DATE FILED: January 21, 2014
CASE NUMBER: 2006CV317

☐ Small Claims ☐ County Court ☒ District Court
☐ Probate Court ☐ Juvenile Court ☐ Water Court
Garfield County, Colorado
Court Address: GARFIELD COMBINED COURTS
109 8TH Street, Suite 104
Glenwood Springs, CO 81601

Plaintiff(s): IVO LINDAUER, SIDNEY and RUTH LINDAUER and DIAMOND MINERALS, LLC on behalf of themselves and all others similarly situated
v.

Defendant(s): WILLIAMS PRODUCTION RMT COMPANY

▲ COURT USE ONLY ▲

Case Number: 06CV317

Div.: Ctrm: B

GARFIELD COMBINED COURTS
Phone Number: 970-945-5075
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ORDER REGARDING ENHANCEMENT

THIS MATTER came before the Court on December 9, 10 and 11, 2013 for trial. The Court having heard the testimony of the witnesses and having read the file and exhibits hereby finds and orders as follows.

STATEMENT OF THE ISSUE TO BE DETERMINED

The Court previously held that Williams could deduct from the royalty payments the transportation expenses it incurred to move gas downstream if doing so enhanced the value of the gas. The Court also ruled that Williams had the burden of proving enhancement on a monthly basis. (See Orders dated August 19, 2013 and October 31, 2013).

The parties have stipulated that the time period involved is July 2000 through July 2008.

The parties also stipulated to the Index Average price for the gas, the gross price Williams received for the gas, and the transportation costs. These were stipulated to on a monthly basis for the relevant time period. These stipulated prices and costs are set forth in Defendant's Exhibit 3.

During the trial, the parties agreed that the starting point for evaluating whether the gas was enhanced by transporting it to distance markets is the inlet to the interstate pipelines in the Piceance Basin (hereinafter "Basin") which are known as the CIG, Northwest, and Questar pipelines. The location of the pipelines is noted on Defendant's Exhibit 1.

The issue for the Court to determine is what price should be used at the starting point of the inlet to the pipelines to measure whether Williams enhanced when it transported and sold the gas downstream. Defendant wants the Court to use the price of the Average Index price minus 25 cents. Plaintiffs' want the Court to use the average of the three indexes set forth in Platts.

FINDINGS OF FACT

Alan Killion has been the Director of Marketing for Williams since 2005. He has worked in the marketing department for Williams since 2000. Mr. Killion has been involved in finding buyers for the gas and negotiating transportation contracts during the entire 14 year period that he has worked for Williams.

Williams acquired a gas company called Barrett Resources in 2001. At that time, Barrett was producing 100,000 MMBtu's of gas a day. Between 2001 and 2008, Williams had a very aggressive growth plan and by the end of July of 2008, Williams was producing one billion cubic feet of gas in the Basin per day. Williams was the largest producer of gas in the Basin during the 2000 to 2008 time frame.

Williams marketing strategy during the 2000 though 2008 time period, as testified to by Mr. Killion, was to gain the highest price possible for the gas, to ensure that Williams could sell of all of its gas, and to obtain the cheapest cost possible when moving the gas downstream. It was William's strategy to always try to get the highest price it could for its gas.

During the 2000 to 2008 time period, Williams was selling gas both inside and outside of the Basin. Inside the Basin, Williams was selling gas in the Northwest, Questar and the CIG pipelines. When the gas Williams produced in the Basin entered the interstate pipelines, it was in a marketable condition. Williams sold gas at the Barrett Master Meter, to Source Gas and British Petroleum, to name a few.

During the 2000 to 2008 time period, Williams also purchased gas inside the Basin. Williams purchased gas from PDC, Noble and Berry.

Williams sold most of its gas outside of the Basin during the 2000 to 2008 time period because the higher priced markets were outside of the Basin. Williams needed to transport the gas away from the Basin (downstream) to obtain those higher prices. Williams sold gas to markets in California, Kansas, Iowa, Oklahoma and Nebraska.

There was a lot of testimony regarding index pricing. The average index price is reported in a publication called Platts. An index price is a price that is given a specific pipeline which is calculated by taking the average sales into that pipeline for the last five (5) business days of the month. It includes sales along the entire pipeline. So, the average index price includes gas sold all along the pipeline which means that it includes gas sold both inside and outside of the Basin. For example, for the CIG pipeline, Platts collects the information to calculate the index price for that pipeline from Wyoming, Colorado, and Utah. (See Plaintiff's Exhibit 83, appendix VII). The average index price reported in Platts does not mean that a company can obtain that index price everywhere along the pipeline. For example, Mr. Killion testified that during the 2000 to 2008 time period, the price for gas Williams actually received at the CIG pipeline was always 15 to 20 cents below the average index price.

