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

OPAL LITTELL and CHERRY RIDER, co-trustee of the Opal Littell Family Trust, and BONNIE BEELMAN, individually and as representative plaintiffs on behalf of persons or concerns similarly situated,	)	
Plaintiffs,	)	
v.	)	
OXY USA INC.,	)	
Defendant.	)	**Case No. 98-CV-51**

PRETRIAL ORDER

1. APPEARANCES

On this 24th day of October, 2002, this matter came before the Court for a pretrial conference. Thomas D. Kitch, Gregory J. Stucky, and David G. Seely of Fleeson, Gooing, Coulson & Kitch, L.L.C., and Erick E. Nordling of Kramer, Nordling & Nordling, L.L.C., appeared on behalf of the Plaintiff Class and Plaintiffs Opal Littell and Cherry Rider, co-trustees of the Opal Littell Family Trust, and Bonnie Beelman. James C.T. Hardwick and Donald L. Kahl of Hall, Estill, Hardwick, Gable, Golden & Nelson, P.C., and Kerry McQueen of Sharp, McQueen, McKinley, Dreiling & Tate, P.A. appeared on behalf of Defendant OXY USA Inc.

2. CONTENTIONS AND THEORIES OF RECOVERY:

A. Plaintiffs' Contentions and Theories of Recovery:

Plaintiffs are owners of mineral interests in lands within the area confines of the Kansas Hugoton Field burdened by oil and gas leases owned in whole or in part by OXY USA, Inc. ("OXY"), which have produced gas from above the base of the Panoma-Council Grove Field. As certified by this Court on March 13, 2001, the Plaintiff Class consists of mineral interest owners whose royalty payments have been reduced by a "gathering/compression" deduction or a "marketing deduct" identified on the monthly gas revenue detail sent by OXY to members of the Class.

Plaintiffs contend that OXY has failed to properly calculate and pay royalty under their respective oil and gas leases, by deducting from such payments expenses incurred to produce the gas and/or expenses incurred to make the gas marketable. This lawsuit does not raise any other possible claim Plaintiffs may have against OXY including, but not limited to, (1) any claim that OXY has not used the proper starting point for calculation of royalty payments, (2) any claim that OXY has failed to make proper royalty payments in connection with any extracted liquid hydrocarbons, and (3) any claim that the deductions from royalty payments are unreasonable in amount.

OXY's wells are located in various portions of the Kansas Hugoton Field. As a result, different groups of OXY's wells are connected to different gathering systems. In addition to gathering systems owned and operated by OXY, OXY wells are connected to gathering systems owned by the following third parties: Duke Energy Field Services; Anadarko Gathering Company; El Paso Field Services; ONEOK Field Services; Pioneer Natural Resources; and Williams Field Services/Amoco Production Company. OXY has gathering agreements with each of those third-parties to provide gathering services for OXY's gas, including compression, dehydration, and delivery to a processing plant for further processing and treatment. Gas from OXY's own gathering systems also flows onto third-party gathering systems: OXY's East Kinsler Gas Gathering System is connected to the Anadarko gathering System; OXY's Ulysses Gas Gathering System is connected to the Mobil Hickock Facility (jointly owned by OXY and Exxon-Mobil) which is connected to a gathering line upstream of the Amoco Jayhawk Plant. Except for gas delivered into an intrastate pipeline owned by Kansas Power and Light (and small quantities consumed locally), the gas from OXY's wells flows through a gathering system to a processing plant, and is compressed, dehydrated, and processed before being delivered into an interstate transmission pipeline.

In calculating royalty payments, OXY begins with the weighted average price received by OXY for the gas (including residue and liquids) at the sales points. From this weighted average price, OXY deducts: (1) a proportionate share of any third-party gathering charges applicable to the gas delivered at the particular sales point, including a proportionate share of applicable fuel charges; (2) a proportionate share of any transmission charges including a portion of applicable fuel charges; and (3) a proportionate share of any applicable taxes. In addition, for gas on OXY's East Kinsler Gas Gathering System and Ulysses Gas Gathering System, OXY subtracts a proportionate share of its per mcf gathering charges ($0.164 and $0.15, respectively) and fuel charges for those systems.

OXY is breaching its contractual obligations under the expressed and implied terms of its oil and gas leases, by deducting expenses incurred to produce gas and to place it in marketable condition from their royalty payments.

