CAUSE NO. 06-01-20302

THE HELEN JONES FOUNDATION, *et al.*	§	IN THE DISTRICT COURT
Plaintiffs,	§	
v.	§	OF HOCKLEY COUNTY, TX
OCCIDENTAL PERMIAN LTD., BP AMERICA PRODUCTION COMPANY, an ALTURA ENERGY LTD.,	§	
Defendants.	§	286TH JUDICIAL DISTRICT

DEFENDANT OCCIDENTAL PERMIAN LTD.'S MOTION FOR JUDGMENT NOTWITHSTANDING THE VERDICT AND TO DISREGARD JURY FINDINGS

To the Honorable Court:

Defendant Occidential Permian Ltd. ("OPL") files this Motion for Judgment Notwithstanding the Verdict and to Disregard Jury Findings, and respectfully shows the Court as follows:

I. Motions for Judgment Notwithstanding the Verdict Are Appropriate in Cases Based on Breach of Contract.

The standard for granting a judgment notwithstanding the verdict is the same as that for a directed verdict. *Fort Bend County Drainage Dist. v. Sbrusch*, 818 S.W.2d 392, 394 (Tex. 1991); TEX. R. CIV. P. 301. Accordingly, a judgment notwithstanding the verdict is appropriate when there is no evidence to support a jury's answer, or conversely, the evidence establishes a different answer as a matter of law. *See Exxon Corp. v. Quinn*, 726 S.W.2d 17, 19 (Tex. 1987); TEX. R. CIV. P. 301. A verdict is supported by "no evidence," and a judgment notwithstanding the verdict should be granted, when: (1) there is a complete absence of a vital fact; (2) the court is barred by rules of law or evidence from giving weight to the only evidence offered to prove a vital fact; (3) the evidence offered to prove a vital fact is no more than a scintilla; or (4) the evidence conclusively establishes the opposite of a vital fact. *City of Keller v. Wilson*, 168 S.W.3d 802, 810 (Tex. 2005); *see also Brown v. Bank of Galveston*, 963 S.W.2d 511, 513 (Tex. 1998). In a "no evidence" review, "incompetent evidence is legally insufficient to support a judgment, even if it is admitted without objection." *City of Keller*, 168 S.W.3d at 812. Similarly, the Court may disregard a jury finding if:

1. there is no evidence to support the submission of the issue to the jury, TEX. R. CIV. P. 301;

2. the defendant is entitled to a contrary finding as a matter of law, *Colom v. Vittow*, 435 S.W.2d 187, 191 (Tex. Civ. App.–Houston [14th Dist.] 1968, writ ref'd n.r.e.); *Jinks v. Whitaker*, 195 S.W.2d 814, 817 (Tex. Civ. App.--Texarkana 1946, writ ref'd n.r.e.); or

3. the question submitted to the jury is immaterial, *C.R. Transp., Inc. v. Campbell*, 406 S.W.2d 191, 194-95 (Tex. 1966).

When a contract is unambiguous and authorizes the act in question, there is no competent evidence to support a jury's finding of breach, and the court must render a take-nothing judgment notwithstanding that finding. *See, e.g., Matagorda County Hosp. Dist. v. Burwell*, 189 S.W.3d 738, 740 (Tex. 2006) (reversing judgment on breach of contract claim and rendering judgment in favor of defendant because "there was no evidence that the [defendant] breached any contract"); *Case Corp. v. Hi-Class Bus. Sys. of Am.*, 184 S.W.3d 760, 772-73 (Tex. App.--Dallas 2005, pet. denied) (reversing trial court's judgment on breach of contract claim and rendering judgment in favor of defendant, despite the jury finding of breach, because nothing in the contract prohibited the claimed acts of breach). Applying these standards here demonstrates that there is no evidence to support the jury's verdict as to both liability and damages and therefore it must be disregarded.

II. As a Matter of Law, OPL Breached Neither Its Contractual nor Common-Law Obligations to Plaintiffs on the Sale of Casinghead Gas Under the "Amount Realized" Leases.

As an initial matter, there is no legal or factual basis to support the jury's findings in Question Nos. 1-4 that OPL failed to pay Plaintiffs appropriate royalties under four "amount realized" leases. In arguing otherwise, Plaintiffs rely on two, apparently alternative theories of recovery: (1) that OPL failed to pay Plaintiffs' royalties under the terms of the lease agreements entered into between OPL's predecessors and Plaintiffs' predecessors; and (2) that OPL breached an implied, common-law duty to "reasonably market" the casinghead gases produced pursuant to the leases. (*See* Jury Charge Question Nos. 1, 3) Because OPL breached neither the plain terms of the "amount realized" leases nor any additional, implied common-law duty, Plaintiffs cannot recover under Question Nos. 1-4 as a matter of law.

A. OPL Paid Plaintiffs Full Royalties Under the Express Terms of the Casinghead-Gas Sales Contracts.

Texas law has long-recognized "a strong public policy in favor of preserving the freedom of contract." *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 649 (Tex. 2007) (quoting *Lawrence v. CDB Servs., Inc.*, 44 S.W.3d 544, 553 (Tex. 2001)). In light of this core principle, the duty of a court adjudicating a contractual dispute in Texas "is to construe the contract as is," *id.* at 649 n.41, giving "effect to the intentions of the parties as expressed in the instrument." *In re Marriage of Klein*, No. 07-06-0222-CV, 2008 WL 2941390, at *1 (Tex. App.--Amarillo July 31, 2008, pet. filed) (mem. op.); *see also Fiess v. State Farm Lloyds*, 202 S.W.3d 744, 746 n.8 (Tex. 2006). In so doing, courts "must consider the entire writing, seeking to harmonize and give effect to all its provisions so that none are rendered meaningless," *Pyramid Constructors, L.L.P. v. Sunbelt Controls, Inc.*, No. 07-03-0445-CV, 2005 WL 464896, at *2 (Tex. App.--Amarillo

Feb. 28, 2005, no pet.) (mem. op.), and must avoid permitting "equitable considerations [to] trump contrary contractual terms." *Fortis Benefits*, 234 S.W.3d at 649 n.41.[1]

In this case, OPL's obligations to Plaintiffs under the "amount realized" leases are governed by two sets of agreements: (1) those requiring OPL to pay Plaintiffs royalties based on the actual sales prices of the casinghead gas for sales at the wells; and (2) those setting the terms of the actual sales of the casinghead gas at the wells. Giving effect to the plain terms of each set of contracts renders only one conclusion: OPL paid Plaintiffs their royalties *in full* under the governing contractual provisions.

