IN THE DISTRICT COURT OF BLAINE COUNTY
STATE OF OKLAHOMA

BILLY J. STRACK, TRUSTEE OF THE PATRICIA ANN STRACK REVOCABLE TRUST DTD 2/15/99 AND THE BILLY JOE STRACK REVOCABLE TRUST DTD 2/15/99, AND DANIELA A. RENNER, SOLE SUCCESSOR TRUSTEE OF THE PAUL ARIOLA LIVING TRUST AND THE HAZEL ARIOLA LIVING TRUST, **FOR THEMSELVES AND ALL OTHERS SIMILARLY SITUATED,** VS. CONTINENTAL RESOURCES, INC., DEFENDANT.	)	CASE NO. CJ-10-75 JUDGE DENNIS W. HLADIK

AMENDED PETITION[1]

COME NOW the Plaintiffs, Billy J. Strack, Trustee of the Patricia Ann Strack Revocable Trust dated 2/15/99 and the Billy Joe Strack Revocable Trust dated 2/15/99, and Daniel A. Renner, Sole Successor Trustee of the Paul Ariola Living Trust and the Hazel Ariola Living Trust (hereafter referred to as "Plaintiffs"), for themselves and all others similarly situated, (hereinafter the Plaintiffs and the putative Class members are collectively referred to as the "Class" or "Plaintiff Class" or "Strack") and for their cause of action, allege and state as follows:

PARTIES, JURISDICTION AND VENUE

The parties to this action are as follows:

[1] This Amended Petition is being filed pursuant to the Scheduling Order entered by the Court on September 10, 2014.

1. Plaintiff Billy J. Strack is a resident of Blaine County, Oklahoma. Plaintiff Daniel A. Renner is a resident of Oklahoma County. Plaintiffs' claims arose in Blaine County, Oklahoma.

2. Defendant Continental Resources, Inc. is an Oklahoma corporation with its principal place of business in Enid, Oklahoma. Continental Resources, Inc., and its unnamed principal shareholder(s), have numerous unnamed operating, marketing, gathering and/or gas processing affiliated entities, all of which Continental Resources, Inc. manages and controls the operations thereof in such a manner that they are mere instrumentalities or alter-egos of Continental Resources, Inc. (hereinafter Continental Resources, Inc. and these unnamed affiliates shall be collectively referred to as "Continental" or "CLR"[2]). Continental operates numerous oil and gas wells in the State of Oklahoma, including wells located in Blaine County in which Plaintiffs are royalty owners.

3. Plaintiff Billy J. Strack, Trustee of the Patricia Ann Strack Revocable Trust dated 2/15/99, owns oil, gas and other minerals underlying Section 9, Township 16 North, Range 12 West of the Indian Meridian; Section 10, Township 16 North, Range 12 West of the Indian Meridian; Plaintiff Billy J. Strack, Trustee of the Billy Joe Strack Revocable Trust dated 2/15/99, owns oil, gas and other minerals underlying Section 33, Township 17 North, Range 11 West of the Indian Meridian, all of which are located in Blaine County, Oklahoma. Plaintiff Daniel A. Renner, Sole Successor Trustee of the Paul Ariola Living Trust and the Hazel Ariola Living Trust, owns oil, gas and other minerals underlying Section 17, Township 16 North, Range 11 West of the Indian Meridian, Blaine County, Oklahoma. The above-stated mineral interests are,

[2] "CLR" is Continental's ticker symbol on the New York Stock Exchange.

or were, subject to oil and gas leases between Plaintiffs and Continental, with said mineral interests being included in governmentally-sanctioned drilling and spacing units. Continental, as operator and a working interest owner, drilled, completed and produced wells on such units ("Plaintiffs' wells"). Continental distributes royalties on Plaintiffs' wells. Plaintiffs may also own other minerals in which Continental is/was a working interest owner and/or operated oil and gas wells within units which encompass such minerals.

4. The remaining Class members own or have owned oil, gas and other minerals underlying tracts of land in Oklahoma which are subject to various oil and gas leases and/or pooling and/or spacing orders of the Oklahoma Corporation Commission pursuant to which Continental is/was a working interest owner in oil and gas wells, and/or operated oil and gas wells within units which encompass such minerals. All of the above-referenced wells are hereafter referred to as the "Continental Wells."

5. In the operation and production of the Continental Wells, and the marketing of hydrocarbons produced from said wells, Continental acted as the agent, joint venturer and mining partner for other unnamed individuals and entities.

6. Upon information and belief, the amount in controversy, exclusive of attorney's fees, litigation expenses, costs and interest, exceeds the sum of $5,000,000.00.

7. Venue and jurisdiction are properly laid in the District Court of Blaine County, State of Oklahoma.

Class Action Allegations

The allegations set forth above are incorporated herein by reference.

8. Plaintiffs bring this action as the representatives of a class pursuant to 12 O.S. §2023 for all similarly situated mineral interest owners in the State of Oklahoma.

9. The Class numbers in the thousands of members; the members reside in many different states; and the Plaintiff Class is so numerous and geographically diverse that joinder of all members is impracticable.

10. This action is governed by Oklahoma law.

11. The averments of fact and questions of law herein are common to the Class.

12. Plaintiffs' claims are typical of the Class' claims.

13. Plaintiffs' will fairly and adequately protect the interest of the Class. Plaintiffs' interests do not conflict with the interests of the Class. Plaintiffs are represented by counsel both skilled and experienced in oil and gas accounting and complex civil litigation matters, including oil and gas royalty class actions. Counsel is accustomed to handling substantial litigation matters.[3]

14. The averments of fact and questions of law herein which are common to the members of the Class predominate over any questions affecting only individual members. A class action is superior to other available methods for the fair and efficient adjudication of this controversy for the following reasons:

a. The questions of law and fact are so uniform across the Class that there is no reason why individual Class members would want to control the prosecution of their own actions, at their own expense;

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[3] The Court has previously appointed Plaintiffs' counsel to serve as Interim Counsel for the putative class.

> The Court finds that Plaintiffs' counsel <u>will fairly and adequately protect the interests of the putative class members</u> until such time that this Court has considered and ruled upon Plaintiffs' motion for class certification. IT IS ORDERED, ADJUDGED AND DECREED THAT, Douglas E. Burns and Terry L. Stowers, of Burns & Stowers, P.C. and Kerry W. Caywood and Angela Caywood Jones of Park, Nelson, Caywood, Jones LLP., be, and <u>are hereby, designated as interim counsel to act on behalf of the putative class of royalty owners described above</u>.

Order Designating Interim Counsel for the Putative Class (1/6/2011) ("The court may designate interim counsel to act on behalf of a putative class before determining whether to certify the action as a class action. Class counsel shall fairly and adequately represent the interests of the class." 12 O.S. §2023(F)(3) & (4)).

b. To Plaintiffs' knowledge, there is no pending litigation by any individual Class member, with the same scope of Class membership sought herein, against Continental relating to improper deductions from royalties, failure to pay royalties on the proceeds Continental received for the sale of gas and other hydrocarbons, and the fraudulent self-dealing by Continental related to the Continental Wells;

c. The interests of all parties and the judiciary in resolving these matters in one forum without the need for a multiplicity of actions is great;

d. The difficulties in managing this class action will be slight in relation to the potential benefits to be achieved on behalf of each and every class member, and not just those who can afford to bring their own actions; and,

e. Continental has fraudulently concealed its actions which give rise to the Class members' cause of action. Many, if not all, of the Class members may never discover the wrongful acts of Continental. Thus, in the absence of a class action, Continental, through its concealment, may successfully be unjustly enriched by millions of dollars to the detriment of the unknowing Class members.

15. For the reasons stated herein, a class action is superior to other available methods for the fair and efficient adjudication of this controversy.[4]

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[4] Further, this case is appropriate for "issue certification", "bifurcation", and prosecution as a "hybrid" class action.

<u>Issue Certification</u>: "[Federal] Rule 23(c)(4)(A) [which is identical to 23 O.S. §2023(c)(6)(A)] permits a class to be certified for specific issues or elements of claims raised in the litigation." *Manual for Complex Litigation*, §21.24 - Role of Issues Classes. 12 O.S. §2023(C)(6) provides that "[w]hen appropriate: (a) an action may be brought or maintained as a class action <u>with respect to particular issues</u> . . . . The provisions of this section shall then be construed and applied accordingly".

<u>Bifurcation:</u> "Bifurcation is a means for managing lawsuits whereby a court divides a case into separate parts and has the parties pursue them in an ordered fashion. Courts will bifurcate in both simple and complex cases, but there is often more bifurcation the more complex the lawsuit." *Newberg on Class Actions* (5th) §10:6. "An issues-class approach contemplates a bifurcated trial where the common issues are tried first. . . ." *Manual for Complex Litigation*, §21.24 - Role of Issues Classes.

<u>Hybrid Certification</u>: "[M]ost commonly, courts use the phrase "hybrid class action" to refer to a single case in which plaintiffs seek both injunctive relief and monetary damages through certification under more than one section of Rule 23. . . . [C]ourts bifurcate the litigation into liability and damage phases and then typically begin by determining the defendant's liability; in so doing, courts may certify a (b)(2) class for the liability phase or determine liability using issue certification under Rule 23(c)(4) [§2023(C)(6)(a)]. If the defendant is found liable, courts adopting this approach will then decide whether to certify a (b)(3) class for *(Continued....).*

GENERAL ALLEGATIONS AND FACTUAL BACKGROUND

The allegations set forth above are incorporated herein by reference. Further, Plaintiffs have supplemented this Amended Petition to provide additional detail related to their claims set forth in their original Petition, as developed through ongoing discovery from CLR in this case. The supplemental facts and allegations included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference, as if fully restated herein.

16. During the times at issue herein, Continental drilled and operated numerous gas wells located in Blaine County and throughout the State of Oklahoma. In addition, Continental participated in the drilling, completion and production of various other oil and gas wells throughout the State of Oklahoma wherein Continental was not the operator. Collectively, these wells are hereinafter referred to as the "Continental Wells."

17. The Continental Wells were drilled on units organized and created pursuant to the oil and gas leases and Oklahoma Statutes.