In the absence of a provision to the contrary in the underlying lease, Kansas law flatly prohibits a lessee from deducting expenses incurred to compress gas, regardless of whether such compression is performed on the lease premises or on the gathering system. This is true whether the purpose of such compression is to lower the pressure at the wellhead and thereby increase the rate at which the gas is produced and the amount of recoverable reserves which the well is capable of producing or to move the gas through the gathering system by raising the pressure of the gas to the level required for entry into high-pressure, long-distance, transmission pipelines which serve the distant markets in which the great majority of gas produced in the Hugoton Field is actually consumed.

As confirmed by the Kansas Supreme Court in the *Sternberger* case, Kansas also prohibits lessees from deducting expenses incurred to place the gas in condition suitable for the market in which the lessee elects to sell it. The holding in *Sternberger* was derived, in part, from two earlier cases (*Gilmore* and *Schupbach*) which had already required producers to bear compression expenses in their entirety for more than 40 years. As stated in *Sternberger*, "Kansas does not permit deductions for compression costs." 257 Kan. at 341. In contrast to both *Gilmore* and *Schupbach*, there was no evidence that the producer in *Sternberger* was using compression. The absence of compression entered directly into the court's decision that the deductions in question were being taken solely for purposes of transporting the gas, as opposed to completing the process of producing and marketing it:

> There is no evidence that Marathon engaged in any activity designed to enhance the product, such as *compression* . . . . 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.

257 Kan. at 331 (emphasis added).

OXY is admittedly deducting expenses which it is incurring to compress, dehydrate and gather the gas involved in this litigation. It is undisputed that OXY is incurring these expenses for the purpose of producing and marketing the gas at the rate and in the manner selected by it, as well as increasing recoverable reserves. None of the leases held by Plaintiffs authorize OXY to take such deductions. *Sternberger* expressly found that the words "market value at the well" are silent with regard to the issue of whether a lessee can deduct expenses which it incurs off the lease premises and based its analysis of the deductions involved in that case on the purpose for which the expenses were being incurred. 257 Kan. at 322. OXY does not claim that any of the royalty instruments involved in this case contains language which limits or overrides its duty to produce and market the gas at its sole expense.

Having decided how to produce and market the gas involved in this litigation, OXY is obligated to account to Plaintiffs in accordance with such decisions–not on the basis of sales it did not make or might have made or on the theory that it could have sold the gas without incurring such expenses.

OXY cannot evade its duty to produce and market the gas at its sole expense by assigning these responsibilities to another party, i.e., third-parties operating gathering systems to which some of OXY's wells are connected. OXY's obligation to bear all expenses incurred to produce and market the gas does not automatically cease at the wellhead, as evidenced by its decision to rely upon the gatherings system involved in this case to perform activities essential to the fulfillment of such duties.

OXY attempts to characterize all of the gathering activities as "transportation" expenses. Such defense, however, is directly contradicted by its repeated admissions that it is compressing and dehydrating the gas and that such "gathering" activities are necessary to both produce the gas and place it in condition suitable for the interstate markets in which it is sold. These admissions appear in OXY's internal documents and in testimony given by its employees.

OXY acknowledges that it could not deduct any of the expenses involved in this litigation if the activities in question (compression and dehydration) were performed on the lease premises. OXY further admits that it has elected to perform such activities off the lease premises and on the gathering system due to economies of scale associated with the centralized locations of the equipment necessary to perform such services, thereby enabling it to secure substantially the same results in terms of both producing and marketing the gas as if such activities had been performed on the leases, but at a substantially reduced cost. Since the underlying purpose of such activities remains exactly the same–to produce and market the gas–performing them on the gathering system, instead of on the leases, does not convert them into deductible expenses. Likewise, OXY's decision to aggregate and commingle the gas for purposes of discharging its duty to produce and market gas from each of the leases involved in this litigation does not alter its obligation to perform such activities at its sole expense.

Plaintiffs have been damaged OXY's failure to pay the full amount of royalties properly due. Plaintiffs seek an accounting to determine the amount of such underpayment, and actual damages in such amount, together with prejudgment interest thereon. Plaintiffs also seek declaratory and injunctive relief providing that OXY's deduction of expenses from royalty payments was and is improper and prohibiting it from engaging in such conduct in the future.

