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

WILLIE JEAN FARRAR and KEITH FARRAR, as Co-Trustees of the Keith Farrar Revocable Trust, dated October 22, 1999 and JOHN ELDON GREGG and KEITH THOMAS GREGG, as Co-Trustees of the Marie Gregg Trust u/a dated April 26, 1979, as amended, and THOMAS L. and PATRICIA A. LAHEY, individually and jointly,

Plaintiffs,

v.

MOBIL OIL CORPORATION,

Defendant.

Case No. 01 CV 12

ORDER

NOW ON THIS 15 day of March, 2012, this matter comes on for hearing on Plaintiffs' Motion for Summary Judgment on their Claim for Mobil's Breach of the 1984 Settlement Agreement (hereafter "Motion"). The parties (hereinafter "plaintiffs" or "the Plaintiff Class" and "Mobil") appear through their respective counsel of record.

WHEREUPON, the Court, having reviewed the court record, hearing the arguments of counsel, and otherwise being duly advised in the premises, finds and concludes as follows:

PROCEDURAL BACKGROUND

Plaintiffs filed their Motion on March 30, 2011. On April 21, 2011, Mobil filed a motion pursuant to K.S.A. 60-256(f), claiming that it needed a continuance in order to conduct discovery with regard to the circumstances surrounding the execution of the 1984 Settlement Agreement upon which the Motion is based. On June 28, 2011, after hearing argument and reviewing the decision rendered by the Kansas Supreme Court in *Central Natural Resources, Inc. v. Davis Operating Company*, 288 Kan. 234 (2009), this Court entered an Order allowing Mobil to engage in discovery with regard to the "context" in which the 1984 Settlement Agreement had been executed, but requiring it to respond to the plaintiff's Summary Judgment Motion no later than September 28, 2011. Mobil filed its Response to the Motion on September 27, 2011, and plaintiffs filed their Reply in Support of the Motion on October 24, 2011. The parties submitted Proposed Finding of Fact and Conclusions of Law. The last filing was received January 9, 2012. Pursuant to Supreme Court Rule 166, this matter is ripe for decision.

MOBIL HAS NOT CONTESTED THE MATERIAL FACTS UPON WHICH PLAINTIFFS' MOTION IS BASED

In their opening memorandum in support of their Motion, plaintiffs set forth ten paragraphs of facts which they claim to be undisputed and upon which they base their Motion, as required by Kansas Supreme Court Rule 141. In its Response, Mobil does not contest the facts contained in paragraphs 1, 3, 4, 5, 6, 7, 8 and 9. As to the contents of paragraphs 2 or 10, Mobil fails to "set out specific facts showing a genuine

issue for trial", as required by K.S.A. 60-256(e)(2), and all of the following facts are, therefore, deemed uncontested for purposes of the pending Motion:

1. As of May 24, 1984, eight individual and class action lawsuits were pending against Mobil in the District Courts of Stevens County and Haskell County, and in the United States District Court of the District of Kansas.

2. The plaintiffs in those various suits alleged that Mobil had violated its royalty payment obligations by making royalty payments to them on the basis of federally regulated prices, rather than the "market value" of gas.

3. As consideration for plaintiffs' release and settlement of their claims, Mobil agreed to pay royalties on gas and gas products under "market value" leases to the plaintiffs after complete federal deregulation in the following manner:

> After complete deregulation as defined herein, with respect to natural gas produced under any lease subject to this Agreement, ***the market value of such gas shall be deemed to be the price paid to Mobil pursuant to Mobil's sales contracts for such natural gas (and gas plant products, where applicable)***; provided, however, that Mobil has exercised good faith in seeking to obtain the highest price obtainable for such natural gas (and gas plant products, where applicable) in accordance with the same or substantially similar standards as those exemplified by the provisions presently applicable to gas which may thereafter be sold under Mobil's Contract No. 6326 with Northern Natural Gas Company dated November 1, 1952, as amended and as exemplified by Mobil's Contract No. S 302 with Cities Service Gas Company, dated June 17, 1946.
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> - - -
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> ***Nothing in this agreement shall result in payment of royalty in amounts less than those payable on the basis of proceeds received by the lessee for the sale of gas produced under the leases above mentioned.***

(1984 Settlement Agreement, ¶¶ 4(e) and (m) (emphasis added)).

4. Paragraph 4(e) of the 1984 Settlement Agreement defines "complete deregulation" as "the first day after which the [FERC] ceases to have authority to regulate the price at which Mobil or any other producer may sell natural gas."

5. "[C]omplete deregulation" occurred on January 1, 1993, the effective date of the Natural Gas Wellhead Decontrol Act.

