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FILED
02 APR -1 PM 10:27
CLERK OF DISTRICT COURT
STEVENS COUNTY, KANSAS

IN THE TWENTY-SIXTH JUDICIAL DISTRICT
DISTRICT COURT, STEVENS COUNTY, KANSAS
CIVIL DEPARTMENT

OPAL LITTELL and CHERRY RIDER,)
co-trustees of the Opal Littell)
Family Trust, and BONNIE BEELMAN,)
individually and as representative)
plaintiffs on behalf of persons)
or concerns similarly situated,)
)
Plaintiffs,)
vs.)
)
OXY USA INC.,)
)
Defendant.)
_____)

Case No. 98-CV-51

**MEMORANDUM IN OPPOSITION TO OXY'S
MOTION TO DECERTIFY CLASS**

OXY's motion to decertify the plaintiff class herein is based solely¹ on the erroneous premise that the holding by the Kansas Supreme Court in *Smith v. Amoco*, ___ Kan. ___, 31 P.3d 255 (September 21, 2001) means that royalty owners in Kansas have lost the protection provided to them for decades by the implied covenant to market. Under OXY's misreading of that opinion, before the implied covenant can be reinstated, the courts must review evidence surrounding the execution of individual leases, many of which have been existence for more than 50 years, to establish the intent

¹ As more fully explained in Section II, below, the law does not permit OXY to make arguments that it failed to advance when the issue of class certification was first before the Court or to reassert arguments previously rejected by this Court when deciding such issue. OXY appears to be using *Smith* as a pretext for violating this fundamental principle.

of the original parties thereto concerning the existence and scope of that covenant. *Smith* holds no such thing.

OXY's argument is directly contradicted by the opinion in *Smith*, by the history of the origin and application of the implied covenant to market in Kansas, and by the holding in *Sternberger v. Marathon Oil Co.*, 257 Kan. 315, 894 P.2d 788 (1994) that “[t]he lessee under an oil and gas lease has the duty to produce a marketable product, and the lessee alone bears the expense in making the product marketable.” 257 Kan. at 315, Syl. ¶2. In *Sternberger*, the Court announced the rule of interpretation to be applied to *all* leases in Kansas: “Absent a contract providing to the contrary, a nonworking interest owner is not obligated to bear any share of production expense, such as compressing, transporting, and processing, undertaking to transform gas into a marketable product.” 257 Kan. at 331 (emphasis added). Nowhere in its opinion did the Court suggest that: (1) a royalty owner must prove the existence of the implied covenant to market by extrinsic evidence; or (2) a lessee can use extrinsic evidence to establish a right to deduct expenses which is “contrary” to what is permitted by the implied covenant itself. As that opinion clearly shows, in order for a lessee to limit the scope or consequences of the implied covenant, it must insert such limiting language in the lease itself; otherwise, the implied covenant controls. Nothing in *Smith* changes this rule.

Adoption of OXY's argument that individual hearings are required to determine the meaning of each instrument involved in this case would destroy the stability of title under oil and gas leases in Kansas. OXY completely ignores the fact that the oil and gas leases at issue are *recorded* documents, which, for the most part, are decades old. If the existence and scope of the implied covenant were to become an issue of fact to be determined on a basis other than the contents of the recorded leases themselves, royalty owners and producers would no longer be able to create or transfer rights in a leasehold without first securing a declaratory judgment as to the nature and extent

of the interest being created or transferred. In short, people would no longer be able to rely upon recorded instruments to establish their respective rights and duties with regard to the minerals which are produced and upon which royalties are paid.

Consistent with its own practice of relying on recorded instruments to conduct its business, OXY has not previously challenged the existence of the implied covenant to market in any of its leases with the members of the class. It does so now only in a last-minute and desperate attempt to avoid being required to refund deductions taken in violation of that covenant to all of its royalty owners in a single case. Instead, OXY wants to delay or avoid justice for the members of the plaintiff class by requiring them to pursue individual litigation of their claims, even though such individual litigation (assuming that it would be economically justifiable) would involve the same evidence of liability that will be presented by the representative plaintiffs in this case. Indeed, as OXY well knows, the cost of discovering and presenting such evidence would undoubtedly preclude the great majority of its royalty owners from pursuing their claims. By its motion, OXY seeks to keep by default what it would otherwise lose in a trial on the merits.