Plaintiffs pray for an accounting and for judgment for actual damages in such amounts determined by the Court to be due and owing pursuant to such accounting, together with prejudgment interest thereon, as well as appropriate declaratory and injunctive relief and the costs of this action, and for such other and further relief as the Court may deem just and equitable.

B. **Defendants' Contentions and Theories of Recovery:**

OXY denies each and every allegation by the plaintiffs that OXY has violated any duty owed to its royalty owners. OXY contends that it has properly paid royalty to the royalty owners

for gas produced from their leases. OXY also asserts that certification of the plaintiff class is improper under the law of Kansas, because it necessarily is based on a covenant "implied in fact" which must be inferred from the facts and circumstances that existed at the time the leases were entered into on a case-by-case basis.[1] OXY contends that the Court should grant its pending Motion to Decertify Class, and allow this action to proceed, if at all, with respect to the named plaintiffs only.

OXY contends that its payments to its royalty owners have met or exceeded those called for by the express provisions of the subject written leases because the vast majority of the subject leases provide that, when gas is sold off the lease, royalty is based on the "market value of the gas at the well." OXY further contends that the gas produced has "market value at the well" and that OXY has paid royalty above the market value of the gas at the well. The market value of gas at the well is "the price which would be paid by a willing buyer to a willing seller in a free market." Holmes v. Kewanee Oil Co., 233 Kan 544, 551, 664 P.2d 1335 (1983). The express lease term—which requires payment of royalty based on the "market value of the gas at the well"—has been satisfied by OXY's method of royalty payment. Further, OXY contends that the royalty clauses of the subject leases contain provisions expressly stipulating the calculation and payment of royalty thereby precluding the imposition of additional or inconsistent implied duties. With respect to those of the subject leases that call for payment of royalty based on a stipulated percentage or fraction of actual proceeds obtained from the sale of the gas, OXY's payment of royalties have also met or exceeded these obligations.

Moreover, Plaintiffs cannot prevail merely by focusing on gathering and compression. At base, plaintiffs claim that the plaintiff class has not been paid the full amount of royalty to which they are entitled. That issue, however, is governed by the express requirements of the subject oil and gas leases. Thus, in order to prevail, plaintiffs must first establish the amount of royalty to which each class member was entitled under that class member's lease **and,** second, establish that the class member received **less** than that amount. Absent such a demonstration, the Plaintiff Class has no legal injury.

OXY contends that, in the vast majority of instances, the parties expressly agreed in the subject leases that royalty was to be valued **"at the well."** By contending that OXY cannot deduct the gathering fee in calculating royalty, plaintiffs are attempting to change the location where royalty is valued to the terminus of the gathering system—in most cases a distance of several miles from the subject leases—where the value of the gas has been enhanced by the gathering services performed rather than "at the well" as the parties expressly agreed in the leases. Deduction of these costs in calculating royalty is, thus, necessary to effectuate the express intent of the parties that royalty be valued "at the well." With respect to those leases that stipulate royalty based on a percentage of the proceeds actually received by OXY from the sale of the gas, plaintiffs' contentions are similarly in derogation of the express terms of the subject leases (and, thus, the intent of the contracting parties).

[1] In this regard, OXY specifically incorporates herein the arguments and authorities urged in its Brief in Support of Motion to Decertify the Plaintiff Class and its reply brief in support thereof, now pending before the Court.

OXY contends that the natural gas produced from the subject wells is marketable at the well. This contention is demonstrated by the existence of several factors including, but not limited to, the facts that: (a) the physical characteristics of this natural gas at the wellhead are such that it is readily "useable" by consumers of this product; (b) significant volumes of this natural gas have historically been sold at the wellhead not only by OXY, but by numerous other Hugoton field producers as well; (c) significant volumes of this natural gas are sold at the wellhead today, not only by OXY, but by numerous other producers as well; (d) all or substantially all of this natural gas could in fact be sold at the wellhead to non-affiliated purchasers; (e) the quality of this gas at the well is within a range of that considered in the industry to be marketable; (f) this natural gas is produced at naturally occurring pressures such that it will flow into gathering lines and away from the well without the aid of compression; and (g) this natural gas is produced at pressures far in excess of those necessary for use by consumers of this product. The gathering and related compression and other services to which the natural gas is subjected downstream from the wellhead of the wells involved in this case (and the associated expenses deducted in calculating royalty payments to plaintiffs) enhance the value of already marketable gas. Moreover, these services (and the associated expenses) are for the purpose of transporting the gas to distant markets. In either case, OXY contends that the costs of these services are properly considered in calculating royalty payments to plaintiffs. Plaintiffs' contention that OXY is not entitled to consider its gathering and related compression costs in computing royalty payments due would require OXY to pay royalty on the value of gathering and related compression services contrary to the express terms of the applicable leases. Moreover, OXY specifically denies Plaintiffs' allegation that OXY has admitted that it could not deduct any of the expenses involved in this litigation if the activities in question were performed on the lease premises.