18. The relationship between Continental and Plaintiff Class is such that the Plaintiff Class has reasonably placed trust and confidence in Continental.

19. Continental has superior access to information relating to the claims herein.

20. Continental has superior bargaining power *vis a vis* Plaintiff Class.

21. Continental is in a fiduciary or other special relationship with Plaintiff Class created by the oil and gas leases, pooling orders or unitization orders of the Oklahoma

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money damages purposes and/or an additional (b)(2) class for final injunctive relief." *Newberg on Class Actions* (5th) §4:38. "Certification of a hybrid action is often thought to be the best of both worlds, achieving the judicial economies associated with group litigation while also respecting the due process rights of individuals with monetary claims should the defendant be found liable during the first phase of the trials." *Newberg on Class Actions* (5th) §4:38.

Corporation Commission, by virtue of the historical relationship of the parties and/or Oklahoma statutes.

22. As a result of this relationship, Continental is (1) held accountable to the Plaintiff Class, (2) held to a high degree of good-faith in its dealings, and (3) not permitted to make use of the relationship to realize unauthorized benefits or profits to their own personal interests at the expense of the Plaintiff Class.

23. Continental has used Continental's position as the operator of the Continental Wells to skim monies rightfully belonging to the Plaintiff Class.

24. Continental has a duty to timely disclose to the putative Class members the true value of oil, gas and other hydrocarbons produced and sold from Continental Wells. Continental did not fulfill this duty.

25. Continental wrongfully deducted from royalties, and in some instances paid itself and/or Continental-related companies, a fee for gathering, compressing, dehydrating, field fuel, treating and/or transporting Continental's gas (including all of the gas for which Continental retained the marketing rights and the gas of those owners for whom Continental acted as the agent, joint venturer and mining partner) from the production equipment located at the well site of the Continental Wells to a market, without regard to the location of that market. All fees charged and deducted from the gross value of the gas, including volumetric reductions, from the Continental Wells for gathering, compression, dehydration, field fuel, and similar services are hereinafter referred to as the "GCDF Fee".

26. The GCDF Fee was for services incurred prior to Continental placing the gas into a marketable or merchantable condition. The GCDF Fee did not enhance an already marketable product. If any portion of the GDCF Fee was for services incurred after the gas became a

marketable product, the GDCF Fee deducted from the royalty exceeded the actual costs incurred by Continental. Furthermore, the GCDF Fee was not reasonable and did not increase the royalties due Plaintiff Class proportionately to the GCDF Fee.

27. The GCDF Fee was deducted from the gross value of the gas prior to royalties being paid to Plaintiff Class. The full extent of these GCDF Fees were fraudulently concealed from the Plaintiff Class by: (a) falsely reporting the full volume of production and/or the gross value and price of the gas sold on royalty check stubs; (b) falsely reporting on the royalty check stubs that no GCDF Fee deductions had been made and/or falsely under-reporting the extent of the GCDF Fee deductions being made; and (c) by otherwise using said check stubs and 1099's to deceive Plaintiff Class into believing that no deductions and/or a lesser amount of deductions had been made from their royalties for GCDF Fees.

28. Continental used Continental-related companies' gathering lines, gathering systems and/or gas plants to retain unreported volumes of gas and unreported liquid hydrocarbons from the Continental Wells. Continental converted these gas volumes and liquid hydrocarbons for its own benefit. Continental never reported these gas volumes and liquid hydrocarbons to the Plaintiff Class and never paid royalties on the proceeds from the sale and/or use of these gas volumes and liquid hydrocarbons. These gas volumes and liquid hydrocarbons were fraudulently concealed from the Plaintiff Class by falsely reporting the gross volume of the gas and liquid hydrocarbons produced and/or the true gross value of the hydrocarbons on royalty check stubs and by using said check stubs to deceive the Plaintiff Class into believing that they had been paid royalties on all hydrocarbons produced from the Continental Wells at their true value.

29. In violation of the implied covenant to market contained in the oil and gas leases, and in violation of its duties, Continental has failed, and continues to fail, to make diligent efforts to secure the best terms available for the sale of oil, gas and other hydrocarbons from the Continental Wells, and the Plaintiff Class has received reduced production royalties from the Continental Wells as a result thereof. In addition, Continental has failed to pay the Plaintiff Class royalties on the full value of oil, gas and other hydrocarbons produced from the Continental Wells by: (1) structuring and implementing sales of unit production in a self-dealing manner; (2) charging to the royalty owners improper and excessive GDCF Fees; (3) not accounting for and paying royalty on all hydrocarbons produced; (4) paying royalty at below-market prices; and (5) otherwise not paying royalty on the true value of the hydrocarbons taken from the Continental Wells.

30. Continental has fraudulently misrepresented and misled the Plaintiff Class into believing they had been paid on the full value of oil, gas and other hydrocarbons produced from the Continental Wells by falsifying and creating misleading check stubs, 1099's, correspondence and other communications sent to the Plaintiff Class related to the payment of royalties.

31. Continental knew that the check stub and 1099 representations were false and intended that the Plaintiff Class rely upon the misrepresentations made on the check stubs and 1099's. Continental's misrepresentations were intentional, or were made with reckless disregard for the truth.

32. The Plaintiff Class did rely upon the information on their check stubs as being correct, and were damaged by relying on Continental's misrepresentation.

33. The tortious acts of Continental go far beyond simple breach of contract and amount to independent torts resulting in damages to the Plaintiff Class.

34. The self-dealing, fraud, deceit and other breaches described herein served to financially benefit Continental at the expense and to the detriment of the Plaintiff Class through the reduction of value the Plaintiff Class received for their oil and gas royalty on production from the Continental Wells.

I. BREACH OF CONTRACT AND STATUTORY OBLIGATIONS

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

35. Continental has breached its contractual and statutory obligations and duties owed to the Plaintiff Class to pay royalties based upon the true value of the gas and hydrocarbons.

36. The Plaintiff Class has been damaged by Continental's breach of contracts and statutory obligations in an amount in excess of $5,000,000.00.

II. BREACH OF FIDUCIARY AND/OR STATUTORY DUTIES

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

37. Continental is in a fiduciary or special relationship with the Plaintiff Class created by the oil and gas leases, pooling orders and/or the unitization orders of the Oklahoma Corporation Commission, by virtue of the historical relationship of the parties and/or Oklahoma statutes.

38. Continental owes the Plaintiff Class a fiduciary and/or statutory duty. Continental breached its duty in a tortious manner to the prejudice and damage of Plaintiff Class. The Plaintiff Class relied on Continental to be honest and follow the law in paying royalties, reporting the true gross value of oil and gas production, and reporting the true deductions taken

by Continental. Continental tortiously failed to fulfill the fiduciary and/or statutory duties owed to the Plaintiff Class.

39. The Plaintiff Class has been damaged by Continental's breach of fiduciary and/or duties in excess of $5,000,000.00.

III. Breach of Duties to Market

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

40. Continental has a duty to market hydrocarbons (both oil and gas) produced from the Continental Wells at the best price and terms available, to act as prudent operator, and to deal fairly with the Class members. Continental has a further duty to not base royalty payments to the Class members on affiliated transactions between Continental-related entities. Continental breached these duties resulting in damages to the Class.

41. Continental's actions were an intentional violation of the rights of the Class.

42. Continental Resources, Inc., its unnamed principal shareholder(s) and their unnamed affiliated operating, marketing, gathering, gas processing, saltwater disposal and oil treatment entities conspired together to defraud, deceive and breach statutory and/or fiduciary duties owed to the Class.

43. The tortious acts of Continental go far beyond simple breach of contract and statutory duties and amount to independent torts resulting in damages to the Class in an amount in excess of $5,000,000.00.

IV. BREACH OF DUTY AS OPERATOR

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

44. Continental owes the Plaintiff Class a duty of candor, the obligation of good faith and the duty of fair dealing, in the performance of its express and implied obligations and as operator of the Continental Wells.

45. Continental has violated its duty of candor, obligation of good faith and the duty of fair dealing owed to the Plaintiff Class.

46. Continental has abused its position as Operator of the Continental Wells and engaged in a fraudulent scheme, design, plan, conspiracy and pattern of unlawful activity and self-dealing to the detriment of the Class and has intentionally violated the rights of the Plaintiff Class.

47. The Plaintiff Class has been damaged by Continental's abuse of its position as Operator of the Class Wells in an amount in excess of $5,000,000.00.

V. ACTUAL FRAUD

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

48. In violation of its duty of candor, Continental falsely represented to the Plaintiff Class the volumes of hydrocarbons produced, the price and terms upon which such production was sold, the deductions taken in the computation of royalties, and the amount of royalty due on such production; however, implying that Continental was paying royalties properly.

49. Continental knew that the royalties were not, in fact, being reported and paid properly.

50. Continental made false representations to the Plaintiff Class of the volumes and values of hydrocarbons produced from the Continental Wells, the amount of deductions made from royalties, and that royalties were properly being paid with the intent that the Plaintiff Class would rely on them to its detriment.

51. The Plaintiff Class justifiably relied on Continental's false representations.

52. The Plaintiff Class was damaged by relying on Continental's false representations.

53. Continental intentionally violated the rights of the Plaintiff Class.

54. The Plaintiff Class has been damaged by Continental's fraud in excess of $5,000,000.00.

VI. Deceit

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

55. In violation of its duty of candor, Continental falsely represented to the Plaintiff Class the volumes of hydrocarbons produced, the price and terms upon which such production was sold, the deductions taken in the computation of royalties, and the amount of royalty due on such production; however, implying that Continental was paying royalties properly.

56. Continental knew that the royalties were not, in fact, being reported and paid properly.

57. Continental disclosed only a portion of the information regarding the true volume and value of the hydrocarbons produced from the Continental Wells. the amount of deductions made from royalties, and the royalties due on gas and oil produced from Continental Wells.

58. Continental made false representations, or failed to fully disclose the truth, concerning the proper amount of royalties due with the intent that the Plaintiff Class would rely on them to its detriment.