6. Counsel for the plaintiffs and Mobil jointly executed affidavits identifying the "market value" leases that are subject to the 1984 Settlement Agreement and explaining how royalties would be paid under such leases following deregulation:

> [T]his Affidavit is to provide notice of the terms of the Settlement Agreement and of the Judgment and specifically the effective amendment of the royalty provisions of the Market Value Leases ... as to the specific lands and acreage described in Exhibit "A" hereto ... [S]uch leases insofar as they cover the specifically described lands were effectively amended by the Settlement Agreement and the Judgment .... ***Upon ... total deregulation, with respect to natural gas produced under any lease subject to this Agreement, the market value of such gas shall then be deemed to be the price paid to Mobil pursuant to Mobil's sales contracts for such natural gas (and gas plant products, where applicable) ...***

(Emphasis added)

7. The parties to the Settlement Agreement caused these Affidavits to be filed with the Register of Deeds in each county where the lands burdened by the "market value" leases were located.

8. Mobil has made royalty payments under the "market value" leases subject to the 1984 Settlement Agreement and identified in the Affidavits described above.

9. Plaintiffs' claims in this lawsuit commence on March 5, 1996.

10. Since at least March 5, 1996, Mobil has assessed the accounts of all members of the Plaintiff Class being paid under "market value" leases with a pro-rata share of certain costs and expenses associated with certain activities, including compression, occurring downstream of the wellhead.

In summary, it in uncontested that since the "complete deregulation" of the natural gas industry, which occurred on January 1, 1993, Mobil has been deducting certain costs and expenses, including compression, from its royalty payments to members of the Plaintiff Class whose "market value" leases were amended by the 1984 Settlement Agreement.

MOBIL HAS FAILED TO CONTEST THE PLAIN MEANING OF THE 1984 SETTLEMENT AGREEMENT

Mobil does not dispute the existence of the language in the 1984 Settlement Agreement recited in paragraph 3 above. The well established rules as recently set forth in *Central Natural Resources, Inc. v. Davis Operation Co.*, 288 Kan. 234, 201 P.3d 680 (2009) require the Court to determine whether the terms "price" or "proceeds", as used in Paragraphs 4(e) and (m), respectively, are clear and unambiguous. 288 Kan. at 244-46.

Plaintiffs take the position that the commonly understood meanings of both "price" and "proceeds" preclude Mobil from deducting any expenses from the amounts it receives in good faith sales when computing royalty payments in the manner required by the 1984 Settlement Agreement.

Mobil does not attempt to argue that "price" should be interpreted to mean "less than price". Instead, Mobil argues that it is free to take deductions because Paragraph 4(e) does not say "a single word about expenses incurred by Mobil downstream from the wellhead". (Mobil's Response, p. 11). This argument runs counter to the clear meaning of "price" and the rule in Kansas that producers wishing to take deductions are

required to spell them out in the lease. *See Gilmore v. Superior Oil Co.*, 192 Kan. 388, 391 (1964); *Sternberger v. Marathon Oil*, 257 Kan. 315, Syl. ¶ 3 (1995). Likewise, Mobil's assertion that "price" received in good faith sales protects it from the claim that it should have gotten more for the gas and plant products (Mobil's Response at p. 5) does not relieve it of its duty to abide by the plain meaning of this term when computing royalties.

In response to the use of "proceeds" in Paragraph 4(m), Mobil relies exclusively on *Matzen v. Hugoton Production Co.*, 182 Kan. 456 (1958). However, the court in *Matzen* was not asked to define "proceeds". *See Matzen*, 182 Kan. at 467 (Fatzer, J. Concurring); *see also Gilmore*, 192 Kan. at 391 and *Sternberger v. Marathon Oil Company*, 257 Kan. 315, 325 (1995), which reconfirm the absence of any such holding.

Most instructive to this Court is the recent case of *Hockett v. Trees Oil Co.*, 292 Kan. 213 (2011) where the Kansas Supreme Court, in discussing the meaning of "proceeds" stated.

> "In conclusion, what the cases cited by Oil Company teach us is that ***the term "proceeds"*** in a royalty clause ***refers to the gross sale price*** in the contract between the first purchaser and the lessee/producer/seller, so long as the contractual rate per mcf has been approved by the applicable regulatory authority. If the lessee claims that it is entitled to compute and pay royalties based upon an amount less than the gross sale price, it must find the authority to do so somewhere other than in the lease's royalty clause." *Hockett v. Trees Oil Co.*, 292 Kan. 213, 223 (2011) (emphasis added).

Mobil has not offered an alternative reading of either "price" or "proceeds" which would make it impossible to be "certain which one of two or more meanings is conveyed by the words employed by the parties". *Central Natural Resources*, 288 Kan. at 245. Based on the plain meaning of these words, the Court concludes that the 1984 Settlement Agreement requires Mobil to pay royalties on the basis of the gross sale price it receives for gas and plant products produced under the "market value" leases amended thereby.

