of the Defendants at various times since late 2006. Plaintiffs also dropped their tortious interference claim and added a conversion claim. In amending their pleading, Plaintiffs abandoned the narrower theories alleged in *Brown* and *Suessenbach* in favor of a more expansive approach.

But by doing so, Plaintiffs have created a number of grounds for dismissal that were never addressed by the Court in deciding the dispositive motion in *Suessenbach*. In expanding the scope and length of their allegations, Plaintiffs have not added the requisite substance to support the sweeping and implausible conspiracies that they attempt to fabricate out of common business relationships and what is really a dispute about the payments Plaintiffs are entitled to receive under their lease terms.

STATEMENT OF FACTS

Plaintiffs allege that they entered into leases for their mineral rights with Anadarko between December 2005 and August 2006. Am. Compl. ¶¶142-43. Plaintiffs further allege that Defendants subsequently entered into a number of joint venture agreements. Chesapeake and Anadarko entered into a Joint Exploration Agreement ("JEA") on September 1, 2006, pursuant to which each allegedly acquired a 50% interest in the others' leasehold interests and agreed to certain operational responsibilities in an area of mutual interest. *Id.* ¶136. Plaintiffs also contend that Anadarko entered into an agreement with Mitsui to share leasehold interests on January 1, 2010, *id.* ¶140, and Chesapeake allegedly entered into a joint venture with Statoil in November 2008 whereby Statoil purchased interests in Chesapeake leases and assets and Chesapeake agreed to conduct leasing, operating, drilling, and marketing services, *id.* ¶141.

In addition, Plaintiffs claim that Chesapeake transferred to Access monopoly power over certain gathering assets in a December 2011 transaction. *Id.* ¶¶211, 247. Plaintiffs claim that Access provided and charged for gathering services, which charges Chesapeake paid, and that Chesapeake deducted a portion of post-production costs from royalty payments to lessors. *Id.* ¶¶253, 261-62. Plaintiffs, however, offer no factual allegations to connect any of these alleged agreements to

their own alleged "loss of royalties" due to deductions for post-production costs. *Id.* ¶¶253, 265.

With respect to their RICO claims, Plaintiffs allege that all ten Defendants joined together, since at least 2010, to achieve the common goal of overcharging post-production costs to lessors. *Id.* ¶¶114-27, 270-75. Plaintiffs further allege that Defendants achieved this purported common goal via mail and wire fraud. *Id.* ¶¶276-85. But Plaintiffs do not allege facts showing an agreement among Defendants to overcharge lessors; instead, Plaintiffs state that certain Defendants entered into various contracts relating to the partial assignment of leases and/or the operation of wells or gathering systems. *See id.* ¶¶136-41. On the pertinent issue of royalty deductions, Plaintiffs allege that the Defendant Lessees had different, independent practices as to the deductions they took from lessors and how and when those deductions were reflected on royalty statements, throughout the relevant time period. *See id.* ¶¶19, 24, 225.

With respect to predicate acts, Plaintiffs do not identify any particular incident of wire fraud, *see id.* ¶¶231-35, 277-85, and they purport to plead mail fraud with broad statements that Defendants "issued periodic (usually monthly) royalty statements and royalty payments . . . which reflected deductions." *Id.* ¶19; *see id.* ¶¶233, 281. Plaintiffs conclude that they were injured by reason of mail and wire fraud, *id.* ¶¶231- 35, but they allege that the mailing of their royalty

statements made the allegedly inflated deductions taken by Chesapeake's subsidiary "more evident." *Id.* ¶214; *see id.* ¶¶177, 216, 218.

Plaintiffs' other claims, including breach of contract and conversion, are based on the general premise that Defendants wrongfully deducted post-production costs and any deductions taken were unreasonable and artificially inflated. *See id.* ¶¶299-310, 316-26.[1] Plaintiffs support these allegations with references to their leases and to alleged hedging activity. *Id.* ¶¶145, 160-62. Plaintiffs, however, do not identify any of the actual deductions taken from their royalty payments at any time nor do they attach a single royalty statement or copy of a lease to support their allegations.

STATEMENT OF QUESTIONS INVOLVED

Have Plaintiffs failed to state a claim for relief under Federal Rule of Civil Procedure 12(b)(6) against the Chesapeake Defendants?

LEGAL STANDARD

To state a claim, a complaint must contain factual allegations that are enough "to raise a right to relief above the speculative level." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). Indeed, "where the well-pleaded facts do not permit the court to infer more than the *mere possibility* of misconduct, the

[1] Plaintiffs incorporate the basis of their RICO claims into the breach of contract count. *See* Am. Compl. ¶¶299, 304, 306, 307; *Kolar v. Preferred Real Estate Invs., Inc.*, 361 F. App'x 354, 363-64 (3d Cir. 2010) (holding claims for breach of contract cannot be repackaged as RICO claims).

complaint has alleged – but it has not 'show[n]' – 'that the pleader is entitled to relief.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009) (emphasis added) (quoting Fed. R. Civ. P. 8(a)(2)); *see Bistrian v. Levi*, 696 F.3d 352, 365 (3d Cir. 2012) (explaining that the court must "peel away those allegations that are no more than conclusions " and then "look for well-pled factual allegations" (internal marks omitted)).

Further, because Plaintiffs allege mail and wire fraud as the basis of their RICO claims, the allegedly fraudulent activities must be pled with particularity. *See* Fed. R. Civ. P. 9(b); *Rolo v. City Investing Co. Liquidating Trust*, 155 F.3d 644, 658 (3d Cir. 1998), *abrogated in part on other grounds by Rotella v. Wood*, 528 U.S. 549 (2000).

ARGUMENT

I. Plaintiffs Fail to State Cognizable Antitrust Claims.

In their Original Complaint, Plaintiffs attempted to state a claim that Chesapeake violated Sections 1 and 2 of Sherman Act, 15 U.S.C. §§ 1 and 2, by allegedly deducting from royalty payments excessive fees for gas gathering services. *See, e.g.*, Compl. ¶200. Those antirust claims failed because, among other reasons identified in Chesapeake's earlier Motion to Dismiss, Plaintiffs did not allege any reduction in competition in the market for "Gathering Services." To state a claim of antitrust injury, the harm – here, the allegedly excessive royalty

deductions – must flow from "a competition-*reducing* aspect or effect." *Atl. Richfield Co. v. USA Petroleum Co. ("ARCO")*, 495 U.S. 328, 344 (1990).

Rather than respond to Chesapeake's earlier motion, Plaintiffs have added an assortment of allegations directed at joint venture activities in two other alleged markets – for "Gas Mineral Rights" and "Operating Rights." But Plaintiffs' bare allegations of joint venture activities are insufficient to survive a motion to dismiss. *See, e.g.*, *In re Fresh & Process Potatoes Antitrust Litig.*, 834 F. Supp. 2d 1141, 1173-75 (D. Idaho 2011) (dismissing Sherman Act claims that insufficiently alleged anticompetitive joint venture conspiracy). The Supreme Court has made clear there is nothing inherently anticompetitive or "per se" unlawful about joint ventures, even between competitors. *See, e.g.*, *Texaco, Inc. v. Dagher*, 547 U.S. 1, 5-6 (2006); *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 23 (1979). To the contrary, the courts recognize the potential procompetitive value of joint ventures and the need for a party challenging joint venture activity to meet the essential elements of a "Rule of Reason" claim. *See, e.g.*, *Deutscher Tennis Bund v. ATP Tour, Inc.*, 610 F.3d 820, 831-32 (3d Cir. 2010); *Augusta News Co. v. Hudson News Co.*, 269 F.3d 41, 47-48 (1st Cir. 2001).

Plaintiffs' failure to plead an antitrust violation in each of the three alleged product markets – for Gas Mineral Rights, for Operating Rights, or for Gathering Services – requires dismissal of Counts I and II of their Amended Complaint.