59. The Plaintiff Class justifiably relied on Continental's representations.

60. The Plaintiff Class was damaged by relying on Continental's representations.

61. Continental intentionally violated its duty of candor and the rights of the Plaintiff Class.

62. The Plaintiff Class has been damaged by Continental's deceit in excess of $5,000,000.00.

VII. CONSTRUCTIVE FRAUD

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

63. Continental owes a duty of candor to the Plaintiff Class ("The PRSA provisions give the royalty owners a right to be accurately informed of the facts and place a legal duty on the respondents to accurately inform the plaintiffs of the facts on which the royalty payments are based." *Howell v Texaco*, 2004 OK 92, ¶ 31.) The Plaintiff Class has the right to be accurately informed of the volume and value of the hydrocarbons produced from the Continental Wells. the amount of deductions made from royalties, and the royalties due on gas and oil produced from Continental Wells. "[T]he Production Revenue Standards Act, 52 O.S.2001, §§ 570.1-.15

(PRSA), provides a legal duty on which the plaintiffs can base a claim for constructive fraud." *Id.* at ¶ 30.

64. Continental concealed from the Plaintiff Class the true volume and sales price of the hydrocarbons produced from the Continental Wells. the full extent of deductions which Continental made from royalties owed the Plaintiff Class, and the full value of the hydrocarbons upon which the royalty was due.

65. The Plaintiff Class justifiably relied on Continental's representation.

66. The Plaintiff Class was damaged by relying on Continental concealments.

67. The Plaintiff Class has been damaged by Continental's fraud in excess of $5,000,000.00.

VIII. CONVERSION

68. The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

69. Pursuant to the Production Revenue Standards Act ("PRSA"), "[a]ll proceeds from the sale of production shall be regarded as separate and distinct from all other funds of any person receiving or holding the same until such time as such proceeds are paid to the owners legally entitled [and] [a]ny person holding revenue or proceeds from the sale of production shall hold such revenue or proceeds for the benefit of the owners legally entitled thereto."

70. Continental, as "the holder of the revenue or proceeds of oil and gas production is an implied trustee who has no rights in or to such revenue or proceeds and who is under a statutory duty to pay the revenue or proceeds of oil and gas production to the implied beneficiaries; i.e., the owners legally entitled thereto [in this case, the Class]. The holder of the

revenue or proceeds of oil and gas production [i.e., Continental] acquires no right, title or interest in such revenue or proceeds." *Oklahoma Attorney General Opinion*, 2008 OK AG 31, ¶22.

71. Continental intentionally and wrongfully diverted for its own use volumes of gas and liquid hydrocarbons, including oil, as well as the separate and distinct proceeds belonging to the Class.

72. Continental's actions constitute conversion of Plaintiff Class members' hydrocarbons and proceeds.

73. The Plaintiff Class has been damaged by Continental's conversion in excess of $5,000,000.00.

IX. UNJUST ENRICHMENT

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

74. The self-dealing, fraud, deceit and other breaches described herein served to financially benefit Continental at the expense and to the detriment of the Plaintiff Class through the reduction of value the Plaintiff Class received for their oil and gas royalty on production from the Continental Wells.

75. Continental has been unjustly enriched as a result of its improper actions. Continental should not be allowed to retain any portion of its ill-gotten gains, or profits on those ill-gotten gains. Continental should be required to disgorge and pay as additional damages, all such gains, and profits on such gains.

X. Civil Conspiracy

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

76. Continental, the Continental-related and affiliated companies and other unnamed individuals and companies conspired to deprive the Plaintiff Class of royalties by the fraudulent skimming schemes described herein and initiated by Continental and to continue fraudulently and deceptively conceal these schemes by falsely reporting information, or failing to report information, to the Plaintiff Class.

77. The Plaintiff Class has been damaged by this conspiracy, and other relationships, in excess of $5,000,000.00.

XI. Punitive Damages

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

78. The tortious acts of Continental described herein were done intentionally, maliciously and with utter disregard for the rights of the Plaintiff Class. Continental should pay punitive damages as punishment and as an example to others of like mind.

XII. Declaratory, Injunctive and/or Mandamus Relief (Including an Accounting)

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

79. Beginning with the 1933 Proration Act, and significant modification thereto in 1935 and 1945, including renaming it the "Conservation Act", the Oklahoma legislature has

developed a comprehensive regulatory scheme to protect the correlative rights of all owners of oil and natural gas rights, and prevent waste of these valuable Oklahoma natural resources.

80. As part of that comprehensive regulatory scheme, in 1980, the Oklahoma legislature enacted 52 O.S. §540 which established the "general rule of conduct for the oil and gas industry that [was] designed to protect correlative rights through affirmative requirements for distribution of proceeds from sales of production." *Oryx Energy v. Plains Resources*, 1994 OK CIV APP 185, ¶4, 918 P.2d 397. "Section 540 was enacted for a purpose - to ensure that those entitled to royalty payments would receive proceeds in a timely fashion. . . . In enacting § 540, the Legislature has expressed its intent that it shall be <u>the public policy in Oklahoma for royalty owners to receive prompt payment from the sale of oil and gas products</u>." *Hull v. Sun,* 1989 OK 168, ¶14, 789 P.2d 1272.

81. Expanding upon this general rule of conduct, in 1984, the Oklahoma legislature proscribed the minimum amount of information that had to accompany every payment to every royalty owner every month, S*ee*, 52 O.S. §568 (1984), commonly referred to as the Oklahoma "check stub statute".

82. In 1992, the legislature again expanded the general rule of conduct by creating the "Production Revenue Standards Act" ("PRSA") (52 O.S. §570.1 through §570.15), adding to, modifying and renumbering 52 O.S. §540 and §568:

> [T]he Oklahoma Legislature substantially rewrote, strengthened and expanded the scope of Section 540 . . . [in] furtherance of the general regulatory scheme to protect correlative rights . . . [and] imposed an affirmative obligation on any person who has received and is holding the revenue or proceeds to "hold such revenue or proceeds for the benefit of the owners legally entitled thereto."
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> * * *
>
> [T]he Act is a comprehensive regulatory scheme and sets out general rules of conduct for the oil and gas industry in respect of the payment of proceeds of production from oil and gas wells in Oklahoma, and is designed specifically to

> protect a broad societal interest in the correlative rights of the owners of that production and the proceeds and revenue therefrom. Included in that comprehensive regulatory scheme and the general rules of conduct is Section 570.10(A), which addresses the ownership of proceeds of production and the payment of those proceeds to the rightful owners.
>
> The Act establishes a number of obligations in respect of payment of production proceeds from the time the oil and gas is produced until the owners get paid for that production:
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> 1. Section 570.3 establishes that the Act applies to "all owners" and "all producing wells, regardless of the date pooled, drilled or of the date of the underlying leases[.]"
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> * * *
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> 3. Section 570.4(A) communitizes3 the royalty share in all proceeds derived from the sale of gas production from a well.
>
>   [fn. 3 “"Communitize" or "communitization" are terms specific to the area of oil and gas law, and refer to the bringing together of smaller tracts in order to create a tract of sufficient size for the granting of a well permit under applicable rules for the spacing of wells.”]
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> 4. Section 570.4[B] establishes a mechanism for the payment of the communitized royalty share.
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> * * *
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> 7. Section 570.10(B) establishes the rights of owners in the proceeds of or revenues from the sale of production and the time for payment of those proceeds. These rights are not limited to royalty owners but rather extend to all "owners." If the proceeds are not timely paid to the "persons legally entitled thereto" within the statutory time frames, those "persons legally entitled thereto" are owed interest on "their" money by the delaying party. . . . [Citations omitted.]

2008 OK AG 31, ¶5, 9 & 10.

83. “The PRSA provisions give the royalty owners a right to be accurately informed of the facts and place a legal duty on the respondents to accurately inform the plaintiffs of the facts on which the royalty payments are based.” *Howell v Texaco*, 2004 OK 92, ¶ 31.

84. “The Legislature intended an implied trust (whether resulting or constructive) under the provisions of Section 570.10(A) of Title 52. . . . [T]he holder of the revenue or proceeds of oil and gas production is an implied trustee who has no rights in or to such revenue or proceeds and who is under a statutory duty to pay the revenue or proceeds of oil and gas

production to the implied beneficiaries; i.e., the owners legally entitled thereto [such as the royalty owners]. The holder of the revenue or proceeds of oil and gas production acquires no right, title or interest in such revenue or proceeds." [Citations omitted.] 2008 OK AG 31, ¶22.

85. The Oklahoma legislature has further expanded the general rules of conduct for the oil and gas industry, *e.g.*, the Oil & Gas Owners' Lien Act of 2010 (52 O.S. §549.1, *et seq.*); the Exploration Rights Act of 2011 (52 O.S. §801, *et seq.*); and the Energy Litigation Reform Act (52 O.S. §901, *et seq.*).

86. Continental has asserted, among other things, that Plaintiffs' case is grounded in: (1) "attorney-driven theories that have no real-world merit in fact or law"[5]; and (2) "untested theories invented by the Plaintiffs' Class Action Bar"[6].

87. Clearly, there are conflicting positions of the parties concerning the interpretation and application of the general rules of conduct for the oil and gas industry (*e.g.*, the PRSA) *vis-à-vis* Continental and its royalty owners (*i.e.*, the Class) (*e.g., see* Continental's "Affirmative Defenses and Matters Constituting Avoidance" asserted by Continental in Defendant's Amended Answer to Plaintiffs' Petition served October 31, 2014, ¶12 & 17).

88. Further, positions taken by Continental in this case demonstrate that there exist numerous conflicting positions of the parties concerning the application of Oklahoma law to Continental's conduct and obligations owed to its royalty owners (*i.e.*, the Class), *see e.g.*:

a. Various "Affirmative Defenses and Matters Constituting Avoidance" asserted by Continental in Defendant's Amended Answer to Plaintiffs' Petition served October 31, 2014;

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[5] Motion to Vacate or Modify Agreed TRO Regarding Communications with Putative Class Members, p.1.