1. The leases governing Question Nos. 1-4 are "amount realized" leases that require royalties to be paid based upon the actual sales prices of the casinghead gas sold at the wells.

By their plain terms, the lease agreements at issue in Question Nos. 1-4 provide that when OPL sells casinghead gas "at the wells," OPL must pay Plaintiffs "one-eighth of the amount realized" from such sales. (*See* Jury Charge Question Nos. 1, 3; *see also* OPL Exs. 5, 6, 9, 1; 9/24/08 RR 298 [Tab 2]) These types of leases are often referred to as "proceeds leases" because they "base the royalty payment [owed] on the price actually received for the gas." *Union Pac. Res. Group, Inc. v. Hankins*, 111 S.W.3d 69, 72 (Tex. 2003); *see also Bowden v. Phillips Petroleum Co.*, 247 S.W.3d 690, 699 (Tex. 2008) ("'Proceeds' or 'amount realized' clauses require measurement of the royalty based on the amount the lessee in fact receives under its sales contract for the gas."). When parties draft royalty provisions to reflect that royalties will be paid based upon the amount realized at the well, *"their intent will be followed by the courts."* *Yzaguirre v. KCS Res., Inc.*, 53 S.W.3d 368, 72 (Tex. 2001) (emphasis added) (citing *Amoco Prod. Co. v. First Baptist Church of Pyote*, 611 S.W.2d 610, 610 (Tex. 1980)). The "plain

[1] "Construction of an unambiguous contract is a matter of law for the court." *Fortis Benefits*, 234 S.W.3d at 649 n.41.

terms" of these lease agreements define both OPL's obligation to pay — and Plaintiffs' right to receive — royalties under the leases. *Cf. Yzaguirre*, 53 S.W.3d at 373.

Here, there can be no dispute that the parties' obligations and rights regarding the payment of royalties are defined by the leases agreed to by the parties' predecessors. In each instance, the parties' predecessors agreed that the lessee (now, OPL) would pay the lessors (now, Plaintiffs) one-eighth of the amount "*actually realized*" from the sales of casinghead gas "*at the well*." For example, the October 17, 1934 contract governing royalties on gas from the Central Mallet Unit Tracts 1, 2, 3, 7, and 8 unambiguously states that "if and when [the] lessee shall sell gas at the wells lessor's royalty thereon shall be one-eighth of the amount realized from such sales." (OPL Ex. 5) The same is also true of the January 28, 1935 lease governing Central Mallet Unit Tracts 4 and 6 (*see* OPL Ex. 6 ("if and when lessee shall sell gas at the wells lessor's royalty thereon shall be one-eighth of the amount realized from such sales")); the May 24, 1935 lease governing Central Mallet Unit Tract 5 (*see* OPL Ex. 9 ("on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale")); and the November 8, 1934 lease governing Christine DeVitt "B" (*see* OPL Ex. 1 ("if and when lessee shall sell gas at the wells lessor's royalty thereon shall be one-eighth of the amount realized from such sales")). Pursuant to the plain terms of these lease agreements, the parties' predecessors unequivocally agreed that royalties would be owed and paid based upon the actual amounts realized from the sales of casinghead gas at the well — *not* on the market value of the gas there or elsewhere, and not on the sale of the gas anywhere other than at the well.

2. **The amounts realized on the sales of casinghead gas are set by the express terms of the casinghead-gas sales contracts entered into by OPL's predecessors.**

Given that Plaintiffs' predecessors entered into "amount realized" leases for the sale of casinghead gas at the well for the leases applicable to Question Nos. 1-4, the Court must look to the terms of OPL's predecessors' casinghead-gas sales contracts to determine what amounts OPL actually realized from the sale of casinghead gas. Because courts are not to re-write the terms of agreed-upon contracts, courts will honor the terms of sales contracts even though the amounts actually realized from such contracts may be "more or less than market value, as when a lease is subject to a long-term purchase contract." *Hankins*, 111 S.W.3d at 74 (citing *Yzaguirre*, 53 S.W.3d at 370 ("noting that the lessee sold the gas 'for more than market value under a long-term sales contract'"); *Tex. Oil & Gas Corp. v. Vela*, 429 S.W.2d 866, 871 (Tex. 1968) ("noting that the lessee sold gas for less than market value under a similar long-term sales contract")). In addition, because parties may enter into lease agreements that base the payment of royalties on the proceeds actually realized – regardless of the past, present, or future market value of the produced gases – courts may not read into proceeds leases an "absolute duty to sell gas at market value.'" *Hankins*, 111 S.W.3d at 74 (quoting *Amoco Prod. Co.*, 611 S.W.2d at 610).

It is uncontested that OPL's predecessors entered into long-term contracts for the sale of casinghead gas from Plaintiffs' leases like those contemplated by the Texas Supreme Court in *Hankins*. *Cf. Id.* It is also uncontested that the long-term contracts entered into by OPL's predecessors "sold gas under a 'percentage of proceeds' (POP) contract," which "is a gas purchase contract providing payment to the purchaser as a percentage of the proceeds realized by the purchaser upon the resale of the gas." *Cf. Bowden*, 247 S.W.3d at 708.