A. Plaintiffs Have Not Stated a Claim with Respect to the Alleged Market for Gas Mineral Rights.[2]

Plaintiffs allege a market for "Gas Mineral Rights," defined as "the market for the lease of subsurface natural gas underlying specific land, together with the rights to explore for, develop, produce, measure and market gas from the leased premises." Am. Compl. ¶238. Plaintiffs occupy the position of sellers in this alleged market; specifically, they sold the right to explore, drill, and produce natural gas underlying their properties. Plaintiffs further allege that Defendant Anadarko was a buyer in the market for Gas Mineral Rights and acquired hundreds of oil and gas leases. *Id.* ¶135. In fact, it is alleged that Anadarko and its predecessor in interest secured and was the sole initial party to *all of the oil and gas leases that are at issue* in the Amended Complaint. *Id.* ¶13.

A fundamental flaw with the Amended Complaint is that all of the alleged anticompetitive conduct ***post-dates*** these transactions in the market for Gas Mineral Rights. Plaintiffs must allege that they have suffered from harm to competition that is causally related to the allegedly anticompetitive activity. *See Eichorn v. AT&T Corp.*, 248 F.3d 131, 138 (3d Cir. 2001). Here, that causal relationship is entirely missing. The dates of the leases with Plaintiffs for mineral rights range from December 29, 2005 to August 14, 2006. Am. Compl. ¶¶142-43.

[2] The alleged market for Gas Mineral Rights is pertinent only to Count I. Am. Compl. ¶238.

Yet, nowhere in the Amended Complaint do Plaintiffs allege ***any*** anticompetitive activity prior to those lease transactions.

By the time of the first alleged joint venture activity – the JEA on September 1, 2006 , Am. Compl. ¶136, Plaintiffs had already entered their lease agreements. Their respective interests as sellers in the alleged market for Gas Mineral Rights were thus not plausibly harmed by the JEA or any subsequent joint venture activities. *See, e.g., Newman v. Universal Pictures*, 813 F.2d 1519, 1522 (9th Cir. 1987); *Z Channel Ltd. P'ship v. Home Box Office, Inc.*, 931 F.2d 1338, 1342 (9th Cir. 1991). Failure to allege a causal relationship between the alleged anticompetitive activity of Defendants and Plaintiffs' interests in the alleged product market warrants dismissal. *See City of Pittsburgh v. W. Penn Power Co.*, 147 F.3d 256, 269 (3d Cir. 1998).

Moreover, Plaintiffs fail to allege a causal link between any purported anticompetitive activity in the market for Gas Mineral Rights and the specific economic harm they have alleged – *i.e.*, "unauthorized or artificially inflated costs" in the alleged market for Gathering Services. Am. Compl. ¶¶253, 265. Antitrust injury requires the plaintiff to have suffered its injury *in the market where the competition is being restrained. Am. Ad Mgmt., Inc. v. Gen. Tel. Co. of Cal.*, 190 F.3d 1051, 1057 (9th Cir. 1999); *Ass'n of Wash. Pub. Hosp. Dists. v. Philip Morris Inc.*, 241 F.3d 696, 704-05 (9th Cir. 2001). In sum, Plaintiffs have not cured the

pleading deficiencies in their Original Complaint by alleging joint venture activities that *post-date* their mineral rights transactions in one market, and then alleging harm for excessive gathering fees in a separate product market. *Cf. Nat'l ATM Council, Inc. v. Visa Inc.*, 922 F. Supp. 2d 73, 89 (D.D.C. 2013) ("The complaints do not specify what market is being restrained, how it is supposed to work, how it was adversely affected, and how that circumstance injured the plaintiffs.").

At most, Plaintiffs have alleged a *post-lease* breach of contract claim. *See Orion Pictures Distribution Corp. v. Syufy Enters.*, 829 F.2d 946, 949 (9th Cir. 1987) (finding no antitrust injury where contract was entered at a time when there was no alleged anticompetitive activity and party's obligations were defined by contract).

B. Plaintiffs Fail to Allege Either Antitrust Injury or Antitrust Standing in the Alleged Market for Operating Rights.[3]

Plaintiffs also identify an alleged market for "Operating Rights," which they define as "the market for the right to operate working interests in oil and gas leases to explore for, produce and market natural gas." Am. Compl. ¶238. But they fail to allege antitrust injury with respect to this product market.

[3] The alleged market for Operating Rights is pertinent only to Count I. *See* Am. Compl. ¶238.

As noted above, antitrust injury is an essential element of every antitrust claim. *ARCO*, 495 U.S. at 344. Not every business harm constitutes antitrust injury. It is the type of injury that the antitrust laws were intended to prevent and flows from that which makes the defendants' conduct unlawful under antitrust law. *See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977). The harm must flow from "a competition-*reducing* aspect or effect" in some relevant market. *ARCO*, 495 U.S. at 344.

In the alleged market for Operating Rights, it was Anadarko and its predecessor, not Plaintiffs, who were the consumers of operating services. As the holder of working interests in the mineral rights, Anadarko needed an operator to extract the gas from the shale underneath the leaseholds. *See, e.g.*, Am. Compl. ¶¶13, 136. In 2006, Anadarko could have followed a model of vertical integration and acted as its own operator of mineral rights or, alternatively, Anadarko could have secured operating services from someone else. As alleged, Anadarko chose the latter approach, by entering the JEA, pursuant to which Chesapeake agreed to serve as the operator of the wells in return for a fifty-percent interest in the leases. *See id.* ¶¶13, 136. Whether Anadarko chose to serve as its own operator or not, Plaintiffs have not alleged how the JEA caused antitrust injury or how allegedly excessive fees for gas gathering flowed from any reduction in competition in the

alleged market for Operating Rights. *See Am. Ad Mgmt.*, 190 F.3d at 1057; *Ass'n of Wash. Pub. Hosp. Dists.*, 241 F.3d at 704-05.

Plaintiffs also lack antitrust standing to complain about any alleged harm to competition in the market for Operating Rights. Antitrust standing is a prudential limitation, which asks whether the plaintiff is the "proper party to bring a private antitrust action." *See Ethypharm S.A. Fr. v. Abbott Labs.*, 707 F.3d 223, 232 & n.17 (3d Cir. 2013) (internal marks omitted); *City of Pittsburgh*, 147 F.3d at 264; *see also Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 110 n.5 (1986) (explaining that "[a] showing of antitrust injury is necessary, but not always sufficient, to establish standing"). Antitrust standing is limited to consumers and competitors in the relevant market, and to those whose injuries are "inextricably intertwined" with the alleged antitrust conspiracy. *See, e.g.*, *Ethypharm*, 707 F.3d at 233; *W. Penn Allegheny Health Sys. v. UPMC*, 627 F.3d 85, 102 (3d Cir. 2010). The Third Circuit has limited "inextricably intertwined" to cases "in which both plaintiffs and defendants are in the business of selling goods or services *in the same relevant market*, though they may not directly compete against each other." *Ethypharm*, 707 F.3d at 237 (internal marks omitted).

Plaintiffs fit none of those categories. They are neither consumers nor competitors in the alleged market for Operating Rights. Moreover, their role as sellers in the upstream market for Gas Mineral Rights is not sufficient to confer

antitrust standing. *Cf. SigmaPharm, Inc. v. Mut. Pharm. Co.*, 454 F. App'x 64, 69 (3d Cir. 2011) (concluding that even though plaintiff provided a crucial input, it was not within the class of parties with antitrust standing); *SAS of Puerto Rico v. Puerto Rico Tel. Co.*, 48 F.3d 39, 44-45 (1st Cir. 1995) (concluding that plaintiff lacked standing because it was neither a consumer nor a competitor in the relevant markets alleged in the complaint; it was only a supplier). A supplier does not suffer an antitrust injury even assuming competition is reduced downstream. *W. Penn*, 627 F.3d at 102. Lack of antitrust standing in the market for Operating Rights is an additional basis to dismiss the Amended Complaint. *See Ethypharm*, 707 F.3d at 225.

C. Plaintiffs Still Have Not Alleged Harm Attributable to a Reduction in Competition in the Gathering Services Market.[4]

Finally, with respect to the alleged market for Gathering Services, Plaintiffs' Amended Complaint retains many of the same allegations and suffers from all of the same deficiencies as their initial pleading. The centerpiece of Plaintiffs' antitrust claim remains the CMO Acquisition. Prior to the CMO Acquisition in December 2012, Chesapeake and its controlled subsidiaries were alleged to be vertically integrated, with ownership of mineral rights, as well as ownership of assets necessary to extract the natural gas from the shale and transport it through

[4] Gathering Services is pertinent to Count I, and it is the only market alleged in Count II. Am. Compl. ¶¶238, 259.

gathering pipelines in the "Exclusive Dedicated Acreage." Am. Compl. ¶247. As part of the CMO Acquisition, Chesapeake divested its interests in the alleged midstream market for Gathering Services to Access Midstream and its affiliates. *Id*.