[6] Motion for Entry of Supplement to Stipulated Confidentiality Agreement, p. 2.

b. Continental's assertions as to what constitutes a "marketable product"[7] under Oklahoma law and its obligations owed to its royalty owners pursuant to the "implied covenant to market";

c. The legal implications of Continental's comingling of the royalty owners' oil with oil and saltwater from non-Continental wells;[8]

d. Continental's obligation to bear various production costs, such as costs to separate the oil and saltwater;[9]

e. Continental's obligations owed to its royalty owners when Continental takes possession of, and markets, the royalty owners' share of oil from the Continental Wells (Does Continental only have to pay royalties on a portion of the consideration it received, or all of the consideration received, including the right to receive the oil back at the market center, where it was resold at a higher price?);[10] and

f. The legal implications on Continental's royalty reporting and payment obligations when it "sells" oil or gas to affiliated marketing company.[11]

89. As a result of the conflicting positions of the parties concerning: (1) the interpretation and application of the general rules of conduct for the oil and gas industry (*e.g.*, the

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[7] *See, e.g.*, "Affirmative Defenses and Matters Constituting Avoidance" asserted by Continental in Defendant's Amended Answer to Plaintiffs' Petition served October 31, 2014, ¶16.

[8] *See* Continental Resources' Consolidated Reply (10/10/2014), p. 4 ("The vast majority of waste oil on which Plaintiffs want royalties did not come from a Continental well. Other Oklahoma operators unaffiliated with Continental pay Continental, as operator of commercial saltwater disposal wells, to dispose of saltwater produced from those other operators' wells. Plaintiffs seek a windfall, claiming millions of dollars in royalties on oil extracted from saltwater produced from those other operators' producing wells in which Continental's royalty owners have no interest.")

[9] *See* Continental Resources' Consolidated Reply (10/10/2014), p. 4 ("The cost of extracting oil from saltwater far exceeds the revenue from sales of waste oil extracted from that saltwater. Plaintiffs want to be paid royalties on the value of the extracted oil without bearing any of the costs of extraction. Under Oklahoma law, producers owe no duty to extract oil from saltwater free of cost to the royalty owners. By seeking royalties on waste oil without having to bear any share of the costs of extraction, Plaintiffs again want a windfall.")

[10] *See* Continental Resources' Consolidated Reply (10/10/2014), p. 4 ("Oil sold from on-lease storage tanks is a marketable product in the tanks, and the cases Plaintiffs cite merely hold that royalty owners are entitled to be paid on the value of the oil at the tanks. Contrary to those cases, Plaintiffs want to participate in trading profits (but apparently not trading losses) in oil trading transactions at the Cushing market center. Again, Plaintiffs seek a windfall.")

[11] *See* Continental Resources' Consolidated Reply (10/10/2014), p. 4 ("Plaintiffs rely on cases addressing "illusory" or "collusive" gas purchase contracts and "intra-company" sales. There is nothing "illusory" or "collusive" about the Continental/Hiland sales contracts, and those contracts were not "intra-company" sales but instead were sales between separate companies in separate businesses.")

PRSA), and (2) the numerous conflicting positions of the parties concerning the application of Oklahoma law to Continental's conduct and obligations owed to its royalty owners, as demonstrated by (but not limited to) the examples set forth above, there are multiple issues that can and should be resolved by a declaratory order of the Court.[12] Therefore, the Plaintiff Class seeks an order of declaratory judgment on all issues determined to be appropriate for declaratory relief by the Court pursuant to 12 O.S. §1651-1657.

90. The Plaintiff Class further requests that the Court enter an order for injunctive and/or mandamus relief pursuant to 12 O.S. §1381, *et. seq.* and §1451, *et. seq.*, requiring Continental to properly account for the production and proceeds attributable to the Continental Wells and to accurately inform the Class of the facts on which their royalties were based.

XIII. TEMPORARY RESTRAINING ORDER

The allegations set forth above, and included in the attached Exhibit 1, Supplement to Plaintiffs' Amended Petition, are incorporated herein by reference.

91. The putative Class members are, for the most part, owners of small mineral interests.

92. Continental must be restrained from contacting any putative Class member concerning any issue herein, unless the Court is specifically advised of the proposed communication and approves the content and form of such communication. This judicial

---

[12] The very assertions made by Continental in this case as ¶17 of its "Affirmative Defenses and Matters Constituting Avoidance" (Defendant's Amended Answer to Plaintiffs' Petition served October 31, 2014), was plead by Continental as an appropriate subject matter for declaratory judgment in *Stamp Brothers v. Continental*, CIV-14-182-C, U.S. District Court, Western Oklahoma, *see, Stamp Brothers*, Answer and Counterclaims (2/16/2014), Count One. Further, in *Stamp Brothers*, Continental sought a declaratory judgment concerning the proper interpretation of, and Continental's compliance with, the PRSA (*see, Stamp Brothers*, Answer and Counterclaims (2/16/2014), Count Two).

scrutiny is necessary to prevent the potential for inadequate, misleading, incomplete, or erroneous representations and communications and to prevent any intimidation, annoyance, harassment, or undue influence.

93. This Court has discretion to so restrain Continental pursuant to 12 O.S. §2023(d)(2), which generally provides the Court with authority to enter appropriate orders for the protection of putative members of the Class and for the fair conduct of the action.

94. Continental maintains files containing the names and addresses of the putative Class members. If Continental is allowed to contact the putative Class members in an attempt to settle the above claims for inadequate consideration, the damage to the putative Class members would be irreparable and monetary damages would be insufficient or simply unavailable to compensate them. The putative Class members do not have another plain, adequate and speedy remedy at law to protect their interests.

95. In view of the fact that Continental has concealed its actions from the putative Class members for many years, no detriment will result to Continental from such an order. The putative Class members would receive the protection of 12 O.S. §2023(e) which requires that no compromise of any claims be made without approval of the Court upon appropriate notice to all Class members.[13]

WHEREFORE, Plaintiff seeks an order of this Court granting them judgment against the Defendant for: (a) declaratory, injunctive and/or mandamus relief (including an accounting), (b)

---

[13] The District Court granted the requested relief, *i.e.*, an "Agreed Temporary Injunction", on January 6, 2011. The Court denied Continental's request to vacate the Injunction on October 16, 2014.

actual damages in excess of $5,000,000.00,[14] (c) punitive damages, (d) interest, (e) attorney's fees, (f) expert and litigation costs, (g) court costs, (h) an order temporarily restraining the Defendant, its agents, servants, employees, and attorneys, or persons acting for or on its behalf from contacting any putative Class member concerning the status or settlement of any claims asserted herein until entry of an order certifying or refusing to certify the Class, and (f) such other relief as the Court may deem just and proper.

---

[14] *See* Plaintiffs' Initial Disclosures filed 1/14/2011 and Amended Initial Disclosures filed simultaneously herewith.

JURY TRIAL DEMANDED
ATTORNEY'S LIEN CLAIMED

Respectfully submitted,

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ATTORNEYS FOR THE PLAINTIFFS AND INTERIM COUNSEL FOR THE PUTATIVE CLASS OF ROYALTY OWNERS

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of November, 2014, a true and correct copy of the above was emailed (with a copy placed in the U.S. Mail) to:

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Terry L. Stowers

Exhibit 1

To

Plaintiffs' Amended Petition

IN THE DISTRICT COURT OF BLAINE COUNTY
STATE OF OKLAHOMA

BILLY J. STRACK, TRUSTEE OF THE PATRICIA ANN STRACK REVOCABLE TRUST DTD 2/15/99 AND THE BILLY JOE STRACK REVOCABLE TRUST DTD 2/15/99, AND DANIELA A. RENNER, SOLE SUCCESSOR TRUSTEE OF THE PAUL ARIOLA LIVING TRUST AND THE HAZEL ARIOLA LIVING TRUST,	)	
FOR THEMSELVES AND ALL OTHERS SIMILARLY SITUATED,	)	CASE NO. CJ-10-75 JUDGE DENNIS W. HLADIK
PLAINTIFFS,	)	
VS.	)	
CONTINENTAL RESOURCES, INC.,	)	
DEFENDANT.	)	

Exhibit 1 - Supplement to Plaintiffs' Amended Petition

Plaintiffs' ("Strack") hereby supplement their Amended Petition to provided additional detail related to their claims developed through ongoing discovery from Defendant, Continental Resources, Inc. ("CLR")[1]. This Supplement is incorporated into the Amended Petition by reference as if fully restated therein.

I. Skim Oil Sales

1. Documents produced by CLR, and Oklahoma Tax Commission records obtained by CLR and produced to Strack, reveal that CLR produced oil from CLR operated wells in Oklahoma (which was commingled with produced saltwater from the CLR wells, and then commingled with saltwater and oil produced from other CLR wells and non-CLR wells) that was

[1] "CLR" is Continental's ticker symbol on the New York Stock Exchange.

sold by CLR at CLR's off-lease saltwater disposal wells ("SWD Wells") and/or at the central treating unit ("CTU") operated by CLR or its affiliates.[2]

2. CLR's oil sales from its Oklahoma SWD Wells and/or CTU totaled over $70 million.[3]

3. Oil sold from saltwater disposal wells or treating facilities is often referred to in the industry as "**skim oil**"[4] or "reclaimed oil".

4. It is clear from public filings, CLR's skim oil operations are considered a significant profit center warranting separate public disclosure under SEC rules and regulations.

> Our crude oil and natural gas service operations consist primarily of the treatment and sale of lower quality crude oil, or reclaimed crude oil. The table below shows the volumes and prices for the sale of reclaimed crude oil for the periods presented.
>
> **<u>Year Ended December 31, Increase</u>**
>
> | **Reclaimed crude oil sales** | **2012** | **2011** | **(Decrease)** |
> |---|---|---|---|
> | Average sales price ($/Bbl) | $91.64 | $92.30 | $(0.66) |
> | Sales volumes (MBbls) | 272 | 259 | 13 |
>
> The increase in sales volumes reflected above, partially offset by lower realized sales prices, resulted in a $1.3 million net increase in reclaimed oil revenues to $25.1 million for the year ended December 31, 2012. Additionally, revenues from saltwater disposal and other services increased $5.4 million to $14.0 million resulting from increased activity. Associated crude oil and natural gas service operations expenses increased

[2] For most of the Class Period, it appears that CLR (as the operator or the well) had CLR's affiliate, Hamm & Phillips ("H&P") haul oil and saltwater from the lease to CLR's own saltwater disposal wells ("SWD Wells). At the CLR SWD Wells, CLR (as the saltwater disposal well operator) then fictionally "sold" the oil to CLR (as the oil purchaser), who then had CLR's affiliate, H&P, once again haul the oil, this time to CLR's central treating unit ("CTU"). CLR once again conditionally "sold" the oil at the tailgate of its CTU, this time to a third-party "purchaser" who was obligated to sell the oil back to CLR at Cushing (*see*, Strack's claim regarding the "barrel-back" scheme, which also includes the oil sold at the tailgate of the CTU), CLR then reacquired the oil at Cushing, where it resold the oil.