For example, on May 3, 1947, Occidental's predecessors entered into two long-term contracts for the sale of much of Plaintiffs' casinghead gas to the owners of the Slaughter Gasoline Plant. (*See* OPL Ex. 43 (contract applicable to Central Mallet Unit and portions of the Christine DeVitt "B" lease))[2] As the Texas Supreme Court contemplated in *Bowden*, 247 S.W.3d at 708, the parties to this contract set the sale of the casinghead gas "at the casingheads of the wells," and set the price paid for the gas (by the Plant owners to OPL's predecessors for the raw, unprocessed gas) as a percentage of the volume and average price of the gas when ultimately sold, after processing, by the Plant owners to third parties. (*See* OPL Ex.43; *see also* 9/25/08 RR 151 (agreeing that contract specifies sale at the wells) [Tab 3]). In other words, OPL's predecessors – in contracting for the sale of raw, unprocessed casinghead gas at the well to the Slaughter Gasoline Plant – obtained an agreement that priced the sale of the unprocessed gas at the well as a percentage of the residue gas and natural gas liquids to be derived from processing the gas, which was to be sold by the plant owners at the tailgate of the plant. In so doing, OPL's predecessors preserved the ability of all interest owners to benefit from the monthly floating price for the liquids and the residue gas for generations to come, ensured that the gas would always have a place to be processed, and limited the likelihood that the wells would be shut in. Moreover, the parties to the contracts and interest owners benefitted because for the life of the plant, the interest owners' gas was dedicated to the plant and the plant was dedicated to the gas.

These contracts, which were subject to later amendments between the parties that are not relevant to the issues presented, remain binding today. (9/23/08 RR 38 ("[T]hose contracts are still in effect today. They all date from 1947 when the plant was built." [Alguire] [Tab 1]).

[2] OPL's predecessors entered into another long-term contract for the sale of the remaining casinghead gas in a separate agreement, dated May 3, 1947. (*See* OPL Ex. 42 (contract applicable to Northwest Mallet Unit, Slaughter Estate Unit, and portions of the Christine DeVitt "B" lease))

Indeed, Plaintiffs have not challenged the validity or enforceability of the contracts. Plaintiffs failed to plead or prove that the casinghead-gas sales contracts were in any way invalid, and have failed to offer any evidence indicating that the contracts should be construed in a way contrary to their plain terms. In fact, Charlie Graham, Plaintiffs' expert, conceded that the contracts were entered into in arms-length transactions that were reasonable and prudent at the time they were made. (9/25/08 RR 161-62 [Tab 3]) And still further, the contracts were later ratified by Plaintiffs' predecessors when, in signing unit agreements, they agreed that all other contracts not in conflict with the unit agreements would remain in force. (*E.g.*, OPL Ex. 16 at § 3.3 ("The provisions of the various leases, agreement, division and transfer orders, or other instruments covering the respective Tracts or the production therefrom are amended to the extent necessary to make them conform to the provisions of this agreement, but otherwise shall remain in effect.") Accordingly, the casinghead-gas sales contracts entered into by OPL's predecessors, along with the leases, plainly govern the amount of royalties OPL is contractually obligated to pay Plaintiffs for the sale of casinghead gas at the well.

3. The evidence conclusively establishes that OPL paid Plaintiffs full royalties for the sale of casinghead gas under the terms of the casinghead-gas sales contracts.

At trial, Plaintiffs presented no evidence that OPL failed to pay Plaintiffs their full share of royalties under the express terms of the casinghead-gas sales contracts entered into by OPL's predecessors in 1947. To the contrary, the evidence conclusively established the opposite. Plaintiffs' expert on the proceeds leases, Charlie Graham, testified that OPL is "making royalty payments to the Mallet Rancher Plaintiffs based on . . . the terms that are expressed in . . . a number of 1947 gas contracts." (*See* 9/24/08 RR 306 [Tab 2]) Indeed, when directly asked whether Occidental had paid "Plaintiffs royalties based on the percentages of proceeds" contracts entered into by Occidental's predecessors, Graham stated, without reservation, "Yes, sir." (9/25/08 RR 155 [Tab 3]; *see also* 9/30/08 RR 159-60 [Tab 5]) Mr. Graham reaffirmed this in his rebuttal testimony:

> Q. Okay. And if the methodology that the Defendants used -- and you already told me earlier that they -- the Defendants paid in accordance with the 1947 percent of proceeds contracts, you remember, on your last time?
>
> A. Yes, sir.
>
> Q. Now, if that methodology is right, and I know experts can assume, I am asking you to assume that if that methodology was right, then I assume you agree the Plaintiffs, if it's right, have been paid what they are due?
>
> A. Yeah. I haven't done that exercise; but, I have exercise; but, I have been working all along on the premise that's the -- the basis they have made actual payments.
>
> Q. All right. And, so, if the methodology is right and if they paid under those 1947 contracts, the Plaintiffs are due zero, right?
>
> A. That's correct.

(9/30/08 RR 189-90 [Tab 5])

In an attempt to circumvent the undeniable (and conceded) fact that Plaintiffs were paid full royalties pursuant to the terms of the valid and enforceable contracts entered into by Occidental's predecessors (*see* 9/25/08 RR 155 [Tab 3]; 9/30/08 RR 159-60 [Tab 5]), Mr. Graham calculated the amount of royalties purportedly owed to Plaintiffs based *not* upon the terms of the actual contracts at issue, but instead on an alternate theory of recovery not contained in the contracts — that Plaintiffs should be paid royalties based on "downstream prices, less reasonable downstream and midstream costs." (9/25/08 RR 62, 140 [Tab 3]) But given that Mr. Graham's alternative theory was not based on the actual contracts at issue in the case, his calculations are neither probative nor material to whether OPL met its contractual obligations.

Cf. Exxon Pipeline Co. v. Zwahr, 88 S.W.3d 623, 629 (Tex. 2002) (criticizing expert "[e]vidence that has no relationship to any issue in the case"). As a result, his testimony was no evidence of a breach of the contracts entered into between OPL's and Plaintiff's predecessors.

As a matter of law, Plaintiffs failed to demonstrate that OPL breached the terms of the "amount realized" leases at issue in Question Nos. 1-4. Instead, the evidence presented at trial conclusively demonstrated that (1) Plaintiffs' leases required the payment of royalties based upon the actual "amounts realized" from the sales of casinghead gases "at the wells"; and (2) OPL paid Plaintiffs their royalties based on the actual amounts realized under the terms of the long-term casinghead-gas sales contracts for the sales made "at the wells." Accordingly, Plaintiffs' breach-of-contract claim with respect to the "amount realized" leases is without merit and cannot support the jury's answer to Question No. 1.