However, the Amended Complaint does not allege that the market for Gathering Services became *less* competitive as a result of the CMO Acquisition. Quite the opposite: Plaintiffs expressly allege in their Amended Complaint that monopoly power existed and that supra-competitive fees were charged in the market for Gathering Services both *before* and *after* the CMO Acquisition. *See id.* ¶¶17, 211, 246-47. *Compare id.* ¶247, *with* Compl. ¶191 (Dkt. 1). Thus, in terms of the amount of competition, nothing is alleged to have changed as a result of the CMO Acquisition. Am. Compl. ¶¶211, 247. The alleged monopoly power in the market for Gathering Services was merely transferred from one company (Chesapeake) to another (Access).

To state an antitrust claim, it is not sufficient to allege that Chesapeake at one time possessed monopoly power in Gathering Services, as Plaintiffs have done with respect to the market for Gathering Services. *See, e.g.*, *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004). Nor is it sufficient for Plaintiffs to state one or more conclusory allegations that Chesapeake "unlawfully acquired" that monopoly power. *See* Am. Compl. ¶¶16, 246, 247.

Plaintiffs offer no allegations to support the label "unlawfully acquired," such as how or why any "acquisition" was unlawful. Mere labels do not satisfy Plaintiffs' pleading burden. *See, e.g.*, *Twombly*, 550 U.S. at 555.

Courts within and outside this Circuit have held that the *transfer* of monopoly or market power from one company to another is not a source of antitrust injury. *See, e.g.*, *Columbia River People's Util. Dist. v. Portland Gen. Elec. Co.*, 217 F.3d 1187, 1190-91 (9th Cir. 2000) (recognizing that the same permissible constraints will exist whether the monopoly is held by one party or another); *Brunswick v. Riegel Textile Corp.*, 752 F.2d 261, 266 (7th Cir. 1984); *Shah v. Harristown Dev. Corp.*, No. 12-2196, 2013 U.S. Dist. LEXIS 174354, at *23-24 (M.D. Pa. Dec. 13, 2013). *Shah* involved the sale of the alleged sole investment-grade hotel in downtown Harrisburg. 2013 U.S. Dist. LEXIS 174354, at *20-21. In dismissing the plaintiff's Section 2 claim, the court recognized that "an existing monopoly's change of ownership is not, by itself, an antitrust violation." *Id.* at *24. Likewise, given the alleged monopoly power before and after the CMO Acquisition, Plaintiffs have no antitrust injury in the market for Gathering Services. *Cf. Riegel*, 752 F.2d at 266 ("The theft of a perfectly valid patent, in contrast, creates no monopoly power; it merely shifts a lawful monopoly into different hands. *This has no antitrust significance*, although it hurts the lawful owner of the monopoly power." (emphasis added)). In the words of *Riegel*,

"[f]rom the standpoint of antitrust law, . . . it is a matter of indifference whether [Chesapeake] or [Access] exploits a monopoly [in Gathering Services]." 752 F.2d at 267. There is, accordingly, no basis for Plaintiffs to maintain antitrust claims against the Chesapeake Defendants because of the transfer of that alleged monopoly power to another. *See also Midwest Gas Servs., Inc. v. Ind. Gas Co.*, 317 F.3d 703, 711 (7th Cir. 2003).[5]

Thus, even if, *after* the CMO Acquisition, Chesapeake increased the deductions for post-production costs from the royalty payments made to Plaintiffs,[6] it was not attributable to a reduction in competition – and, therefore, it does not constitute antitrust injury.[7]

---

[5] Plaintiffs' vague allegations that Chesapeake "augmented," Am. Compl. ¶211, or "bolstered and extended," *id.* ¶247, the existing market power it held in Gathering Services do not cure the failure to allege harm flowing from a reduction in competition. Such conclusory allegations without supporting facts are not sufficient to withstand a Rule 12(b)(6) motion to dismiss. *See, e.g., Bistrian*, 696 F.3d at 365. Moreover, the words do not negate the express allegations that Chesapeake already possessed monopoly power, and supra-competitive fees were charged, *before* the CMO Acquisition. Am. Compl. ¶¶211, 247.

[6] The Amended Complaint itself provides an explanation for the deductions that has nothing to do with any reduction in competition. In particular, Plaintiffs recognize that in 2010 the Pennsylvania Supreme Court in *Kilmer v. Elexco Land Services, Inc.*, 990 A.2d 1147 (Pa. 2010), clarified the law, permitting producers to deduct lessors' share of post-production costs. *See* Am. Compl. ¶163.

[7] Plaintiffs also lack antitrust standing in the market for Gathering Services for the same reasons that they lack antitrust standing in the market for Operating Rights – Plaintiffs are neither consumers nor competitors in the market and cannot be "inextricably intertwined" in the market. *See supra* Part I.B.

D. Plaintiffs Have Not Alleged A Plausible Antitrust Conspiracy.

In addition to failing to allege antitrust injury and antitrust standing, Plaintiffs still have not alleged a plausible antitrust conspiracy. As noted above, the Amended Complaint relies on the JEA, the CMO Acquisition, and related agreements. To satisfy the pleading requirements of an antitrust conspiracy, however, it is not enough for Plaintiffs to identify one or more express contracts. *See, e.g.*, *Loren Data Corp. v. GXS, Inc.*, 501 F. App'x 275, 280 (4th Cir. 2012). There must be "a conscious commitment to a common scheme designed to achieve an unlawful objective." *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 768 (1984). The corporate transactions identified by Plaintiffs do not, either individually or collectively, meet this standard.

In particular, there is nothing anticompetitive about a vertically integrated energy company – as Anadarko was alleged to have been prior to the JEA, Am Compl. ¶12, or as Chesapeake was alleged to have been prior to the CMO Acquisition, *id.* ¶131 – selling off some of its assets and, thus, becoming less vertically integrated.[8] Plaintiffs have, likewise, failed to allege any conspiratorial conduct in the aftermath of those corporate transactions. Just the opposite is

[8] Quite the contrary, divestiture is a common antitrust *remedy* when vertical integration raises antitrust concerns. *See, e.g.*, U.S. Dep't of Justice, *Antitrust Division Policy Guide to Merger Remedies* at 7 (2011) (recognizing that an effective structural remedy for mergers, including vertical integration, "often will require divestiture of an existing business"), http://www.justice.gov/atr/public/guidelines/272350.pdf.

apparent from the allegations – Plaintiffs allege that Defendants each had diverse practices with regard to royalty deductions. *See, e.g.*, Am. Compl. ¶¶163, 168-69, 177-78.

Allegations of such unilateral business behavior do not satisfy Plaintiffs' obligation to plead an antitrust conspiracy and require dismissal. *See Iqbal*, 556 U.S. at 678; *Twombly*, 550 U.S. at 554 (finding allegations insufficient where conduct was "just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market"); *Burtch v. Milberg Factors, Inc.*, 662 F.3d 212, 221 (3d Cir. 2011).

E. Plaintiffs Have Not Pled Plausible Geographic Markets.

Plaintiffs bear the burden of defining plausible markets to survive dismissal. *Queen City Pizza v. Domino's Pizza, Inc.*, 124 F.3d 430, 436 (3d Cir. 1997). Plaintiffs purport to define three geographic markets, Am. Compl. ¶¶237, 258, but they do not allege facts to justify the boundaries of those markets. *See, e.g.*, *Tunis Bros. Co. v. Ford Motor Co.*, 952 F.2d 715, 726 (3d Cir. 1991) (noting geographic market is defined by where customers look to procure product or service). Instead, they focus on contractual limitations allegedly imposed by particular service agreements, which is not appropriate for defining a market for antitrust purposes. *See Queen City Pizza*, 124 F.3d at 438. Moreover, Plaintiffs offer no factual allegations about the nature of competition within the alleged markets to support

the conclusory statements of "market" or "monopoly" power. *See Carpenter Tech. Corp. v. Allegheny Techs.*, 646 F. Supp. 2d 726, 735 (E.D. Pa. 2009) (finding dismissal appropriate where allegations about market competition are lacking).