[3] This amount represents the amount included in the OTC-produced spreadsheets from July 1990 through April 2012. Strack has identified numerous gaps in the data produced that, once filled, will dramatically increase the value of the skim oil sold by CLR (it is expected that the value will increase to over $100 million in sales).

[4] *See, e.g.*, "'Skim-oil', the crude oil that is entrained in the waste water is skimmed at the disposal well, separated and sold." Salt Water Disposal Institute, http://amerexoil.com/saltwater-disposal-institute/.

> $5.5 million to $32.2 million for the year ended December 31, 2012 due mainly to an increase in the costs of purchasing and treating reclaimed crude oil for resale and in providing saltwater disposal services." [Emphasis added.]

CLR 2012 Annual Report, p. 55-56.

5. CLR never disclosed the skim oil sales to the royalty owners (or CLR's working interest partners).

6. CLR never allocated any of the skim oil sales back to the CLR wells.

7. CLR never accounted to the royalty owners (or CLR's working interest partners) for their share of the oil sold from CLR's saltwater disposal wells.

8. No royalties have been paid to the mineral owners on CLR sales of the mineral owners' oil at the SWD Wells or CTU.

9. Despite not paying royalties on these oil sales, CLR did pay gross production and severance taxes on these oil sales to the State of Oklahoma.[5]

10. This very issue (royalties due on skim oil sales) has previously been certified as a class action in Oklahoma, and affirmed on appeal. Strack has identified at least one case where the District Court certified a royalty owner class action against Phillips Petroleum, et al. related to unpaid royalties due by the operator on skim oil sales (*Dodson v Phillips Petroleum*, Case No. CJ-2004-119, District Court of Beckham County). Class certification was affirmed on appeal, *see, Dodson v Phillips*, Case No. 103,535, Oklahoma Court of Civil Appeals, Opinion (8/7/2007). Phillips, et al. ultimately settled the *Dobson* class action in 2010, paying $10.4 million to the plaintiff class (*see, Dodson* Settlement Agreement (6/9/2010), Case No. CJ-2004-119, District Court of Beckham County).

[5] It is clear that there are significant gaps in the data received from the Oklahoma Tax Commission. Whether CLR paid gross production taxes on the skim oil during these unaccounted for time periods has is undetermined.

11. CLR has sold over $70 million worth of oil hauled to, and sold from, its Oklahoma SWD Wells and/or CTU since July 1990. The royalty share of the proceeds CLR received for the sale of this oil is over $11 million (not including the additional royalty due on the gap periods described above, or the additional value resulting from the barrel-back scheme described below). The royalty share of the number of barrels of oil (oil actually owned by royalty owners) which CLR converted from the royalty owners is over 2,250,000 barrels (based upon the Oklahoma Tax Commissions' records).

II. Oil Barrel-Back Transactions

12. A "barrel-back" arrangement or scheme commonly refers to the situation where a well operator conditionally "sells" oil at the well for a certain price, but also has an agreement with that "purchaser" that the well operator (or one of its affiliated companies) will "buy" the very same number of barrels of oil back at Cushing (i.e., the term "barrel-back"), less a price differential representing the costs to transport the oil from the well to Cushing (*i.e.*, the "purchaser" is simply paid the margin to transport the oil from the wells to Cushing). After the well operator (or one of its affiliated companies) "buys" the oil back, it un-conditionally re-sells the oil at Cushing (or some other downstream location), presumably for a higher price (this arm's length, unconditional sale is sometimes referred to as an "outright sale"). Royalties are then paid on the fictional "first sale" at the well, not for the real price the well operator (or its affiliated company) actually received when it made an outright sale of the oil at Cushing, less the transportation costs.

13. For a more detailed explanation of the barrel-back scheme, *see, In Re Lease Oil Anti-trust Litigation*, 186 F.R.D. 403 (1999), MDL Docket No. 1206, United States District Court for the Southern District of Texas, Corpus Christi Division, Order No. 75 (5/12/1999):

> The antitrust allegations are best stated in the MDL–1206 Consolidated Complaint wherein the plaintiffs have identified the kind of price-fixing behavior they suspect Defendants engaged in. . . . [T]he basic mechanism for depressing pricing may be illustrated by considering a typical scheme which occurs in the following four transactions—one contractual exchange, two sham sales at posted prices, and one arm's length sale on the market:
>
> > **(1) Contractual Transaction at the Lease Location**
> > The Defendant Operator takes possession of all of the oil produced at the lease . . . .
> >
> > **(2) First Sale: At the Lease Location**
> > Operator sells the oil to Transporter (another Defendant who will transport the oil to the Trading Center) at the lease, based on the Posted Price. Plaintiff's royalty or working interest payment is calculated from this price.
> >
> > **(3) Second Sale: At the Trading Center**
> > After Transporter has taken the oil to the Trading Center, Transporter sells the oil back to the Operator at the same Posted Price plus the actual cost of the transportation services.
> >
> > **(4) Third Sale: On the Market**
> > Operator sells the oil to an arm's length Buyer on the market at Market Price (which exceeds the Posted Price plus transportation costs), reaping anticompetitive profit.
>
> *Id.* at 412-413.

This MDL litigation was pursued for both working interest owners and royalty owners in various states, including Oklahoma, and resulted in Global and Stand Alone Settlements totaling over $188 million (not including other related payments and settlements), with over $11.25 million being allocated to Oklahoma royalty owners.

14. The *In Re Lease Oil Anti-trust Litigation* described above, and this case against CLR, have not been the only class actions filed involving an operator's liability for additional royalties being due on oil sales because of self-dealing and/or barrel-back arrangements:

- ***Young v. West Edmond Hunton Lime Unit*, 1954 OK 195**: The unit operator paid royalties based upon sales to itself at operator's own posted price of $2.65 despite $3.00 being available to the unit. Royalty owners were entitled to royalties at "the highest market price available at the time of such production";

- ***Rudman v Texaco*, CJ-97-1, District Court of Stephens County**: The unit operator sold oil to an affiliate at affiliate's posted price, the affiliate then delivered like-barrels of oil to operator's refinery, *see Rudman v Texaco*, CJ-97-1, District Court of Stephens County, Finding of Fact, Conclusions of Law and Order on Plaintiffs' Motion for Class Certification (9/8/1998); *Rudman v. Texaco*, Appeal No. 92,012, Oklahoma Court of Civil Appeals, Memorandum Opinion (9/14/1999), *affirming Class Certification*, p.2. Texaco ultimately settled the *Rudman* class action in 2001, paying $25 million to the plaintiff class; and

- ***Brown v. Citation*, CJ-04-217, District Court of Caddo County**: *see,* Order Certifying Class (7/1/2009), p. 2, for the description of the "barrel-back" scheme engaged in by Citation (the same scheme CLR engaged as described above). Citation ultimately settled the *Brown* statewide class action in 2009, paying $5.25 million to the plaintiff class, *see*, *Brown v. Citation*, CJ-04-217, District Court of Caddo County, Settlement Agreement.

15. Based upon the documents produced thus far by CLR,[6] it is clear that CLR has engaged in typical "barrel-back" arrangements for at least the past fifteen (15) years with regard

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[6] For example, on June 19, 1998, effective with July 1998 production, Sue Ann Hamm, V.P. of Oil Marketing for CLR, entered into a single contract with Plains Marketing and Transportation ("Plains") that provided in:

"Part A": Plains would deliver to CLR at the ARCO facility in Cushing, 1,800 barrels per day of "Domestic Sweet" oil at the NYMEX price, **<u>plus 60¢ per barrel</u>**; and

"Part B": CLR would deliver to Plains at approximate 500 well locations throughout Oklahoma, 1,800 barrels per day of "Domestic Sweet" oil at the NYMEX price. [CLR-329487 though CLR-329500].

The net effect of this contract is that Plains received 60¢ per barrel to transport "CLR's" oil to Cushing (this was not only CLR's oil, but the oil of CLR's working interest owner partners and CLR's royalty owners).

On September 24, 1998 (after 2 ½ months of production under this contract), Plains sent "Amendment No. 1" of the contract to CLR. There is no indication in the documents produced as to who requested the amendment. The Amendment had a typed effective date of September 1, 1998, but on October 20, 1998 (now after 3 ½ months of production), CLR made a hand-written interlineation and backdated the amendment to July 1, 1998, retroactively effecting 3 months of production already delivered under the contact. The backdated amendment changed the pricing structure, effective with the original date of the contract. The effect of the change reflected in the Amendment (**~~Deletions~~/<u>Additions</u>**) is as follows:

"Part A": Plains would deliver to CLR at the ARCO facility in Cushing, 1,800 barrels per day of "Domestic Sweet" oil at the NYME price, **~~plus 60¢ per barrel~~**; and

"Part B": CLR would deliver to Plains at approximate 500 well locations throughout Oklahoma, 1,800 barrels per day of "Domestic Sweet" oil at the NYME price, **<u>less 60¢ per barrel</u>**. [CLR-329458 through 329471].

The net effect of the backdated Amendment No. 1 to the contract is that Plains still received 60¢ per barrel to transport CLR's oil to Cushing. But, CLR retroactively reduced the price upon which it paid its royalty owners and working interest partners for oil by 60¢ per barrel, in addition to still having CLR's (and CLR's working interest partners' and royalty owners' oil) available to sell at Cushing at the higher market center price.