Because there is no evidence to support the jury's answer to Question No. 1 (the liability question for breach of the "amount realized" leases), the Court must also disregard the jury's damages finding in response to Question No. 2. Plaintiffs simply cannot recover damages under Question No. 2 without a supportable liability finding in Question No. 1. Moreover, Plaintiffs' expert's damages calculation on these leases is inconsistent with the plain terms of the leases: the plain terms of the leases set the amount of royalties owed based on the price paid for the gas "at the well" (*see* OPL Exs. 1, 5, 6, & 9; 9/24/08 RR 298 [Tab 2]; 9/25/08 RR 151 [Tab 3]), but Plaintiffs' expert calculated the amount of royalties owed based on the sale of the natural gas liquids *far downstream* from the well at Mt. Bellvue on the Houston Ship Channel, less deductions for what he believed to be reasonable costs. (9/30/08 RR 173-75 [Tab 5]). Because Plaintiffs' calculations of the royalties owed contravene OPL's obligations set forth in valid and enforceable contracts, their calculations of damages owed under the "amount realized" leases provide no evidence to support the jury's award in Question No. 2.

B. Plaintiffs Also Failed To Demonstrate that OPL's Payment of Royalties Pursuant to the Plain Terms of the Long-Term Sales Contracts Violated any Implied Duty under Texas Law.

Unable to demonstrate that OPL failed to pay Plaintiffs royalties based on the actual proceeds of the casinghead-gas sales contracts, Plaintiffs alternatively asked the jury to find that OPL's payments under the "amount realized" leases breached an implied duty "to reasonably market the gas" produced under the leases. (*See* Jury Charge Question Nos. 3, 4) On this issue as well, however, Plaintiffs' claims fail for want of evidence and as a matter of law.

1. There is no absolute duty to pay market-value royalties on a proceeds lease, and courts may not convert proceeds leases into market-value leases.

Although the jury was asked whether Occidental "fail[ed] to reasonably market the gas produced" from the proceeds leases (*see* Jury Charge Question No. 3), the Texas Supreme Court has made clear that there is no implied absolute duty to sell gas at market value under a proceeds royalty clause. *Yzaguirre*, 53 S.W.3d at 373 (*quoting Pyote*, 611 S.W.2d at 610); *see also Bowden*, 247 S.W.3d at 701 (holding that there is not an implied duty to market "in all proceeds leases"). Rather, duties above and beyond the plain terms of an oil-and-gas lease will be implied only "if the lease is silent" on a particular subject. *Yzaguirre*, 53 S.W.3d at 373; *see also Bowden*, 247 S.W.3d at 701. Courts may not add terms to a contract that contradict the express obligations agreed to by the parties. *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 236 (Tex. 2003); *Yzaguirre*, 53 S.W.3d at 373. Accordingly, implied duties to market gas will "not override the express terms of [an] oil and gas lease," and courts "will not . . . rewrite [a] lease's terms to give [royalty owners] the benefit of a bargain they never made." *Yzaguirre*, 53 S.W.3d at 374.

Plaintiffs have failed to demonstrate that OPL breached any implied duty to market the casinghead gas above and beyond the plain terms of the contracts at issue. In fact, Plaintiffs' own expert testified that the casinghead-gas sales contracts were consistent with what a reasonable and prudent operator would contract for when the contracts were signed in 1947. (*See* 9/25/08 RR 161-62 [Tab 3]). That concession is also consistent with the Texas Supreme Court's recognition that the amounts realized from long-term sales contracts may very well be "more or less than market value." *Hankins*, 111 S.W.3d at 74.

Furthermore, Plaintiffs' implied-duty-to-market theory suffers from a lack of proof. Although Plaintiffs assert that OPL breached a duty to reasonably market casinghead gas, Plaintiffs failed to offer a single piece of evidence supporting its theory. Plaintiffs offered no testimony – expert or otherwise – indicating what specific marketing measures OPL (or its predecessors) were required to implement in order to satisfy Plaintiffs' proposed implied duty, nor did Plaintiffs offer any evidence regarding how OPL's failure to implement these unspecified marketing measures impacted Plaintiffs' royalties.

Rather than providing evidence of any marketing measures that OPL failed to implement, it appears that Plaintiffs are simply asking the Court to rewrite their proceeds leases to convert them into market-value leases or to impose an implied duty on OPL to abandon the 1947 casinghead-gas contracts and negotiate new gas sales contracts. The Court should reject Plaintiffs' invitation to re-write their leases in a way that was not bargained for (or contemplated) by their predecessors, to disregard the valid casinghead-gas contracts, and to impose a duty the law does not recognize. *Cf. Yzaguirre*, 53 S.W.3d at 374 (refusing to rewrite lease's plain terms to give royalty owners the benefit of a bargain they never made).

2. Plaintiffs have failed to demonstrate that the proceeds actually paid by OPL to Plaintiffs were a sham or a fraud.

In a recent discussion of the legal duties governing proceeds leases, the Texas Supreme Court made clear that the real "question under a proceeds lease" is *not* whether lessees paid royalties at market value, but is instead "whether the proceeds actually received by the lessee were a fraud or a sham." *Hankins*, 111 S.W.3d at 74; *see also Bowden*, 247 S.W.3d at 708 (noting that the legal inquiry in proceeds-lease cases is very different from that in market-value-lease cases). Because Plaintiffs have offered no such evidence, their attempts to recover under the proceeds leases fail as a matter of law.

Indeed, Plaintiffs made no attempt to demonstrate that the royalties actually paid by OPL were not the amounts owed to Plaintiffs under the long-term casinghead-gas sales contracts. Rather, Plaintiffs' expert Charles Graham acknowledged that Plaintiffs were paid royalties from the sales of casinghead gases as specified in the actual sales contracts, *see supra*, and Plaintiffs offered no testimony (expert or otherwise) to the contrary.

Mr. Graham similarly conceded that OPL's predecessors entered into the 1947 casinghead-gas sales contracts in good-faith, arms-length transactions. (9/25/08 RR 161 ("Q: … [A]t the time these contracts were entered into, it wasn't Stanolind, the seller, selling just to Stanolind, was it? A: No, sir, there were other owners in the plant. Q: Okay. It wasn't a left-hand/right-hand only contract, was it? A: I never said that, in 1947, no sir.) [Tab 3]) And critically, Mr. Graham also testified that OPL's predecessors fully complied with their duties as "prudent operator[s]" when they entered into the long-term casinghead-gas sales contracts in 1947. (*Id.* ("I think it's the exercise of a prudent operator.") [Tab 3]) In short, Plaintiffs have failed to demonstrate that their royalty payments were actually "a fraud or a sham." *Cf. Hankins*, 111 S.W.3d at 74. Accordingly, there is no evidence to support the jury's answer to question 3.