Thus, consistent with the market definition arguments advanced by Chesapeake's co-defendants, Counts I and II of the Amended Complaint should be dismissed on this basis as well.

II. Plaintiffs Fail to State a Valid RICO Claim.

To avoid dismissal of their RICO claims, Plaintiffs must satisfy the pleading requirements of 18 U.S.C. § 1962(c) and § 1962(d). Under § 1962(c), "'the plaintiff must allege (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity.'" *In re Ins. Brokerage Antitrust Litig.*, 618 F.3d 300, 362 (3d Cir. 2010) (quoting *Lum v. Bank of Am.*, 361 F.3d 217, 223 (3d Cir. 2004)). To plead a conspiracy to violate § 1962(c), a plaintiff must allege "(1) knowledge of the corrupt enterprise's activities and (2) agreement to facilitate those activities." *Smith v. Berg*, 247 F.3d 532, 535 (3d Cir. 2001) (citing *Salinas v. United States*, 522 U.S. 52, 66 (1997)). Liability for a RICO conspiracy "will arise only from services which were purposefully and knowingly directed at facilitating a criminal pattern of racketeering activity." *Id.* at 538.

In addition, Plaintiffs must adequately plead injury, causation, and the allegedly fraudulent predicate acts. That is, Plaintiffs must show that they were

"injured in [their] business or property by reason of" the RICO violations asserted. *See* 18 U.S.C. § 1964(c). And, because Plaintiffs allege that the "racketeering activity" consisted of mail and wire fraud, Am. Compl. ¶¶19, 277-85, Plaintiffs must also plead–with the specificity required by Rule 9(b)–that (1) Defendants used the mails "for the purpose of executing" a "scheme or artifice to defraud" that was "reasonably calculated to deceive persons of ordinary prudence and comprehension," (2) the purported mail and wire fraud violations were "related," and (3) they "pose a threat of continued criminal activity." *See Kehr Packages, Inc. v. Fidelcor, Inc.*, 926 F.2d 1406, 1412-17 (3d Cir. 1991).

Plaintiffs have filed a sprawling Amended Complaint that alleges a purported RICO scheme that is fundamentally different than the RICO schemes alleged in the *Brown* and *Suessenbach* actions. This newly alleged RICO scheme dates back to at least 2010 and consists of ten different entities and all of the individuals associated with those entities. *See* Am. Compl. ¶¶114-27, 270-75. Specifically, Plaintiffs allege that subsets of the Defendants entered into customary business contracts or joint venture agreements at different times, but none of the identified agreements involves all the RICO Defendants or any well-pleaded purpose or provision to overcharge lessors. *See id.* ¶¶136, 140-41. In contrast, the *Brown* and *Suessenbach* plaintiffs alleged a distinct and much smaller, bilateral RICO scheme that was premised on a single 2012 Gas Gathering Agreement

allegedly entered into between Chesapeake Appalachia and Access Midstream as part of a corporate divestiture process. By changing the nature and scope of their RICO claims, Plaintiffs have failed to satisfy their pleading burden in several new ways.

A. Plaintiffs Do Not Plead a Cognizable RICO Enterprise.

There are two categories of associations that can satisfy the "enterprise" element of the RICO statute: (1) legal entities such as corporations and partnerships, and (2) associations-in-fact. *See Ins. Brokerage Litig.*, 618 F.3d at 364 (citing *United States v. Turkette*, 452 U.S. 576, 581-52 (1981)). Here, Plaintiffs purport to plead an association-in-fact enterprise "consisting of Defendants, together with their respective officers, directors, employees and agents." Am. Compl. ¶270.

Under well-established law, "an association-in-fact enterprise must have at least three structural features: a purpose, relationships among those associated with the enterprise, and longevity sufficient to permit these associates to pursue the enterprise's purpose." *Boyle v. United States*, 556 U.S. 938, 946 (2009). Thus, "an association-in-fact enterprise is simply a continuing unit that functions with a common purpose." *Id.* at 948. To survive a motion to dismiss, a plaintiff must plead "facts plausibly implying the existence of an enterprise with the structural attributes identified in *Boyle*." *Ins. Brokerage Litig.*, 618 F.3d at 369-70.

To meet this burden, a plaintiff must do more than allege that defendants engaged in similar illicit conduct; a plaintiff must plausibly allege that the defendants coordinated in their alleged commission of the predicate acts to serve a common purpose. *See Boyle*, 556 U.S. at 947 n.4 ("[T]hat several individuals, independently and without coordination, engaged in a pattern of crimes listed as RICO predicates . . . would not be enough to show that the individuals were members of an enterprise."); *Ins. Brokerage Litig.*, 618 F.3d at 370 (finding that the enterprise requirement demands more than parallel and contemporaneous conduct because anything less creates "an open gateway to the imposition of potentially massive costs on numerous defendants" without "the collaboration necessary to trigger liability"). Thus, dismissal is appropriate where the enterprise allegations do not support "the basic requirement that the components function as a unit, that they be put together to form a whole." *Id.* at 374.

Here, Plaintiffs allege that all ten Defendants and all of their officers, directors, employees, and agents, "were associated for the common purpose of defrauding the leaseholders of the Lessee Defendants, including Plaintiffs, by [] overcharging them for post-production costs associated with the gathering, transportation and marketing of natural gas produced from the leasehold properties in which [Plaintiffs] hold royalty interests." Am. Compl. ¶¶270, 272. But when it comes to taking deductions from the royalty payments of lessors, Plaintiffs allege

nothing more than separate conduct among the Defendants that is only sometimes allegedly parallel and sometimes not. For example, the Amended Complaint repeatedly references independent and varied conduct engaged in by "each" of the Defendant Lessees rather than coordinated, unified activity among all the Defendants. *See, e.g.*, *id.* ¶¶19, 23, 149, 155-63, 165-67, 225, 227. Indeed, Plaintiffs admit that not all of the Defendants even engaged in the alleged activity of taking "unauthorized or excessive deductions at the same time," *id.* ¶24, and there are no well-pleaded allegations that the Defendant Lessees coordinated or functioned as a unit with respect to what they chose to deduct/reflect on their royalty statements to Plaintiffs, much less that there was coordination in the alleged predicate acts of mailing those statements.

Instead, Plaintiffs allege that various subsets of the Defendant Lessees entered into joint venture agreements at different times. *See* Am. Compl. ¶¶136-41. According to Plaintiffs' allegations, these agreements contained partial assignments of leases and/or designated an operator of the wells or gathering systems covering certain areas. *See id.* Plaintiffs, however, do not allege that any of these identified agreements involved concerted action among all the Defendants (or, indeed, any of them) to overcharge the Plaintiffs. Thus, the Amended Complaint lacks factual allegations demonstrating a global agreement or relationship among *all* the Defendants and all of their agents, let alone one that

functions as a unit for the common purpose of overcharging deductions from lessors. *See e.g.*, Am. Compl. ¶¶136, 140, 141; *see also Ins. Brokerage Litig.*, 618 F.3d at 375 (rejecting allegations of a multi-defendant association-in-fact enterprise based upon a series of smaller enterprises).[9]

In an apparent effort to skirt these fatal deficiencies, Plaintiffs conclude that all Defendants "knew and expressly or implicitly agreed that such artificially inflated gathering and transportation fees would be passed-on to holders of royalty interests in leases with the Lessee Defendants, including Plaintiffs, in the form of deductions from the royalties payable to them." Am. Compl. ¶276(c). It is well-established, however, that such conclusory allegations cannot satisfy Plaintiffs' pleading burden and defeat a Rule 12(b)(6) motion, *Ins. Brokerage Litig.*, 618 F.3d at 370 (applying *Twombly* to RICO claims),[10] and therefore the RICO claim should be dismissed.

