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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

PLAINTIFFS' REPLY IN SUPPORT OF THEIR MOTION FOR CLASS CERTIFICATION

INTRODUCTION

In an attempt to limit its potential liability for improperly imposing production and marketing costs on all members of the putative class herein, OXY has elected to resist certification of the claims being advanced on their behalf.[1] Obviously, by trying to force each putative class member to file his or her own action, OXY is hoping to delay, if not avoid altogether, accounting to all of its royalty owners in conformity with Kansas law. In its effort to prevent certification, OXY mischaracterizes and distorts what this lawsuit is about. When OXY's arguments are examined in

[1]The defendants in the first two gathering cases previously scheduled for class certification hearings in this Court have agreed that classes should be certified in those actions. *Coulter v. Anadarko*, Case No. 98-CV-40; *Alford v. Pioneer*, Case No. 93-CV-37. Copies of those orders are attached hereto as Exhibits 1 and 2.

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In an attempt to limit its potential liability for improperly imposing production and marketing costs on all members of the putative class herein, OXY has elected to resist certification of the claims being advanced on their behalf.[1] Obviously, by trying to force each putative class member to file his or her own action, OXY is hoping to delay, if not avoid altogether, accounting to all of its royalty owners in conformity with Kansas law. In its effort to prevent certification, OXY mischaracterizes and distorts what this lawsuit is about. When OXY's arguments are examined in

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terms of the issues actually raised by plaintiffs, however, it is clear that plaintiffs have met the requirements for certifying this case as a class action.

I. The Evidence Before the Court Confirms The Propriety of Certifying The Class.

Discovery conducted by plaintiffs and the analysis performed by their experts, as well as the expert employed by OXY, together with the admissions contained in OXY's Brief in Response to Plaintiffs' Motion for Class Certification (OXY's Brief), leave no doubt that plaintiffs' motion should be granted:

1. OXY deducts a pro-rata share of all the expenses it incurs to gather the gas, including fuel, from the account of each member of the putative class. (Deposition of Kevin P. Moore, at Pages 14 and 84, copy attached hereto as Exhibit 3). OXY shows such deductions under the heading "gathering/ compression" or "marketing deduct" on the royalty remittance statements it sends to each member of the plaintiff class each month. (Deposition of Kevin P. Moore, Exhibit 3 hereto, at Pages 60 to 63). For its own gathering systems,[2] OXY takes such deductions in the form of an

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[2]Defendant's expert witness, Douglas L. Burton, incorrectly states that "OXY itself owns no gathering facilities in the Kansas Hugoton Field, either directly or through any affiliated entity." This statement is wrong. OXY owns two gathering systems in Kansas Hugoton Field. (Deposition of David L. Bushnell, Pages 29 to 45, copy attached hereto as Exhibit 4). In its Brief, OXY halfway corrects this error by acknowledging that it owns one gathering system in the Hugoton Field. (Page 10, n. 6.) It then erroneously states that OXY did not own this gathering system "prior to deregulation." *Id.* If OXY's statement refers to its Ulysses Gathering System, which is by far the largest of the two gathering systems it owns in the Hugoton Field, this statement is also incorrect. Since at least 1949, OXY and its predecessor companies have owned a gathering system which serves wells located on approximately 43,000 acres in Grant and Haskell Counties, Kansas, as evidenced by the Gas Purchase Contract, dated November 18, 1949, between Columbian Fuel Corporation, predecessor to OXY, and Cities Service Gas Company, predecessor to Williams Natural Gas Company, a copy of which is attached hereto as Exhibit 5. As is discussed in Paragraph 8 below, OXY's decision to begin deducting "a proportionate share of the discounted market value of these services" from royalty, as stated at note 6 on Page 10 of its Brief, is a direct reversal of its prior practice of not charging its royalty owners any portion of the costs incurred to construct and operate this gathering system.

"imputed calculation cost." (*Id.*at Page 16, lines 7 to 11). When assessing its royalty owners a proportionate share of expenses incurred on gathering systems operated by third parties, OXY uses invoiced costs. (*Id.* at Pages 14 and 15).[3]

2. The costs associated with operating each of the gathering systems involved in this case include compression and dehydration. (Deposition of David L. Bushnell, Pages 34-35, 40, and 44, Exhibit 4 hereto; ¶ 16 of Affidavit of Richard L. Hanson, copy attached hereto as Exhibit 8; ¶ 16 of Affidavit of B.J. White, copy attached hereto as Exhibit 9; ¶ 12 of Affidavit of Charles E. Graham, III, copy attached hereto as Exhibit 10(compression)). OXY admits these undisputed facts throughout its Brief.[4]

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[3]OXY's claim that these deductions are actually being taken for "transportation" activities is directly refuted by its own royalty accounting system, which clearly distinguishes between "gathering" and "transportation." (Deposition of Kevin P. Moore, Exhibit 3 hereto, at Page 70). Moreover, as is reflected by the terminology which OXY uses on the remittance statements which it sends to each class member, the costs which OXY charges to its royalty owners for activities performed by third parties are based upon fees set forth in "Gathering Agreements " with such entities. (*See, e.g.*, Exhibit 12 to Deposition of David L. Bushnell, copy attached hereto as Exhibit 6). As OXY's own expert concedes, for purposes of computing royalties on federal leases, the federal government has issued regulations which draw the same distinction between "gathering" and "transportation" that is used by OXY in its accounting system and on its remittance statements. (Affidavit of Douglas L. Burton, ¶¶ 12 and 15, copy attached hereto as Exhibit 7). Whether such evidence precludes OXY from contending that its gathering activities actually constitute deductible transportation expenses is one of the many common questions in this litigation.