I. THERE HAS BEEN NO CHANGE IN KANSAS SUBSTANTIVE LAW.

A. OXY MISREPRESENTS *SMITH* v. *AMOCO*

At issue in *Smith* was the narrow question of whether the five-year statute of limitations for claims on written contracts, K.S.A. 60-511, or the three-year statute for claims on contracts not in writing, K.S.A. 60-512(1), was applicable to the claims of the plaintiff class that Amoco had failed to obtain the best price possible under the plaintiffs' leases and thereby breached the implied covenant to market and the implied duty of good faith and fair dealing. In holding that the five-year statute applied, the Court concluded that the implied covenant to market was implied in fact rather

than in law,² and noted that the plaintiffs' claims were encompassed by the prudent operator standard.³

OXY conveniently overlooks the fact that *Smith* was (and still is) a class action. Nothing in *Smith* suggests that it could not proceed as a class action or that a claim based upon the implied covenant cannot be certified under Rule 23. To the contrary, the Court agreed that the duty is found *in* all leases: "The Smith Class correctly points out that in oil and gas leases, lessees are bound by the covenant to market gas." 31 P.3d at 269.

B. THE IMPLIED COVENANT IS DERIVED FROM THE LEASE ITSELF

Kansas has recognized the existence of implied covenants in oil and gas leases for nearly a century. *Brewster v. Lanyon Zinc*, 140 F. 801 (8th Cir. 1905). OXY wishes to largely negate this century of Kansas jurisprudence by imposing upon royalty owners the burden of proving that their oil and gas leases contain those very implied covenants. OXY's argument turns Kansas law on its head.

²In its discussion, the Court downplayed the significance of the distinction between implied in law and implied in fact: "Does it make any difference whether covenants are implied in fact or in law? Judging from the reported cases, the answer seems to be, not often and not much." 31P. 3d at 267, quoting 5 Williams & Meyers OIL AND GAS LAW, §803, at p. 18 (2001). "One may wonder why all the sound and fury about the question of implication 'in law' or 'in fact' when the consequences seem so minor and the authorities so uniformly in favor of implication in fact." 31 P.3d at 267, quoting 5 Williams & Meyers, §803, at p. 19.

The authors of Williams & Meyers conclude: "we believe that the rationale of implied covenants in oil and gas lease is a syntheses of the two extremes and that, accordingly, the 'in fact' and 'in law' distinction is, jurisprudentially, a false dichotomy. If the principle of cooperation is accepted as the correct basis for implying covenants, then there is an element of both fact and law in the implication." 5 Williams & Meyers, §803, at p. 24. "The principle of cooperation requires that parties to a contract cooperate in order to carry out the purposes of the agreement. It is based upon both the reasonable expectations of the parties when they enter into an agreement and ethical concepts of conduct." *Id.*, §802.1, at p. 9.

³As plaintiffs have previously explained, they are not challenging the manner in which OXY has elected to market the gas. *E.g.*, Plaintiffs' Memorandum in Support of Class Certification, page 3, n.2. Their claim for wrongful deductions does not involve the prudent operator standard: whether a "prudent operator" would attempt to charge its royalty owners with costs of producing gas or of putting it in marketable condition is irrelevant, and evidence of such a practice would not constitute a defense to the claim that OXY is breaching the covenant by taking such deductions. In contrast to *Smith*, the Court will not be asked to make any prudence determinations with regard to any of the gas involved in this case.