[9] At most, Plaintiffs allege Defendants entered into business contracts that are common in the industry, and such allegations cannot support the existence of an association-in-fact enterprise. *See, e.g., United Food & Commercial Workers Unions & Emp'rs Midwest Health Benefits Fund v. Walgreen Co.*, 719 F.3d 849, 854-55 (7th Cir. 2013).

[10] *See Elsevier Inc. v. W.H.P.R., Inc.*, 692 F. Supp. 2d 297, 307 (S.D.N.Y. 2010) (finding that in the "post-*Twombly* era . . . a plaintiff must allege something more than the fact that individuals were all engaged in the same type of illicit conduct during the same time period"); *McCullough v. Zimmer, Inc.*, No. 08cv1123, 2009 WL 775402, at *13 (W.D. Pa. Mar. 18, 2009) ("[C]ourts should reject association-in-fact enterprise allegations which are imprecise, vague, conclusory, and lack both clarity and any degree of specificity."), *aff'd*, 382 F. App'x 225 (3d Cir. 2010).

B. Plaintiffs Do Not Plead Predicate Acts with Particularity.

Plaintiffs allege that Defendants engaged in "racketeering activity" consisting of mail and wire fraud. Those allegations of fraud must be pleaded with specificity under Federal Rule of Civil Procedure 9(b). *See Rolo*, 155 F.3d at 658. To meet this burden, Plaintiffs must plead "the date, place, or time of the fraud" or otherwise "inject[] precision and some measure of substantiation into their allegations of fraud." *Lum*, 361 F.3d at 224 (internal marks omitted), *abrogated in part on other grounds by Twombly*, 550 U.S. 544. Plaintiffs must also allege "who made a misrepresentation to whom and the general content of the misrepresentation." *Id.* They are required to "link their own injuries to the alleged RICO enterprise" by "alleg[ing] what happened to *them*." *Rolo*, 155 F.3d at 659 (emphasis added).

The Court of Appeals has repeatedly dismissed RICO claims where plaintiffs allege a general scheme to defraud but fail to provide specific factual allegations as to how each plaintiff was impacted by the alleged fraud. For example, in *Rolo*, the Court noted:

> While many of the allegations relating to the allegedly fraudulent scheme are quite detailed, the Complaint lacks any specific allegations about the presentations made to any of the named plaintiffs. . . . The same is true with regard to the allegedly fraudulent mailings. The content of the mailings is described in reasonably specific terms, but when, by whom, and to whom a mailing was sent and the precise content of each particular mailing are not detailed.

Id. at 658-59. Similarly, the Court dismissed RICO claims in *Lum* because the plaintiffs' allegations of mail fraud consisted of "conclusory" statements, which "[did] not indicate the date, time, or place of any misrepresentation; nor [did] they . . . identify particular fraudulent financial transactions." 361 F.3d at 224.

Like the plaintiffs in *Lum* and *Rolo*, Plaintiffs here fail to allege any specific facts as to how the alleged fraud impacted each of them in particular. Compare, for example, the allegations held insufficient in *Lum*,

> Each month during the Class Period, Defendants mailed thousands of bank statements, advertisements for credit cards, contracts, and promotional materials containing the fraudulent stated and artificially inflated interest rates,

id., with strikingly similar deficient allegations in Plaintiffs' Amended Complaint:

> The use of the mails formed a central feature of the scheme and included, by way of example and as described above,[11] the conduct of the Defendants in causing and permitting the Lessee Defendants to send to Plaintiffs, and the conduct of the Lessee Defendants in sending to Plaintiffs, their periodic (typically, not always, monthly) royalty statements and royalty payments.
>
> * * * *
>
> Defendants have, on a regular monthly or other periodic basis, transferred payments between themselves by wire, pursuant to and in furtherance of the conspiratorial agreement among them described herein.

Am. Compl. ¶¶233, 235. Plaintiffs' allegations are no different than the

[11] Not surprisingly, there are no illuminating allegations "described above," and Plaintiffs provide no cross-reference for any such allegations.

indiscriminate allegations that were rejected in *Lum*, and they should be rejected here as well.

C. Plaintiffs Do Not Plead That They Were Injured "By Reason of" the Alleged RICO Violation.

In addition, Plaintiffs' RICO claim fails because Plaintiffs have not alleged that they suffered an injury caused "by reason of" Defendants' alleged RICO violation. *See* 18 U.S.C. § 1964(c). To recover, Plaintiffs must adequately allege a "pattern of racketeering activity"—as opposed to some other factor—was both the "but for" and the proximate cause of injury to Plaintiffs' "business or property." *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 453, 457 (2006). The "central question," is whether Defendants' alleged predicate acts "led directly to the plaintiff's injuries." *Id.* at 461.

1. Plaintiffs Do Not Allege Causation.

Plaintiffs do not allege that the Chesapeake Defendants' purported predicate acts of mail and wire fraud caused Plaintiffs to incur inflated deductions from their royalty checks. Based on Plaintiffs' theory of liability, their injury was the direct result of the Defendants' alleged (albeit in a conclusory fashion) agreement to pass on artificially inflated gathering and transportation fees, not on the subsequent

mailing of royalty statements. *Compare* Am. Compl. ¶¶19, 276, *with id.* ¶¶281-82.[12]

Indeed, it is undisputed that the amounts deducted from royalty statements are determined and taken *before* the statements and corresponding checks are mailed. The mere act of mailing the statements is not necessary to take deductions, as Plaintiffs do not take any action to pay the Chesapeake Defendants (or otherwise effectuate the deductions) upon receipt of the mailing. Instead, a Chesapeake subsidiary mails Plaintiffs their royalty checks and corresponding statements together, after determining the amounts Plaintiffs are entitled to receive. Consequently, the mailing of the royalty statements is immaterial to the consummation of the alleged scheme. *See Parr v. United States*, 363 U.S. 370, 392-93 (1960) (holding that mailings were not "for the purpose of executing the scheme" because defendants achieved the goal of their scheme – obtaining goods and services from a gas station – regardless of the alleged mailings).[13]

[12] Plaintiffs have utterly failed to inject any specificity into their allegations of wire fraud, *see* Am. Compl. ¶¶235, 279, 280, which, as discussed above, is fatal to Plaintiffs' RICO claim. *See Flannery v. Mid Penn Bank*, No. 1:CV-08-0685, 2008 WL 5113437, at *6 (M.D. Pa. Dec. 3, 2008).

[13] *See, e.g., United States v. Maze*, 414 U.S. 395, 402 (1974) (rejecting predicate acts of mail fraud where "there [was] no indication that the success of [plaintiff's] scheme depended in any way" on the mailings), *superseded on other grounds by* 18 U.S.C. § 1344; *Kann v. United States*, 323 U.S. 88, 93-94 (1944) (same); *United States v. Evans*, 148 F.3d 477, 483 (5th Cir. 1998) (same); *United States v. Cross*, 128 F.3d 145, 151 (3d Cir. 1997) (same).

Unsurprisingly, Plaintiffs do not support their conclusion that the royalty statements are "an essential part of the scheme" with any well-pleaded facts. *Maze,* 414 U.S. at 413. Plaintiffs do *not* allege that the royalty statements were designed to conceal the deductions or lull Plaintiffs into complacency. *See Suessenbach Family Ltd. P'ship v. Access Midstream Partners*, No. 3:14-1197, ECF 61 at 28 (March 31, 2015).

In fact, based on Plaintiffs' own allegations, the royalty statements made discovery of the alleged fraud more likely. For instance, Plaintiffs state that they "believe and aver, *based on comparisons of [] their respective statements from Chesapeake* . . . many of the deductions taken by Chesapeake in connection with the underlying self-dealing, related party transactions were arbitrary, excessive and unreasonable." Am. Compl. ¶177 (emphasis added). Plaintiffs further allege that, following the CMO Acquisition, Chesapeake's deduction of "inflated and improper post-production costs" grew "dramatically worse and *more evident*." *Id.* ¶214 (emphasis added). Likewise, Plaintiffs' regurgitated musings from the *ProPublica* article demonstrate that the information disclosed on the royalty statements was what raised questions and concerns by lessors. Am. Compl. ¶¶216, 218. Plaintiffs' allegations provide that the royalty statements tended to expose any alleged overcharges, rather than conceal them or provide a "cloak of legitimacy" to the alleged fraudulent scheme. *See Maze*, 414 U.S. at 403 (holding

that mailings had "increased the probability that respondent would be detected and apprehended"); *Plater-Zyberk v. Abraham*, No. 97-3322, 1998 WL 67545, at *7 (E.D. Pa. Feb. 17, 1998) ("If anything the mailings increased the odds that Plaintiff would discover [the scheme] eventually."), *aff'd*, 203 F.3d 817 (3d Cir. 1999).