Finding that the 1984 Settlement Agreement is clear and unambiguous, this Court does not need consider affidavits submitted by experts for the purpose of determining its meaning.

MOBIL'S OTHER DEFENSES ARE WITHOUT MERIT

Mobil contends that royalty owners may have signed documents, such as division orders, that have relieved Mobil of its obligation to pay royalty in the manner prescribed in the 1984 Settlement Agreement. This is an affirmative defense, and Mobil has the burden of coming forward with such evidence if it wishes to avoid liability under the contract put in evidence by plaintiffs. *See Stang v. Caragianis*, 243 Kan. 249, 281 (1988) ("[T]he pleading of an affirmative defense puts the burden on the defendant to prove the existence and validity of the defense.") It is firmly established that this burden applies when a defendant contends that a contract has been modified by subsequent agreements. As stated in *Sparks v. Sparks*, 51 Kan. 195, 202 (1893):

> "The plaintiff set up and relied upon a written contract purporting to have been executed by the defendant. The execution of this contract was admitted by the defendant ... [Plaintiff] is not required to disprove the facts alleged in the

> defendant's affirmative defense. The defendant asserts that the contracts relied upon by the plaintiff, and the making and execution of which he admits, have been changed by other agreements and understandings. The defendant has the affirmative of these propositions, and the burden of maintaining them rests upon him."

Accord Mullins v. TestAmerica, Inc., 564 F.3d 386, 411 (5th Cir. 2009) ("[R]ecognized affirmative defenses to breach of contract such as modification ... either admit or do not engage the plaintiff's allegations of breach but assert other, independent facts as a basis for negating liability that the defendant must plead and prove.")

Mobil has not brought to the Court's attention any documents that might have the effect of modifying or amending the terms of the 1984 Settlement Agreement. It, therefore, has not met its burden, and such defense cannot stand as a bar to a finding of liability. This conclusion is consistent with the decisions in both *Gilmore* and *Sternberger*, which require a producer such as Mobil to obtain the permission of its lessors to take the deductions.

Mobil's claim that plaintiffs are not entitled to an accounting is likewise without merit. Mobil makes monthly royalty payments which it calculates on the basis of a formula which charges the account of each of its royalty owners with a pro-rata share of certain expenses. This Court has concluded that Mobil is not entitled to take such deductions. Numerous Kansas cases have recognized that an accounting is the proper remedy for the underpayment of royalties, including improper deductions. *See, e.g., Brubaker v. Branine*, 237 Kan. 488, 494 (1985); *Lipper v. Angle*, 211 Kan. 695, 698, 704 (1973); *Ruthven & Co. v. Pan Am. Petroleum Corp.*, 206 Kan. 639 (1971); *Schupbach*, 193 Kan. at 401, Syl ¶ 1. In at least two prior cases, this Court has held that royalty underpayment claims were properly brought as claims for accounting. *Littell v. OXY*

USA, Inc., Case No. 98-CV-51, Order by the Court Upon the Plaintiff's Motion for Trial by the Court (April 30, 2002); *Coulter v. Anardarko Petroleum Corporation*, Case No. 98-C-40, Order by the Court Upon the Plaintiff's Motion for Trial by the Court (December 4, 2001). Mobil's own employee has filed an affidavit with this Court documenting how complex its accountings are, which is inconsistent with the notion that anyone but Mobil is capable of computing the amounts of the refunds owed to each member of the Plaintiff Class. (*See* Affidavit of Robert C. Scarborough [Exhibit 8 to Mobil's Response])

Mobil also argues that K.S.A. 55-1615, which is part of the Interest on Proceeds From Production Act, should control the award of prejudgment interest on the underpayment of royalties rather than K.S.A. 16-201, which establishes the legal rate of interest when o other rate is agreed upon. The Court rejects that argument. The legislative history of K.S.A. 55-1615 offered by plaintiffs clearly shows that this statute was designed to address the specific problem of lengthy suspensions of payments of royalties by producers, not their failure to pay royalties in the correct amount. Both of the Kansas cases which have discussed the Interest on Proceeds From Production Act – *Thoroughbred Assocs., LLC v. Kansas City Royalty Co., LLC*, 45 Kan. App. 2d 312 (2011), *pet. for rev. filed*, March 11, 2011, and *Reynolds-Rexwinkle Oil, Inc. v. Petex, Inc.*, 268 Kan. 840 (2000) – dealt with suspended or delayed payments. As stated in *Thoroughbred Assocs.*, "[t]he Act is aimed at curtailing sharp practices in the oil and gas industry where a purchases refuses to make ***timely payment*** for petrochemicals to the owners of the mineral interests." 45 Kan. App. 2d at 332 (emphasis added)