[4]*See, e.g.*, Page 4 ("To the extent that the Gathering Companies apply compression to their pipelines..." and "The Gathering Companies also generally provide certain dehydration services..."), Page 6 ("...the compression in question is but a component part of a facility..."), Page7 ("...such compression ...speeds the recovery of the reserves"), and Page 37 ("Plaintiffs assert that the same activities–compression and dehydration–take place on all gathering systems. The factual existence of compression and dehydration is not a question....Even if this is a correct factual statement of activities occurring on the various gathering pipelines...").

3. The gathering facilities used by OXY actually produce the gas[5] (Deposition of David L. Bushnell, Pages 172; 185, Exhibit 4 hereto; ¶31 of Affidavit of Richard L. Hanson, Exhibit 8 hereto; ¶19 of Affidavit of Charles E. Graham, III, Exhibit 10 hereto) and increase the amount of recoverable reserves underlying its wells.[6]

4. Substantially all the gas at issue is destined for markets outside the Kansas Hugoton Field, which can only be accessed by long-distance transmission pipelines.[7] (Bushnell deposition at Pages 36 and 111, Exhibit 4 hereto; Exhibit 2 to Bushnell Deposition, copy attached hereto as

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[5]In its Brief, OXY carefully avoids using the term "production" when describing the function of the gathering systems. It does acknowledge, however, that it is creating "economic value" by accelerating the recovery of reserves. (Deposition of David L. Bushnell, Exhibit 4 hereto, at Page 191). The acceleration of the recovery of reserves is a production activity, just as is the "fracing" of a well or the drilling of an in-fill well. The acceleration of the recovery of reserves necessarily increases the amount of gas produced in a given period of time. Whether this is a production activity is, again, a common question which affects all members of the plaintiff class in the same manner.

[6]OXY suggests that the compression on the gathering systems does not increase its recoverable reserves from the wells connected to them. OXY's Brief at Page 5. Plaintiffs' experts disagree. (Affidavit of Charles E. Graham, III, ¶27(f)(iv), Exhibit 10 hereto; Affidavit of Richard L. Hanson, ¶31, Exhibit 8 hereto). Whether the lowering of pressure in the gathering system actually increases the amount of reserves that OXY is able to recover from the wells attached to the gathering systems is a common question of fact. Likewise, whether the enhancement of recoverable reserves must be accomplished before compression is deemed a production expense raises common questions of law and fact for the class.

[7]OXY has sold insignificant amounts of gas at or near the wellhead to irrigators and two small-volume purchasers. (Bushnell deposition, Exhibit 4 hereto, at Pages 220 and 221-222). OXY's made the latter sales because the subject wells produced relatively small volumes of gas and were isolated from the principal gathering systems that it in the Hugoton Field. It was not economically feasible for those wells to be connected to such gathering systems and thereby aggregated with larger volumes of gas being produced by OXY from other wells in the field. *(Id.)* OXY's marketing personnel do not know of any wellhead sales being made by other producers in the Hugoton Field. (*Id.* at Page 225). Whether such sales are being made and, if they are, such activity establishes that <u>all</u> gas in the Hugoton Field is "marketable" at the wellhead, as is contended by OXY, generates additional questions of law and fact common to the class as a whole.

Exhibit 11; Affidavit of Douglas L. Burton ¶¶ 10 and 25, Exhibit 7 hereto; Affidavit of B.J. White, ¶5(e), Exhibit 9 hereto; Second Supplemental Response 9 to Plaintiffs' First Request for Admissions, attached hereto as Exhibit 12). OXY carefully avoids contesting this fundamental fact in its Brief.[8] These long-distance transmission pipelines publish substantially similar tariff specifications which the gas must meet before it can be transported in them. (Affidavit of Richard L. Hanson, ¶20, Exhibit 8 hereto). These specifications include maximum water content and minium pressures. (Affidavit of Richard L. Hanson, ¶¶ 21 and 24, Exhibit 8 hereto). All of the gas involved in this litigation is (1) water-saturated, thereby requiring dehydration before it can be transported on the transmission pipeline and (2) emerges from the well below pipeline pressures, thereby requiring compression to

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[8]At Page 6 of its Brief, OXY states "the compression in question is but a component part of a facility whose primary function is the movement of gas over considerable distances from wellhead to transmission line interconnection. . ." In paragraphs 3 and 4 on Pages 8 and 9 of its Brief, OXY attempts to dilute this concession by vaguely stating that (1) gas that it does not dispose of at the wellhead, which is minimal in amount and excluded from this action because it is not being gathered, is sold "at one or more pooling points downstream of the well (these points may be upstream or downstream of the interstate transmission facilities)" and that (2) "all of OXY's gas is sold within the confines of the Hugoton Field." What it avoids telling the Court in either paragraph 3 or 4, however, is that (1) it is selling such gas at or near the "interconnections" with the interstate transmission pipelines, (2) the gas is in suitable condition for transportation on the interstate pipeline grid at the time such sales are made, (3) the gathering activities in which it engages (or for which it contracts) enable the gas to meet the specifications established by such pipelines, and (4) if such sales occur within the "confines of the Hugoton Field," it is because the interstate transmission pipelines cross the field or have trunk lines running into the field. It would have been a simple matter for OXY to reveal these facts to the Court. The bottom line for purposes of class certification is that all of the gas involved in this litigation is being compressed and dehydrated to the levels required by the transmission pipelines which deliver it to the markets where it is consumed. OXY cannot change these fundamental facts by telling half-truths or by misrepresenting plaintiffs' position, as it does in paragraph 4 on Page 9 by arguing that such "mainline transmission specifications...do not...establish the only market for gas produced from the Hugoton Field" (emphasis added) and at Pages 10-11 by claiming that plaintiffs are basing their claim on the "location" where the gathering activities occur.