For all of these reasons, the well-pleaded allegations do not establish a direct causal link between the mailing of royalty statements and a cognizable RICO injury. Plaintiffs' RICO claims should be dismissed.

2. Plaintiffs Do Not Allege Cognizable "Injury"

Unlike in *Suessenbach*, Plaintiffs here do not even attempt to plead any factual allegations to substantiate their own claimed injuries. The *Suessenbach* plaintiffs alleged that "the deductions from their royalty statements jumped from 24% in October 2013 to 39% in January 2014" and this increase corresponded with the execution of the Marcellus Gathering Agreement. *Suessenbach*, ECF 61 at 25. Additionally, the *Suessenbach* plaintiffs attached their royalty statements to their Complaint, which detailed their actual deductions from October 2012 to January 2014.

In contrast, the Plaintiffs here do not plead any specific facts regarding any purported increases or overcharges in their own royalty deductions. While they make conclusory allegations that Defendants were engaged in a RICO enterprise to overcharge lessors increasingly inflated post-production costs, Am. Compl. ¶¶214,

272, 274, missing from the Amended Complaint are Plaintiffs' royalty statements or well-pleaded allegations as to the actual deductions taken from each Plaintiff's royalties (a) prior to 2010, (b) in 2010 when the RICO enterprise allegedly began, and/or (c) in 2012 or thereafter when the overcharges allegedly increased. Accordingly, Plaintiffs' RICO claim should be dismissed because their conclusory allegations as to their own injuries give rise to impermissibly speculative claims of harm. *See, e.g., Maio v. Aetna, Inc.*, 221 F.3d 472, 483 (3d Cir. 2000) (stating that a showing of injury "requires proof of a concrete financial loss" (quotations omitted)); *Johnson v. Heimbach*, No. 03-2483, 2003 WL 22838476, at *4 (E.D. Pa. Nov. 25, 2003) (noting that RICO injury must be pleaded with "some certainty" and cannot be "speculative").

D. Plaintiffs Do Not State a RICO Conspiracy Claim.

Plaintiffs' RICO conspiracy claim fails for two reasons. First, Plaintiffs' § 1962(d) claim fails because their allegations do not state a claim under § 1962(c), as set forth above. *See Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1191 (3d Cir. 1993). Second, Plaintiffs' conspiracy claim fails because they do not allege the requisite "agreement to commit predicate acts" or "knowledge that those acts" constituted a "pattern of racketeering activity" in violation of the RICO statute. *Mega Concrete, Inc. v. Smith*, No. 09-4234, 2011 WL 1103831, at *13 (E.D. Pa. Mar. 24, 2011) (citing *Rose v. Bartle*, 871 F.2d 331, 366 (3d Cir. 1989)).

Plaintiffs have not pleaded any factual allegations to demonstrate that the Defendants collectively agreed to inflate post-production costs and pass such costs on to the Plaintiffs, much less that they knew they were engaged in a pattern of racketeering activity by mailing royalty statements that reflected deductions for post-production costs. Plaintiffs' wholly conclusory statements, Am. Compl. ¶¶276(c), 295, are insufficient to establish an agreement among the Defendants to commit the alleged predicate acts or knowledge that such acts were criminal. *See Grant v. Turner*, 505 F. App'x 107, 112-13 (3d Cir. 2012) (upholding dismissal of RICO conspiracy claim for lack of well-pleaded allegations that defendants agreed to commit the predicate acts of mail and wire fraud). Consequently, Plaintiffs' conspiracy claim under § 1962(d) should be dismissed.

III. Plaintiffs' Breach of Contract Claim Fails as a Matter of Law.

Plaintiffs' breach of contract claim has several components. They contend that Chesapeake Appalachia, L.L.C. ("CALLC") failed to pay the correct price, was not permitted to take deductions, was not permitted to retroactively take deductions, and was not permitted to deduct what Plaintiffs consider to be unreasonable or excessive costs. Each theory fails as a matter of law.

A. Plaintiffs Receive the Price That the Leases Promise.

Plaintiffs allege that CALLC failed to pay lessors based on CALLC's "hedging" activities, such as selling gas pursuant to forward future contracts and buying and selling derivatives of farther forward sales of gas to lock-in higher prices for gas. Am. Compl. ¶¶160-62. As Plaintiffs allege, CALLC does not pass on gains from those transactions (but nor does it pass on losses).

Plaintiffs' desire to receive benefits from hedging transactions is supported by neither their leases nor the applicable law. Courts around the country – including in Pennsylvania – have ruled against Plaintiffs' position, finding that an oil and gas lessor is not entitled to royalties from the proceeds realized from the lessee's purely financial, cash-settled hedging activities. *See Cimarex Energy Co. v. Chastant*, Nos. 11-1713, 11-2146, 2012 U.S. Dist. LEXIS 180815, at *6-11 (W.D. La. Dec. 18, 2012), *aff'd*, 537 F. App'x 561 (5th Cir. 2013); *Pollock v. Energy Corp. of Am.*, No. 10-1553, 2012 U.S. Dist. LEXIS 186089, at *28, *35-36 (W.D. Pa. Oct. 24, 2012); *Candelaria Indus., Inc. v. Occidental Petroleum Corp.*, 662 F. Supp. 1002, 1003-04, 1007 (D. Nev. 1984). The royalty interests based on the production of natural gas are unrelated to Chesapeake's purely financial hedging transactions.

Plaintiffs' leases entitle them to royalties, and under Pennsylvania law, "royalty" is defined as "'[t]he landowner's share of *production*, free of expenses of

production.'" *Kilmer*, 990 A.2d at 1157 (emphasis added). The royalty provision in the leases provides for payment for gas "produced from the premises" and the value of the gas "at the well." Am. Compl. ¶145. Therefore, Plaintiffs have a royalty interest in the actual, physical production of oil and gas or the proceeds derived from the sale of actual physical production of oil and gas.

Hedging, in contrast, is "[a] risk management strategy used in limiting or offsetting probability or loss from fluctuations in the prices of commodities, currencies, or securities." *BusinessDictionary.com*, http://www.businessdictionary.com/definition/hedging.html (last visited Sept. 18, 2015); *see Cimarex*, 2012 U.S. Dist. LEXIS 180815, at *6 n.4. Chesapeake can gain or lose in a hedging transaction. CALLC, however, does not calculate and pay royalties based on the gains or losses from the hedging activities of any Chesapeake affiliate, subsidiary, or related company because those gains or losses do not result from the sale of actual physical production. *See* Chesapeake 2014 Form 10-K at 112, available at http://www.sec.gov/Archives/edgar/data/895126/000089512615000076/chk-20141231_10k.htm (Sept. 18, 2015). Natural gas is not transferred or sold pursuant to these financial hedging transactions. *Id.* Instead, the financial hedges that the Chesapeake Defendants have entered into are settled on a monthly basis with a cash payment between Chesapeake and the third-party counterparty. *See id.*; *see also* Am. Compl. ¶160.

Chesapeake's hedges thus do not affect pricing under Plaintiffs' leases.

B. The Deductions for Post-Production Costs Are Authorized by Pennsylvania Law.

Plaintiffs claim that CALLC is in breach of Plaintiffs' leases because CALLC, among others, has deducted post-production costs, which Plaintiffs allege is not permitted by the leases. Am. Compl. ¶¶303-04. But the plain language of the leases and applicable Pennsylvania law unambiguously permit deduction of post-production costs.[14]

Plaintiffs' leases entitle them to royalties based on the market value of the gas *at the well*. *See id.* ¶145. The Pennsylvania Supreme Court has held that the market value of gas "at the well" is determined by using the net-back method of accounting, which includes deducting costs for transporting, processing, and manufacturing from the proceeds received from the sale of gas. *See Kilmer*, 990 A.2d at 1149 & n.3, 1158 (citing 30 C.F.R. § 206.151). Accordingly, Plaintiffs' leases together with Pennsylvania law permit deductions for post-production services.

