OKLAHOMA CITY UNIVERSITY LAW REVIEW

VOLUME 46 WINTER 2021 NUMBER 1

NOTE

CLASS-ACTIONS THREATEN THE ENERGY INDUSTRY: CLASS-ACTION LAWSUITS AND ROYALTY LITIGATION IN LIGHT OF *CLINE V. SUNOCO*

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INTRODUCTION

In Oklahoma, the two prevailing interest groups are the agriculture sector and the energy sector. Both provide countless jobs and resources to the state and neither seems to take precedence over the other. However, the competing interests of landowners and energy companies are often pitted against each other, and the Legislature is forced to create laws that aim to satisfy both sectors. In a lawsuit filed by a land or mineral owner against an oil and gas company, the power imbalance is apparent. One way

[*] Juris Doctor candidate, Oklahoma City University School of Law, May 2022. I owe endless thanks to my family and friends for all the laughs, encouragement, and love throughout law school. I would like to thank my faculty sponsor, Professor Paul Clark, for his feedback and guidance during the research and writing process. Finally, I would like to thank the members of the Oklahoma City Law Review for their diligent efforts in making this publication possible.

for plaintiffs to beef up their lawsuit and really shake the oil and gas company is through class-action lawsuits.

Class-action litigation is expensive. These cases will rack up countless hours preparing for litigation, large attorney's fees, and could result in massive judgments. Defense counsel is usually paid as the litigation progresses, but class counsel is often left hoping for a favorable judgment in the end in order to keep their lights on. From the world of oil and gas law have emerged class-action lawsuits regarding royalty payments. Many states have a statutory requirement for oil and gas companies to pay royalty interest owners their respective share and failure to do so results in a penalty. Oklahoma has one of the strictest, mineral-owner friendly statutes governing this topic. Considering an individual claim for improperly paid royalty may only be a few thousand dollars, the costs of litigation would likely outweigh the damages award. By including a way for the winning party to obtain attorney's fees, the law has incentivized mineral owners to seek relief on claims that may not have been worth the cost of litigation without the law. Now, if a prospective plaintiff can find tens of thousands of similarly situated individuals the oil and gas company has a huge battle to fight. A class-action royalty payment lawsuit has become a very powerful tool for mineral interest owners to assert their rights against oil and gas companies and to actually have an impact on the industry.

The goal of this Note is to explore patterns in class-action royalty litigation as well as the impact of recent court decisions, with a specific focus on Oklahoma. Throughout the Note different outcomes will be illustrated based on whether the well was producing oil or gas. The objective is to discuss the impact of class-action royalty litigation on the industry and provide a few considerations that could help bring back balance to the relationship between mineral owners and oil and gas companies.

First, this Note will explain the basic concepts of oil and gas law, such as defining what a mineral interest is and the rights associated with that interest. The first section will also explain how a mineral interest owner makes money by introducing the oil and gas operator and first purchaser roles. Second, this Note will explore the options a mineral interest owner has for remedies when the obligated party fails to make payments. This section will include a deep dive into the Oklahoma Production Revenue Standards Act ("PRSA"). Third, this Note will discuss the issues associated with post-production costs and how their calculation effects

royalty payments depending on what the well is producing—oil or gas. Fourth, this Note will outline the requirements for class certification with a focus on the commonality requirement. Fifth, this Note will bring together the issues associated with calculation of royalties, how they differ depending on if it is a gas well or an oil well, and how all of these factors play out in royalty litigation. This section will include case law to illustrate the outcomes in Oklahoma; it will highlight *Cline v. Sunoco, Inc.*, a 2020 Oklahoma court decision that is bound to have a significant impact moving forward. Sixth, this Note will provide commentary on: the threat, if any, class-actions pose to the energy industry; if first purchasers should continue to bear the risk of distributing royalty payments; and whether or not the mineral interest owner should bear any responsibility for claiming improperly paid royalty payments. Last, this Note will conclude by sampling similar statutes in surrounding states. This Note will evaluate whether the Oklahoma Legislature's objective for introducing the PRSA has properly served the dueling interests of mineral owners and energy companies.

BASIC CONCEPTS OF OIL AND GAS

a. Oil and Gas Production and Marketing

A mineral interest includes the right to explore, develop, and produce oil, gas, and other minerals from the land.[1] Inherent in the mineral interest are three rights: the right to profit (and the obligation for costs), the right to lease or sell the mineral interest, and the right to benefits under an oil and gas lease.[2] These rights are important because mineral owners typically do not possess the capital and expertise necessary to explore, develop, and produce their minerals. Due to the lease incidents, a mineral owner is able, and likely, to transfer their rights to explore, develop, and produce to an oil and gas company via an oil and gas lease.[3] Generally, in exchange for the right to explore, develop, and produce minerals on the land, the mineral owner receives an immediate cash bonus as well as royalty payments if the lease is productive.[4] A royalty interest owner is

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1. JOHN S. LOWE ET AL., CASES AND MATERIALS ON OIL AND GAS LAW 113 (7th ed. 1993).
2. *Id.* at 113-14.
3. *Id.*
4. *Id.* at 191.

entitled to a share of production or the value or proceeds of sale of a part of production.[5]

To better understand this abstract concept, consider this hypothetical about Farmer Paul: Farmer Paul owns land in Grady County, Oklahoma. Farmer Paul possesses the surface and mineral interests for the property. As the mineral interest owner, Farmer Paul has the right to explore, develop, and produce any minerals on the property. Recently, Farmer Paul was approached by a small oil and gas operator, OG Operator, that wants to explore and produce minerals from the property. Lacking time, expertise, and money to exploit the minerals on his own, Farmer Paul enters into a lease agreement with OG Operator. Under the lease, Farmer Paul transfers his rights to explore, develop, and produce minerals to OG Operator and receives an immediate cash bonus as well as the promise of royalty payments if the lease is productive (i.e., minerals are produced). The royalty payments allow Farmer Paul to share in the wealth from a successful well produced on his mineral interest.