enter the transmission pipelines. (Bushnell Deposition, Exhibit 4 hereto, at Page 60; Affidavit of B.J. White, ¶¶ 13 and 14, Exhibit 9 hereto; Affidavit of Richard L. Hanson, ¶¶ 21 and 24, Exhibit 8 hereto; Second Supplemental Responses 5 and 6 to Plaintiffs' First Request for Admissions, Exhibit 12 hereto). Thus, the gathering facilities used by OXY not only produce gas but also condition the gas in the manner required to make it marketable. (Affidavit of B.J. White, ¶ 14, Exhibit 9 hereto).

5. OXY uses a uniform methodology which it applies to all class members when determining the amount of each deduction to be taken from their royalty payments. (Deposition of Kevin P. Moore, Exhibit 3 hereto, at Pages 41-42).[9] OXY's methodology does not distinguish among individual wells connected to gathering systems on the basis of (1) the composition of the gaseous streams emerging from the wells (except for MMBTU adjustments), (2) the reservoir pressures; (3) the volumes of gas produced from the wells; (4) the reserves associated with particular wells; or (5) any other possible factor that might vary from well to well. (Affidavit of B.J. White, ¶ 19, Exhibit 9 hereto). The only variable is volume.

6. When computing royalties, OXY does not vary its calculations on the basis of any difference in the language contained in any royalty instrument held by any member of the plaintiff

[9]In paragraph 5 on Page 9 of its Brief, OXY purports to deny such uniform treatment, but does not provide any evidence in support of that denial. Posing it as a hypothetical, as it must, OXY says merely that "in the event that a lease were to prohibit the deduction of gathering fees in the calculation of royalty, OXY's payment system would calculate that lessor's interest without deducting such fees." OXY conspicuously fails to identify any such lease upon which it pays royalties to a member of the plaintiff class. In fact, it has never done so. *See* note 10 below.

class.[10] (Response To Interrogatory 1 to Plaintiffs' Fifth Set of Interrogatories and Fourth Set of Document Requests, Exhibit 13 hereto). It makes all royalty calculations in the same way.

7. OXY fails to challenge the proposition that it would not be able to deduct the costs of compressing and dehydrating the gas if it were performing these activities on the lease premises. By necessity, OXY is taking the position that it is the location where the activities take place, as opposed to their purpose or function, which dictates whether the underlying expenses can be deducted from royalty payments.[11]

8. OXY's deductions are without historic precedent. Moreover, its own accountant admits OXY has previously charged such expenses back to the lease (i.e., the working interest owners and not the royalty owners), even when incurred off the lease premises, because they are operating expenses which should be billed to joint interest owners, not royalty owners. (Deposition of

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[10]OXY claims that it examines the language in each of the leases. (OXY Brief at Page 6). With the exception of its leases with the Mineral Management Service, which are expressly excluded from the plaintiff class, OXY has concluded that all of its leases within the confines of the Kansas Hugoton Field permit it to reduce royalty payments by what it has denominated "gathering/compression" deductions or "marketing deducts." (OXY's Response 1 to Plaintiff's Fifth Set of Interrogatories and Fourth Set of Document Requests, copy attached hereto as Exhibit 13). In defense of its position, OXY states that "[T]he law of the State of Kansas, generally, allows the deduction of costs incurred after natural gas is severed from the wellhead, absent express and clear language to the contrary." (Response To Interrogatory 1 to Plaintiffs' Fifth Set of Interrogatories and Fourth Set of Document Requests, Exhibit 13 hereto). OXY's statement does not accurately reflect Kansas law. As stated in *Sternberger v. Marathon Oil Co*, 257 Kan. 315, 894 P.2d 788 (1995), Syl. ¶ 2, Kansas law actually provides: "Absent a contract providing to the contrary, a non-working interest owner is not obligated to bear any share of production expense, such as compression, transportation and processing, undertaken to transform gas into a marketable product" (emphasis added). In any event, whether OXY's interpretation of Kansas law is correct is yet another common question which affects all members of the plaintiff class.

[11]Since all of the activities in question take place off the lease premises, the issue of whether this fact converts nondeductible expenses into deductible expenses generates still more common questions of law and fact which impact every member of the class in exactly the same way.