OXY denies all allegations that the gathering systems or compression on the gathering systems servicing the subject wells are "production" costs and thus cannot be deducted in calculating plaintiffs' royalty payments. To the contrary, OXY contends that this natural gas is "produced" as a matter of law, at the wellhead, once it is severed from the earth. Further, the subject leases, as well as custom and usage in the industry, contemplate that the production process ceases once the gas has been brought to the surface and severed from the earth. OXY contends that plaintiffs are unlawfully attempting to extend the implied covenant to market in a manner that has already been rejected twice (once by the Kansas Supreme Court and once by the U.S. District Court in Kansas) with respect to other Hugoton Field producers who sold gas off the lease through the use of gathering systems. Matzen v. Hugoton Production Co., 182 Kan. 456, 321 P.2d 576 (1958); Ashland Oil & Refining Company v. Staats, Inc., 271 F. Supp. 571 (D. Kan. 1967). In finding that it was proper to deduct expenses related to gathering, processing and dehydrating, the Kansas Supreme Court stated:

> It was as much [the lessee's] duty to find a market on the leased premises without cost to the plaintiffs as it was to find and produce the gas [citations omitted], **but that duty did not extend to providing a gathering system to transport and process the gas off the leases at a large capital outlay with attending financial hazards in order to obtain a market at which the gas might be sold.**

182 Kan. at 462-3 (emphasis added). Plaintiffs are wrongfully attempting to impose the costs of operating and paying for the gathering systems used to transport gas from the subject wells on OXY alone.

Alternatively, any further consideration of the obligations imposed by the implied covenant require the Court to examine the facts and circumstances by which each lease was made and the existence of any such obligations will require a finding, based on "the presumed intention of the parties as gathered from the [express lease terms]," that the parties intended the lessee to bear all costs to compress the gas and transport it to a distant pipeline at lessee's sole expense and that this intent "was so clearly within the contemplation of the parties that they deemed it unnecessary to express it . . ." Smith v. Amoco Production Co., ___ Kan. ___, 31 P.3d 255, (2001); Danciger Oil & Ref. Co. v. Powell, 137 Tex. 484, 490-92, 154 S.W.2d 632 (1941). The obligations sought to be here imposed fail that test.

OXY contends that plaintiffs' claims must be denied based on OXY's affirmative defenses of failure to state a claim, estoppel, waiver, statute of limitations, laches, failure to join indispensable parties, agreement and course of dealing. Plaintiffs' contention that marketability of the gas is determined by the market in which OXY sells its gas is contrary to Kansas law as stated in Sternberger v. Marathon Oil Co., 257 Kan. 315, 894 P.2d 788 (1995). Plaintiffs' contention that marketability of the gas is determined by specification of the applicable interstate (transmission) pipeline is contrary to Kansas law as stated in Sternberger.

The language of the royalty clauses of the subject leases contain language expressly stipulating the manner of calculating royalty, thus, foreclosing any implied obligation on the subject. The language of the royalty clauses in the vast majority of the subject leases expressly stipulates that the gas is to be valued "at the well" for purposes of determining royalty, thus, foreclosing plaintiffs' arguments that the gas is to be valued only after its value is enhanced by gathering and compression services procured at OXY's sole cost and further affirming OXY's deduction of gathering and compression in determining royalty. Further, Kansas' adoption, in Smith v. Amoco, of the implied-in-fact approach to the existence of implied covenants and Kansas' rejection, also in Smith v. Amoco, of Merrill's implied in law approach invalidates the marketable condition approach referred to in Gilmore v. Superior Oil Co., 192 Kan. 388, 388 P.2d 601 (1964) and Sternberger. OXY contends that the lease royalty clauses in this case (whether framed as a fraction of "market value" or "proceeds") are to be understood as contemplating a sale at the well and that when the sale is at a distant location OXY's costs of gathering and related compression, at a minimum, must be deducted to effect the parties' intent.