There are several different kinds of royalty interests: a lessor's interest (sometimes called a leasehold interest), an overriding interest, and a nonparticipating interest.[6] A lessor's interest is the interest outlined in the royalty clause in an oil and gas lease.[7] An overriding interest is carved out of the lessee's interest and is generally reserved for paying landmen, geologists, or others who have helped with the venture.[8] The nonparticipating interest is carved out of the mineral interest and gives the owner a share of production without consideration from an oil and gas lease.[9] A nonparticipating royalty interest is usually a fraction of a mineral interest owned and conveyed by another. This division of an interest can create many different owners with very small fractions of royalty to be paid to them.

Three years into the lease, OG Operator is able to produce oil from Farmer Paul's mineral interest. Farmer Paul is now able to collect a royalty on the profits of the oil produced. In the lease, Farmer Paul reserved a one-eighth royalty interest; this is the lessor's interest. OG Operator gets the remaining profits from the produced oil. However, OG Operator has set aside a fraction of the profits to pay the landmen, engineers, and other

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5. *Id.* at 115.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*

workers who participated in the well site; this is the overriding interest. The well OG Operator drilled has been producing for over a decade and unfortunately Farmer Paul has passed away. Farmer Paul left one-third of the mineral interest to his favorite sister Susan, and one-third to each of his children, Charles and Claire. Susan conveyed her one-third interest in equal parts to her three children. Charles and Claire have conveyed fractions of their mineral interest to business partners and other family members. Before Farmer Paul's death, there was only one mineral interest owner who was to receive a one-eighth royalty interest. Now there are several parties with even smaller fractions of royalty interest to be paid; Susan, Charles, Claire, and any additional conveyances each have a nonparticipating interest. These types of conveyances are quite common and can span generations. It can be incredibly challenging to keep track of each of the parties and their respective interest.

b. Role of the First Purchaser

Royalty is paid by the first purchaser; a first purchaser is the first person to purchase oil or gas produced from the interest owner. The oil and gas company operating the lease may be the first purchaser; however, the first purchaser is generally a third-party who purchases from the lessee.[10] The first purchaser's obligation to pay production proceeds to mineral owners "arise[s] under lease royalty clauses, purchase contracts, division orders, and transfer orders."[11] Royalty clauses set out the point at which royalty will be calculated: either at the well head, or further downstream after incurring post-production costs.[12] Since the lessee is not often the first-purchaser or party responsible for distributing royalty payments, a purchase contract allows the lessee to shift payment obligations to a third-party first purchaser who will take on the responsibility of disbursing all royalty payments.[13] Division orders often fill in details that oil and gas leases lack, regarding timing of payments, mechanics of payment, and ability to suspend an account due to questionable title.[14] Transfer orders are used when a mineral interest owner assigns or conveys their interest to another and contain similar terms to a

10. *See* Philip William Lear, *First Purchaser Suspense Accounts*, 33 ROCKY MTN. MIN. L. INST. §17.01 (1988).
11. *Id.* §17.02.
12. *Id.*
13. *Id.*
14. *Id.*

division order.[15]

Continuing with the Farmer Paul hypothetical, OG Operator is a small oil and gas operator with a limited or nonexistent title department. Since OG Operator is a small company it will be difficult for them to manage all of the different leases and payments that need to be made. Luckily, there is a much larger and more sophisticated company, Big Oil Purchaser, that wants to purchase the oil from OG Operator. Big Oil Purchaser has an extensive title department and agrees to take on the responsibility of paying the interest owners in exchange for being able to purchase the oil produced from OG Operator's wells. This agreement is ironed out in a purchase contract. OG Operator also gives Big Oil Purchaser the corresponding division orders that include details about well locations and the various interests on each well. Big Oil Purchaser is considered a first purchaser.

c. First Purchaser Duty to Identify Mineral Interest Owner

There are several reasons why royalty interest may be left unpaid: defects in title, incomplete transfer orders, or inaccurate owner information are among the most common reasons. The latter is common in situations where mineral interest has been conveyed as nonparticipating royalty interest and now exists in highly fractionalized interests.

Remember when Farmer Paul died and conveyed his mineral interest to Susan, Charles, and Claire, who each made their own conveyances? Now the mineral interest exists in many small pieces each with corresponding royalty interest. It is possible that amongst all of these conveyances some paperwork was incorrect or not recorded properly. It is also a possibility that when OG Operator transferred the responsibility to pay interest owners to Big Oil Purchaser, that not all of the information was provided. After all, OG Operator is a small company that may have been too overwhelmed and understaffed to take on a large volume of title records. All of these factors could lead to incorrect or incomplete information given to Big Oil Purchaser. Big Oil Purchaser took on the responsibility of paying all of these interest owners, but how can that be done with incorrect or incomplete information?

When royalty payments are left unpaid, first purchasers will either place these funds in "suspense" or escheat the money to the state as unclaimed property. What duty is imposed on a first purchaser to correct

15. *Id.*

interest owner information and resolve funds sitting in "suspense"? Although there is much scholarly debate on what relationship exists between lessor and first purchaser, the Oklahoma Supreme Court has held that first purchaser must "act diligently in determining the legal owners" of proceeds from the sale of oil and gas.[16] The Court has not yet given further instruction on what constitutes diligent actions.