Kevin P. Moore, Exhibit 3 hereto, at Pages 41-42). It is uncontroverted that historically: (1) gathering costs were never deducted from royalty payments; (2) the prices received by producers under long-term contracts for gas sold to pipelines at the wellhead were the result of arms'-length negotiations which had nothing to do with the costs which the pipeline would be incurring to gather, compress and dehydrate the gas; (3) as confirmed by defendant's own expert witness, Douglas A. Burton, such costs were actually added to the price paid for the gas and recovered by the pipeline from the consumers of such gas;[12] and (4) during the period from 1954 until the late 1980's, when regulating the price being paid to producers by pipelines at the wellhead, the federal government never established prices or rates by means of a "netback" methodology, which is the methodology OXY is presently employing to compute royalty payments for the gas at issue herein. (Affidavit of B.J. White, ¶ 6(e), Exhibit 9 hereto).[13]

II. OXY Misinterprets And Misapplies *Sternberger.*

OXY misconstrues the cases upon which the holding in *Sternberger v. Marathon Oil Co.*, 257 Kan. 315, 894 P.2d 788 (1995) is based. *Sternberger* states that "*Scott*, *Voshell*, and *Molter* are

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[12]During federal regulation of production, "[t]he cost of that gathering was recovered by the pipeline through its gas resale charges." (Affidavit of Richard L. Burton, ¶18, Exhibit 7 hereto).

[13]OXY incorrectly states: "[T]he producer and royalty owner [during the era of federal regulation] each shared in the gathering (or compression) expense through the receipt of a lower price for the gas." (Page 8). This statement is directly contradicted by Mr. Burton's admission discussed in note 12, *supra.* Again, however, how OXY and other producers sold their gas in the Hugoton Field before they began taking the deductions in question, the manner in which such price was regulated by the federal government, and the way in which OXY accounted to its royalty owners prior to deregulation, as well as the relevance of each of such inquiries, are common questions which impact all members of the class in the same fashion.

dispositive of the issue in this case" precisely because those Kansas cases dealt with "transportation expenses." 257 Kan. at 324, 326; 894 P.2d at 796. *Sternberger* discusses but does not directly rely upon either *Matzen v. Hugoton Production Co.*, 182 Kan. 456, 3212 P.2d 576 (1958)[14] or *Ashland Oil & Refining Co. v. Staats*, 271 F.Supp. 571 (D. Kan. 1967),[15] precisely because those cases did not deal with the propriety of deducting any expenses whatever and, for that reason, did not address the distinction between transportation and gathering, which is essential to the holding in *Sternberger* itself. Most certainly, neither case supports OXY's claim that it can deduct compression and dehydration expenses.

OXY attempts to blur the fundamental distinction between "transportation" expenses and "gathering" expenses, upon which the holding in *Sternberger* is based, by suggesting that "the lack of compression or dehydration played no role in the court's analysis or its conclusion, nor were they even mentioned in connection with it." (OXY's Brief at Page 21). OXY's reading of the case is directly contradicted by the language of *Sternberger* itself:

> There is no evidence that Marathon *engaged* in any activity designed to enhance the product, such as *compression*, processing, or *dehydration*. There is no evidence that Marathon attempted to deduct any expenses in making the gas marketable other than those of constructing a pipeline to *transport* the gas to the purchaser or to a transmission pipeline. Therefore, the deductions made by Marathon are properly characterized as "*transportation*" rather than "*gathering*" or other production costs.

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[14]As pointed out in *Sternberger* itself, *Matzen* is of doubtful precedential value, because the plaintiff royalty owners did not contest the propriety of deducting "gathering" costs from royalty. *Sternberger*, 257 Kan. at 327, 894 P.2d at 798.

[15]In *Staats*, the royalty owners wanted the producer to pay royalties on reimbursements it was receiving under federal regulation for the cost of transporting gas from several wells to the interstate pipeline, which was purchasing the gas. In contrast to the present case, as well as in *Sternberger*, the royalty owners in *Statts* did not claim (and had no basis for claiming) that such expenses were being deducted from royalties.

257 Kan. at 331, 894 P.2d at 799-800 (emphasis added).[16]

In its attempt to defeat class certification, OXY specifically argues that *Sternberger* requires denial of class certification because "the factors which govern the deductibility of post-production costs are individual to each well and lease, and therefore not susceptible to trial in a class action." (OXY's Brief at Page 13). This statement is extraordinary when one considers that *Sternberger* itself was a class action. If OXY were correct, then the claims asserted in *Sternberger* could never have been certified.

III. In An Attempt To Avoid Certification, OXY Erroneously Claims That Plaintiffs Must Offer Well-by-Well Evidence To Prove That It Is Wrongfully Deducting The Expenses In Question.

The Supreme Court stated in *Shutts v. Phillips Petroleum Co.*, 222 Kan. 527, 557, 567 P.2d 1292, 1314 (1977) that the existence of uniform treatment of royalty owners by a producer, regardless of any variation in individual circumstances, makes "it difficult to imagine a more manageable plaintiff class action." As demonstrated above, OXY has treated each member of the putative plaintiff class in exactly the same manner with regard to the deductions at issue. OXY has adopted a uniform method of computing royalty payments by which it systematically deducts expenses which it admittedly incurs to produce the gas at the rate desired by it and to place the gas in a condition suitable for the market selected by it. In so doing, OXY has not differentiated among

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[16]At Page 20 of its Brief, OXY points out, and then attempts to exploit, a citational error in plaintiffs' brief. Plaintiffs incorrectly cited Syl. ¶3 of the *Sternberger* opinion for the proposition that the Kansas Supreme Court has expressly recognizes that "gathering" is a production expense. As evidenced by the underlined portion of the indented quotation, the Court made this statement in the body of its opinion, 257 Kan. at 331, 894 P.2d at 800, not in the syllabus.

the members of the putative class on the basis of the language of the royalty clause contained in the leases or any other factor.

