IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

GERTRUDE PETROLEUM CORPORATION,	§	
	§	
Plaintiff and Counterdefendant,	§	
vs.	§	Civil Action No. 98-0001
	§	
ROGER J. ROYALTY, et. al.	§	
	§	
Defendants and Counterplaintiffs	§	

THE ROYALTY OWNERS' RESPONSE TO
GERTRUDE PETROLEUM CORPORATION'S MOTION TO EXCLUDE
TESTIMONY OF LAWYER DESIGNATED AS "EXPERT WITNESS"

To the Honorable E.M. Jurist,
United States District Judge:

The Royalty Owners file this Response to Gertrude Petroleum Corporation's ("GPC") Motion to Exclude Testimony of Lawyer Designated as "Expert Witness" by Royalty Group and Brief in Support ("GPC's exclusion motion").

Overview

1. GPC pays gas royalty to the Royalty Owners under two oil and gas leases. The plain language of the leases prohibits GPC from deducting post-production expenses—namely marketing and transportation costs that GPC incurs in transporting and selling the gas—before it calculates and pays royalties. Despite this indisputable lease language, GPC has been deducting marketing and transportation costs before calculating and paying the Royalty Owners' royalty ever since GPC assumed responsibility for paying the royalty in 1996. The result of GPC's misconduct has been a substantial underpayment of the Royalty Owner's royalty. GPC rationalizes this misconduct by relying on the Texas Supreme Court's decision in *Heritage Resources, Inc. v. Nationsbank*, 939 S.W.2d 118 (Tex. 1996), *rehearing overruled*, 960 S.W.2d 619 (Tex. 1997).

2. GPC contends that *Heritage* is dispositive legal authority that authorizes GPC to deduct post-production expenses before calculating and paying royalties despite lease language that prohibits such deductions. However, GPC misinterprets the precedential value of the *Heritage* decision, and that misinterpretation is reflected in its exclusion motion. GPC's deduction of post-production expenses in the face of clear lease language prohibiting such deductions before payment of royalties is neither condoned under Texas law nor customary oil and gas industry standards. The Royalty Owners' Trial Memorandum in this case explains the limited precedential effect of *Heritage* and why GPC's reliance on it is dubious. This response explains why Mr. McDaniel's expert testimony on oil and gas industry standards is customary non-scientific expert testimony and, thus, admissible during the trial of this case.

Argument and Authorities

3. Mr. McDaniel—who is unquestionably qualified in oil and gas law—will testify that GPC's deduction of post-production expenses in the face of the lease language prohibiting such deductions is not the common practice under customary oil and gas industry standards. As such, Mr. McDaniel's expert testimony is admissible to assist the Court in understanding the fact issue of whether GPC's conduct involved in this proceeding is consistent with customary oil and gas industry standards.

4. FED R. EVID. 702 provides as follows:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise.

5. GPC's exclusion motion is based essentially on the principle that an expert witness may not offer testimony regarding the law. *See*: ¶¶ 18-22, pp.6-8 of GPC's exclusion motion.

6. Although the principle that an expert witness may not offer testimony regarding the law is generally correct, there are exceptions:

- For example, an expert may explain the law with which the trial court lacks familiarity. *Hunt v. Coastal States Gas Producing Co.*, 583 S.W.2d 322, 327 (Tex.), *cert. denied*, 444 U.S. 992 (1979); *see also*: *Texas Rules of Evidence Handbook*, 20 HOUS.L.REV. 445, 470 n. 96 (1983);

- Similarly, expert testimony is admissible on a mixed question of law and fact when a standard has been established by law and the question is whether conduct measures up that standard. *Birchfield v. Texarkana Memorial Hospital*, 747 S.W.2d 361, 365 (Tex. 1987); and

- Finally, FED R. EVID. 704 provides as follows: "Testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact."

7. In its effort to rationalize deducting post-production expenses from the Royalty Owners' royalty when the leases provide specifically that it cannot do so, much of GPC's exclusion motion pertains to the *Heritage* decision. GPC's motion to exclude not only misinterprets the limited precedential effect of *Heritage*, but also overlooks the main reason why Mr. McDaniel's expert testimony is admissible—i.e., to testify regarding customary oil and gas industry standards.

8. In its exclusion motion, GPC's preoccupation with the *Heritage* decision distracts GPC from focusing on the purpose of Mr. McDaniel's testimony. Although Mr. McDaniel's expert report courteously sets forth for GPC the reasons why he believes that the *Heritage* decision is dubious legal authority, the basis for Mr. McDaniel's expert testimony is found in the final sentence of the first full paragraph of the second page:

> Based on the lease language and applicable law, I believe that the standard oil and gas industry practice would be not to deduct these post-production costs from the royalty to be paid under the leases.

9. State and federal courts have long and consistently held that expert testimony is admissible on issues of industry standards and reasonableness. *See, e.g., Young v. Amoco Prod. Co.*, 610 F. Supp. 1479, 1487 (E.D. Tex. 1985), *aff'd*, 786 F.2d 1161 (5th Cir. 1986) (what a reasonably prudent operator would have done to develop a hydrocarbon formation); *Bachler v. Rosenthal*, 798 S.W.2d 646, 649 (Tex. Civ. App.—Austin 1990, no writ) (whether a prudent oil and gas operator would have continued to operate an oil and gas lease); *Augusta Dev. Co. v. Fish Oil Well Servicing Co.*, 761 S.W.2d 538, 545-46 (Tex. Civ. App.—Corpus Christi 1988, no writ) (how a reasonably prudent operator would conduct a re-entry operation).