MINERAL INTEREST OWNER'S REMEDY

Royalty payments are contractually owed to the royalty interest owner under the oil and gas lease. One would assume that failure to pay royalty payments would be a breach of covenants in the oil and gas lease and should result in lease termination. Instead, when the lessee or first purchaser, whichever is the obligated party, fails to make royalty payments, the mineral interest owner's remedy is to "sue for the royalty plus interest at the statutory rate."[17] Although this is not the interest owner's exclusive remedy, courts seem to treat it as such, as they are often reluctant to terminate the lease for unpaid royalty.[18]

In *Cannon v. Cassidy*, the Supreme Court of Oklahoma refused to cancel an oil and gas lease even though royalties had not been paid for three months, finding that there was an adequate remedy at law to make the mineral interest owners whole.[19] The royalty interest owners argued that failure to pay royalties was actually a breach of the implied covenant to market, which would result in lease termination, but failed to provide any persuasive authority.[20] The Court reasoned that since the oil and gas lease did not contain an applicable forfeiture provision and there existed a "plain, speedy and adequate remedy at law," the oil and gas lease would not be terminated.[21] In many states, including Oklahoma, the remedy is statutory.

a. Oklahoma Production Revenue Standards Act

The Oklahoma Production Revenue Standards Act ("PRSA") describes the time frame in which royalty is to be paid to the interest

16. Goodall v. Trigg Drilling Co, 1997 OK 74, ¶ 11, 944 P.2d 292, 295.
17. JOHN S. LOWE, OIL AND GAS LAW IN A NUTSHELL 331 (7th ed. 1983).
18. LOWE ET AL., *supra* note 1, at 440.
19. Cannon v. Cassidy, 1975 OK 151, ¶18, 542 P.2d 514, 517.
20. *Id.* ¶ 9, 542 P.2d at 516.
21. *Id.* ¶ 17, 542 P.2d at 517.

owner, as well as the applicable penalties. The first purchaser has six months after the sale of oil or gas produced from the well to begin royalty payments[22] and must pay "thereafter not later than the last day of the second succeeding month after the end of the month within which such production is sold."[23] In instances where royalty payments are not paid in the applicable time period, the unpaid portions will accrue at a twelve percent interest rate compounded annually from the date of first sale (not the date payment was due).[24] When royalty is not paid because the proper interest owner cannot be identified (typically due to marketable title issues), the interest rate is reduced to six percent.[25] This statute provides mineral interest owners a surefire remedy in unpaid royalty cases. Although unpaid royalty claims do not have huge payouts, the claim is easy to prove, and the statute even provides a way for mineral interest owners to recoup attorney's fees and other litigation costs.[26]

Issues Associated with Post-Production Costs

In every oil and gas lease there are six implied covenants, which are unwritten promises inherent in the language of the lease that protect the lessor and place obligations on the lessee.[27] The six implied covenants are: (1) the implied covenant to drill an initial exploratory well, (2) the implied covenant to reasonably develop the lease premises, (3) the implied covenant to further explore, (4) the implied covenant to protect against drainage, (5) the implied covenant to market, and (6) the implied covenant to conduct operations with reasonable care.[28] Of the six implied covenants, the implied covenant to market is most directly related to royalty.[29] After the operator has successfully drilled, the operator will seek to make a profit by marketing the product. The operator has an implied duty to sell the product; marketing and sale of the product allows the lessor to collect royalty payments. The implied covenant to market requires the operator to act as a reasonably prudent operator would to find a market and negotiate

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22. Okla. Stat. tit. 52 §570.10(B)(1)(a) (2021).
23. §570.10(B)(1)(b) (2021).
24. §570.10(D)(1) (2021).
25. §570.10(D)(2)(a) (2021).
26. §570.14(A)(2) (2021).
27. *See generally* Lowe et al., *supra* note 1.
28. *Id.*
29. *Id.* at 354.

a sale.[30]

Three duties arise under the implied covenant to market: the duty to market within a reasonable time, the duty to market at an appropriate price, and the duty to market free of post-production costs. A mineral royalty owner does not receive royalty payments until the lessee markets the product; therefore, the operator must act as a reasonably prudent operator would and market the product within a reasonable time.[31] A reasonable time period considers the industry custom and practice, as well as the specific facts of the case including any specific clauses in the lease.[32] The duty to market within a reasonable time can be further complicated by shut-in clauses in the lease and whether the state is a capable-of-production or an actual-production state; those concepts are beyond the scope of this Note and will not be addressed.[33] The duty to market at an appropriate price simply means the operator, acting reasonably and prudently, must obtain a market for the product at a "prevailing market price."[34] The last duty, the duty to market free of post-production costs, tends to create the most issues with royalty payments.

The operator is generally responsible for all of the costs of exploring, drilling, and producing, while the royalty interest owner generally enjoys a cost-free interest in the production of minerals underlying the leased premises.[35] One issue that can arise is which party bears the burden of paying for post-production costs. If the royalty interest owner is meant to share in post-production costs, the result is a lower royalty payment than if the operator was the sole bearer of post-production costs. The impact of post-production costs on royalty payments is different depending on if the mineral produced is oil or gas.

a. Impact of Post-Production Costs on Oil

Once oil is extracted it can be easily stored in tanks or transported via pipeline to refineries. Oil is generally marketable without additional costs incurred from post-production processing and can be sold at or near the well.[36] Since there are not usually post-production costs associated with

30. *Id.*
31. *Id.*
32. *Id.* at 355.
33. *Id.* at 354.
34. *Id.* at 356.
35. *Id.* at 348-49.
36. *Id.* at 368.

the production of oil, calculating the royalty is simpler. The royalty interest owner is going to receive the royalty payment agreed upon in the lease calculated from the profits made after the sale of oil, without the deduction of post-production costs.

b. Impact of Post-Production Costs on Gas

Gas is much different than oil. The lessee must calculate royalty free of production costs, but there are disputes over "when and where 'production' is completed."[37] Unlike oil, which can be sold at the well or easily stored, the physical nature of gas typically requires gathering and transportation to a downstream location as well as separation, compression, dehydration, treating, and processing before the gas is in a marketable condition.[38] Royalties are paid on marketable product, so the amount a lessee can reduce the mineral interest owner's royalty depends on when the gas is considered marketable and how many post-production process costs can be shared with the mineral interest owner. Marketable product determination varies by jurisdiction.