3. **AMENDMENTS TO THE PLEADINGS**:

None.

4. **THE PARTIES AGREE TO BE BOUND BY THE FOLLOWING STIPULATIONS**:

A. The Court has jurisdiction over the parties and the subject matter.

B. Venue is proper in Stevens County, Kansas.

C. Clear and accurate photocopies may be used in lieu of original documents in the trial of this matter.

D. Subsequent to the exchange of exhibits identified in Section 6 below, all documents which have been exchanged between the parties in formal or informal discovery and identified as trial exhibits are genuine, and are business records within the meaning of K.S.A. 60-460(m) and may be admitted into evidence without further foundation, subject only to objections for relevance.

E. By separate stipulation, the parties may agree that certain affidavits and deposition and trial transcripts in other, related matters may be entered into evidence in this action and relied upon herein.

5. **WITNESSES:**

Final Witness Lists are to be exchanged no later than November 4, 2002.

6. **EXHIBITS:**

Exhibit Lists are to be exchanged no later than November 4, 2002, and copies of all trial exhibits will be exchanged no later than 45 days prior to trial.

7. **MOTIONS**:

A. The Court notes that Plaintiffs' Motion to Decertify is pending.

B. The Court orders the following:

Summary Judgment Motions to be filed December 2, 2002.

Motions in Limine to be filed February 14, 2003.

C. The Court understands that the parties reserve the right to file motions to compel discovery.

8. **TRIAL:**

A. The trial of this case shall be to the Court. Estimated length of the trial is two weeks and shall commence on March 31, 2003. This is a priority setting. The Court notes OXY's objection to the trial of this matter to the Court and such objection is preserved for appeal.

9. **GUARDIAN AD LITEM:**

No appointment of a guardian ad litem is necessary.

10. **LIMITATION OF CUMULATIVE OR EXPERT WITNESSES:**

The parties reserve objections to cumulative witnesses.

11. **QUESTIONS OF FACT:**[2]

Plaintiffs contend that the issues of fact are:

A. Whether OXY is deducting expenses incurred to compress the gas?

B. Whether all or a portion of such compression is being used to produce the gas in the first instance–cause it to flow out of the ground in a captive state?

C. Whether the gathering systems at issue in this case are being used since at least the commencement of the claim period to "produce" the gas–by means of compression and line sizing necessary to cause the gas to flow out of the wells at the rate desired by OXY?

D. Whether compression and dehydration on the subject gathering systems are being used to put OXY's gas in marketable condition?

E. Whether the services required to meet the specifications of the interstate pipelines are necessary to put OXY's gas in marketable condition?

F. What is the amount of actual damages and prejudgment interest to be recovered by Plaintiffs? (To be determined after an accounting)

Defendant contends that the issues of fact are:

A. Whether the natural gas produced from the subject wells is "marketable" at the well.

B. Whether the gas produced from the subject leases constitutes a marketable product.

C. Irrespective of A. and/or B., whether the natural gas has a "market value at the well?" If so, how is that value to be determined and what is that value.

D. Whether OXY's method of calculating its royalty payments resulted in a payment of royalty to royalty owners at or above the market value of the gas at the well.

E. Whether OXY's method of calculating its royalty payments resulted in payments to royalty owners of an amount not less than required by the terms of the subject leases.

[2] To the extent that any questions of law identified in section 12 are deemed to be questions of fact, the Court incorporates those questions of law herein.

F. Whether OXY has paid all the royalty owed to the members of the royalty owner class.

G. Whether the gathering systems, including compression on the gathering systems, are being used to transport or carry marketable gas.

H. Whether the gathering systems, including compression on the gathering systems, are used for the purpose of transporting gas.

I. Whether the gathering systems, including compression on the gathering systems, enhance the value of the gas over its value at the well by aggregating the volume produced from many wells at a pressure needed to allow hydrocarbon liquids and helium to be removed.

J. Whether OXY's use of the gathering systems, including compression on the gathering systems, enhances the value of the gas produced over its value at the well.

K. Whether the gathering systems, including compression on the gathering systems, are being used by OXY to "produce" gas from the Hugoton Field.

L. Whether the physical condition of the gas at the well is such that it can be commercially used.

M. Whether OXY's practices in calculating and paying royalties to the royalty owner class are consistent with industry customs and usage.