Because there is no evidence to support the jury's response to Question No. 3, there is also no supportable liability finding to support the jury's damages award in its response to Question No. 4. Moreover, Plaintiffs' damages calculations contravene the plain terms of the proceeds leases at issue. Given that an implied duty cannot contradict the terms of a contract, the improper damages calculations that contravene the terms of the contracts at issue constitute no evidence to support the jury's award. For each of these reasons, the Court should disregard the jury's answers to Question Nos. 3-4 and render judgment notwithstanding the verdict in favor of OPL.

III. There Is No Evidence to Support the Jury's Finding in Question No. 5 that OPL Failed to Pay Plaintiffs Gas Royalties Based on the Market Value in the Field.

For at least three reasons, there is likewise no evidence to support the jury's answer to Question No. 5 that OPL failed to pay Plaintiffs royalties based on "the market value in the field for gas produced from [the Northwest Mallet Unit and Slaughter Estate Unit] between January 2002 and August 2008." First, as a threshold matter, Plaintiffs' expert, Christopher Kay Alguire, did not actually perform a market value analysis under Texas law. Under Texas law, a market value royalty claim requires evidence that gas sold for a particular price should have been sold for a higher price, thus entitling the plaintiff to the difference in value. To support a market value royalty claim in Texas, an expert is therefore required to offer testimony regarding the prices comparable gas is selling for per MCF or MMBTU. Thus, in *Exxon Corp. v. Middleton*, 613 S.W.2d 240 (Tex. 1981), the Texas Supreme Court approved a market value analysis in which the plaintiff's expert reviewed over 30,000 Monthly Gas Tax Reports (Form 60-150s) filed with the State Comptroller of Public Accounts to ascertain the prices paid for any quantity of gas in the relevant market area. *Id.* at 245-46. The expert then used the four comparability factors – time, quality, quantity, and availability of marketing outlets – to locate comparable gas, as defined by the Court, and adjusted those sales prices according to the BTU content of the gas to make them comparable. *Id.* at 246-47.

Alguire did not perform a similar analysis here. In fact, she never testified to the price paid for any gas – much less the prices being paid for gas comparable to the gas at issue in this case. *See id.* at 246 ("Market value is defined as the *price* property would bring when it is offered for sale . . . .") (emphasis added). Instead, based on her review of a handful of sales contracts, she merely opined that the percentage of proceeds was below other contracts: "[T]he 33 percent basis for the percentage of proceeds was below the range observed for comparable casinghead gas sales in the area." (9/23/08 RR 130 [Tab 1]) Because Alguire failed to discuss the prices that were or should have been paid for the gas, her testimony is irrelevant to determining and constitutes no evidence of "the market value in the field for the gas produced," and it cannot support the jury's answer to Question No. 5 for this reason alone. *Cf. Exxon Pipeline Co. v. Zwahr*, 88 S.W.3d 623, 631 (Tex. 2002) (because expert "failed to apply the before-and-after valuation method," his testimony was "irrelevant to determining the value of the land taken").

Second, even assuming Alguire performed a market value analysis, as a matter of law, sales of casinghead gas with low CO_2 content, as utilized by Alguire per the instructions of Plaintiffs' counsel, are not comparable in quality to the high-CO_2 content gas actually produced from the leases at issue. Third, sales of casinghead gas produced outside of the Slaughter Oil Field in New Mexico or South Texas are not comparable in location and in marketing outlets to the gas produced at the wells at issue and constitute no evidence of the "market value in the field" as required by the leases' royalty provisions. Accordingly, these sales cannot support Alguire's conclusion that "the 33 percent basis for the percentage of proceeds was below the range observed for comparable casinghead gas sales in the area." (9/23/08 RR 130 [Tab 1]; *see also id.* at 165 [Tab 1])

Under well-settled Texas law, market value is defined as "the price property would bring when it is offered for sale by one who desires, but is *not obligated to sell*, and is bought by one who is under no necessity of buying it." *Middleton*, 613 S.W.2d at 246 (emphasis in original); *see Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 122 (Tex. 1996) ("Market value is the price a willing seller obtains from a willing buyer."). The preferred method for determining market value is "to use comparable sales." *Heritage Res.*, 939 S.W.2d at 122. As the Court properly instructed the jury, a comparable sale is one that is "comparable in time, quality, quantity, and availability of marketing outlets." *Id.*; *Middleton*, 613 S.W.2d at 246. Sales comparable in quality are those of "similar physical properties such as sweet, sour, or casinghead gas." *Middleton*, 613 S.W.3d at 246. As set forth below, the sales utilized in Alguire's market value study were *not* comparable to the gas produced from the Northwest Mallet and Slaughter Estate Units and cannot support the jury's answer to Question No. 5.

Alguire recognized that one of the initial steps in her market value study was to identify "the characteristics of the gas produced from these two properties" in order to "know whether it's comparable to the other sales you will be looking at." (9/23/08 RR 31-32 [Tab 1]) To that end, Alguire determined that "[t]he natural gas production [from the two leases at issue] is extremely contaminated, mostly by carbon dioxide." (*Id.* at 224-25 [Tab 1]; BP Ex. 106) She admitted that the Slaughter Estate Unit was under CO_2 flood and that the levels of CO_2 gas in that unit were in the 80-90% range throughout the relevant period. (9/23/08 RR 32, 176-77 [Tab 1]; *see also id.* at

34 [Tab 1]) She similarly acknowledged that the levels of CO_2 in the Northwest Mallet Unit ranged from 20-30% in the mid-1990s, increased steadily over time until it reached the 60-70% range in 2007, and was "in the 50 percent range" when OPL purchased the property in 2000. (*Id.* at 116, 119, 185 [Tab 1])[3] And she conceded that, on a per volumetric basis, casinghead gas with low concentrations of CO_2 is "worth more" than gas with high concentrations of CO_2, and that "the more CO_2 you put in gas . . . the lower the BTU value." (*Id.* at 160, 179-80 [Tab 1]) Despite these admissions, Alguire could not identify a "single contract" in the 50% or higher CO_2 range that returned more than 33% of the proceeds (like the leases at issue here). (*Id.* at 185 [Tab 1]) Rather, in conducting her market valuation based on so-called "comparable sales," Alguire admitted that she only considered one sale that had "about a 25 percent CO_2 concentration" and that "the concentrations in those contracts we looked at were generally lower than that found on CO_2 flooded properties." (*Id.* at 167 [Tab 1]) In fact, the CO_2 concentrations in most of Alguire's so-called "comparable sales" consisted of less than 10% CO_2.