Another representative example of CLR's barrel-back scheme is CLR's sham oil sale to ConocoPhillips. ConocoPhillips conditionally "purchased" the oil at the lease, subject to the condition that it re-sell the oil to CLR by

(continued .....)

to what appears to be production from all of the CLR operated wells and CLR's SWD Wells and/or CLR's CTU.

16. CLR never disclosed the existence or terms of the oil barrel-back arrangement to CLR's royalty owners (or CLR's working interest partners).

17. CLR never disclosed the existence or terms of its oil sales at the oil market center(s) (*i.e.*, Cushing, OK), or to end users, to CLR's royalty owners (or CLR's working interest partners).

18. CLR never accounted to CLR's royalty owners (or CLR's working interest partners) for their share of: (1) the volume of oil re-delivered to CLR at the market center (Cushing, OK); (2) the value of the barrel-back contractual term; or (3) the value of the oil sales at the market center (Cushing, OK) or to end users.

19. No royalties have been paid to the mineral owners for: (1) the value of the barrel-back contractual term related to the sales of the mineral owners' share of the oil by CLR; or (2) the increased value of the mineral owners' share of the oil sales at the market center (Cushing, OK) or to end users.

20. CLR appears to have no documentation which authorizes CLR to sell oil which belonged to its royalty owners. In the absence of legal authorization to sell such oil, CLR's purported sales of such oil is conversion of property belonging to another.

Continued....

in-line transfer at a specific location in Cushing (*see e.g.*, "**Crude Oil Sell vs. Lease Agreement**" CLR-329139 to CLR-329148). At Cushing, CLR then re-sells the oil to ConocoPhillips (or some other purchaser) by in-line transfer at the exact same location in Cushing, this unconditional oil sales contract being titled a "**Crude Oil Outright Purchase Agreement**" (*see e.g.*, CLR-564223 to CLR-564224). Under the "Crude Oil Outright Purchase Agreement", "*Continental warrants that the barrels sold herein are an outright purchase by ConocoPhillips. ConocoPhillps is under no obligation, express or implied, to exchange, sell, or in any way pay back barrels to Continental as a condition of this purchase*"; there is no such warranty in the "Crude Oil Sell vs. Lease Agreement").

> The detriment caused by the wrongful conversion of personal property is presumed to be:
>
> 1. The value of the property at the time of the conversion with the interest from that time; or,
> 2. Where the action has been prosecuted with reasonable diligence, the highest market value of the property at any time between the conversion and the verdict, without interest, at the option of the injured party; and,
> 3. A fair compensation for the time and money properly expended in pursuit of the property.

23 O.S. §64.

21. In the event CLR did have authorization to sell oil belonging to the royalty owners, then at a minimum, CLR had the obligation to sell such oil on the best price and terms available, and in no event less than the value of all consideration received in an unaffiliated, arm-length sale.

III. Gas and Gas Liquids (NGLs) Issues

CLR and CLR's Gas Marketing Affiliates:

22. Beginning in the early 1990s, when CLR marketed gas from Oklahoma wells, CLR "negotiated" and entered into sales contracts with a wholly owned subsidiary marketing affiliate named Continental Gas, Inc. ("Continental Gas").[7] In 1992, Continental Gas also began building and acquiring gas gathering systems (also known as mid-stream facilities) in areas where CLR was actively operating.

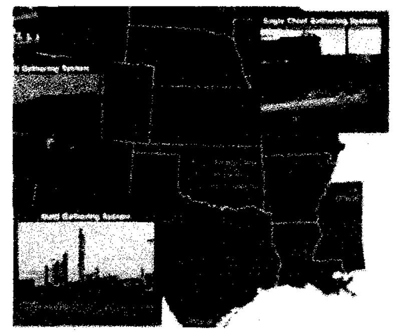
> We [Hiland Partners, LP] commenced our midstream operations in 1990 when Continental Gas, Inc., then a subsidiary of Continental Resources, constructed the Eagle Chief gathering system in northwest Oklahoma. Since 1990, we have grown through a combination of building gas gathering and processing assets in areas where Continental Resources has active exploration and production assets and through acquisitions of existing systems which we have then expanded.[8]

[7] Continental Gas was incorporated on April 24, 1990.

[8] Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 11 of 611.

23. At the time of the creation of Hiland Partners, LP ("Hiland")[9] in 2004, Continental Gas was not only the "purchaser" of CLR's gas, but it also owned and operated two gathering systems and gas plants in Oklahoma that were transferred, along with its gas purchase contracts, to Hiland.[10]

> Our midstream assets include the following:
> • ***Eagle Chief Gathering System***. The Eagle Chief gathering system is a 524-mile gas gathering system located in northwest Oklahoma that gathers, compresses, dehydrates and processes natural gas. Our Eagle Chief gathering system has a capacity of 30,000 Mcf/d and the average volume of natural gas flowing through the system, or throughput, was approximately 20,020 Mcf/d for the nine months ended September 30, 2004.



> * * *
>
> • ***Matli Gathering System***. The Matli gathering system is a 23-mile gas gathering system located in central Oklahoma that gathers, compresses, dehydrates, treats and processes natural gas. Our Matli gathering system has a capacity of 20,000 Mcf/d and average throughput was approximately 15,200 Mcf/d for the nine months ended September 30, 2004. [Emphasis added.][11]

24. In 2007, Hiland began construction of the Woodford Shale Gathering System.

> • **Woodford Shale Gathering System**. The Woodford Shale gathering system is a 55-mile gathering system located in southeastern Oklahoma

[9] Hiland Partner, LP was formed as a publicly traded master limited partnership. Although publicly traded, Hiland was controlled by Hamm, as reflected in Hiland's own public disclosures.

[10] "The current owners of Continental Gas . . . will contribute to us [Hiland], prior to consummation of this offering, all of the assets and operations of Continental Gas, other than a portion of its working capital assets. . . . Continental Gas currently owns all of our natural gas gathering, processing, treating and fractionation assets . . . . Prior to July 21, 2004, Continental Gas was owned by Continental Resources, an independent exploration and development company owned by Harold Hamm, the Chairman of the Board of our general partner, the Harold Hamm DST Trust and the Harold Hamm HJ Trust, which we collectively refer to as the Hamm Trusts. Harold Hamm and the Hamm Trusts are collectively referred to herein as the Hamm Parties. On July 21, 2004, Continental Resources completed the sale of Continental Gas to the Hamm Parties." [Emphasis added.] Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 16 of 611.

[11] Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 5 & 12 of 611.

> and is designed to provide low-pressure gathering, compression and dehydrating services. The system includes four compressor stations and has approximately 17,400 horsepower installed. Natural gas gathered on the Woodford Shale gathering system is processed at third party processing facilities. Our Woodford Shale gathering system has a capacity of 65,000 Mcf/d and average throughput was 27,447 Mcf/d of natural gas which produced approximately 1,214 Bbls/d of NGLs[12] for the year ended December 31, 2008.[13]

25. In 2009, through a merger with affiliates of Hamm, Hiland ceased to be publicly traded and CLR's gas marketing affiliate once again became wholly owned by Hamm, the Hamm Trusts and other affiliates of Hamm.

> The Hiland companies, Hiland Partners, LP (Nasdaq: HLND) and Hiland Holdings GP, LP (Nasdaq: HPGP), today announced that each of the Hiland companies has signed a separate definitive merger agreement with an affiliate of Harold Hamm, pursuant to which affiliates of Mr. Hamm have agreed to acquire for cash all of the outstanding common units of each of the Hiland companies that are not owned by Mr. Hamm, his affiliates or Hamm family trusts.[14]

26. Whether it was: (1) Continental Gas as a wholly owned subsidiary of CLR; (2) Hiland as a publicly traded master limited partnership[15]; or (3) Hiland as an entity owned by Hamm, the Hamm Trusts and other Hamm affiliates, one thing is for certain – there has always been common control of CLR and the entity marketing CLR's gas. The common control of course was Harold Hamm[16] ("We [Hiland] began our midstream operations in 1990 when then

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[12] Royalties were not paid on the NGLs. Damages related to the failure to pay royalties on the NGLs are reflected as "NGL Uplift" in the Class damage model.

[13] Hiland Partners, LP, 2008 Annual Report, SEC 10-K, p. 11 of 162, http://www.annualreports.com/HostedData/AnnualReports/PDF/hlnd2008.pdf.

[14] National Association of Publicly Traded Partnerships, *Hiland Partners, LP and Hiland Holdings GP, LP Enter into Merger Agreements to be Acquired by Affiliates of Harold Hamm*, 6/1/2009, http://www.naptp.org/News/PTPsNews/Hiland_Merger_Agreements.html.

[15] Although Hiland was a publicly traded master limited partnership, Hiland acknowledged publicly that "Harold Hamm controls our general partner, which has sole responsibility for conducting our business and managing our operations" Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 13 of 611.

[16] Even today, Hamm controls both CLR and Hiland, not only as the majority equity owner of both entities, but as their Chairman of the Board of Directors. "Harold G. Hamm has served as Chief Executive Officer and a director *(continued .....)*

privately held Continental Resources, Inc. formed a gas gathering/processing company to support its exploration and production activities. Hiland and Continental Resources are separate entities, with Harold Hamm as the controlling equity holder of both."[17]).[18]

27. The Oklahoma Supreme Court has repeatedly warned producers, such as CLR, that affiliate sales contracts cannot be the basis for calculating royalties due in Oklahoma.

> Courts should take care not to allow lessors to be deprived or defrauded of their royalties by their lessees entering into illusory or collusive assignments or gas purchase contracts. Whenever a lessee or assignee is paying royalty on one price, but on resale a related entity is obtaining a higher price, the lessors are entitled to their royalty share of the higher price.[19] The key is common control of the two entities.

Tara Petroleum Corp. v. Hughey, 1981 OK 65, ¶ 20, 630 P.2d 1269.

28. In *Howell v. Texaco, Inc.*, 2004 OK 92, 112 P.3d 1154, the Oklahoma Supreme Court expressly reaffirmed its holding in *Tara* that: "A royalty owner has a right to be paid on the best price available. . . . The plaintiffs here are entitled to have their royalty payments based on the prevailing market price or the work-back method, whichever one results in the higher

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Continued....

since our [CLR's] inception in 1967 and currently serves as Chairman of the board of directors [of CLR]. He also serves as Chairman of the board of directors of the general partner of Hiland Partners LP and as Chairman of the board of directors of the general partner of Hiland Holdings GP, LP ("Hiland Holdings"). Hiland Holdings owns the general partner interest and units in Hiland Partners LP." http://www.clr.com/about/leadership/harold-g-hamm.