As noted above, the Kansas Supreme Court reiterated in *Sternberger* that “[a]bsent a contract providing to the contrary,” a royalty owner is not obligated to bear any expense “undertaken to transform gas into a marketable product.” 257 Kan. at 315, Syl. ¶3, 331. Thus, the royalty owner is not required to prove through extrinsic evidence that the implied covenant exists in the oil and gas lease. Rather, under Kansas law, OXY is required to include clear and express language in the royalty instrument if it wishes to avoid the implied covenant. As the Court stated in *Gilmore v. Superior Oil Co.*, 192 Kan. 388, 391, 388 P.2d 602 (1964), “the lessee has the opportunity to protect itself by the manner in which it draws the lease” and cannot impose costs on the royalty owner which the lessee is otherwise obligated to bear under the express and implied terms of the lease.

Accordingly, the implied covenant was the nexus for identifying the common legal and factual issues raised on behalf of the class certified in *Sternberger*. As the authorities cited by the Court in *Smith* confirm, the implied covenant to market has always been necessary to achieve “the nature and purpose of the leasing transaction.” *E.g.*, 31 P.3d at 268, quoting 1 David E. Pierce, KANSAS OIL & GAS HANDBOOK, §10.01, pp. 10-4 to 10-5 (1991); 31 P.3d at 265, citing *Danciger Oil & Ref. Co. v. Powell*, 137 Tex. 484, 490092, 154 S.W.2d 632 (1941). Contrary to OXY’s claim that the existence of the covenant depends upon a factual inquiry outside the terms of the lease itself, the Court in *Smith* cites Professor Hemingway: “Although courts state that they are effectuating the intent of the parties, seldom is an actual inquiry to intent reported” 31 P.2d at 268, quoting Hemingway, THE LAW OF OIL & GAS §8.1, p. 543 (3d ed. 1991).

Consistent with the foregoing, OXY has identified no material variations in terms used in the leases held by class members or any extrinsic evidence, circumstantial or otherwise, that will be offered by either side to prove the intent of the original parties to the leases. Instead, OXY proceeds from the erroneous premise that there is a presumption *against* the implied covenant to market in

Kansas, so that every plaintiff must specifically prove the existence and parameters of the covenant under each lease before being entitled to its protection. OXY's premise was flatly rejected in *Sternberger*, which held that the implied covenant exists, unless there is an express provision in the lease which nullifies the implied covenant. OXY knows that no such provision exists in any of the leases held by members of the plaintiff class.

C. OXY RELIES ON A TEXAS CASE THAT IS CONTRARY TO KANSAS LAW

Unable to point to anything in *Smith* or *Sternberger* that would support its presumption against the implied covenant, OXY relies instead upon an unpublished (2-1) split-decision from the Texas Court of Appeals, *Union Pacific Resources Group, Inc. v. Neinast*, 2001 W.L. 1098140 (Tex. Civ. App. 2001). As the well-reasoned dissent makes clear, the majority in *Neinast* improperly delved deeply into the merits of that case in order to reverse an order of class certification. More fundamentally, the panel in *Neinast* appears to have inverted the analysis mandated by *Sternberger*, by adopting a presumption against the existence of any implied covenants.

The majority opinion in *Neinast* appears to be based upon a misreading of *Danciger Oil & Ref. Co. v. Powell*, 154 S.W.2d 632 (Tex. 1941) and *HECI Exploration Co. v. Neel*, 982 S.W.2d 881 (Tex. 1998). Consistent with the law of Kansas, both of those cases confirm that implied covenants arise from the "presumed intention of the parties," not extrinsic evidence. In *Danciger*, the court declined to imply a covenant to develop in a *conveyance*—not a lease—that reserved an overriding 1/8th interest in the minerals to be delivered to the grantor free of cost when mined. The *Danciger* court emphasized the distinction between a mineral lease (which necessarily contemplates development during a defined period) and a conveyance (which does not). 154 S.W.2d at 635-36. The majority in *Neinast* completely ignored that distinction and incorrectly stated that *Danciger* involved a lease. 2001 W.L. 1098140, at *4.

HECI involved a novel claim of an implied duty to notify lessors of a claim against the operator of an adjoining lease. Not surprisingly, the court held that such a duty was not necessary “to give effect to the purpose of the lease as a whole” and therefore declined to imply such a duty. 982 S.W.2d at 890. When basing its holding on *HECI*, however, the court in *Neinast* failed to recognize the distinction between implied covenants that are well-established and widely-recognized and those that are being advanced for the first time.