Alguire not only failed to utilize sales of casinghead gas with high-concentrations of CO_2 as comparables, she intentionally (and erroneously) ignored those sales per the instructions of Plaintiffs' counsel:

> Q. . . . [W]hen you came across a property with injected CO_2, at Mr. Holmes' instruction, you ignored those contracts, didn't you?
>
> A. I did.

(*Id.* at 168 [Tab 1]) Alguire was aware of two contracts in 2004 covering properties under "active CO_2 flood" with "very high levels of injected CO_2" that returned 33% of the proceeds.

[3] Although the Northwest Mallet Unit was not under active CO_2 flood until the mid-2000s, it had "high levels" of CO_2 that seeped from neighboring properties under CO_2 flood. (*Id.* at 11-12, 34, 116, 118-19 [Tab 1])

(*Id.* at 115 [Tab 1])[4] Those sales did not, however, play a role in Alguire's market value study. (*Id.*) Nor did Alguire consider an April 2002 sale involving injected CO_2 levels approaching 90% or any of the sales of high CO_2 content gas by Bass Enterprise, Hess, or Apache in the mid-2000s. (*Id.* at 134-36, 183-84 [Tab 1]) In fact, Alguire admittedly "did not include properties with very high levels of injected CO_2 in the market values, in the comparability standards" because she "was instructed [by Plaintiffs' counsel] not to include injected CO_2." (*Id.* at 115, 117 [Tab 1]) As Alguire bluntly stated: "[T]he Slaughter Estate Unit did have high levels of injected CO_2, which I was asked to ignore." (*Id.* at 169-70 [Tab 1]; *see also id.* at 173 [Tab 1])

Consequently, and notwithstanding her recognition that the casinghead gas produced by the Northwest Mallet Unit and Slaughter Estate Unit from 2000-2008 consisted of over 50% CO_2, Alguire's purported market value analysis conveniently excluded *any* sales of casinghead gas from 1996-2008 that had a 50% or greater concentration of CO_2 gas. (*Id.* at 173-76, 178 [Tab 1]) *Cf. Guadalupe-Blanco River Auth. v. Kraft*, 77 S.W.3d 805, 808 (Tex. 2002) ("The comparable sales method fails when the comparison is made to sales that are not, in fact, comparable to the land condemned. The two sales [plaintiff's expert] used as comparables may have had characteristics similar to [plaintiff's] hypothetical tract, but they were not comparable to the easement actually taken."). And not surprisingly, those excluded "comparable" sales — unlike the inapposite sales that Plaintiffs' counsel instructed Alguire to rely upon — conclusively demonstrate that, even under Alguire's so-called "market value" analysis, OPL did, in fact, pay Plaintiffs royalties based on the market value for gas produced from the Northwest Mallet Unit and Slaughter Estate Unit. Because there is no evidence to support the jury's contrary finding (and because the evidence conclusively demonstrates a different answer as a matter of law), the

[4] Alguire was also aware of a 1996 contract with Exxon involving "high CO_2 content gas" that returned a mere 28% of the proceeds. (*Id.* at 100, 173-74, 182-83 [Tab 1])

jury's answer to Question No. 5 should be disregarded and judgment notwithstanding the verdict should be rendered in favor of OPL.

Alguire compounded this fatal defect in Plaintiffs' proof and her model by disregarding the "market value in the field" language in the leases at issue and instead focusing her study on gas sales in counties far removed from the Slaughter Oil Field. In particular, Alguire repeatedly relied on sales of gas in New Mexico, Yoakum County, Texas, or other parts of Texas. (*See, e.g.*, 9/23/08 RR 68, 120, 122, 171, 193-95 [Tab 1]) For the relevant time period between 2000 and 2008, she did not review gas sales for gas produced from the Slaughter Field. (*Id.* at 193-95 [Tab 1]) Her testimony is thus incompetent for at least two additional reasons.

First, although the gas royalty provision unambiguously provides that royalties are to be based on the "market value *in the field*," Plaintiffs (through Alguire's testimony) impermissibly attempted to rewrite that provision to calculate their royalties based on the value of gas from *other* fields and far removed counties -- not the Slaughter Oil Field. But as the Texas Supreme Court observed in *Yzaguirre*, 53 S.W.3d at 374, "[w]e will not now rewrite this lease's plain terms to give the Royalty Owners the benefit of a bargain they never made." The same is likewise true here. Plaintiffs are only entitled to royalties based on the market value of comparable gas in the Slaughter Oil Field, and their testimony regarding the value of gas elsewhere is irrelevant and cannot support the jury's answer to Question No. 5. Second, in addition to ignoring the actual lease terms and the quality of the gas, Plaintiffs made no showing at trial that the gas produced from other fields is comparable in the availability of marketing outlets to the gas produced at the Northwest Mallet Unit and Slaughter Estate Unit. In the absence of this showing, there is no basis for Alguire's reliance on these sales as "comparable," and such sales cannot support her ultimate conclusion and the jury's answer to Question No. 5.

For any or all of these reasons, the jury's answer to Question No. 5 should be disregarded, and judgment notwithstanding the verdict should be rendered in OPL's favor. For similar reasons, the Court should disregard the jury's damages findings in response to Question No. 6. First, in the absence of a supportable liability finding (Question No. 5), Plaintiffs are not entitled to damages under Question No. 6. Second, Plaintiffs' calculation of the "market value" of their royalty share in Question No. 6 suffers from the same fundamental flaws as discussed above and is therefore no evidence.