In short, when performing its royalty calculations, OXY does not distinguish among individual wells on the basis of any of the factors which it now suggests might distinguish one well from another for purposes of resolving the issues raised by this lawsuit. In other words, OXY wants this Court to disregard its own uniform treatment of its royalty owners–the actual circumstances which give rise to this lawsuit–in favor of some hypothetical exercise, which completely ignores the very practices in which it is presently engaged and upon which plaintiffs' claims are based.

OXY's resistance to certification is based almost exclusively on the proposition that, if its actual accounting methodology is disregarded and a different method for calculating royalties were somehow utilized, the new method would raise so many individual issues that common questions of law or fact would no longer be predominant. OXY cannot have its cake and eat it, too: it cannot conduct its business as if any variations in individual circumstances are not relevant and then oppose certification on the ground that they are. The inequities inherent in OXY's position are compounded by its refusal to tell the Court exactly how it would be required to compute royalties under such an alternative scheme. Is it suggesting that it would be impossible for it to utilize an accounting methodology that comports with Kansas law? Or is it simply saying that its method of accounting for royalties should be immune from attack in a class action? OXY's failure to provide the obvious answers to these questions–"no" to the first and "yes" to the second–underscores the illusory nature of its opposition to class certification.

Because the Kansas Supreme Court in *Sternberger* has specifically forbidden producers from deducting certain expenses from royalty payments, it is not surprising that at the outset of its Brief,

OXY attempts to argue that this case is not about compression and dehydration. Thus, it entitles Pages 5-7 of its Brief, "Plaintiffs' [sic] Erroneously Assert That This Case Is About Compression And Dehydration." Using classic "straw man" tactics, OXY argues that this case is not suitable for certification because plaintiffs are required to prove that each class member is "receiving less" than he or she would be entitled to receive without reference to the deductions in question:

> ...Merely focusing upon the deductions utilized by OXY in computing its royalty payments will not, in and of itself, determine the amounts properly payable to OXY's royalty owners. Unless Plaintiffs can establish the amount of royalty to which Plaintiffs and each of the putative class members were entitled and that such royalty owners received less than that amount [as the result of the manner in which OXY is calculating royalties], there can be no recovery.

(OXY's Brief at Page 27).

When stripped of its contrived complexity, OXY's ensuing argument (Pages 28-32) amounts to nothing more than the proposition that plaintiffs must prove that they are receiving less than required by each of the underlying leases without reference to the fact that OXY is taking the deductions in question.[17] Nearly all of its discussion of this issue (i.e., from the middle of Page 29 to the beginning of subsection 4 on Page 34), however, is devoted to market value leases. At Page 32 of its Brief, OXY finally reveals the goal of this tortuous exercise, which is to require plaintiffs

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[17]Although OXY in its Brief suggests that certification should be denied because there are "over one thousand separate lease agreements (with numerous and varying royalty payment provisions),"(Page 28 at note 21), it quickly concedes that the "universe of leases" can be categorized into "two types: market value leases and proceeds leases" for purposes of its analysis. (Page 28). It then abandons any discussion of the certification of proceeds leases, declaring instead that such leases give it the right to deduct the expenses in question. (Page 29). OXY, however, does not explain how it arrives at its conclusion that it is authorized to take deductions from proceeds leases. At any rate, this is a merits argument--not a basis for resisting certification. By making it, OXY effectively concedes that the portion of the "universe" represented by proceeds leases should be certified, since exactly the same question is raised with regard to each such lease–whether it authorizes the deductions in question.

to prove that the royalties they are receiving are less than the "market value" represented by "other arms' length sales of gas from the same well" or "comparable sales within a relevant area from which market value can be determined." In other words, OXY is claiming that plaintiffs have the burden of comparing what they are getting with what they might have received if OXY had chosen to sell the gas in a different manner.

Plaintiffs have not assumed such a burden. As they previously advised the Court, this lawsuit does not raise or involve the question of whether OXY is selling the gas in a prudent manner.[18] Plaintiffs challenge OXY's accounting methodology, not its sales. Plaintiffs have excluded any and all wellhead sales by OXY from this litigation[19] and are not challenging its decision to sell the remainder of the gas at or into the high-pressure transmission pipelines which connect the Hugoton Field to the interstate markets where the gas is actually consumed.

This lawsuit is much narrower than OXY suggests. At the heart of this case lies a single issue: whether OXY can charge its royalty owners with any portion of the costs it incurs to gather the gas, including compression and dehydration, so that it can be sold by OXY in the interstate markets where it has chosen to sell such gas. Only if plaintiffs were challenging OXY's marketing

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[18]Plaintiffs' Memorandum in Support of Class Certification, Page 3, note 2: "Plaintiffs are not challenging the manner in which OXY has elected to market the gas involved in this case. The only issue is whether it must bear any expenses it incurs to place the gas in a condition suitable for sale in such market."