Perhaps in recognition that their "no deduction" claim is barred by the leases and by *Kilmer*, Plaintiffs further allege a supposed implied-in-fact lease obligation

[14] Unambiguous contracts are construed by the Court as a matter of law. *See Lapio v. Robbins*, 729 A.2d 1229, 1232 (Pa. Super. Ct. 1999); *see also Willison v. Consolidation Coal Co.*, 637 A.2d 979, 982 (Pa. 1994) (recognizing construction of oil and gas leases is controlled by contract law); Am. Compl. ¶310 (asserting Plaintiffs' belief that leases are clear and unambiguous).

that deductions for post-production costs must not be "grossly excessive or otherwise unreasonable." Am. Compl. ¶307. The Pennsylvania Supreme Court, however, also rejected the invitation to create such an implied obligation in *Kilmer*, finding that lessors' and lessees' interests are aligned. 990 A.2d at 1158. The Pennsylvania Supreme Court did not impose a "reasonableness" standard because producers already have an incentive to keep costs low.

C. CALLC Did Not Waive the Right to Deduct Post-Production Costs.

Plaintiffs suggest that CALLC breached its obligations under the leases by retroactively deducting post-production costs from current royalties. Am. Compl. ¶305. Plaintiffs do not allege which terms of the leases these retroactive deductions violated. In fact, as discussed above, the express terms of the lease and Pennsylvania law *allow* CALLC to deduct post-production costs.

Moreover, Pennsylvania law requires waiver of a legal right to be a clear, unequivocal, and decisive act with an evident purpose to surrender the right. *Brown v. City of Pittsburgh*, 186 A.2d 399, 401 (Pa. 1962). Otherwise, Plaintiffs must show that they were misled and prejudiced by delayed collections. *See id.*

Plaintiffs allege no facts to suggest that CALLC clearly, unequivocally, or decisively waived its right to collect post-production costs; they allege only that CALLC's initial royalty payments to Plaintiffs did not deduct post-production costs. Am. Compl. ¶163. In addition, Plaintiffs admit that Chesapeake sent a letter

explaining the initial decision not to deduct and asserting its right under *Kilmer* to deduct post-production costs. *Id.* Plaintiffs do not claim that they were misled or prejudiced. Accordingly, Plaintiffs' assertions regarding CALLC's alleged retroactive collection of post-production costs do not state a claim.

IV. Plaintiffs Fail to State a Claim For An Accounting.

An action for a legal accounting requires (1) a valid contract between the parties, (2) a legal duty upon the defendant to account, (3) a failure to account, and (4) a breach or dereliction of duty under the contract. *Haft v. U.S. Steel Corp.*, 499 A.2d 676, 677-78 (Pa. Super. Ct. 1985). Further, "there can be no legal accounting unless the defendant has breached a valid contract." *Ankerstjerne v. Schlumberger Ltd.*, No. 03-3607, 2004 WL 1068806, at *7 (E.D. Pa. May 12, 2004), *aff'd*, 155 F. App'x 48 (3d Cir. 2005). Because Plaintiffs have failed to adequately allege a breach of contract, *see supra* Part III., they have also failed to allege a claim for a legal accounting.

Similarly, Plaintiffs have failed to plead a right to an equitable accounting, which is not available where there is no fiduciary relationship or the plaintiff possesses an adequate remedy at law. *Harold v. McGann*, 406 F. Supp. 2d 562, 578 (E.D. Pa. 2005) (citing *Rock v. Pyle*, 720 A.2d 137, 142 (Pa. Super. Ct. 1998)). Plaintiffs have not alleged a fiduciary relationship. *See* Am. Compl. ¶¶311-15; *Harold*, 406 F. Supp. 2d at 571-72 (a fiduciary relationship does not arise from a

business contract that benefits both parties); *see also McWreath v. Range Res.—Appalachia, LLC*, 81 F. Supp. 3d 448, 468 (W.D. Pa. 2015) (oil and gas lease does not create a fiduciary relationship). And, Plaintiffs seek money damages for an alleged breach of contract demonstrating that an adequate remedy at law exists.

Moreover, an equitable accounting is inappropriate because the information Plaintiffs seek can be obtained through ordinary discovery. *See* Am. Compl. ¶168; *Schirmer v. Principal Life Ins. Co.*, No. 08-2406, 2008 U.S. Dist. LEXIS 101646, at *12-13 (E.D. Pa. Oct. 31, 2008); *Buczek v. First Nat'l Bank of Mifflintown*, 531 A.2d 1122, 1124 (Pa. Super. Ct. 1987).

Finally, Plaintiffs must also allege that they requested an accounting and Chesapeake failed to provide one. *See McWreath*, 81 F. Supp. 3d at 468 (quoting *Hohman v. Dabulski*, No. GD 08-000903, 2009 Pa. Dist. & Cnty. Dec. LEXIS 207, at *16 (Alleghany Cnty. Ct. Com. Pls. Dec. 18, 2009)). Plaintiffs make no such allegation. *See* Am. Compl. ¶168.

Accordingly, neither an equitable nor a legal accounting is available to Plaintiffs and Count VI should be dismissed.

V. Plaintiffs Do Not State a Claim for Conversion.

Plaintiffs' claim for conversion fails because Plaintiffs do not have a property interest in the funds that were allegedly converted. *See It's Intoxicating, Inc. v. Maritim Hotelgesellschaft mbH*, No. 11-cv-2379, 2013 WL 3973975, at

*21-22 (M.D. Pa. July 31, 2013) (Mannion, J.) ("Money may be the subject of a conversion only where the plaintiff had a property interest in the money at the time of the alleged conversion." (internal marks omitted)). Moreover, Plaintiffs' claim for conversion fails because Pennsylvania law does not permit a plaintiff to convert an alleged breach of contract into a tort action. *See Pittsburgh Constr. Co. v. Griffith*, 834 A.2d 572, 584 (Pa. Super. Ct. 2003).

A. Plaintiffs' Conversion Claim Fails Because Plaintiffs Were Not Deprived of Their Property.

Plaintiffs' claim for conversion fails because the property that was allegedly converted was not property that belonged to Plaintiffs. "Conversion is a tort by which the defendant deprives the plaintiff of his right to a chattel or interferes with the plaintiff's use or possession of a chattel without the plaintiff's consent and without lawful justification." *Pittsburgh Constr.*, 834 A.2d at 581. A cause of action in conversion lies only if the plaintiff "had actual or constructive possession of a chattel . . . at the time of the alleged conversion." *Chrysler Credit Corp. v. Smith*, 643 A.2d 1098, 1100 (Pa. Super. Ct. 1994).

Here, Plaintiffs have alleged that Defendants "caused unauthorized or artificially inflated and unreasonable deductions to be taken from royalties" and that they are "entitled to receive the wrongfully deducted amounts pursuant to their leases." Am. Compl. ¶¶317, 318. Plaintiffs' allegations amount to nothing more than a claim that Defendants withheld payments due to Plaintiffs pursuant to a

contract – their leases. As recognized by this Court, "[t]he right to payment of money under a contractual agreement does not constitute a property interest for purposes of conversion." *It's Intoxicating*, 2013 WL 3973975, at *21; *see also Kia v. Imaging Scis. Int'l, Inc.*, 735 F. Supp. 2d 256, 270 (E.D. Pa. 2010) ("[T]here is nothing in the record to show that [plaintiff] had any property interest in the money allegedly converted by the individual defendants. . . . He therefore has no evidence that the money allegedly converted by the individual defendants 'belonged' to him."); *James J. Binns, P.C. v. Flaster Greenberg, P.C.*, 480 F. Supp. 2d 773, 781 (E.D. Pa. 2007) ("Money may be the subject of conversion under a narrow set [of] circumstances, but failure to pay a debt is simply not conversion."); 3-6 Williams & Meyers, Oil and Gas Law § 656.6 (stating that conversion is generally unavailable where a gas lease provides for a cash royalty).