[17] Hiland 2008 Annual Report, p. 4 of 162, http://www.annualreports.com/HostedData/AnnualReports/PDF/hlnd2008.pdf.

[18] The common control of CLR and Continental Gas/Hiland was not limited to Harold Hamm; consider Randy Moeder. "***Randy Moeder*** was elected Chief Executive Officer, President and a director of our [Hiland's] general partner in October 2004. Mr. Moeder has been Manager of Hiland Partners, LLC since its inception in October 2000. He also has been President of Continental Gas, Inc. since January 1995 and was Vice President from November 1990 to January 1995. Mr. Moeder was Senior Vice President and General Counsel of Continental Resources, Inc. from May 1998 to August 2000 and was Vice President and General Counsel from November 1990 to April 1998." Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 105 of 611.

[19] CLR's "related entity", Continental Gas and Hiland, sold residue gas and NGLs for a higher price or greater value than it paid CLR under its "percentage-of-proceeds" ("POP"), "percentage-of-index" ("(POI") and "fixed-fee" contracts. It was those lower POP, POI and fixed-fee prices and values that CLR calculated and paid its royalty obligations to the Class, in violation of *Tara* (and *Howell*).

market value. We hold that an intra-company gas sale cannot be the basis for calculating royalty payments." *Id.* at ¶ 22.

29. In calculating its royalty obligations to Class Members, CLR used as its basis the illusory "wellhead" gas sales contract between CLR and its gas marketing affiliate Continental Gas/Hiland.

30. Under Oklahoma law, the starting point for CLR's royalty calculations should have been, and must be, the point at which Continental Gas, Hiland or CLR sold marketable residue gas and marketable NGLs removed from the raw gas stream to an unaffiliated third party purchaser. That point is either: (1) the tailgate of Eagle Chief Gathering System; (2) the tailgate of the Malti Gathering System; (3) the tailgate of the Woodford Shale Gathering System; (4) the tailgate of third-party owned gathering systems; and/or (5) further downstream of the tailgate of said gathering systems.[20]

Midstream Services Provided by Continental Gas and Hiland Were Necessary to Make CLR's Gas (and NGLs) "Marketable" And are Not Deductible in the Calculation of Class Royalties:

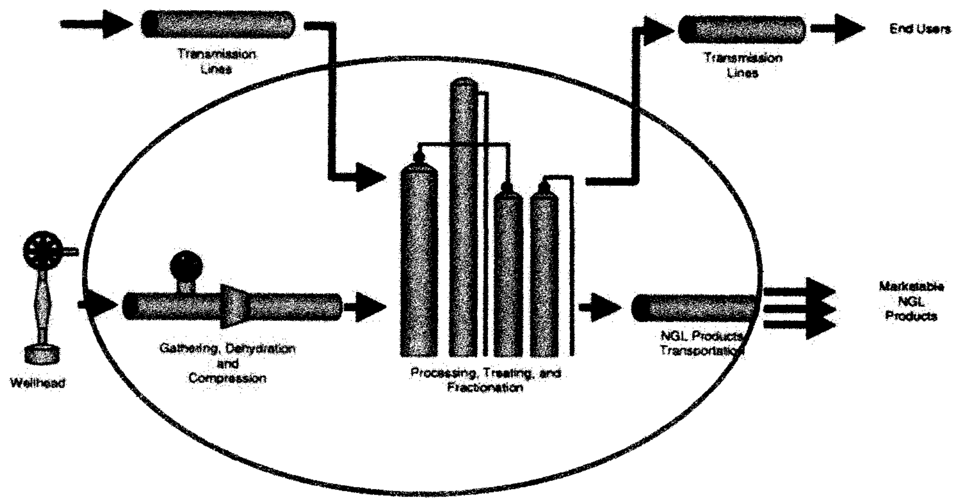
31. Only "costs incurred after the gas becomes marketable may be apportioned between the royalty owner and the producer." [Emphasis added.] *Howell*, 2004 OK 92 at ¶ 21.

32. Midstream services provided by Continental Gas, Hiland and third parties were necessary to make CLR's raw gas (and NGLs) into a "marketable product."

33. Hiland described these midstream services in public filings as follows (the red oval added by Strack in the diagram Hiland prepared represents typical midstream services[21]):

[20] *See, e.g.*, Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 92-97.

[21] This illustration can be found at: Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 90.



Overview

[W]e connect the wells of natural gas producers in our market areas to our gathering systems, treat natural gas to remove impurities, process natural gas for the removal of NGLs, fractionate NGLs into NGL products and provide an aggregate supply of natural gas and NGL products to a variety of natural gas transmission pipelines and markets.

* * *

Our midstream operations consist of the following:

- **gathering and compressing** natural gas to facilitate its transportation to our processing plants, third-party pipelines, utilities and other consumers;
- **dehydrating** natural gas to remove water from the natural gas stream to meet pipeline quality specifications;
- **treating** natural gas to remove or reduce impurities such as carbon dioxide, hydrogen sulfide and other contaminants to ensure that the natural gas meets pipeline quality specifications;
- **processing** natural gas to extract NGLs and selling the resulting residue natural gas and, in most cases, the NGLs; and
- **fractionating** a portion of our NGLs into a mix of NGL products, including ethane, propane and a mixture of butane and natural gasoline, and selling these NGL products to third parties. [Hiland does not own any fractionating facilities in Oklahoma.] [Emphasis added.][22]

* * *

Natural gas gathering and compression. The natural gas gathering process begins with the drilling of wells into gas bearing rock formations. Once a well has been completed, the well is connected to a gathering system. Gathering systems generally consist of a network of small diameter pipelines that collect natural gas from points near producing wells and transport it to larger pipelines for further transmission.

[22] Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 85-86.

Gathering systems are operated at design pressures that will maximize the total throughput from all connected wells. Since wells produce at progressively lower field pressures as they age, it becomes increasingly difficult to deliver the remaining production in the ground against a higher pressure that exists in the connecting gathering system. Natural gas compression is a mechanical process in which a volume of gas at an existing pressure is compressed to a desired higher pressure, allowing gas that no longer naturally flows into a higher-pressure downstream pipeline to be brought to market. Field compression is typically used to allow a gathering system to operate at a lower pressure or provide sufficient pressure to deliver gas into a higher downstream pipeline. If field compression is not installed, then the remaining natural gas in the ground will not be produced because it cannot overcome the higher gathering system pressure. In contrast, if field compression is installed, then a well can continue delivering natural gas that otherwise would not be produced.

Natural gas dehydration. Produced natural gas is saturated with water, which **must be removed** because the combination of natural gas and water can form ice that can plug various parts of the pipeline gathering and transportation system. Water in a natural gas stream can also cause corrosion when combined with carbon dioxide or hydrogen sulfide in natural gas. In addition, condensed water in the pipeline can raise pipeline pressure. To avoid these potential issues and to meet downstream pipeline and end-user gas quality standards, natural gas is dehydrated to remove the saturated water.

Natural gas treating. Natural gas has a varied composition depending on the field, the formation and the reservoir from which it is produced. Natural gas from certain formations can be high in carbon dioxide or hydrogen sulfide. Natural gas with high carbon dioxide or hydrogen sulfide levels may cause significant damage to pipelines and is generally not acceptable to end-users. To alleviate the potential adverse effects of these contaminants, many pipelines regularly inject corrosion inhibitors into the gas stream.

* * *

Natural gas processing. Natural gas processing involves the separation of natural gas into pipeline quality natural gas and a mixed NGL stream. The principal components of natural gas are methane and ethane, but most natural gas also contains varying amounts of other NGLs. Most natural gas produced by a well is not suitable for long-haul pipeline transportation or commercial use and must be processed to remove the heavier hydrocarbon components. Natural gas is processed not only to remove unwanted NGLs that would interfere with pipeline transportation or use of the natural gas, but also to separate from the gas those hydrocarbon liquids that have higher value as NGLs. The removal and separation of individual hydrocarbons by processing is possible because of differences in weight, boiling point, vapor pressure and other physical characteristics.

> ***Fractionation.*** Fractionation is the process by which NGLs are further separated into individual, more valuable components. NGL fractionation facilities separate mixed NGL streams into discrete NGL products: ethane, propane, isobutane, normal butane and natural gasoline. . . . Because the fractionation process uses large quantities of heat, energy costs are a major component of the total cost of fractionation. . [Hiland does not own any fractionating facilities in Oklahoma.]
>
> ***Natural gas transportation.*** Natural gas transportation pipelines receive natural gas from other mainline transportation pipelines and gathering systems and deliver the processed natural gas to industrial end-users and utilities and to other pipelines. We currently do not engage in natural gas transportation.
>
> ***NGL transportation.*** NGLs are transported to market by means of pipelines, pressurized barges, rail car and tank trucks. The method of transportation utilized depends on, among other things, the existing resources of the transporter, the locations of the production points and the delivery points, cost-efficiency and the quantity of NGLs being transported. Pipelines are generally the most cost-efficient mode of transportation when large, consistent volumes of NGLs are to be delivered. We currently do not engage in NGL transportation.[23]

34. Hiland is not the only midstream service company that publically recognizes that their services are necessary to convert raw natural gas into "marketable" products. For example, ONEOK, Oklahoma's largest natural gas distributor, asserts:

> Through gathering systems, natural gas is aggregated [gathered] and treated or processed for removal of water vapor, solids and other contaminants, and to extract NGLs in order to provide marketable natural gas, commonly referred to as residue gas.[24]

Further, Duke Energy and Spectra Energy, both of whom are associated with DCP Midstream, another large midstream company in Oklahoma, define 'marketable' gas as:

> **Marketable (Merchantable)** – Raw natural gas from which impurities

[23] Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005, p. 90-92.

[24] ONEOK 10-K, http://www.sec.gov/Archives/edgar/data/1039684/000103968411000029/form_10-k.htm.