[19]At Page 10 of its Brief, OXY notes that "[p]laintiffs do not contest the amount of royalty payments made to those royalty interest owners with respect to gas that is sold by OXY at the wellhead; that is, where OXY does not incur the fees associated with movement of the gas and where OXY and its royalty owners receive a lower gross price for such gas." *See* discussion at note 7, *supra*. OXY fails to observe, however, that plaintiffs are not claiming that any of the sales actually made by OXY are imprudent.

decisions would sales being made by other producers be relevant. Since plaintiffs have not challenged the prudency of OXY's sales, it is clear that OXY's concerns about the complexity of the evidence the Court would face are totally contrived. The Court should not allow its decision on certification to be influenced by OXY's fictional accounts of evidence to be presented by plaintiffs in this case.[20]

IV. Common Issues Predominate.

The individual questions identified by OXY at Pages 32-34 of its Brief are a product of its imagination--not the issues actually raised by this litigation. Plaintiffs seek to modify OXY's uniform accounting practice, which is a byproduct of its decision to aggregate the gas produced from all wells connected to each gathering system,[21] in only one respect. Instead of allocating its gathering costs on an 8/8ths basis, it is plaintiffs' contention that OXY should be required to absorb all such costs, since such activities are the means by which it is discharging its express and implied duties under the leases. When presenting their case at trial, plaintiffs have no intention of offering any evidence regarding individual wells, except to the extent necessary to rebut any attempt by OXY

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[20]In truth OXY is the only party that will attempt to offer evidence of sales other than those involved in this case. It will offer such evidence in an attempt to prove that all gas in the Hugoton Field is in marketable condition when it emerges from the well because it could be bought and sold at that location. Whether such evidence exists or is admissible to justify OXY's deduction of gathering charges from all its royalty owners is a common question which cuts across the claims asserted on behalf of all class members. Inherent in such common question is the issue of how *Sternberger* should be interpreted. In any event, OXY's proof of this purported defense – that all gas is marketable at the well -- will not vary from well to well, but will necessarily rely upon the application of a uniform standard of marketability.

[21]In other words, OXY has implemented its decision to aggregate the gas streams by connecting multiple wells to the same gathering system.

to prove that some of the gas in question may not require compression or dehydration in order to be placed in a condition suitable for sale in the markets in which OXY has elected to sell it[22] or that compression does not assist the process of producing the gas from each of the wells located on the gathering system in question.

The individualized inquiries listed at Page 33 of OXY's Brief are a complete ruse. They are based upon the false premise that the "marketability" of the gas in question should be determined on a basis other than the requirements of the market in which OXY is actually selling the gas. In other words, OXY wants to be permitted to account to its royalty owners on the basis of sales it did not make and without reference to the expenses it actually incurs to make the sales it does make. Quite apart from the absurdity inherent in this proposition, which is simply another version of its discredited argument that plaintiffs cannot prove the deductions are improper unless they first prove they would have received more if it had sold the gas in a different manner, OXY carefully avoids explaining exactly how it intends to present such evidence in its defense. As plaintiffs have repeatedly stated, they do not intend to offer such evidence and cannot imagine what form it would take.

If OXY offers any such evidence in its case, it will be for the purpose of proving its defense that all gas in the Hugoton Field is in marketable condition when it emerges from the ground in a captive state–not for the purpose of suggesting that some of the gas involved here is marketable at the wellhead and some is not. In fact, by taking the former position, which requires exactly the same

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[22]It is highly doubtful that OXY would attempt to present such evidence itself, since this would mean that the deductions it is taking with regard to the gas produced from any such well would be for activities which are unnecessary, thereby evidencing fraud on its part.

proof with regard to every lease involved in this case, OXY has effectively precluded itself from taking the contrary position for the cynical purpose of defeating certification. Finally, if OXY has some real reason for believing that its blanket treatment of its royalty owners is wrong–not because Kansas law prohibits it from deducting compression and dehydration expenses but because some (but not all) of the gas is already in marketable condition when it emerges from the well, it should provide the Court with a candid explanation of how it would make such a distinction, instead of hiding behind the turgid jargon in its Brief.

The issues raised by the pleadings and the evidence which the parties intend to offer in support of their positions in this case, as confirmed by OXY's Brief and the opinions expressed by the experts employed by both parties, establish that there are numerous common questions of fact and law in this case, all of which relate directly to the issue of whether OXY is properly accounting to the plaintiff class for the results of the activities in which it is engaged.

Plaintiffs claim that the deductions in question are being taken for acts necessary to produce and market the gas. OXY claims that such activities simply enhance the value of a product that has already been produced and is already in marketable condition. Neither side varies its position with regard to gas flowing from a particular well. Which characterization of such activities is correct is a common question affecting all members of the plaintiff class in the same manner. This fundamental inquiry raises the following subsidiary questions, among others–all of which are common to the class and address the question of whether OXY is simply "transporting" the gas, as it contends, or is actually "gathering" the gas, as plaintiffs claim:

1. Whether OXY's own accounting system and terminology preclude it from contending that its gathering activities actually constitute deductible transportation expenses.

2. Whether, since OXY is admittedly using the compression in question to accelerate of the recovery of reserves, which necessarily increases the amount of gas produced in a given period of time, such activity produces the gas into the gathering system at the rate desired by OXY.

3. Whether, since OXY is admittedly also using compression to enable the gas to enter transmission pipelines, which is the market in which it has elected to sell such gas, such activity is necessary to make the gas marketable.

4. Whether the lowering of pressure in the gathering system actually increases the amount of reserves that OXY is able to recover from the wells attached to the gathering systems.

5. Whether compression must enhance the amount of recoverable reserves before such activity can be deemed a production expense.