N. Whether the subject wells have sufficient reservoir pressure to produce gas at the well.

O. What were the factual circumstances and intent of the parties with respect to the calculation and payment of royalties that existed at the time the subject leases were executed?

P. Whether such circumstances in O. above gave rise to an obligation "implied in fact" that would impose a duty on OXY to incur 100% of the cost of operating gathering systems to transport gas off of the subject leases to a distant sales point.

Q. Whether the lease royalty clauses in this case (whether framed as a fraction of "market value" or "proceeds") are to be understood as contemplating a sale at the well and whether when the sale is at a distant location OXY's costs of gathering and related compression, at a minimum, must be deducted to effect the parties' intent.

R. Whether the parties to the subject leases understood and intended that royalty would be paid on value added by gathering and related compression.

S. Whether parties to leases requiring royalty to be calculated utilizing a share of "proceeds" but not expressly specifying "at the well" understood and intended that royalty would be computed "at the well."

T. Whether the parties to the subject leases understood and intended that such leases would permit gathering and related compression costs to be used, by way of deduction in order to calculate royalty when the gas is sold in a distant market.

U. If the Court determines that any of the expenses incurred by OXY are not properly deductible in calculating royalty payments to the Plaintiff Class, what portion of those expenses are not deductible?

12. **QUESTIONS OF LAW[3]:**

Plaintiffs contend that the issues of law are:

A. Whether the gathering charges (including compression and fuel adjustments), dehydration, and other projects, such as line-looping, at issue in the instant case may, under Kansas law, be deducted prior to calculating royalty under the express and implied terms of the subject oil and gas leases and the facts of this case.

B. How Kansas law defines "production."

C. Whether the fact that OXY utilizes the services of third-parties, rather than providing those services itself, relieves OXY of its obligation to bear the expense of producing gas and putting it in marketable condition

D. Whether OXY is obligated to bear all expenses of production.

E. Whether plaintiffs are entitled to declaratory and injunctive relief.

F. Whether OXY should be required to account to Plaintiffs.

Defendant contends that the issues of law are:

A. If the gas produced has "market value at the well," whether, as a matter of law, it is "marketable" at the well.

B. Do the subject leases expressly provide that the location for valuation of royalty is "at the well" when gas is marketed off the lease?

C. Whether plaintiffs' contentions are in derogation of the express terms of the subject leases (and, thus, the parties' intent at the time of contracting) for those

[3] To the extent that any questions of fact identified above are deemed to be questions of law, the Court incorporates those questions of fact herein.

leases that specify royalties based on market value at the well or on a stipulated share of proceeds.

D. Whether a royalty provision requiring the payment of royalties based on a stipulated percentage or fraction of the proceeds actually received by OXY from the sale of the gas precludes the implication of additional or inconsistent obligations for the calculation and payment of royalties.

E. Whether a royalty provision requiring the payment of royalties based on a stipulated percentage or fraction of market value of the gas at the wellhead precludes the implication of additional or inconsistent obligations for the calculation and payment of royalties.

F. Whether a royalty provision stipulating that royalty is to be "at the well" precludes the implication of additional or inconsistent obligations that would require royalty valuation at a different location.

G. Whether a royalty provision stipulating that royalty is to be "at the well" authorizes OXY to deduct its gathering and related compression costs in this case when the gas is sold at a distant market.

H. Whether any implied obligation can exist in the face of an express lease term disclaiming any implied covenants.

I. Whether the implied covenant to market, as applicable here, imposes a duty on OXY to incur the cost of operating gathering systems in order to market gas off the subject leases and to carry this gas to a distant market at OXY's sole cost.

J. Whether any contract "implied in fact" exists that imposes a duty on OXY to incur the cost of operating gathering systems to market gas off the subject leases at a distant market at OXY's sole cost.

K. Whether OXY's affirmative defenses bar any of plaintiffs' claims.

L. Whether plaintiffs are entitled to an accounting.

M. Whether, if they prevail, plaintiffs are entitled to prejudgment interest.

N. Which party has the burden of proof on the issues raised herein.

O. Whether the implied duty to market requires OXY to bear all costs necessary to deliver its gas to its chosen market without cost to lessors.

P. At what point in the extraction of gas from the reservoir is the gas considered to have been "produced?"

Q. Whether the provisions of OXY's lease royalty clauses stipulating the manner of calculation and payment of royalty foreclose any implied obligation requiring OXY to bear all cost to compress the gas and transport it to a distant market?