The Supreme Court of Oklahoma's decision in *Mittelstaedt v. Santa Fe Minerals, Inc.* provides guidance: (1) "[t]he lessee has a duty to provide a marketable product available to market at the wellhead or leased premises"[39] and (2) royalty interest owners may bear certain post-production costs (such as dehydration, blending, transportation, compression, etc.) if (a) the costs are reasonable, (b) the costs increase in proportion to the revenues earned by the lessor, and (c) the costs involve taking an already marketable product into an enhanced marketable condition.[40] It is the lessee's burden to prove that the post-production costs occurred on an already marketable product, that the costs were reasonable, and that the royalty interest owner's revenues increased in proportion to the costs incurred.[41]

CLASS CERTIFICATION IN OKLAHOMA

A class can be certified in Oklahoma state or federal court if all four

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37. *Id.*
38. *Id.* at 368-69.
39. Mittelstaedt v. Santa Fe Minerals, Inc., 1998 OK 7, ¶20, 954 P.2d 1203, 1208.
40. *Id.* ¶ 2, 954 P.2d at 1205.
41. *Id.*¶ 26, 954 P.2d at 1209.

parts of Okla. Stat. tit. 12, § 12-2023(A), or Fed. R. Civ. P. 23(a) and at least one of the requirements in Okla. Stat. tit. 12, § 2023(B) or Fed. R. Civ. P. 23(b) are satisfied. The plaintiff (i.e., the party seeking class certification) bears the burden of establishing:

> (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect interests of the class.[42]

A plaintiff must also establish one of the three requirements under Section 2023(B) or Rule 23(b); in oil and gas royalty litigation, plaintiffs usually use Section 2023(B)(3) or Rule 23(b)(3), which requires a court to find "the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."[43]

As a defense against class certification, the commonality requirement in Section 2023(A)(2) and Rule 23(a)(2) is most often attacked. In *Wal-Mart Stores, Inc. v. Dukes*, the United States Supreme Court expanded on the concept of commonality for class certification.[44] Instead of asking questions that "[a]ny competently crafted class complaint literally raises,"[45] the Court held that the plaintiff must claim "a common contention . . . of such a nature that it is capable of classwide resolution – which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke."[46] In oil and gas royalty litigation, Oklahoma courts have found lack of commonality when an adjudication in favor of the named plaintiff based on the "physical and market-related facts as to *her* well, [which] would merely set the stage for class member-by-class member [sic] determinations . . . on the basis of *their* facts."[47] Oklahoma courts have

42. OKLA. STAT. tit. 12 §2023(A); FED. R. CIV. P. 23(a).
43. §2023(B); FED. R. CIV. P. 23(b).
44. Wal-mart Stores, Inc. v. Dukes, 564 U.S. 338, 349-50 (2011).
45. *Id.* at 349 (citing Richard Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev 97, 131-32 (2009)).
46. *Id.* at 350. (citing Nagareda, *supra* note 45, at 132).
47. Foster v. Merit Energy Co., 282 F.R.D. 541, 560 (W.D. Okla. 2012).

also denied class certification on commonality grounds when there would be an "owner by owner and month by month" inquiry into how much each royalty owner was paid versus how much they should have been paid.[48] In *Foster v. Merit Energy Co.*, Judge Friot of the Western District of Oklahoma combined the law stated in *Mittelstaedt* with the requirement of commonality for class certification, writing "[i]f anything is clear from the Court's opinion in *Mittelstaedt*, it is that there are few all-embracing rules governing allocation of costs to royalty interests . . . . 'Post-production costs must be examined on an individual basis to determine if they are within the class of costs shared by a royalty interest.'"[49]

ROYALTY LITIGATION AND CLASS-ACTION LAWSUITS

Filing under the PRSA is not novel. Since its inception, mineral interest owners have been asserting their rights to unpaid interest on late royalty payments. The PRSA provides mineral interest owners a relatively straightforward remedy for collecting unpaid royalty interest. Mineral interest owners file as individuals, but also as large classes of similarly situated parties. The class-action cases are typically settled prior to trial or are decertified. Energy companies facing a class-action lawsuit will seek to decertify the class and attempt to litigate each plaintiff individually. As previously mentioned, one of the most common defenses to class certification is to attack the commonality requirement. The success of this defense seems to play out differently depending on whether the wells produced oil or gas.

a. Commonality and Gas Royalty Litigation

In royalty litigation where the class comprises royalty interest owners of wells which produce gas, courts have found reason to decertify the class due to a lack of commonality. In *Foster v. Apache Corp.*, a class of over 10,000 royalty owners and over 1,200 gas wells asserted that their rights as royalty owners were violated when the lessee imposed a share of the gathering, compression, and processing costs on the royalty interest

48. McKnight v. Linn Operating, Inc., No. CIV-10-30-R, 2016 WL 756541, at *8 (W.D. Okla. Feb. 25, 2016).

49. *Foster*, at 550 (citing Mittelstaedt v. Santa Fe Minerals, 1998 OK 7, ¶19, 954 P.2d 1203, 1208).

owners.[50] The class representative argued that "Apache must bear all costs necessary to place gas in [marketable] condition without deduction from the royalty share unless" otherwise specifically stated in the royalty interest owner's lease.[51] The court referred to Oklahoma's Production Revenue Standards Act to point out that royalty interests from gas producing wells are "communitized" under the Act.[52] Therefore, shorting the royalty pot by deducting post-production costs shorted the entire group who shared the proceeds from that pot.[53] Since the main contention was determining when the gas was marketable, the court turned to *Mittelstaedt* to determine what matters are relevant for a royalty owner's claim for improperly paid royalty.[54] After considering the impact of *Mittelstaedt* on gas royalty litigation, the court quoted *Mittelstaedt* as holding that "[p]ost-production costs must be examined on an individual basis" and wrote that "*Mittelstaedt* did not provide a categorical answer to the question of when gas is in a marketable condition."[55] The court refused to find commonality because the question of when gas becomes marketable could not be answered on a class-wide basis due to the various marketing arrangements used by Apache.[56]