6. Whether the issue of what expenses are being incurred by OXY to make the gas marketable can be answered apart from the requirements imposed by the market in which OXY has elected to sell such gas.

7. Whether sales are being made by other producers at the wellhead in the Hugoton Field and, if they are, whether such activity establishes that all gas in the Hugoton Field is "marketable" at the wellhead.

8. Whether the fact that all of the activities in question take place off the lease premises converts them from nondeductible expenses into deductible expenses.

9. Whether Kansas law prohibits producers from deducting expenses incurred to compress and dehydrate gas, regardless of how questions 2-8 are answered.

10. Whether the outcome of this case in any way depends upon how OXY and other producers sold their gas in the Hugoton Field before they began taking the deductions in question,

the manner in which such price was regulated by the federal government, and the way in which OXY accounted to its royalty owners prior to deregulation. If so, what the answers to such inquiries are.

As the above analysis shows, common issues do not merely predominate in this litigation--they are the only issues that truly exist.[23] Consistent with that fact and because it has adopted a uniform accounting methodology that does not differentiate among wells or leases on any basis other than the volume of gas produced during a given month, OXY will itself present evidence that constitutes a common defense of such practice. By definition, OXY cannot defend its uniform practice by offering any evidence that varies in significance from well to well.[24]

V. The Representative Plaintiffs Can Adequately Represent the Class.

In a parting shot, OXY suggests that the representative plaintiffs cannot adequately represent the class. OXY's sole argument is that because the representative plaintiffs receive payments under

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[23] The listing of these common issues should not be construed to mean that any of the underlying facts related thereto will ultimately be disputed. Therefore, these would be common issues of law.

[24] As is stated by Bill White, who is plaintiffs' gas marketing expert, in paragraph 11 of his Affidavit, at Exhibit 9: "If the court were to conclude that the "netback" methodology being utilized by OXY comports with the law, resolution of this common issue in its favor would effectively dispose of the issue of whether the deductions are proper and no individualized inquiries would be necessary, since OXY's computation of royalties would be proper, regardless of any variation in the condition of the gas that emerges from each well. In other words, the defense raised by OXY applies equally to all of its leases, all of its wells, all of the gas produced from such wells, and all of the royalty payments it makes on all of the gas produced from such wells. This is not surprising, since the "netback" methodology does not distinguish among wells on the basis of the quality of the gas which they produce. [footnote 8 omitted] The success or failure of that defense does not depend upon the condition of the gas at the wellhead or any analysis of what is done to the gas downstream of the wellhead. Thus, when this case is viewed from the perspective of the defendant, common issues of law and fact dominate the proceedings because they effectively exclude any individual issues in the case. Put another way, it is obvious that OXY does not intend to offer evidence of any variation in the condition of the gas at the well to support such defense."

"market value at the well" leases, they cannot adequately represent the interests of the members of the putative class with "proceeds" leases. OXY's unspoken assumptions are that its royalty obligation under a "market at the well" lease is different from its obligation under a "proceeds" lease and that such difference generates a conflict between royalty owners with the two types of leases. Both assumptions are wrong.

To begin with, OXY continues to avoid the reality represented by its own accounting methodology: when calculating royalties, it makes no distinction between those two types of leases. In each instance, OXY deducts from the actual proceeds it receives the costs it incurs to gather the gas. In other words, in attempting to defeat class certification, OXY again disregards its own uniform practice that binds this putative class together, and points instead to a fictional scenario.

Not only does OXY ignore the facts, it ignores the law. In connection with the discrete issue raised by plaintiffs in this case, there is no distinction between the two types of leases under Kansas law. Neither type of lease permits a producer to charge royalty owners with expenses incurred to produce gas. It is OXY's duty under both types of leases to find and produce the gas without cost to its royalty owner. *See, e.g. Howerton v. Gas Co.*, 81 Kan. 553, 106 Pac. 47 (1910); *Collins v. Oil & Gas Co.*, 85 Kan. 483, 118 Pac. 54 (1911). That cost-free component is a fundamental attribute of royalty. The representative plaintiffs can certainly adequately champion the interest of all royalty owners on this issue, irrespective of the language of the royalty clause.

There is also a unity of interest in connection with plaintiffs' claim that OXY is improperly deducting expenses incurred to place the gas in marketable condition. Under a "proceeds" lease, the

royalty clause manifestly states "proceeds," and so no deductions are permitted to be deducted to place the gas in marketable condition.[25]

Kansas law also firmly establishes that under a "market value at the well" lease, such deductions are not permitted. In *Gilmore v. Superior Oil Company,* 192 Kan. 388, 388 P.2d 602, 389 (1964), the producer

> installed a large compressor station on the leased premises in order to compress thereby all the gas produced from such premises rather than installing small compressors at the mouth of each well and at that time [1956] defendant commenced compressing such gas and selling it to Cities Service Gas Company at twelve cents per 1,000 cubic feet.

192 Kan. at 389, 388 P.2d at 604. The trial court had found that

> under the terms of the lease the lessee was required to pay one eighth of the proceeds from sale of the gas at the mouth of the well where gas only was found; at the mouth of the well the gas was unmarketable and had no market value; it was only after the gas was taken from the mouth of the well, either immediately into a compressor or at a gathering compressor farther out in the field, that it became marketable....