R. What requirements must gas meet to constitute a "marketable product" within the meaning of Sternberger?

S. Whether the express terms of the royalty clauses of the subject leases foreclose the imposition of any implied terms affecting the calculation of royalty.

T. Whether plaintiffs' contention that marketability of the gas is determined by the market in which OXY sells its gas is contrary to Kansas law as stated in Sternberger.

U. Whether Kansas' adoption, in Smith v. Amoco, of the implied-in-fact approach to the existence of implied covenants and Kansas' rejection, also in Smith v. Amoco, of Merrill's implied in law approach invalidates the marketable condition approach referred to in Gilmore v. Superior Oil Co., 192 Kan. 388, 388 P.2d 601 (1964) and Sternberger.

V. Whether plaintiffs' contention that marketability of the gas is determined by specification of the applicable interstate (transmission) pipeline is contrary to Kansas law as stated in Sternberger.

W. Whether the lease royalty clauses in this case (whether framed as a fraction of "market value" or "proceeds") are to be understood as contemplating a sale at the well and whether when the sale is at a distant location OXY's costs of gathering and related compression, at a minimum, must be deducted to effect the parties' intent.

X. Whether any member of the Plaintiff Class has suffered any legal injury or damage as a result of any act of OXY, and if so, in what amount.

13. **QUESTIONS OF EVIDENCE OR PROCEDURE:**

Plaintiffs contend that unusual questions of evidence or procedure are:

A. If OXY takes the position that a portion of the expenses are deductible under Kansas law, which party has the burden of coming forward with the evidence or of proof with regard to this issue?

B. Which party has the burden of proving whether OXY has fully and accurately accounted to Plaintiffs?

C. If OXY is entitled to deduct a portion, but not all, of the expenses at issue in this litigation, which party has the burdens of coming forward with evidence and of proving how such expenses should be divided?

D. Whether evidence of industry custom and practice with regard to the calculation and payment of royalties is admissible for any purpose.

Defendant contends that unusual questions of evidence or procedure are:

A. Must Plaintiff's bear the burden of proving not only that certain expenses of OXY are not properly deductible in calculating royalties payable to the Plaintiff Class, but also that this resulted in each member of the Plaintiff Class, in fact, being paid less than the royalties to which such member was entitled.

B. Do plaintiffs have the burden to prove that the gas is not "marketable at the well?"

C. Do plaintiffs have the burden to prove that the gas does not have "market value at the well?"

D. Do plaintiffs have the burden to prove that OXY paid royalty at less than the "market value of the gas at the well?"

E. If the express terms of any of the subject leases do not preclude the imposition of implied terms, do Plaintiffs bear the burden of demonstrating the contracting parties' intent at the time of contracting with respect to any implied in fact covenant, as well as OXY's performance (or breach) thereunder?

F. If Plaintiffs contend that OXY has breached any implied in fact covenant, do Plaintiffs bear the burden of demonstrating such a breach?

14. **JURY INSTRUCTIONS**:

Not Applicable.

15. **TRIAL BRIEFS:**

The parties shall file trial briefs on or before March 14, 2003.

16. **ORDERS:**

A. All discovery is terminated, except:

Uncompleted discovery, which is hereby allowed as follows:

(1) Defendant shall be permitted to depose the named plaintiffs on or before December 1, 2002.

(2) The Parties shall serve rebuttal expert reports, if any, on or before October 29, 2002.

(3) Expert discovery shall be completed by November 15, 2002.

(4) Defendant shall answer Plaintiffs' Six Set of Interrogatories on or before October 25, 2002.

B. This Pretrial Order supercedes the pleadings, and shall govern the trial of this matter.

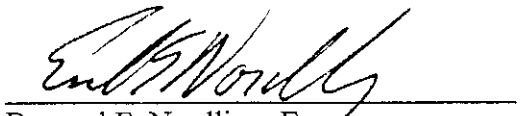
C. Witnesses and exhibits (including demonstrative and illustrative exhibits) listed by one party may be called or used by any other party.

D. The trial of this case shall be limited to the issues, witnesses and exhibits listed, and no deviation therefrom will be permitted except for rebuttal or impeachment purposes or by order of the Court to prevent manifest injustice.

Hon. Tom Smith

Approved:

KRAMER, NORDLING & NORDLING



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