> have been removed so that the natural gas meets the quality specifications of the pipeline transmission facility that will receive it for transportation to market. Also called PIPELINE QUALITY GAS.[25]

35. The Counsel of Petroleum Accountants Societies (COPAS) also makes reference to "Marketable Gas" in its publications and supports the above definition, *e.g.,* COPAS AG-15:

> Generally low pressure gas must be compressed to be marketable. Gas with high carbon dioxide, nitrogen, hydrogen sulfide, or other contaminants must be treated to meet gas pipeline specifications. Occasionally gas well gas is commingled prior to the separation of the gas and condensate. The gas brought together in the gathering system or transmission line may be delivered directly to a gas pipeline for transportation or sale, it may be compressed or treated to make the gas marketable (meet the pipeline specifications for pressure/quality) . . . . Gas in a particular gathering system may require compression in order to be sold or transported, used in field operation such as injection or gas lift, or processed for the extraction of liquid hydrocarbons. Gas pipelines and processing plants have specific operating pressure and the gas from the gathering line must equal or exceed that pressure in order to flow into the pipeline or plant. [Emphasis added]. *Id.* at 3-2 and 3-5.

36. "[T]he transformation of raw gas into residue gas, which requires gas to be gathered and moved from wellhead to processing plant, is generally a necessary part of the production of gas as a marketable commodity."[26]

37. The Oklahoma Supreme Court in *Mittelstaedt v. Santa Fe Minerals, Inc.,* 1998 OK 7, ¶2, 954 P.2d 1205, and the Oklahoma Court of Appeals in *Laverty v. Newfield Exploration Mid-Continent, Inc.*, Okla. Ct. App. Case No., 102,525 (August 25, 2006), held that a lessee is prohibited from deducting costs before a marketable product is created and that as a precondition of making such deductions, the lessee must show that any costs deducted are

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[25] *See,* http://www.duke-energy.com/glossary-of-energy-terms/g.asp, and http://www.spectraenergy.com/Natural-Gas-101/Glossary-of-Energy-Terms/G/.

[26] *Duke Energy Nat. Gas Corp. v. Commissioner of Internal Revenue*, 172 F.3d 1255, 1258 (10th Cir. 1999); *see also, Apache Corp. v. State*, 2004 OK 48, ¶ 13, 98 P.3d 1061, (Apache sought a tax refund based on evidence "that raw hydrocarbons are not marketable at the moment they reach the surface, and that field processing is required by all buyers of oil and natural gas.").

reasonable and enhance the value of an already marketable product.[27]

38. An oil and gas lessee (like CLR) is prohibited "from deducting a proportionate share of transportation, compression, dehydration, and blending costs when such costs are associated with creating a marketable product." *Mittelstaedt* at ¶2. *See also, TXO v. CLO,* 1994 OK 131, ¶17, 903 P.2d 259, 263 (holding lessee is not entitled to deduct cost of gas compression from royalty owners' interest); *Wood v. TXO,* 1992 OK 100, 903 P.2d 206 (holding lessee is not entitled to deduct cost of gas gathering from royalty owner interest). "In order to burden the royalty interest with a proportionate share of the costs, the producer [like CLR] must show: (1) that the costs enhanced the value of an already marketable product, (2) that such costs are reasonable, and (3) that actual royalty revenues increased in proportion with the costs assessed against the nonworking interest." *Howell* at ¶21, quoting *Mittelstaedt*, at ¶2.

39. There is a rebuttable presumption against the making of deductions from the royalty owners' proceeds and the burden is placed upon the producer to rebut that presumption before any deduction can be made.

> In sum, a royalty interest **may** bear post-production costs of transporting, blending, compression, and dehydration, when [1] the costs are reasonable, [2] when actual royalty revenues increase in proportion to the costs assessed against the royalty interest, [3] when the costs are associated with transforming an already marketable product into an enhanced product, and [4] **when the lessee meets its burden of showing these facts**. [Emphasis added.]

Mittelstaedt, at ¶30.

40. The basis of the Oklahoma rule that royalty is not subject to any deductions before the products become marketable is the "lessee's duty to market" (also called the "implied covenant to market"), which is included in all oil and gas leases unless (and only to the extent)

[27] *Mittelstaedt* and *Newfield* both involved direct sales to third party purchasers; under *Howell* and *Tara*, the affiliated "first sales" are ignored for royalty purposes.

modified by specific, express language allowing deductions to make the gas marketable. The "implied duty to market means a duty to get the product to the place of sale in marketable form." *Mittelstaedt* at ¶12 (*quoting TXO v. CLO*, 903 P.2d at 262, *quoting Wood v. TXO*, 854 P.2d at 882). "The costs for compression, dehydration and gathering are not chargeable to [royalty owner] because such processes are necessary to make the product marketable under the implied covenant to market." *TXO Production Corp. v. State ex. rel Commr's of Land Office*, 903 P.2d at 260.

41. The Oklahoma Supreme Court unequivocally confirmed that it "decided the royalty owner cases based on the implied covenant of marketability under the oil and gas lease." *XAE Corp. v. SMR Property Management Co.*, 1998 OK 51, ¶10, 968 P.2d 1201.

42. All of the fees charged, deducted or absorbed into the price paid by Continental Gas and Hiland, or by third-party purchasers[28] (for gathering, compression, dehydration, fuel. treating, blending and processing) to CLR, which CLR then secretly deducted from the royalty owners,[29] were costs necessary to make the raw gas (and NGLs) into marketable residue gas and NGLs.

43. Unless CLR's lessor explicitly modified the implied covenant to market with express language in the lease allowing deductions to make the gas marketable, none of these deductions were appropriate deductions to the royalty owners.

44. Even in those leases where express lease covenants allow these deductions, CLR may only deduct its (Continental Gas and Hiland's) reasonable costs for the services, i.e., CLR and its affiliates may not profit by it. In this case, none of the deductions were either reasonable

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[28] Some of CLR's gas was sold by CLR to third-party gas purchasers.

[29] In recent years, beginning about the time this case was filed, CLR began reporting some, but not all of the fees on the royalty check stub.

or limited to recovery of the real "costs".

Continental Gas and Hiland "Charged" CLR For Midstream Services in Three Different Ways:

45. The improper deductions from royalty owners were deducted and concealed through three different types of contracts entered into between CLR and Continental Gas/Hiland.

46. These three types of contracts were described by Hiland as follows:

- ***Percent-of-proceeds arrangements***. Under percent-of-proceeds arrangements, we generally purchase natural gas from producers at the wellhead, gather, treat, and process the natural gas, in some cases fractionate the NGLs into NGL products, and then sell the resulting residue gas and NGLs or NGL products at index-related prices. We remit to the producers either an agreed upon percentage of the proceeds or an index-related price for the natural gas and the NGLs.

* * *

- ***Percentage-of-index arrangements***. Under percentage-of-index arrangements, we purchase natural gas from the producers at the wellhead at a price that is at a fixed percentage of the index price for the natural gas that they produce. We then gather, treat and process the natural gas, in some cases fractionate the NGLs into NGL products and then sell the residue gas and NGLs or NGL products pursuant to natural gas or NGL arrangements described above. Since under these types of arrangements our costs to purchase the natural gas from the producer is based on the price of natural gas, our total segment margin under these arrangements increase as the price of NGLs increase relative to the price of natural gas.

* * *

- ***Fixed-fee arrangements***. Under fixed-fee arrangements, we purchase natural gas from the producers at the wellhead at an index based price less a fixed fee to gather, dehydrate, compress, treat and/or process their natural gas. These types of arrangements typically require us to pay the producer for the value of the wellhead gas less the applicable fee.[30]

47. In addition to keeping a portion of the value of the NGLs through the arrangements described above, there appears to have been other NGL sales that were not reported to the royalty owners.

[30]Hiland Partners, LP, SEC Form S-1, Registration Statement, Amendment No. 3, 2/1/2005.

48. In public filings with the Security Exchange Commission (SEC) it has been revealed that CLR's affiliate, Hiland, sold over 1,200 barrels of liquid hydrocarbons per day in 2008 (i.e., over 440,000 barrels during 2008) from CLR operated wells on its gathering system in Southeast Oklahoma known as the "Woodford Shale Gathering System". The sales of these liquid hydrocarbons were never disclosed to the royalty owners, and no royalties were paid on the sales of these liquid hydrocarbons.

> Woodford Shale Gathering System. The Woodford Shale gathering system is a 55-mile gathering system located in southeastern Oklahoma and is designed to provide low-pressure gathering, compression and dehydrating services. The system includes four compressor stations and has approximately 17,400 horsepower installed. Natural gas gathered on the Woodford Shale gathering system is processed at third party processing facilities. Our Woodford Shale gathering system has a capacity of 65,000 Mcf/d and average throughput was 27,447 Mcf/d of natural gas which produced approximately **1,214 Bbls/d of NGLs for the year ended December 31, 2008.**" [Emphasis added.]

Hiland Partners, LP, 2008 Annual Report, SEC 10-K, p. 11 of 162, http://www.annualreports.com/HostedData/AnnualReports/PDF/hlnd2008.pdf.

49. Other documents already produced in this case reflect that CLR and/or Hiland sold condensate (i.e., liquid hydrocarbons) from various compressor sites on the Eagle Chief and Matli gathering systems in Northwest Oklahoma. As sample months only, records reflect 189.21 barrels were sold in January 2009 (Hiland-365), 190.21 barrels sold in November 2004 (Hiland366), 320.44 barrels sold in March 2010 (Hiland404). The sales of the condensate from the CLR-owned compressor sites were never disclosed to the royalty owners, and no royalties were paid on the sales of the condensate from these compressor sites. The condensate found in the gas gathering lines or associated "drip pots" is commonly referred to as "**scrubber oil**" or "**slop oil**" and royalties are due thereon.

50. CLR has not disclosed or accurately informed CLR's royalty owners of the true, complete and accurate facts on which the natural gas and natural gas liquids (and oil as discussed above) royalty payments were based.

51. Before CLR secretly made deductions from its royalty owners, CLR made no showing to meet its burden to negate Oklahoma's rebuttable presumption against making deductions from royalties.