In a 2013 decision, the Tenth Circuit Court of Appeals vacated a district court's class certification for lack of commonality. The class comprised "more than 16,000 royalty owners who ha[d] approximately 14,300 leases covering some 2,296 wells."[57] Similar to the class in *Foster*, the class complained that they were not paid proper royalty amounts due to the deduction of costs associated with turning the gas into a marketable product.[58] The Tenth Circuit found that the district court had improperly applied the Rule 23 analysis set forth in *Dukes* when it rested commonality on a common question; however, the district court failed to consider whether variations in lease language and the marketable condition issue presented by post-production costs could destroy commonality.[59]

50. Foster v. Apache Corp., 285 F.R.D. 632, 636 (W.D. Okla. 2012).
51. *Id.* at 639.
52. *Id.* at 638.
53. *Id.*
54. *Id.* at 642.
55. *Id.* at 643.
56. *Id.*
57. Chieftain Royalty Co. v. XTO Energy, Inc., 528 F. App'x 938, 940 (10th Cir. 2013).
58. *Id.*
59. *Id.* at 942-43.

With the heightened standard from *Dukes*, a class certification will not stand if the plaintiff simply asks common questions; instead those questions must lead to common answers.[60] Given the intricacies of calculating marketable product and determining which costs are sharable amongst royalty interest owners, it is not surprising that many plaintiffs' class certifications have been denied or not withstood a challenge on appeal.

b. Commonality and Oil Royalty Litigation

Oil royalty litigation has proceeded differently. The issue of commonality in gas royalty litigation falls apart because the marketability of gas and the associated costs vary owner-to-owner; oil marketability does not present the same issues since oil is generally marketable without additional processing at the well. On its face it seems like commonality would be less of an issue and oil royalty litigation could lead to massive class-action lawsuits that could have a lasting impact on the energy industry. In August 2020 the United States District Court for the Eastern District of Oklahoma issued its opinion on the December 2019 trials of *Cline v. Sunoco*. *Cline* was a certified oil-royalty-interest-owner class-action lawsuit under the PRSA.

1. *Cline v. Sunoco, Inc.*

This dispute arose between Sunoco and Cline (the named plaintiff) in a class-action lawsuit for unpaid interest on late royalty payments. Under the PRSA, Sunoco was a first purchaser; Sunoco bought crude oil from the lessees and sold the oil. As first purchaser, Sunoco was responsible for disbursing royalty payments to mineral interest owners. In order to make payments, "Sunoco often relie[d] on information provided by a well operator to pay owners their proceeds."[61] "That information [was] not always correct."[62] Cline was an Oklahoma farmer who owned interest in three wells,[63] and "Cline represent[ed] a class of individuals and entities who own[ed] royalty interests in wells from which Sunoco purchased

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60. Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 350 (2011) (quoting Nagareda, *supra* note 45, at 132).
61. Cline v. Sunoco, Inc., 479 F.Supp.3d 1148, 1159 (E.D. Okla. 2020).
62. *Id.*
63. *Id.*

crude oil and paid proceeds late without paying interest on the proceeds."[64] The class "comprise[d] 53,000 individuals and over 1.5 million late payments."[65] Sunoco had a good track record of on-time royalty payments; only approximately one percent of Sunoco's payments were made late.[66] Payments can be made late for a variety of reasons: internal error, unreturned division order, or inaccurate or incomplete owner information.[67]

Cline originally filed this case in Oklahoma state court on July 7, 2017, seeking compensatory and punitive damages.[68] Sunoco almost immediately removed the case to the United States District Court for the Eastern District of Oklahoma and filed a response.[69] Almost two years after the original filing, Cline moved to certify the class on June 14, 2019.[70] The court certified the class on October 3, 2019, with a trial date set for December 16, 2019.[71] The district court's opinion was issued on August 17, 2020, awarding just under $75 million in actual damages and $75 million in punitive damages to Cline.[72] An appeal is now pending before the Tenth Circuit Court of Appeals.

The court determined that Cline adequately represented the class and that Sunoco was liable to all class members for unpaid interest on late royalty payments at the "default" rate of twelve percent per annum.[73] Cline proved Sunoco knew it owed interest and intentionally withheld the payments until mineral interest owners asked for the payments, and at the end of trial, compensatory damages amounted to $74,763,113.00.[74] As if the compensatory damages weren't enough, the court also awarded $75 million in punitive damages because it found Sunoco's conduct amounted to "a reckless disregard of the class members' rights."[75]

64. *Id.*
65. *Id.* at 1164.
66. *Id.*
67. *Id.* at 1159-60.
68. *Id.* at 1155.
69. *Id.*
70. *Id.*
71. *Id.* at 1156.
72. *Id.* at 1181-82.
73. *Id.* at 1176.
74. *Id.* at 1179, 1181.
75. *Id.*

2. *Cline* and the Commonality Requirement

Sunoco made several challenges to class certification and the court upheld certification in every instance.[76] Cline contended that the class satisfied the commonality requirement, because Sunoco had a "uniform policy of not paying statutory interest."[77] Once the court determines if Sunoco has a statutory requirement to pay the interest without request, then the answer will be applicable to all class members.[78] Unlike the cases discussed regarding gas royalty litigation, where the issues tended to revolve around how the royalty payments were calculated, the current issue is about timing of payment and the statutory obligation to do so. There are fewer factors to consider and fewer individualized questions to resolve when determining the proper payment timeline than determining when and at what cost a product was in marketable condition.