Deliveries into the Northwest pipeline include gas from Wyoming, Utah and Colorado. The same is true for the Northwest pipeline. Just because you are selling gas through the Northwest pipeline does not mean that you can obtain the index average price everywhere along the Northwest pipeline. Mr. Killion testified that when Williams sold gas on the Northwest pipeline in the Basin, they would typically only get the index price minus 20 cents.

The Questar pipeline goes from Colorado to Utah. The index average from Platts includes deliveries into the pipeline from Colorado, Wyoming and Salt Lake City. When Williams sold gas on the Questar pipeline in the Basin, Williams would typically only be able to get 5 to 10 cents below the index.

The index price is also volume weighted, so if there are more volumes of gas sold in locations further downstream, those sales are going to affect the index price because they are generally higher sales prices.

Mr. Killion testified that during the 2000 through 2008 time period, the sale of gas at the three pipelines was typically fifteen to twenty cents below the index average. On occasion Williams could sell the gas in the Basin for a price higher than the index price but this was during the winter months when gas was at a higher demand.

Defendant's Exhibit 30 is a Gas Purchase Agreement date January 1, 2007 between Williams and Noble Energy, Inc. Page 12, paragraph 5.7.2 provides for an interim purchase price that Nobel would to Williams which was 100% of the Questar Pipeline average as posted in Platts less 10 cents. Mr. Killion testified that for the May of May of 2006, the Questar price was 5.39. Under the contract, 5.39 minus 10 cents would be 5.29. The index average for May of 2006 was 5.57. So the interim purchase price that Williams was selling the gas for the month of May of 2006 was 28 cents lower that the index average.

Williams purchased gas from PDC in the Basin from 2002 through October of 2006 for the average of the CIG, NWPL and Questar indices minus 13 cents for transportation. (See Defendants Exhibit 27, page 21).

Williams purchased gas in the Basin from Berry beginning on July 1, 2005. Williams was paying Berry the average of the three indices minus the 13 cents for transportation. (See Defendant's Exhibit 27, page 21).

As reflected in Exhibit 3, in 2007, Williams for the most part received a higher price for the gas they sold downstream than the index average price.

Elizabeth Edgeller has been employed by Williams marketing accounting group since 1994. Her marketing group is responsible for preparing the pricing sheets which reflect the sales price that Williams receives for its gas and the transportation costs associated with those sales. Defendants Exhibit 13 is an example of these pricing sheets. Ms. Edgeller compared the average index month price to the sales at the inlets price for selected months:[1]

Date	Index price	BMM inlet	RC inlet	Barrett Inlet
1/06	$8.81	-$1.62 lower [2]	-$0.14	-$6.33
2/06	$6.58	-$0.27	-$0.08	-$4.10
3/06	$6.01	-$0.42	+0.02	-$3.49
4/06	$5.49	-$0.02	+0.09	-$2.97
5/06	$5.57	-$0.76	n/a	-$3.05
6/06	$4.70	+$0.40	n/a	-$0.54
6/07	$3.13	n/a	n/a	-$0.54

This "Sales at Inlets" demonstrative exhibit shows that in 13 of the 17 months reflected, the price of the gas at the inlet was lower than the index price.

Ms. Edgeller testified that the average cost of transportation on the Questar pipeline for downstream sales for the stipulated months was 13.3 cents. For the CIG pipeline, the average cost of transportation for downstream sales was 35 cents. For the

[1] The BMM inlet is at the Quastar pipeline, the RC inlet is at the CIG pipeline and the Barrett *inlet is at the* Northwest pipeline.

[2] A minus sign means that the sales price was lower than the Index price

NWPL, it was 8 and 1/2 cents. Ms. Edgeller testified that these transportation costs were not out of the ordinary.

Ms. Edgeller also testified that the majority of the gas produced during 2000 through 2008 was sold outside of the Basin.

Mary Ellen Denomy is a certified public accountant who specializes in oil and gas accounting. She explained that the WPX Net Price in Exhibit 3 is the actual price the royalty owners received. It's the gross price that Williams received minus the transportation expenses.

Ms. Denomy believes that the appropriate measure of the price of gas at the inlet to the interstate pipeline is to take the index prices for the three pipelines CIG, Northwest and Questar as published in Platts, and average them. Ms. Denomy testified that it is a common oil and gas industry standard to use these index averages. In order to determine whether the gas was enhanced you would then compare the index average to what the royalty owners were actually paid. In the very last column of Defendant's Exhibit 3 are her calculations which show the difference that should be reimbursed to the royalty owners because the value of the gas was not enhanced by transporting it. If the last column is blank, that means the value of the gas was enhanced and Williams was entitled to take the full transportation cost for that month.