Contrary to OXY’s suggestion, the implied covenant to market has already been found to exist *in all* leases in Kansas. *E.g., Smith*, 31 P.3d at 269. *Smith* did not change this law, and OXY cannot rely upon extrinsic evidence, real or imagined, to avoid complying with it. Under *Sternberger*, the implied covenant to market requires OXY to bear all expenses associated with putting the gas in marketable condition. In short, there has been no change in the substantive law governing this case.

II. OXY HAS FAILED TO SHOW ANY MATERIAL CHANGE IN CIRCUMSTANCES

Once a class is certified, “the parties can be expected to rely on it and conduct discovery, prepare for trial, and engage in settlement discussion on the assumption that in the normal course of events it will not be altered except for good cause. Sometimes, however, developments in the litigation, such as the discovery of new facts or changes in the parties or in the substantive or procedural law, will necessitate reconsideration of the earlier order and the granting or denial of certification or redefinition of the class.”

Cook v. Rockwell International Corp., 181 F.R.D. 473, 477 (D. Colo. 1998), quoting MANUAL FOR COMPLEX LITIGATION, §30.18 at 223 (3d ed. 1995).

In the absence of materially changed or clarified circumstances, or the occurrence of a condition on which the initial class ruling was expressly contingent, courts should not condone a series of rearguments on the class issues . . . in the guise of motions to reconsider the class ruling.

H. NEWBERG & A. CONTE, NEWBERG ON CLASS ACTIONS, § 7.47 (3d ed. 1992).

OXY is not entitled to *de novo* reconsideration of class certification upon demand. Unless and until OXY shows some change in the law or the facts that would warrant revisiting the Court's order on class certification, no re-analysis of that issue is required, much less the "rigorous analysis" urged by OXY. Thus, the sole issue now before the Court is whether OXY has shown grounds for reconsideration. The answer is plainly "No."

A motion for reconsideration is the opportunity for the court to (1) correct manifest errors of law or fact; (2) review newly discovered evidence; or (3) review a prior decision in light of a recent change in the law. *Cross Timbers Oil Co. v. Rosel Energy, Inc.*, 168 F.R.D. 649, 650 (D. Kan. 1996) (citing *Major v. Benton*, 647 F.2d 110, 112 (10th Cir. 1981)). A party's failure to present its strongest case in the first instance does not entitle it to a second chance in the form of a motion to reconsider. *Id.*, citing *Renfro v. City of Emporia, Kan.*, 732 F.Supp. 1116, 1117 (D. Kan. 1990). The decision of whether to grant or deny a motion for reconsideration is committed to the court's discretion. *Id.* (citing *Hancock v. City of Oklahoma City*, 857 F.2d 1394, 1395 (10th Cir. 1988)).

Zapata v. IBP, Inc., 75 F.R.D. 578, 580 (D. Kan. 1997)(denying renewed motion for class certification). "An improper use of the motion to reconsider 'can waste judicial resources and obstruct the efficient administration of justice.'" *Harding v. Tambrands, Inc.*, 168 F.R.D. 290, 291 (D. Kan. 1996), quoting *United States ex rel. Houck v. Folding Carton Administration Committee*, 121 F.R.D. 69, 71 (N.D. Ill. 1988).

Having failed to show a material change in the law or the underlying facts, OXY is not entitled to have this Court reconsider its decision certifying the class in this case. Moreover, as is shown below, OXY's brief actually demonstrates that such decision was correct.

III. OXY REASSERTS OLD ARGUMENTS WITHOUT IDENTIFYING ANY EVIDENCE THAT WILL VARY FROM LEASE TO LEASE

Unable to identify a specific provision in an individual lease or any evidence of the circumstances surrounding its execution that could be used to nullify the implied covenant to market,

OXY again resorts to its bogus legal argument that the implied covenant to market cannot coexist with royalty clauses that refer to “market value” or “proceeds.” Although this argument goes directly to the merits of the case, which should not be considered when class certification is being addressed, *e.g.*, *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-78, 40 L.Ed.2d 732, 748, 94 S.Ct. 2140 (1974); *Rodolico v. Unisys Corp.* 199 F.R.D. 468, 473 (E.D.N.Y. 2001), it raises an issue of law that is common to all members of the class claiming under such leases. Thus, OXY’s brief asserts a common defense which underscores the propriety of this Court’s certification order.