In attacking the commonality requirement, Sunoco argued that its "defenses are too individualized."[79] The court deflected this argument with the Rule 23(b)(3) consideration of predominance.[80] Predominance is related to commonality; the common questions must not be overwhelmed or dominated by individual concerns.[81] A court will determine which issues are and are not common to the class and then weigh which issues predominate.[82] Sunoco argued that the individual nature of damage calculations far outweighs any common questions. However, the court stated, "As long as 'at least one common issue predominates, a plaintiff can satisfy Rule 23(b)(3)–even if there remain individual issues, such as damages . . . .'"[83]

MOVING FORWARD AFTER *CLINE*

With the industry holding its breath while *Cline* awaits appeal at the Tenth Circuit, let's discuss the threat of more class-action lawsuits under the PRSA, the risk associated with being the party responsible for properly

76. *Id.* at 1164.
77. Cline v. Sunoco, Inc., 333 F.R.D. 676, 683 (E.D. Okla. 2019).
78. *Id.*
79. Cline v. Sunoco, Inc., 479 F.Supp.3d 1148, 1164 (E.D. Okla. 2020).
80. Cline v. Sunoco, Inc., 333 F.R.D. 676, 683 (E.D. Okla. 2019).
81. *Id.* at 686.
82. *Id.*
83. *Id.* (citing Naylor Farms Inc. v. Chaparral Energy, LLC, 923 F.3d 779, 789 (10th Cir. 2019)).

paying royalties, and whether some of the responsibility should be on the royalty interest owner to request unpaid royalties.

a. The Threat of More Class-Action Lawsuits

Has *Cline* given class counsel the confidence they need to not settle? After *Cline*, it seems like the best weapon the energy industry had to decertify the class has been stripped from its arsenal and a how-to on litigating a successful class-action royalty lawsuit has been released to the public. In a case like *Cline*, where the royalty comes from wells producing oil, not gas, and marketable product is not the issue, it seems like as long as the plaintiff-class can show that the oil and gas company has a propensity to not make payments (regardless of whether the failure to make payments is on purpose or the result of a clerical error), the class will survive. However, class counsel is not out of the woods yet.

In a state where agriculture and energy are prominent sectors, the Legislature needs to strike a balance between protecting the interests of both land/mineral owners and oil and gas companies. The PRSA was created with the interests of land and mineral owners in mind but it might prove to be too harmful toward the energy industry. The PRSA provides an easy remedy for mineral owners and incentivizes the use of that remedy by shifting attorney's fees to the losing party. Without suggesting that oil and gas companies should get off scot-free for failing to make royalty payments, the PRSA is simply too favorable to mineral owners, putting all of the ownership and responsibility on oil and gas companies. The ideas of ownership and responsibility are discussed later in this Note.

b. Risk to Paying Party

It is common industry practice for the first purchaser to be the party responsible for making royalty payments to royalty interest owners. This practice stems from a history of large oil and gas companies leveraging their resources to earn business from small oil and gas operators who do not have the ability to manage the payments on their own. This arrangement appeared to be virtually risk-free, until class-action lawsuits began popping up over improperly paid royalties a few years ago. Class actions rarely seemed to make it to final judgment completely unscathed; the class size was often reduced (due to statute of limitations, reducing class size to keep commonality, etc.), or the class certification would be challenged and decertified. *Cline* has upended energy litigation by

awarding a judgment of over $150 million against the oil and gas company.

Is it still worth it to assume the risk of being the paying party? It is a company-by-company determination with no one-size-fits-all solution. However, companies should weigh the benefit of increasing business against a significant risk of administrative error that could result in a massive lawsuit. Oil and gas companies that frequently act as a first purchaser should consider changing their policies so that they no longer bear the burden of managing payments. What used to be a business strategy is turning into an administrative nightmare.

c. Should the Royalty Interest Owner Take Some Responsibility?

In *Cline*, the plaintiffs had not asked for the statutory interest on late payments, and the court determined that the plaintiffs were not required by statute to request interest; the interest was automatically owed to them under the PRSA.[84] Does it make sense that there is no responsibility placed on the royalty interest owner to take ownership of their property and request it? As described in *Cline*, Sunoco paid ninety-nine percent of their payments on time, but the one percent of late payments amounted to millions of individual payments due to the enormous volume of work they do.[85] When a company is managing hundreds of millions of payments, concerning countless wells, across several states, it almost seems obvious that some will slip through the cracks. There should be some responsibility on the royalty interest owner to request a missing payment before seeking legal remedies. The royalty could go unpaid for a long time before the administrative workers at the oil and gas company ever realize it has gone unpaid at all. Courts have recognized that the PRSA was adopted by the Oklahoma Legislature because of "abusive practices" by the energy industry of withholding royalty payments from interest owners "for a long time."[86] Legislators seem to have ascribed a level of willful neglect to the industry. The PRSA suggests that the Legislature reached the conclusion that the industry purposely does not make payments. One commentator has acknowledged this issue: when oil and gas companies are unable to make a payment, locate the owner, etc., the royalty payment usually goes

84. Cline v. Sunoco, Inc., 479 F.Supp.3d 1148, 1155 (E.D. Okla. 2020).
85. *Id.* at 1159.
86. *Id.* at 1157.

into "suspense" and is essentially withheld until the owner is discovered.[87] The commentator also notes that oil and gas companies usually do very little, if anything, to determine who the owner is.[88] It is this Author's belief that at least some burden should be placed on the royalty interest owner to bring the missing payment to the attention of the payer. Consider this: if you were consistently receiving a paycheck from your employer, and then one week the paycheck did not come, would you wait for the employer to recognize the error and correct it or bring it to their attention as quickly as possible? The situation becomes more complicated, and the employer paycheck example no longer fits, when you consider royalty interests that are passed through wills and span generations. Sometimes owners of interests acquired in that manner do not even know they are the lawful owner.