Ms. Denomy is critical of Williams's method because the sales made in the Basin that it relies on are only a fraction of the sales and therefore is not a valid sample. Ms. Denomy testified that during the period of time at issue, Williams only sold approximately 1 percent of its gas in the Basin.

Ms. Denomy admits that her analysis presumes that the index price could be received at the three inlets in the Basin.

Mr. Harper testified as an expert in the field of oil and gas marketing. Mr. Harper testified that index prices as published in Platts are the acknowledged benchmark for market prices in the industry. Platts is the most widely used published index of natural gas prices. In Mr. Harper's opinion, the index average method is the appropriate starting point price to use to determine if the gas was enhanced as a result of transporting the gas downstream. He believes that it is the industry custom and practice to use the average price index to assess enhancement.

Mr. Harper testified that the Berry and PDC contracts are not relevant because they don't involve gas delivered into the interstate pipeline.

Mr. Harper doesn't have any quarrel with the downstream marketing strategy employed by Williams.

CONCLUSIONS OF LAW AND ORDER

As stated above, the Court previously ruled that Williams was entitled to deduct from the royalty payments, the transportation expenses it incurred to sell the gas downstream if it could prove that by doing so, the value of the gas was enhanced. The Court also ruled that Williams had to prove this on a monthly basis.

The parties have stipulated to many issues. They agree that the time period involved is July 2000 through July 2008. They agreed to the average index price and list them on a monthly basis on Defendant's Exhibit 3. They stipulated to the gross price for the gas that Williams received on a monthly basis as reflected in Defendant's Exhibit 3. They stipulated to the transportation costs that were incurred by Williams as reflected in Defendant's Exhibit 3. They stipulated to the net price that Williams received after deducting the transportation cost. They also agree that the starting point for evaluating whether the gas was enhanced should be at the inlets of the CIG, Northwest and Questar pipelines in the Basin. The only issue remaining for the Court to determine is what price should be used to make the comparison. Williams wants the Court to hold that Index minus 25 should be used. Plaintiff's want the Court to hold that the average index price for each of the three pipelines as determined by Platts should be used.

The Court notes at the outset that there is no case law in Colorado or elsewhere to assist the Court in its determination. Counsel for both parties are specialists in oil and gas law and if there was anything out there, the Court is certain that they would have brought it to the attention of the Court.

During the July 2000 through July 2008 time period, it was Williams marketing strategy to get the highest price it could obtain for its gas. This resulted in most of its gas being sold outside of the Basin because Williams could get a higher price. This marketing strategy benefited both Williams and the Plaintiff class. Williams did have some sales during this time period in the Basin, however, according to Mr. Killion who has direct knowledge of the sales, the price that Williams received at the inlets to the pipelines was lower than the average index price. The price that Williams received at the GIG pipeline was 15 to 20 cents lower than the average price index. The price that Williams received at the Northwest pipeline was 15 to 20 cents below the average price index and the price Williams received at the Questar pipeline was 5 to 19 cents below the average price index.

The contracts Williams had with Noble also show that Williams could not get the average index price in the Basin. The interim Noble contract was index minus 28 cents. The PDC and Berry contracts in the Basin were index minus 13 cents.

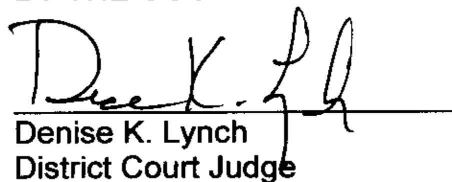
The Court concludes that the evidence does not support using the average index price as the comparison point to determine whether the gas was enhanced. The index price includes markets outside of the Basin. The average index price is not a fair

reflection of the price Williams could obtain for gas sold in the Basin. The evidence is that Williams could not obtain the average index price in the Basin which is why the gas was sold outside of the Basin. The Court finds that the average index price should be adjusted to reflect what gas could sell for in the Basin. The Court concludes that this price should be the index price minus 20 cents which is what Mr. Killion testified the gas sold for in the Basin during the relevant time period.

The Court enters judgment in favor of Williams. The Court understands that the parties have agreed to how the accounting the accounting should be conducted. The Court further orders that this accounting should be completed within 60 days of the date of this Order and that the index price minus 20 cents should be the benchmark of comparison to determine if the gas was enhanced.

Dated this 21st day of January, 2014.

BY THE COURT:



Denise K. Lynch
District Court Judge