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Class Action Royalty Litigation in the Shale Plays

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Although royalty underpayment litigation has existed since the inception of the United States oil and gas industry, the shale revolution profoundly impacted this type of litigation. This article analyzes nationwide trends in the filing and certification of royalty class action cases, which result in much greater exposure to producers than individual royalty owner cases. For example, in the past five years, producers have settled class actions for amounts in excess of \$80 million.

Ninety-six putative class actions filed during the period from 2001 to the present are analyzed in this article. Since Congress enacted the Class Action Fairness Act of 2005 (CAFA), most of these cases were litigated in federal court.

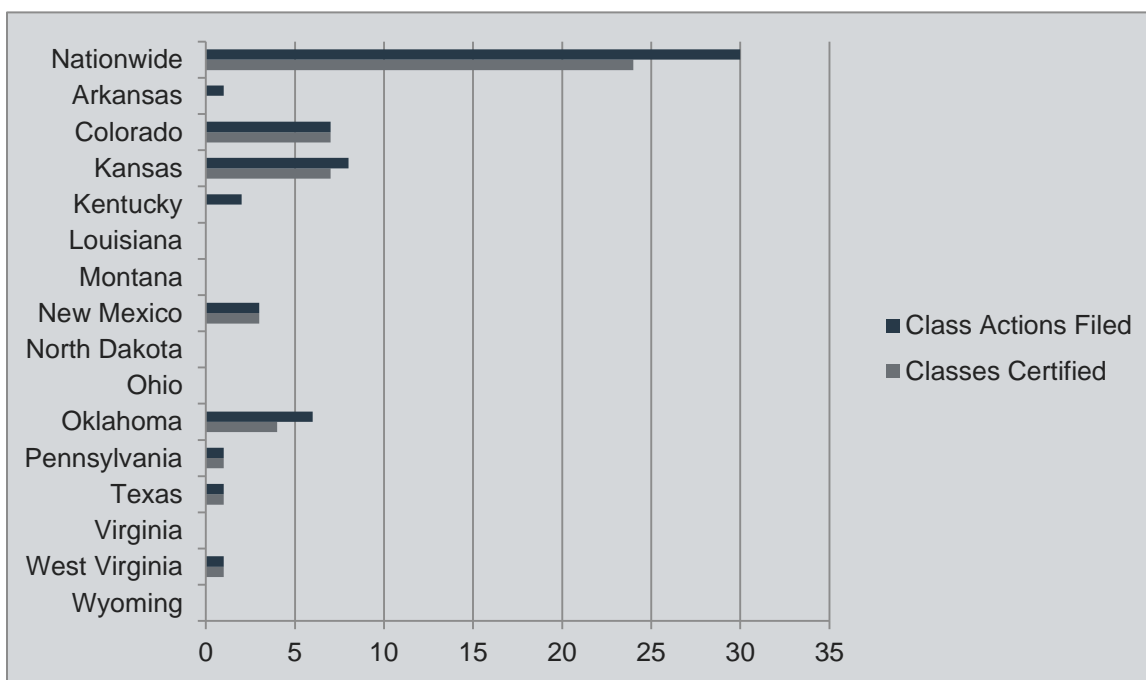
These cases deal almost exclusively with alleged underpayment of natural gas royalties (oil royalty litigation rarely arose during the period analyzed). Typically, a producer sells raw gas to an affiliated or non-affiliated entity at the wellhead. The gas is subsequently gathered, compressed, dehydrated, treated, processed and transported to downstream markets where the buyer resells it to third parties at published index prices. The producer receives a wellhead price for the raw gas that is determined by an arithmetic formula based upon the buyer's weighted average resale price adjusted for the buyer's post-production costs. This formula is commonly referred to as the netback method. Ultimately, the producer pays natural gas royalties based upon the wellhead price that is determined by this formula.

The cases selected for analysis generally involve three discrete legal issues:

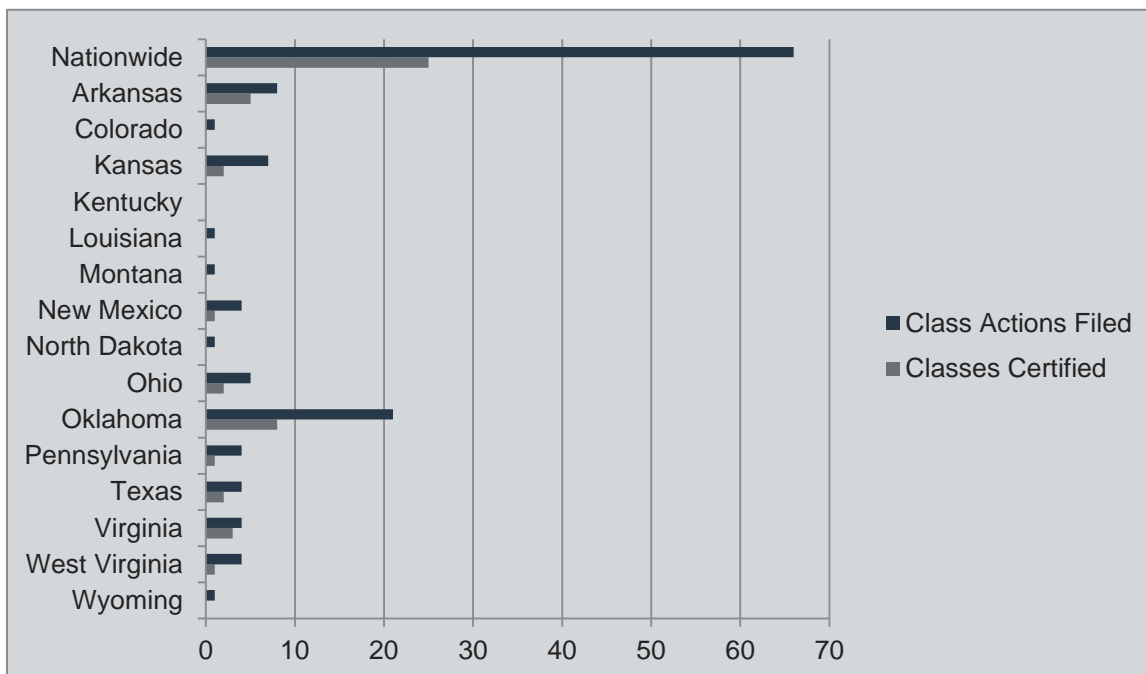
1. Whether the producer must pay royalties based upon the higher downstream resale price that its gas buyer receives rather than the lower wellhead price that the producer receives.
2. Whether the buyer's post-production costs, which are included in the formula for calculating the producer's wellhead price, are reasonable.
3. Whether transactions in which the producer sells gas to an affiliate are legitimate.

The analysis below is divided into two time periods: 2001 to 2009 and 2010 to 2018. January 1, 2010 was chosen as a rough approximation of the date on which production in many of the shale plays reached a critical mass.

2001-2009 Class Actions Filed and Classes Certified



2010-2018 Class Actions Filed and Classes Certified



- From 2001 to 2018, more class actions were filed in Oklahoma than any other state. Arkansas, Colorado, Kansas, and New Mexico also saw a significant number of class actions filed.
- Between the two time periods, the number of class action cases filed more than doubled (a 120 percent growth rate).
- The states with the largest growth in raw number of cases filed are Oklahoma, Arkansas and Ohio.
- During 2001-2009, 80 percent of class actions filed went on to be certified; that rate fell to 38 percent during 2010-2018.
- Several states—Arkansas, Ohio, Oklahoma, Texas, and Virginia—had growth in the raw number of class action cases certified.
- States with statistically significant numbers of class action cases filed in both time periods saw precipitous drops in the rate of class certification. The percentage of classes certified in Oklahoma dropped 29 percent. The percentage of classes certified in Kansas dropped 59 percent.

These certification trends confirm several widely-accepted, but generally anecdotal, conclusions held by attorneys experienced in class action royalty litigation:

- The U.S. Supreme Court's 2011 decision in *Wal-Mart Stores, Inc. v. Dukes* appears to have curtailed royalty class actions, particularly in Oklahoma federal courts. The *Wal-Mart* case requires a trial court to engage in a more rigorous analysis of class certification requirements. This rigorous analysis appears to have played a key role in several royalty litigation cases originating in Oklahoma, including the Tenth Circuit's decision in *Wallace B. Roderick Living Trust v. XTO Energy, Inc.*, which reversed class certification.
- The Kansas Supreme Court's 2015 decision in *Fawcett v. Oil Producers, Inc. of Kansas* appears to have significantly curtailed Kansas royalty class actions. In *Fawcett*, the court held that a lessee's obligation to bear the costs of producing a marketable product was satisfied where raw gas was sold at the wellhead in a condition acceptable to the buyer.
- Significant declines in class certifications in Kansas and Oklahoma have been partially offset by increases in class certifications in states with less-developed law and judges who are often less experienced in royalty class action litigation. This appears to be the case in Arkansas, Ohio, and Virginia—all states essentially seeing this type of class action case for the first time.