10. Simply put, a fact issue in this proceeding is whether GPC's deduction of post-production expenses in the face of lease language prohibiting such expenses is reasonable under customary oil and gas industry standards. Although understanding the limited precedential impact of the *Heritage* decision is important to an expert opinion on this issue, Mr. McDaniel's impeccable credentials and extensive experience in representing clients in the oil and gas industry—not his opinion on the *Heritage* decision—is the basis for his non-scientific expert testimony.

11. GPC's exclusion motion goes on to suggest that Mr. McDaniel's testimony should be disallowed because of lack of reliability and bias. *See*: ¶¶ 23-29, p. 8-10 of GPC's exclusion motion. However, this GPC argument ("GPC's *Kumho/Daubert* argument") assumes that Mr. McDaniel's testimony would be based upon legal issues rather than industry standards and reasonableness. Consequently, GPC's *Kumho/Daubert* argument does not appear to apply to the purpose of Mr. McDaniel's expert testimony—i.e, standard oil and gas industry practices regarding deduction of post-production expenses from royalty.

12. But even if GPC insists that its *Kumho/Daubert* argument does apply to the purpose of Mr. McDaniel's testimony, GPC misinterprets the effect of the standards established under the *Daubert, Kumho,* and *Robinson* decisions that define the limits of scientific expert testimony. *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993); *E.I. du Pont de Nemours & Co., Inc. v. Robinson*, 923 S.W.2d 549 (Tex. 1995); *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137 (1999).

13. Contrary to the restrictiveness suggested in GPC's exclusion motion, the United States Supreme Court in *Daubert* actually ruled that a broader range of expert testimony is admissible under the Federal Rules of Evidence than under the previously used (and more restrictive) *Frye* standard enunciated in *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923). Under the Federal Rules, "[a]ll relevant evidence is admissible . . ." FED R. EVID.402. "Relevant evidence" is defined as that which has "any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." FED R. EVID.401. Accordingly, *Daubert* overruled *Frye* as being "at odds with the 'liberal thrust' of the Federal Rules and their 'general approach of relaxing the traditional barriers to opinion testimony.'" *Daubert*, 509 U.S. at 588 (citations omitted).

14. Although *Daubert, Kumho,* and *Robinson* deal with scientific expert testimony, the general principles also apply to non-scientific expert testimony such as Mr. McDaniel's that is based on skill or experience gained from observation (rather than scientific expert testimony based on application of scientific principles). *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 722-26 (Tex. 1998). In fact "[e]xperience alone may provide a sufficient basis for an expert's testimony

. . ." *Gammill*, 972 S.W.2d at 725. The Texas Supreme Court in *Gammill* quotes with approval the beekeeper analogy from *Berry v. City of Detroit*, 25 F.3d. 1342 (6th Cir. 1994):

> On the other hand, if one wanted to prove that bumblebees always take off into the wind, a beekeeper with no scientific training at all would be an acceptable expert witness if a proper foundation were laid for his conclusions. The foundation would not related to his formal training, but to his firsthand observation. In other words, the beekeeper does not know any more about flight principles than the jurors, but he has seen a lot more bumblebees than they have.

Gammill, 972 S.W.2d at 724.

15. Consequently, contrary to GPC's *Daubert/Kumho* argument, Mr. McDaniel's testimony is relevant and reliable. GPC contends that the *Heritage* decision condones its deduction of post-production costs in the face of clear lease language to the contrary. Mr. McDaniel will testify that the standard practice in the oil and gas industry is *not* to ignore the plain language of a lease in calculating royalty. Similarly, Mr. McDaniel's non-scientific expert testimony is reliably based on extensive experience in advising and representing clients in the oil and gas industry. Finally, although GPC's allegation of bias toward Mr. McDaniel is rather far-fetched (Mr. McDaniel represents both royalty owners *and* operators such as GPC), any such alleged bias may easily be explored through cross-examination. Inasmuch as this proceeding will be tried to the Court as opposed to a jury, any bias that might taint Mr. McDaniel's testimony is not likely to prejudice the fact finder.

16. GPC has requested a ruling on its exclusion motion prior to trial. The Royalty Owners do not object to that request.

Conclusion

GPC's misconduct—dilution of royalties through deduction of post-production expenses despite clear lease language prohibiting such deductions—must stand on its own, including scrutiny from experts in the oil and gas industry. Mr. McDaniel is prepared to testify on the issue of whether GPC's conduct is reasonable under customary oil and gas industry standards. Such expert testimony is commonly and correctly admitted in all types of litigation. Given Mr. McDaniel's experience, there is no question that his testimony is reliable. Accordingly, Mr. McDaniel's testimony is admissible, and GPC's exclusion motion should be denied.

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Houston, Texas

Respectfully submitted,

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