The right of Kansas royalty owners to recover prejudgment interest on claims for underpayment of royalties was well-established in 1991 when the legislature passed the

interest on Proceeds From Production Act. *See, e.g., Schupbach*, 193 Kan. at 408. K.S.A. 55-1615 does not state that it displaces or otherwise amends the general provisions regarding prejudgment interest found in K.S.A. 16-201. If the legislature had intended to have this new law govern the assessment of interest in disputes between a producer and its royalty owners over the amounts owed, as opposed to the interest owed due to the late payment of amounts that are undisputed, it could and would have said so. As stated by the Supreme Court in *State v. Roderick*, 259 Kan. 107, Syl. ¶ 6 (1996):

> "Repeal by implication is not favored. Legislation will not be held to have been repealed by implication unless a later enactment is so repugnant to the provisions of the first statute that both cannot be given force and effect. Repeal by implication is not applied when both statutes may operate independently without conflict."

It is clear that K.S.A. 55-1615 generates a right to interest in the context of "late" payment of undisputed amounts that are admittedly due and owing to someone, while K.S.A. 16-201 applies when the underlying liability is both disputed and liquidated. The respective ambits of these two statutes are clear and their texts and underlying purposes can be read in harmony with each other. Because Mobil deducted exact amounts from the "price" or "proceeds" it received for gas sold under "market value" leases subject to the 1984 Settlement Agreement, those amounts are "definitely ascertainable by mathematical calculation" and therefore "liquidated" for purposes of establishing the right of such class members to recover prejudgment interest under K.S.A. 16-201.

IT IS THEREFORE, THE ORDER, JUDGMENT AND DECREE OF THIS COURT THAT:

1. Plaintiffs' Motion for Summary Judgment with regard to Mobil's breach of the 1984 Settlement Agreement is hereby **granted**;

2. Each member of the Plaintiff Class, whose oil and gas lease is a "market value" lease subject to the 1984 Settlement Agreement, is entitled to recoup any and all deductions, both monetary and volumetric, from the price paid to Mobil for the sale of gas and liquids produced pursuant to such leases, from March 5, 1996, to date, plus prejudgment interest as prescribed in K.S.A. 16-201, as determined pursuant to the accounting described below;

3. Within 30 days from the entry herein, Mobil shall submit to the Court and Plaintiffs' counsel the following information in both paper copy and in electronic format compatible with the equipment of Plaintiffs' counsel:

a. The names and most currently available addresses of all members of the Plaintiff Class whose leases are subject to the 1984 Settlement Agreement, the corresponding names of the wells producing under such leases, and the period during which such owners owned their royalty interest;

b. On a monthly basis, with respect to each such member of Plaintiff Class described in "a" above, any and all deductions, both monetary and volumetric, from the price paid to Mobil for the sale of gas and plant products produced pursuant to such leases, from March 5, 1996, to date;

c. As of the date of Mobil's filing, the amount of prejudgment interest with respect to each such class member for each such month, at the statutory rate prescribed by K.S.A. 16-201;

4. Mobil shall pay into the registry of the Court the total amount of deductions and interest due thereon at the time it files its account;

5. With respect to royalty payments made under "market value" leases subject to the 1984 Settlement Agreement, Mobil is hereby enjoined from deducting any amount, both monetary and volumetric, from the price paid to Mobil for the sale of gas and plant products produced pursuant to such leases; and

6. The Court shall retain jurisdiction in order to supervise any other procedures necessary to effectuate the account and the entry of final judgment.

IT IS SO ORDERED.

Dated this 15 day of March, 2012.

Bradley E. Ambrosier
Chief District Court Judge

CERTIFICATE OF SERVICE

I, Roberta M. Tackett, do hereby certify a true and correct copy of the above and foregoing ORDER was mailed by U.S. Mail postage prepaid on this 15th day of March, 2012, to the following:

Mr. Erick E. Nordling
Kramer, Nordling & Nordling
209 E. 6th Street
Hugoton, KS 67951

Mr. Richard C. Hite
Hite, Fanning & Honeyman LLP
100 N. Broadway, Suite 950
Wichita, KS 67202-2209

Ms. Shannon Ratliff
Ratliff Law Firm, LLC
600 Congress Avenue, Suite 3100
Austin, TX 78701-2984

Mr. Brian S. Engel
Barrett Daffin Turner, et al
610 W. 5th Street, Suite 602
Austin, TX 78701

Mr. David G. Seely
Fleeson Gooing Coulson & Kitch LLC
P.O. Box 997
Wichita, KS 67201-0997

with the Original to:

Ms. Kelsee Burnett
Clerk of the District Court
200 E. 6th Street
Hugoton, KS 67951

Roberta M. Tackett

Roberta M. Tackett, Administrative Assistant