OXY’s claim that market value leases inherently authorize it to deduct the expenses in question was rejected by the Court in *Sternberger*, which held that the comparable language “market price at the well” is “silent” with regard to the issue of whether expenses incurred off the leased premises can be deducted from royalty payments. 257 Kan. at 322. Accordingly, the Court relied upon and applied the implied covenant to market in reaching its decision. *See also Rogers v. Westerman Farm Co.*, 29 P.3d 887, 898 (Colo. 2001) (“Neither phrase, referring to proceeds for gas sold at the well or market value at the well for gas used off the premises, indicates whether there was an intent to allocate costs between the parties, nor whether deductions should be made prior to calculating royalties. Thus, . . . the . . . lease language is also silent as to cost allocation.”).⁴

OXY’s argument that the “proceeds” royalty clause “leaves no room for an implied covenant” (OXY’s Brief, at p.15) suffers from the same deficiencies. Again, OXY asserts a

⁴OXY’s reliance on *Yzaguirre v. KCS Resources, Inc.*, 53 S.W.2d 368 (Tex. 2001) is misplaced. That case merely held that the implied covenant does not require a lessee to pay royalties in excess of “market value” under a lease containing that language. The court did not say that the implied covenant was pre-empted *in toto*, expressly noting that the royalty owners were not claiming that the defendant had breached the implied covenant by selling gas away from the leased property in order to reduce the royalties owed. 53 S.W.2d at 373 n. 3. Moreover, *Yzaguirre* appears to be inconsistent with the holding in *Smith*, 31 P.3d at 268-271, 272 (“Amoco’s implied covenant to market pricing obligation, under the facts here, is contained within its duty to act at all times as a reasonably prudent operator.”).

common defense to the claims raised on behalf of all of its royalty owners under such leases. This strategy confirms, rather than undermines, the propriety of certification. Again, OXY's argument has been repeatedly rejected by the courts. *See, e.g., Rogers*, 29 P.3d at 897.

In an effort to avoid this authority, OXY incorrectly cites *Matzen v. Hugoton Production Co.*, 182 Kan. 456, 321 P.2d 576 (1958), and *Ashland Oil & Refining Co. v. Staats, Inc.*, 271 F. Supp. 571 (D. Kan. 1967). As the Supreme Court explained in *Gilmore*: "The *Matzen* case is not applicable here for the very cogent reason the parties there had stipulated in court that the lessee could and had properly deducted costs of a large gathering system to transport gas from the leased property to a far distant pipeline." 192 Kan. at 391. Because the plaintiffs in *Matzen* stipulated that such expenses were deductible, any mention of them in the opinion was merely dicta.⁵

Staats is also distinguishable. There, the plaintiff class was seeking to recover royalties on reimbursements which the producer was receiving from the pipeline for "gathering and transportation" costs. The case simply held that the plaintiffs were not entitled to be paid royalties on reimbursed expenses—not that such expenses could be deducted from royalty payments.

In its Journal Entry of Decision by the Court and Order of the Court Certifying Class Nunc Pro Tunc, this Court concluded that "common questions among the proposed class predominate over issues unique to each class member" (at p. 3), and specifically identified eight common questions of law or fact (pp. 3-4). OXY simply ignores these common questions in its brief. OXY also fails to discuss its common defense, which applies to *all* members of the class, that *all* of its gas in the Hugoton Field is in marketable condition at the well. Indeed, that "common question" was the basis

⁵ Neither compression nor dehydration expenses were being deducted from royalty payments in *Matzen*. As the Court will recall from the *Alford v. Pioneer* litigation, under the Gas Purchase Contract that existed at the time, Kansas Power and Light Company was required to supply any necessary compression and reimbursed the producer for any dehydration which it performed.

for OXY's unsuccessful attempt to consolidate this case with *Coulter v. Anadarko* and *Youngren v. Amoco*. (OXY USA Inc.'s Motion to Consolidate For a Limited Purpose).