192 Kan. at 390, 388 P.2d at 604.

The only issue in *Gilmore* was whether the producer was entitled to "deduct three cents per 1,000 cubic feet for taking the gas from the mouth of the well to the compressor and making it marketable." 192 Kan. at 390, 388 P.2d at 605. Notwithstanding the lessee's use of "at the mouth of the well" in the lease form, the Kansas Supreme Court concluded that the answer was "no."

> The lessee in our case did not consult with the lessor on any details pertaining to the location of the compressing station but on its own responsibility placed it on the Gilmore lease which was a part of the overall lease including the property of both plaintiffs. The only purpose for the compressing station was to put enough force

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[25]"Proceeds of a sale, unless there is something in the context showing to the contrary, means total proceeds." *Matzen v. Hugoton Production Co.*, 182 Kan. 456, 467, 321 P.2d 576, 585 (1958) (Fatzer, J., concurring).

behind the gas to enable it to enter the pipeline on the lease. This made the gas marketable and was in satisfaction of the duties of the lessee so to do.

192 Kan. at 390, 388 P.2d at 604.

Schupbach v. Continental Oil Co., 193 Kan. 40, 394 P.2d 1 (1964), involved the same gas field, the same lease form and the same pipeline purchaser. However, in *Schupbach*, unlike *Gilmore*, the compressor was not located on the leased premises. 193 Kan. at 406, 394 P.2d at 5. The contract between the producer and the pipeline required the defendant to gather the gas at a central location. 193 Kan. at 404, 394 P.2d at 3. Knowing that its lease form did not address the costs at issue, the defendant in *Schupbach* sought to amend the agreement by asking the lessor to sign a division order which authorized deductions for "gathering, processing and compressing" the gas. The royalty owner refused, and the Court again concluded that the costs were not deductible:

> ...Continental, like Superior, constructed its compressor station at a central location on one of its leases and commenced compressing the gas from its adjoining leases in the area without consulting the lessors and royalty owners as to the location of the compressor station or as to the size or number of stations or as to any intention on its part to charge compression costs to the royalty owners, and the fact that the compressor station was constructed under a business lease on the Newkirk section is of little consequence.

193 Kan. at 406, 394 P.2d at 5.

In *Sternberger*, the Kansas Supreme Court interpreted the phrase "market price at the well for gas sold or used." 257 Kan.at 321, 894 P.2d at 794. Because there was no evidence that the gas was being compressed, dehydrated or treated before it entered the purchaser's transmission line or that the gas was not already in marketable condition but for the want of a purchaser at the wellhead, the court concluded that the activities in question were "properly characterized as 'transportation' rather than 'gathering' or other production costs." 257 Kan. at 331, 894 P.2d at 800. The language

"market price at the well" did not authorize the *Sternberger* producer to deduct expenses incurred away from the well to place the gas in marketable condition.

The Supreme Court of Kansas has repeatedly warned lessees that it is their responsibility to spell out any deductions they wish to take. *See, e.g. Gilmore*, 192 Kan. at 391, 388 P.2d at 605. Producers have long known what language to use. *Schupbach*, 193 Kan. at 404, 394 P.2d at 4 ("less the actual cost and expense of gathering, processing, and compressing"). *Gilmore, Schupbach and Sternberger* consistently hold that "market value at the well" or equivalent language in a royalty clause does not permit the producer to deduct from royalty payments expenses incurred to make the gas marketable.

OXY's attack against the representative plaintiffs is unfounded both in fact and in law. Both "market value at the well" and "proceeds" royalty owners can consistently advance the same claims: OXY is prohibited from deducting from its royalty payments expenses incurred to produce the gas and expenses incurred to make the gas marketable. No potential conflict exists because OXY cannot use one type of lease to justify imposing costs on the other type. Because of the complete unity of interest in the claims raised in this lawsuit, the representative plaintiff can adequately represent royalty owners under all types of royalty clauses.

CONCLUSION

Plaintiffs have clearly demonstrated that common questions exist and predominate, as the direct result of (1) OXY's own conduct, (2) the true nature of the issues in this litigation, and (3) the evidence which each side intends to offer in support of their respective positions. Plaintiffs have

also demonstrated that OXY's attacks against the representative plaintiffs are unfounded. Accordingly, Plaintiffs' Motion for Class Certification should be granted.

Attached hereto as Exhibit 14 is a proposed Order certifying the class.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of October, 2000, I served a copy of the foregoing Plaintiffs' Reply in Support of their Motion for Class Certification by mailing same, postage prepaid and properly addressed to:

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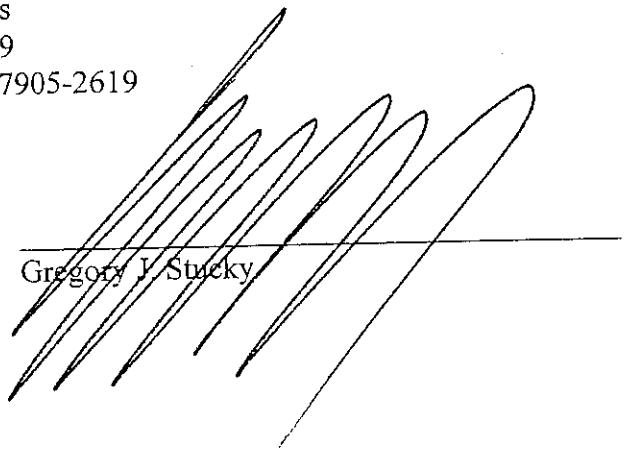

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