SURVEY OF SIMILAR STATUTES IN OTHER STATES

Several states have enacted legislation to deter oil and gas companies from withholding royalty proceed interest from entitled interest owners. All of these statutes impose some sort of interest rate on late royalty payments as well as a way for the prevailing party to recoup attorney's fees and costs. Considering that claims under this type of legislation are relatively easy for mineral interest owners to prove, the statutes incentivize mineral owners to seek relief and deter oil and gas companies from withholding funds. There is a clear divide amongst the statutes: those that impose a penalty regardless of why payments are made late (e.g., Oklahoma and Wyoming) and those that allow oil and gas companies to escape liability for unpaid royalty and interest when there is a title defect or other issue (e.g., New Mexico, Colorado, Montana, North Dakota, and Texas).

a. Wyoming

Under Wyoming law, first purchasers must begin making royalty payments no later than six months "after the first day of the month following the date of first sale."[89] Subsequent payments must be made

87. Si S. Bondurant, *To Have and To Hold: The Use and Abuse of Oil and Gas Suspense Accounts*, 31 OKLA. CITY U. L. REV. 1, 7 (2006).
88. *Id.*
89. WYO. STAT. ANN. §30-5-301(a) (2013).

within sixty days "after the end of the calendar month."[90] If payment cannot be made "for any reason" within the applicable time period, the party responsible for paying must deposit all proceeds credited to the interest owner in an escrow account.[91] Once the legally entitled person is determined, the escrow agent must try to deliver the funds. If the escrow agent is unable to deliver the funds for three years, the funds escheat to the state.[92] If any lessee, operator, purchaser, or obligated payer violates the statute, they are liable to the interest owner for the entitled proceeds plus interest at eighteen percent per annum.[93]

b. New Mexico

In New Mexico, the first purchaser must begin making payments "not later than six months after the first day of the month following the date of first sale," and then forty-five days after that for all subsequent payments.[94] Payments not made within the time period are subject to an interest rate of eighteen percent per year.[95] Interest on delayed royalty payments due to title issues is "the discount rate charged by the federal reserve bank of Dallas to member banks plus one and one-half percent on the date payment is due."[96] At the time this Note was written, the interest rate of the federal reserve bank of Dallas was one-quarter (0.25) percent, bringing the royalty interest to one and three-quarters (1.75) percent. The statute also provides a method of obtaining attorney's fees.[97] Interestingly, there is also a provision that explicitly states the duty to locate a mineral interest owner is on the operator or lessee, not the first purchaser.[98] This provides first purchasers protection against liability for unpaid royalties.

c. Colorado

Colorado statute allows purchasers six months from the end of the month after first sale before royalty payments need to be made, and then

90. *Id.*
91. §30-5-302.
92. *Id.*
93. §30-5-303(a).
94. N.M. Stat. Ann. §70-10-3 (2020).
95. §70-10-5.
96. §70-10-4(b).
97. §70-10-6.
98. §70-10-3.1.

"not later than sixty days for oil and ninety days for gas" on subsequent sales.[99] Failure to make timely payments results in an interest rate "two times the discount rate at the federal reserve bank of Kansas City as such rate existed on the first day of the calendar year or years in which proceeds were withheld."[100] At the time this Note was written, the interest rate of the federal reserve bank of Kansas City was one-quarter (0.25) percent, bringing the royalty interest to one-half (0.50) percent. Interest payments are not implemented in three instances: (1) when there is a failure or delay by interest owner to confirm in writing the fractional interest after a reasonable written request; (2) when there is a reasonable doubt as to the mineral interest owner's identity, location, or clear title to the proceeds, and; (3) when litigation would affect the distribution of payments.[101] The statute also places a duty on the mineral interest owner to provide written notice to the payer of outstanding royalty interest, and the payer then has twenty days after receiving the notice to pay proceeds plus interest to the owner.[102] The prevailing party may be entitled to reasonable attorney's fees and costs.[103]

d. Montana

In Montana, first purchasers must make payment within 120 days of the initial sale and within sixty days for oil and ninety days for gas for all subsequent sales.[104] Parties may make a written agreement for the interest rate, not to exceed fifteen percent or six "percentage points per year above the prime rate published by the federal reserve."[105] The first purchaser owes no royalty or interest if there is a dispute regarding title, such that the outcome affects distribution of payments.[106] The statute provides for recovery of reasonable attorney's fees and costs by the prevailing party.[107]

99. Colo. Rev. Stat. §34-60-118.5(2)(a) (2021).
100. §34-60-118.5(4).
101. §34-60-118.5(3)(I)-(III).
102. §34-60-118.5(7).
103. §34-60-118.5(6).
104. MONT. CODE. ANN. §82-10-103(2) (2021).
105. §31-1-107.
106. §82-10-103(4).
107. §82-10-101(2), (4).

e. North Dakota

The North Dakota Legislature is much more generous to oil and gas producers than the Oklahoma Legislature. Under North Dakota law, producers have 150 days after the product is marketed to pay mineral interest owners.[108] If royalty is not paid within the 150-day period, an eighteen percent interest rate per year applies.[109] Although this interest rate is six percent higher than in Oklahoma, there is no interest due on payments withheld because of title issues.[110] Similar to Oklahoma's PRSA, the North Dakota law allows the prevailing party to recover reasonable attorney's fees; this is another example of a statute which makes recovering late payment, if not lucrative, at least relatively easy.[111]

f. Texas

Texas's applicable statute is the most generous to oil and gas purchasers, having the lowest interest rate and placing the burden on the mineral interest owner for requesting unpaid interest. Texas law requires payments to be made within "120 days after the end of the month of first sale[,]" and then within the time frame agreed upon in a lease or other agreement.[112] If no time is specified in a lease, the frequency is within sixty days of the end of the month for oil and ninety days after the end of the month for gas.[113] Interest on unpaid royalty is significantly lower in Texas than other states discussed. In Texas, the interest rate is calculated as "two percentage points above the percentage rate charged on loans to depository institutions by the New York Federal Reserve Bank," unless the parties specify a different rate in a written agreement.[114] At the time this Note was written, the interest rate of the federal reserve bank of New York was one-quarter (0.25) percent, bringing the late royalty interest rate to two and one-quarter (2.25) percent. The relevant Texas statute outlines three instances that allow the obligated payer to withhold payments without interest: (1) when there is a dispute concerning title; (2) when there is reasonable doubt the interest owner has sold or authorized sale to the first

