Chapter 7

Certification of Royalty Claims Under Oil and Gas Leases as Class Actions

Kevin C. Abbott
Amy M. Kerlin[1]
Reed Smith, LLP
Pittsburgh, Pennsylvania

Synopsis

§ 7.01. Overview.

Royalty disputes come in many forms. After deregulation of the industry allowed lessees to sell gas for higher prices at points downstream from the wells, many disputes focus on whether the lessees may net out of the proceeds of such sales the post-production costs incurred between the well and the point of sale – such as gathering, compression, processing, and interstate

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1 The authors are attorneys in the Pittsburgh, PA office of Reed Smith LLP and frequently represent energy companies in class actions. The authors gratefully acknowledge the research work of Leah L. Langhans, a student at the University of Pittsburgh School of Law.

transportation – before calculating the lessor's royalties. Such disputes focus on whether the language of the leases permits netting out costs, whether the costs incurred are reasonable, whether the post-production costs enhance the value of the gas, whether it is proper for a producer to use an affiliate to provide post-production services, or whether it is proper to base royalties on sales to affiliates.

In the past, disputes between a lessor and lessee over the calculation of royalties under an oil and gas lease were handled like any other contract dispute. The lessor and lessee would go to court or to arbitration, and the resulting judgment or award would resolve the dispute between them. Whether the resolution of the dispute by a court would have any impact on other lessors depended on the application of the usual doctrines of precedent and collateral estoppel. If resolved in arbitration, the award would have no application to other lessors.

To broaden the impact of the resolution of royalty disputes, counsel for lessors started using the class action vehicle to resolve royalty disputes. Class actions are intended to resolve claims that apply to a large number of people with the same issue but the amount in controversy is too small to warrant individual suits. The classic example is a consumer claim – if thousands of consumers suffer identical damages in small amounts, the theory of the class action is that a representative of the class brings a claim on behalf of all and, if successful, all benefit. The counsel for the class acts as a private attorney general and, if successful, is compensated from the total amount recovered. The class action vehicle, however, also poses the risk that many persons are made parties to a lawsuit — and an eventual result — over which they have no control. Where claims do not fit the traditional model, the class representatives may not actually represent all of the persons involuntarily dragged into court, there may be significant conflicts of interest within the class and the class counsel may pursue a resolution that benefits counsel but harms much of the class.

In recent years, the United States Supreme Court has tightened the standards for certification of class actions, requiring the lower courts to closely scrutinize class action claims to make sure that the members of the

proposed class are actually similarly situated and that the class representative actually is adequate.

As discussed below, the courts have applied the tighter standards required by the Supreme Court to royalty claims. Royalty underpayment claims do not fit the classic mold of a consumer class action because lessors are not consumers (they are actually sellers), such claims are often large enough to warrant individual actions and not all lessors have similar motivations and interests. In some cases, it is difficult to even ascertain who is in the class and will be bound by a judgment or settlement over which they have no control. This chapter will address how courts have dealt with the certification of royalty disputes brought as class actions.

§ 7.02. Class Action Standard.

Federal Rule of Civil Procedure 23 establishes certain preconditions that must be met prior to certification of a class action. A party seeking class certification must: (1) satisfy the four requirements of Fed. R. Civ. P. 23(a); (2) establish the requirements of one of the subsections of Fed. R. Civ. P. 23(b); and (3) clearly "define the class and the class claims, issues, or defenses" under Fed. R. Civ. P. 23(c).[2] Some jurisdictions also require that the putative members of the class be "ascertainable" after certification.[3] "Rule 23 does not set forth a mere pleading standard," but instead, "[a] party seeking class certification must affirmatively demonstrate [her] compliance with the Rule — that is, [she] must be prepared to prove that there are in fact sufficiently numerous parties, common questions of law or fact, etc."[4]

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2 Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 345 (2011). [hereinafter cited as *Wal-Mart*]

3 *See generally* Byrd v. Aaron, 784 F.3d 154 (3d Cir. 2015). "The party seeking certification bears the burden of establishing that *all* requirements of Rule 23 have been satisfied." Unger v. Amedisys Inc., 401 F.3d 316, 320 (3d Cir. 2005); *see also In re* Hydrogen Peroxide Antitrust Litig., 552 F.3d 305, 320 (3d Cir. 2008). [hereinafter cited as *In re Hydrogen Peroxide*]

4 *Wal-Mart*, 564 U.S. at 350; Johnston v. HBO Film Mgmt., Inc., 265 F.3d 178, 189 (3d Cir. 2001) (holding that the district court properly "examine[d] the factual record underlying plaintiffs' allegations in making its certification decision").