OXY also repeats its argument that class certification is inappropriate because there are five gathering systems involved in this case. OXY has already conceded that it deducts the gathering fees for all five systems and, again, fails to identify any evidence that the different systems perform different functions. Indeed, OXY will no doubt attempt to characterize *all* such activities as "transportation" of an already marketable product.

IV. OXY CONTINUES TO MISREPRESENT PLAINTIFFS' MARKETABILITY CLAIM AND IGNORE THEIR PRODUCTION CLAIM

OXY continues to mischaracterize plaintiffs' claims and to misrepresent how plaintiffs will prove them at trial.⁶ This case is about whether OXY is improperly deducting expenses, not whether it has failed to sell the gas in a prudent manner. It is the purpose for which OXY is incurring such expenses, not the price it might have received if it had elected to sell the gas in a different manner, which will control the outcome of this case. In any event, plaintiffs will *not* be offering evidence of comparable sales or breach of the duty to obtain market value for the gas. OXY's insistence that plaintiffs must offer such evidence is simply nothing more than another common defense to the claim for wrongful deductions, which is easily resolved as a matter of law without any factual inquiry.

Inconsistently, OXY attempts to interpose the market value royalty clause as a bar to examining the propriety of certain deductions included in the proceeds-less-expenses methodology

⁶Repeating its earlier argument, OXY claims that individualized issues predominate because "[e]ach plaintiff must establish the amount of royalty to which he or she was entitled and that the specific royalty owner received less than that amount." (OXY's Brief, at p.11).

that it employs to compute royalties. OXY's claim that plaintiffs must use comparable sales to prove their claim is directly contradicted by OXY's own failure to use this method to calculate royalties. In short, OXY's method of calculating royalties constitutes an admission that the gas is not in marketable condition at the wellhead but is in marketable condition at the transmission pipeline, which is where the price (or starting point) for OXY's royalty calculations is set.

Finally, OXY continues to ignore plaintiffs' production claim. OXY does not even suggest, much less establish, that there is some individual variation in leases or "surrounding circumstances" that would dilute OXY's obligation to produce gas in a captive state at its own expense. The production claim alone justifies class certification in this case.

CONCLUSION

Notwithstanding OXY's delusional mis-reading, *Smith v. Amoco* merely clarified the application of the statute of limitations and has no other substantive effect on this case.

The only thing that has changed in the eleven months since this Court entered its order certifying this case as a class action is that the Court has now had the benefit of hearing three lawsuits involving claims and defenses similar to those herein: *Youngren v. Amoco*, 89-CV-22; *Alford v. Pioneer*, 93-CV-37; and *Coulter v. Anadarko*, 98-CV-40. Originally, OXY insisted that two of those cases were so closely related to the instant case that they should be consolidated so that "common issues" could be decided. (See OXY USA Inc.'s Motion to Consolidate For a Limited Purpose). While consolidation of these cases for trial would have presented insurmountable logistical hurdles, the three trials that have taken place demonstrate that class certification was entirely proper. Hypothetical problems interposed to defeat certification gave way to the realities of trial, and all of the evidence offered by all of the parties was aimed at resolving common issues of fact raised by their claims and defenses. Neither the plaintiffs nor the defendants offered any


evidence that was designed to raise or resolve individual issues.

OXY has failed to identify a material change in circumstances since this Court entered its order certifying the class herein. Its ongoing failure to identify any individual issues of fact, combined with its reassertion of common defenses to the class claims, underscore the propriety of that order.

OXY's motion to decertify the plaintiff class should be denied.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of March, 2002, I served a copy of the foregoing **Memorandum in Opposition to OXY's Motion to Decertify Class** by mailing same, postage prepaid and properly addressed to:

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