IV. Having Ratified the 1947 Casinghead Gas Contracts, As a Matter of Law, Plaintiffs Are Estopped From Claiming that OPL has Breached Its Obligations Under the Leases to Pay Plaintiffs' Gas Royalties and that OPL has Breached an Implied Duty to Reasonably Market the Gas Produced.

Additionally, OPL has proved its affirmative defenses that Plaintiffs have ratified the 1947 casinghead gas contracts and are estopped from claiming that they have been underpaid royalties as a result of OPL's payment of royalties in accordance with sales made under the 1947 casinghead gas contracts. Ratification occurs when a party recognizes the validity of a contract by affirmatively acknowledging the contract, and when a party ratifies a contract, that party cannot withdraw the ratification and avoid the contract. *Mo. Pac. R.R. Co. v. Lely Dev. Corp.*, 86 S.W.3d 787, 792 (Tex. App. — Austin, 2002, pet. dism'd) (citing *Mo. Pac. Ry. Co. v. Brazil*, 72 Tex. 233, 10 S.W. 403, 406 (1888)). Estoppel by contract is a form of quasi-estoppel based upon the idea that a party to a contract will not be permitted to take a position inconsistent with its provisions to the prejudice of another. *Hawn v. Hawn*, 574 S.W.2d 883, 886 (Tex. Civ. App. — Eastland, 1978, writ ref'd n.r.e.). These well-established principles of law preclude all Plaintiffs' claims as a matter of law.

There is no dispute that all Plaintiffs are parties to the Unit Agreements for the properties involved in this case. The parties have so stipulated. (Agreed-to Stipulations, Sept. 15, 2008 ¶ 1)

As parties to the Unit Agreements, the Plaintiffs have agreed in paragraph 3.3 that "[t]he provisions of the various leases, agreement, division and transfer orders, or other instruments covering the respective Tracts or the production therefrom are amended to the extent necessary to make them conform to the provisions of this agreement, but otherwise shall remain in effect." (*E.g.*, OPL Ex. 16, ¶ 3.3) There is no dispute that the 1947 casinghead gas contracts pre-date the Unit Agreements, that these gas contracts are "agreement[s] . . . covering the respective Tracts or the production therefrom," and that the Unit Agreements do not specifically cover the sale of gas. As a result, according to the plain language of paragraph 3.3, the Plaintiffs, as parties to the Unit Agreements, have agreed that the casinghead gas contracts "shall remain in effect" and thereby ratified those gas contracts.

Having ratified the casinghead gas contracts, the Plaintiffs may not now withdraw their ratification and seek to avoid the contracts. The Plaintiffs are also estopped from denying the validity of the casinghead gas contracts. Because the royalty owners are parties to the Unit agreement and the Unit Agreement confirmed that the casinghead gas contracts "shall remain effective," the Plaintiffs may not now deny that those contracts are effective to accomplish the sale of the casinghead gas produced from the properties at issue in this case.

Yet, that is what the Plaintiffs are attempting to do. The Plaintiffs ultimately presented their liability case and their damage model through the testimony of Charles Graham, who ignored the casinghead gas contracts in concluding that OPL had underpaid royalties to the Plaintiffs:

> Q. (By Mr. Davis) I want to talk to you – I want to go back to these gas contracts. The way the Defendants accounted to the Plaintiffs and paid the Plaintiffs was as though the percentages in the three contracts we looked at were in effect, correct?
>
> A. Correct.

Q. All right. And the way you did your damage calculation, when we get everything out of the way, other than picking the point of sale, you ignored the percentages in the three contracts, didn't you?

A. Yes, sir.

Q. And you treated those contracts as not binding on the parties, correct?

A. Well, certainly, they are not binding, I wouldn't think, on the royalty owners, no.

(9/25/08 RR 166-67 [Tab 3]) In answer to the Court's questions outside the presence of the jury, Graham explained that "I am just griping about the magnitude of the deductions they made against royalty under the guise of our -- [The Court: Okay. Wait] – '47 arrangement." (9/25/08 RR 71 [Tab 3]) And he later reiterated that "I am just saying whoever in Occidental Permian Ltd. made the decision to account to these Mallet Rancher Plaintiffs based on that '47 agreement underpaid them by a significant amount of money." (9/25/08 RR 226 [Tab 3])

All of Plaintiffs' claims for underpayment of royalties, whether for breach of the royalty provisions of the leases or for breach of the implied duty to market reasonably, either challenge or disregard the 1947 gas contracts. Because as a matter of law they have ratified those contracts and they are estopped from disregarding or challenging them, Plaintiffs' claims fail as a matter of law.

V. There Is No Evidence to Support the Jury's Finding in Question No. 7 that Plaintiffs Are Entitled to Attorneys' Fees.

Even assuming there is sufficient evidence to support the jury's underlying liability findings against OPL, there is no evidence to support the jury's answer to Question No. 7 that a reasonable fee for the necessary services of Plaintiffs' attorneys in this case as to the claims against OPL for preparation and trial is $1.97 million. First, Plaintiffs failed to offer evidence of the relevant factors required to support an award of attorney's fees. And second, the jury impermissibly premised the award on a percentage of Plaintiffs' damages.

Under Texas law, a party seeking attorney's fees must proffer evidence of the factors set forth in *Arthur Andersen & Co. v. Perry Equipment Corp.*, 945 S.W.2d 812, 818 (Tex. 1997), and "cannot simply ask the jury to award a percentage of the recovery as a fee." In contravention of these well-settled principles, Marc Stanley, Plaintiffs' expert on attorney's fees, asked the jury to award a fee "within the range of 25 percent to 38 percent of whatever is recovered in this case, actual damages in order to try to make the Plaintiffs whole." (9/26/08 RR 50 [Tab 4]) But as the Texas Supreme Court recognized in *Perry Equipment*, "because the jury is not informed what the total amount of the judgment will be, the jury can only speculate about whether a percentage of that unknown recovery will represent a reasonable and necessary fee in that particular case." 945 S.W.2d at 819. Thus, the jury "must decide the question of attorney's fees specifically in the light of the work performed in the very case for which the fee is sought." *Id.* Plaintiffs offered no evidence to allow the jury to do so here.