108. N.D. CENT. CODE §47-16-39.1(1) (2021)
109. *Id.*
110. *Id.*
111. *Id.*
112. TEX. NAT. RES. CODE ANN. §91.402(a) (West 2021).
113. §91.402(a)(1)-(2).
114. §91.403(a).

purchaser or has clear title in the mineral interest, or; (3) when there is a title issue regarding identity or location of the entitled interest owner.[115] Additionally, if the mineral interest owner intends to seek relief for untimely payments, the interest owner must first send written notice to the payer who then has thirty days after receiving notice to make payment before the interest owner may file suit.[116] The Texas Legislature puts the burden on the mineral interest owner to request payment of the interest, unlike the other states discussed. If the interest owner files suit to collect proceeds and interest, and prevails, they are entitled to reasonable attorney's fees.[117]

g. Comparison

Of all the states explored above, New Mexico and Oklahoma have the most similar statutes. Each provides, in varying magnitude, an interest rate for late royalty payments and for payments made late due to title issues. Even though they are similar, Oklahoma still differs from New Mexico because New Mexico provides a safeguard for oil and gas purchasers by putting the burden on the oil and gas operator or lessee to provide accurate interest owner information to the first purchaser. By law, New Mexico allocates the risk to the operator or lessee, which makes sense because the lessee is the party privy to all of the information regarding interest owners, well information, etc. It is also not unreasonable to believe that when transferring the royalty interest owner's information to the first purchaser, some could be left out. In that case, the first purchaser would never have had the opportunity to make a payment to that interest owner, because the first purchaser would never have been provided that information. It makes complete sense that the lessee would be the party responsible for managing interest owner information since they are the party most involved with it. Though Oklahoma may not change their statute to place the same burden on lessees in the state, it would not be surprising if, in light of recent class-action lawsuits, first purchasers begin to change their internal policies such that they are not responsible for managing royalty payments.

At the time this Note was written, North Dakota had the highest interest rate at eighteen percent on late payments. However, the state forgives interest on all late payments due to title issues. Considering some

115. §91.402(b)(1).
116. §91.404.
117. §91.406.

of the complicated situations that can come from mineral interest conveyances (e.g., fractional interests passed down for generations or incomplete transfer of information from lessee to first purchaser), it would not be surprising to discover that many late payments are in fact made due to title issues; therefore, this statute (which has one of the highest interest rates) may actually turn out to be one of the most forgiving.

Although geographically close, Texas and Oklahoma's statutes are the most different. Texas imposes a much lower interest rate on late royalty payments, and a low or nonexistent interest rate on payments made late due to title issues. Texas also requires that the mineral interest owner put the payer on notice before filing legal action. Had Oklahoma's statute included a similar provision, the issue faced in *Cline* would likely have been remedied; Sunoco sent a check to Cline for the unpaid interest amount in an attempt to resolve the issue.[118] Assuming the objective of Texas's statute is the same as Oklahoma's statue (i.e., to deter oil and gas companies from withholding royalty payments), perhaps the Texas statute is not as effective at achieving that goal because it is too energy friendly. The interest rate seems so minimal that it is not acting as much of a deterrent and places responsibility on the interest owner to request payment of unpaid royalty. There is definitely a balance to be struck between deterring energy companies from holding on to funds and placing responsibility on all parties.

Interestingly, New Mexico, Colorado, and Texas all include provisions that put responsibility on the mineral interest owner to request payment of unpaid royalties. This idea was presented earlier in the Note as a way the Oklahoma Legislature could strike a better balance between the interests of mineral owners and energy companies. It is a common-sense idea that if it is your property you should take the initiative and request it.

CONCLUSION

A mineral interest owner may find it challenging to understand the rights they possess or how their royalty is calculated. Without a thorough understanding of how the operation works from beginning to end, a mineral interest owner is left to trust that the operators are working in a manner that is best for both the mineral owner and the operator. If a mineral interest owner believes that they have been under paid or paid late,

118. Cline v. Sunoco, Inc., 479 F.Supp.3d 1148, 1156 (E.D. Okla. 2020).

that opens the door for royalty litigation under the PRSA. In the last several decades, class-action royalty litigation has become more common across the industry. In a state like Oklahoma, where the PRSA tends to be more mineral-owner-friendly than energy-industry-friendly, the only hurdle left for a mineral interest owner is to establish at what point the product was marketable and to ensure that only the appropriate costs were deducted, if any. As is illustrated above, marketable condition is more individualized in gas royalty litigation and has led to several failed class certifications. On the other hand, as *Cline* shows, oil royalty litigation is not faced with the same challenges of marketable product and has exposed a poor industry practice of not paying interest without request.

This Note has illustrated how class-action royalty litigation has played out in Oklahoma courts under the PRSA. The PRSA has taken aim at Oklahoma oil and gas companies but may be too powerful. Realizing that it is important to strike a balance between the mineral owner and the energy industry, it may be time for the Oklahoma Legislature to take another look at how the PRSA is being used and the impact it is having. This Note has considered a practical justification for reevaluating the PRSA; the property owner should bear some responsibility for claiming what is rightfully theirs. This idea is expressed in other states with statutes similar to the PRSA, and Oklahoma may do well to follow suit.