B. Plaintiffs' Conversion Claim Fails Because It Is Premised on Contractual Losses.

For multiple reasons, Plaintiffs' conversion claim is barred under Pennsylvania law because it arises from a contractual right, not a tort obligation. *See* Am. Compl. ¶¶318-19 ("Defendants collected the amounts wrongfully deducted from Plaintiffs' royalties" and "Plaintiffs were entitled to receive the wrongfully deducted amounts *pursuant to their leases*." (emphasis added)).

First, Plaintiffs' conversion claim is barred by the "gist of the action" doctrine, which prevents Plaintiffs from recasting ordinary breach of contract claims as tort claims. *Rahemtulla v. Hassam*, 539 F. Supp. 2d 755, 777 (M.D. Pa. 2008) (Mannion, J.) ("[C]ourts have applied the 'gist of the action' doctrine to conversion claims when entitlement to the chattel is predicated solely on the agreement between the parties.") Where, as here, "the success of the conversion claim depend[s] entirely on the obligations as defined by the contract," *Pittsburgh Constr. Co.*, 834 A.2d at 584, conversion claims fail as a matter of law. *Diodato v. Wells Fargo Ins. Servs., USA, Inc.*, 44 F. Supp. 3d 541, 579 (M.D. Pa. 2014).

Unlike in *Suessenbach*, Plaintiffs here allege a breach of contract claim. Am. Compl. ¶¶299-310, and both the conversion and breach of contract counts are premised upon allegations that the Lessee Defendants overcharged Plaintiffs deductions for post-production costs in violation of Plaintiffs' lease rights. *Id.* ¶¶303-04, 307, 317-20. Plaintiffs' conversion claim should therefore be dismissed.

Second, Plaintiffs' conversion claim is barred under Pennsylvania's "economic loss doctrine." Similar to the "gist of the action" doctrine, a plaintiff cannot recover "in tort economic losses to which their entitlement flows only from a contract." *Lex & Smith Prof'l Assocs., Ltd. v. Wilmington Prof'l Assocs., Inc.*, No. 98-6422, 1999 WL 33100113, at *1 n.3 (E.D. Pa. May 18, 1999) (internal marks omitted); *Samson Lift Techs., LLC v. Jerr-Dan, Corp.*, No. 09-1590, 2010

WL 1052932, at *6, *8 (M.D. Pa. Mar. 22, 2010) (dismissing conversion claim based on the economic loss doctrine). Plaintiffs plead that their claim to greater royalty payments arises purely from their ***contractual*** agreements. Am. Compl. ¶318. Thus, Plaintiffs cannot bring a conversion claim to recover the alleged economic losses flowing solely from their leases. *See Rahemtulla*, 539 F. Supp. 2d at 774.

VI. Plaintiffs' Civil Conspiracy Claim Fails As A Matter of Law.

Plaintiffs' conspiracy claim fails because they have failed to plead a valid conversion claim. *See supra* Part V.; Am. Compl. ¶329; *Festa v. Jordan*, 803 F. Supp. 2d 319, 326 (M.D. Pa. 2011). Because the only tort claim underlying the civil conspiracy claim is invalid, Plaintiffs' civil conspiracy claim is similarly barred. *See, e.g., Raneri v. DePolo*, 441 A.2d 1373, 1376 (Pa. Commw. Ct. 1982); *McGreevy v. Stroup*, 413 F.3d 359, 371 (3d Cir. 2005).

In addition, Plaintiffs' conspiracy claim fails because they have not sufficiently alleged an agreement among the Defendants to overcharge lessors. "Proof of a civil conspiracy requires a plaintiff to show that two or more persons 'combined or agreed with intent to do an unlawful act or to do an otherwise lawful act by unlawful means.'" *Bair v. Purcell*, 500 F. Supp. 2d 468, 500 (M.D. Pa. 2007) (quoting *Thompson Coal Co. v. Pike Coal Co.*, 412 A.2d 466, 472 (Pa. 1979)). A claim for civil conspiracy under state law, brought in federal court, is

governed by the Federal Rules of Civil Procedure and "conclusory allegations of concerted action, without allegations of fact that reflect joint action, are insufficient to meet Rule 8 pleading requirements." *Thomas v. U.S. Airways*, No. 13-6121, 2014 WL 1910245, *5 (E.D. Pa. May 13, 2014) (internal marks omitted).

Here, Plaintiffs fail to plead facts to establish that all ten Defendants reached an agreement to take wrongful royalty deductions. Although Plaintiffs allege that various subsets of the Defendants entered into business contracts, Plaintiffs fail to allege that these particular arrangements involved any provisions regarding what would be charged to lessors. *See* Am. Compl. ¶¶136, 140-41. Indeed, the alleged content of those contracts fails to support an inference of an agreement to overcharge anyone. *See e.g.*, Am. Compl. ¶¶27, 136, 137, 140-41, 185. Consequently, Plaintiffs have not alleged a claim for civil conspiracy.[15]

VII. Plaintiffs Are Not Entitled to Declaratory Relief.

District courts have discretionary authority to determine whether to preside over a declaratory judgment action. *State Auto Ins. Cos. v. Summy*, 234 F.3d 131, 133 (3d Cir. 2000); *see also Wilton v. Seven Falls Co.*, 515 U.S. 277, 286 (1995); 28 U.S.C. § 2201. This Court should decline to exercise jurisdiction over Plaintiffs' claim for declaratory relief because the request duplicates Plaintiffs' breach of contract claim. *See, e.g., Westfall Twp. v. Darwin Nat'l Assurance Co.*,

[15] Because Counts VII and VIII fail, the Court should also strike Plaintiffs' request for punitive damages. *See Hilbert v. Roth*, 149 A.2d 648, 652 (Pa. 1959).

No. 14-cv-1654, 2015 U.S. Dist. LEXIS 1564, at *16 (M.D. Pa. Jan. 7, 2015). As it stands, however, Plaintiffs' breach of contract claim fails as a matter of law, and their claim for declaratory relief – asking the court to adjudicate the same issues – necessarily fails as well.

CONCLUSION

For the foregoing reasons, the Chesapeake Defendants respectfully request the Court to dismiss Counts I-IX against them.

Dated: September 18, 2015

Respectfully submitted,

/s/ Daniel T. Brier
Daniel T. Brier
John B. Dempsey
MYERS BRIER & KELLY, LLP
425 Spruce Street
Suite 200
Scranton, PA 18503
Tel: (570) 342-6100
Fax: (570) 342-6147
Email: dbrier@mbklaw.com
jdempsey@mbklaw.com

Seamus C. Duffy (admitted *pro hac vice*)
William M. Connolly (admitted *pro hac vice*)
DRINKER BIDDLE & REATH LLP
One Logan Square, Suite 2000
Philadelphia PA 19103
Tel: (215) 988-2700
Fax: (215) 988-2757
Email: seamus.duffy@dbr.com
william.connolly@dbr.com

Attorneys for Defendants Chesapeake Energy Corporation, Chesapeake Appalachia, L.L.C., Chesapeake Energy Marketing, L.L.C., Chesapeake Operating, L.L.C., and Chesapeake Exploration, L.L.C.

CERTIFICATE OF SERVICE

I hereby certify that on September 18, 2015, a copy of the foregoing was filed electronically. Notice of this filing will be sent to all parties who have appeared in this action via the Court's electronic filing system. Parties may access this filing through the Court's system.

/s/ Daniel T. Brier
Daniel T. Brier

CERTIFICATE OF COMPLIANCE

I hereby certify pursuant to L.R. 7.8(b)(2) that the text of this filing contains 9,987 words, excluding the caption, Table of Contents, Table of Authorities, and signature blocks, which is within the limit of 10,000 words as permitted by the Court, *see* ECF No. 108.

/s/ Daniel T. Brier
Daniel T. Brier

CERTIFICATE OF CONCURRENCE

I hereby certify pursuant to L.R. 7.1 that counsel for Defendants Chesapeake Energy Corporation, Chesapeake Appalachia, L.L.C., Chesapeake Energy Marketing, L.L.C., and Chesapeake Operating, L.L.C. sought concurrence for their Motion to Dismiss from counsel for Plaintiffs. Counsel for Plaintiffs does not consent to the motion.

/s/ Daniel T. Brier
Daniel T. Brier