Stanley did not testify or otherwise offer any evidence of a specific amount of money that would be a reasonable fee for the necessary services of Plaintiffs' attorneys. *See id.* (a plaintiff "must ask the jury to award the fees in a specific dollar amount, not as a percentage of the judgment"). Although Stanley acknowledged the existence of three of the *Perry Equipment* factors – *i.e.*, the amount of money involved and the results obtained, the time limitations imposed by the client or the circumstances, and the nature and length of the professional relationship with the clients – he did not apply any of those factors to the facts of this case. (9/26/08 RR 46-47 [Tab 4]) Moreover, Stanley never addressed two of the other *Perry Equipment* factors – (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill required to perform the legal service properly; and (2) the likelihood that the acceptance of the particular employment will preclude other employment by the lawyers.

Indeed, Stanley did not know how many hours any of Plaintiffs' attorneys had worked on the case. (*Id.* at 59-60 [Tab 4]) He had not reviewed any of the time records of Plaintiffs' attorneys except for some of "Mr. Holmes' time . . . for the earlier portion of the case." (*Id.* at 45 [Tab 4]) And he did not testify or offer any opinions regarding a reasonable hourly fee for the services rendered by any of Plaintiffs' attorneys. (*Id.* at 49 [Tab 4]). Stanley further compounded these deficiencies by failing to segregate Plaintiffs' attorney's fees between claims that were submitted to the jury and prevailed upon at trial and claims which were not prevailed upon because they were dismissed prior to or during trial.

Thus, in the end, Stanley's opinion was premised on little more than his observations that he was "very impressed with what James Holmes has done in this case" and that Plaintiffs' attorneys had a contingent fee arrangement with their clients. (9/26/08 RR 42, 47-48 [Tab 4]) Based on these two factors, Stanley opined that a reasonable attorney fee would be "within the range of 25 percent to 38 percent of whatever is recovered in this case, actual damages." (*Id.* at 50 [Tab 4]) And in accordance with that opinion, the jury awarded Plaintiffs approximately 31% of the damages it found against OPL in Question Nos. 2 and 6. Simply because Plaintiffs agreed to pay a 38% contingent fee to their attorneys if this case proceeded to trial (9/26/08 RR 50 [Tab 4]) does not mean that it was reasonable for the jury to award such a fee to them. *See Perry Equip.*, 945 S.W.2d 818 ("We cannot agree that the mere fact that a party and a lawyer have agreed to a contingent fee means that the fee arrangement is in and of itself reasonable for purposes of shifting that fee to the defendant.").

The fallacy of Stanley's approach to calculating a reasonable and necessary fee for Plaintiffs' attorneys is evidenced by his pre-trial expert report and the opinions contained therein. Notably, in that report, Stanley opined that $450,000 was a "reasonable and necessary attorney's fees and recoverable expenses . . . attributable to Plaintiffs' counsels' legal services in Cause No. 06-01-20302." (Expert Report of Marc Stanley at 4 [Tab 6]) Of course, this $450,000 figure also included Plaintiffs' claims against BP America, as well as several of Plaintiffs' claims that were dismissed (voluntarily or involuntarily) before or during trial. Stanley did not, however, similarly testify at trial as to a precise dollar amount of reasonable attorney's fees. Because Stanley's trial testimony did not correlate the contingency percentage he asked the jury to award with the time and labor actually expended by Plaintiffs' counsel and the fee customarily charged in the locality for similar legal services, the jury was impermissibly allowed to award Plaintiffs a windfall of $1.97 million in attorney's fees against OPL (as well as another $1.067 million against BP Amoco) based solely on the amount of damages awarded to Plaintiffs. If permitted to stand, Plaintiffs will recoup more than $3,000,000 in attorney's fees in a case that their own expert previously opined that $450,000 would be a reasonable and necessary fee.

In many respects Stanley's testimony is similar to the testimony that the court in *San Antonio Credit Union v. O'Connor*, 115 S.W.3d 82 (Tex. App.--San Antonio 2003, pet. denied), concluded was legally insufficient to support an award of attorney's fees to the plaintiff. In that case, the plaintiff's attorney testified that he had a 40% contingency fee agreement and that such a percentage was the standard in Bexar County and reasonable. *Id.* at 106. He also discussed the guidelines set forth in *Perry Equipment*, identifying the "time and labor" factor and testifying that the trial itself consumed a significant amount of his time; he discussed the novelty and difficulty of the question involved, recognizing that it was not a particularly simple case; he testified that his involvement in the case prevented him from being involved in other cases; and he recognized that neither the time limitation nor the nature and length of the relationship with the client factors were relevant to the case. *Id.*

On appeal, the San Antonio Court of Appeals reversed, concluded that the evidence was legally insufficient to support the jury's award of attorney's fees, and rendered judgment that the plaintiff take nothing on his claim for attorney's fees. *Id.* As the court explained, the attorney's testimony was "too general" and "ignore[d] the degree of specificity [*Perry Equipment*] requires, because [he] offered no time sheets and only made a 'guesstimate' about in-court versus out-of-court time." *Id.* Moreover, in contravention of *Perry Equipment*, the attorney "never testified that a specific amount of money was a reasonable attorney's fee award." *Id.*

The same is also true here. If anything, Stanley's testimony is even more deficient than the testimony in *O'Connor* because, unlike the attorney in that case, Stanley did not even discuss the time and labor required, the novelty and difficulty of the questions involved, or the likelihood that the acceptance of the particular employment precluded other employment by the lawyers (much less apply those factors to this case). As a result, Stanley's testimony is legally insufficient to support the jury's answer to Question No. 7, the answer should be disregarded, and judgment should be rendered that Plaintiffs take nothing on their claim for attorney's fees.

VI. Conclusion

For the reasons stated above, OPL respectfully requests that the Court disregard the jury's answers to Question Nos. 1, 2, 3, 4, 5, 6, and 7, render a take-nothing judgment notwithstanding the verdict, and grant OPL such other and further relief to which it is entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of this document was served on all counsel of record via email and regular mail on this 1st day of December, 2008 in accordance with TEX. R. CIV. P. 21a.

Deborah G. Hankinson

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