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## Grouping the Marcellus Payout: Use of Class Actions in Royalty Litigation Concerning Post-Production Cost Deductions

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# GROUPING THE MARCELLUS PAYOUT: USE OF CLASS ACTIONS IN ROYALTY LITIGATION CONCERNING POST-PRODUCTION COST DEDUCTIONS

KAREN E. KAHLE\* AND DENIELLE M. STRITCH\*\*

## ABSTRACT

As drilling and operations in the Marcellus, Utica, Bakken, and other United States shales increase across the country, so naturally does litigation between those owning the land and minerals, and those producing them. This Article will outline the growing trends that entitle lessors to royalties without any deduction of production or transportation costs, as well as the parallel application of these principles to establish commonality for class certification of lessors. Regardless of the differences between drilling, leases, and pooling agreements in the shale context, Appalachian jurisdictions are likely to hold the course and continue examining royalty issues, and class certification of those issues, as liberally as they have in other contexts. Part II of this Article will address royalty payments and cost deductions in state courts through the present, focusing on how courts have handled similar disputes in the past. Part III of this Article will outline the general processes needed to certify a class. Part IV will examine the commonality requirement of class certification more thoroughly, and Part V will review that commonality requirement in the context of landowner royalty disputes. Part VI of this Article will examine how courts have addressed contract-based class actions. Finally, Part VII will argue that as landowner, royalty, and cost deduction disputes arise in the context of the shales, courts are likely to apply the implied covenant to market against any lessee and find commonality where leases bear similar language, subjecting the lessee to such a covenant.

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## I. INTRODUCTION

Recently, the Appalachian states have seen remarkable growth in natural gas drilling in the Marcellus and Utica shales. These shales are geological formations of accumulated sediment, buried millions of years ago and compressed to produce the shale.<sup>1</sup> It is well known that the Marcellus is rich in fossil fuels, but until technology caught up with desire, there was no practical way of accessing the natural gas trapped within this formation.<sup>2</sup> However, with the advent of technology came the ability to access, produce, and profit from the natural gas in the Marcellus.<sup>3</sup> A similar “rush” is underway with the Utica shale, another gas, and potentially oil rich, shale formation located on the western side of the Appalachian Basin.<sup>4</sup> Similar to the Utica and Marcellus shales, the Bakken shale, located largely in North Dakota, and other various shale formations throughout the country, are experiencing similar “rushes.”<sup>5</sup> As shale production and leasing activities increase, courts are likely to see an influx in issues not previously addressed in-depth. Because of these changes in extraction in the shales, new twists on legal issues as to ownership and royalty rights are cropping up more often. Oil and gas companies are seeing new problems arise in their leasing structures, practices, production methods, and royalty payouts. Landowners are clashing with these companies in new and unique ways.

One particular area courts are likely to be pulled into battles between landowners (lessors) and drilling companies (lessees) is royalty payment calculations and post-production cost allocation.<sup>6</sup> In particular, landowners are bringing more claims alleging that lessees are engaging in a common pattern of miscalculating the royalty payments owed under leasing agreements, which are often payments under pooling agreements.<sup>7</sup> These

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1. See Kristen Allen, *The Big Fracking Deal: Marcellus Shale – Pennsylvania’s Untapped Resource*, 23 VILL. ENVTL. L.J. 51, 54 n.26 (2012).

2. See *id.* at 54-55.

3. See *id.* at 55.

4. See generally Stephanie Karisny, *Hydraulic Fracturing in Michigan: Reassessing State Regulations in Light of New Drilling in the Collingood and Utica Shales*, 57 WAYNE L. REV. 627 (2011).

5. See Christopher S. Kulander, *Environmental Effects of Petroleum Production: 2010-2011 Texas Legislative Developments*, 44 TEX. TECH. L. REV. 863, 881 (2012) (“The problems being heard by the Eagle Ford Task Force are analogous to another shale gas boom currently underway in remote and sparsely populated western North Dakota wherein the Bakken Shale is found.”). See generally Karisny, *supra* note 4.

6. See *infra* Part II.E.

7. Randy M. Awdish, *Wolverine Gold Rush? A Primer on the Utica/Collingwood Shale and Gas Lease Issues*, 38 MICH. REAL PROP. REV. 64, 70 (2011) (“A typical lease will contain a provision allowing the lessee the right to consolidate or ‘pool’ the leased premises with adjoining premises.”).

landowners are likely to band together and attempt to certify a class to maximize the impact of the litigation, especially when common patterns of miscalculations are alleged and/or payments under pooling agreements are in dispute. Similar claims have been brought for many years, involving leases for vertical well drilling.<sup>8</sup> As a result, courts will need to determine whether the previous analytical frameworks will apply to these new leasing arrangements, and if so, which of many rationales best fits this situation.

While horizontal drilling in the various shales across the country has exploded and litigation related to the drilling process of the oil and gas interests involved has dramatically increased, courts need not reinvent the wheel to resolve royalty calculation or cost allocation disputes between lessors and lessees. Nor must they start from scratch in determining whether lessors involved in horizontal drilling may bring a class action against a lessee. This Article will show that, while differences may be necessary within leasing arrangements due to the nature of natural gas extraction from the shales, these differences do not alter the analysis for approaching class certification.<sup>9</sup> This Article will outline the growing trends that entitle lessors to royalties without any deduction of production or transportation costs, as well as the parallel application of these principles to establish commonality for class certification of lessors. Regardless of the differences between drilling, leases, and pooling agreements in the shale context, Appalachian jurisdictions are likely to hold the course and continue examining royalty issues and class certification of those issues as liberally as they have in other contexts.

Part I of this Article will address royalty payments and cost deductions in state courts through the present, focusing on how courts have handled similar disputes in the past. Part II of this Article will outline the general requirements needed to certify a class. Part III will examine the commonality requirement of class certification more thoroughly, and Part IV will review that commonality requirement in the context of landowner royalty disputes. Part V of this Article will examine how courts have addressed contract-based class actions. Finally, Part VI predicts that as landowner royalty and cost deduction disputes arise in the context of the shales, courts are likely to apply the implied covenant to market against lessees and find commonality where leases bear similar language subjecting the lessee to such a covenant.

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8. *See infra* Parts II.E, V.

9. *See infra* Parts II.E, III.

## II. ROYALTY PAYMENTS AND COST DEDUCTIONS: HOW WE GOT WHERE WE ARE

This Article will focus on fairly specific types of lawsuits and the contexts in which they arise – generally, related to extraction of natural gas from underground formations by one party to a lease (the lessee) with the property’s owner (the lessor). Prior to getting into those issues, however, it is essential to understand, in very general terms, the relevant property ownership principles, natural gas extraction techniques, recent technological advancements resulting in changes to those techniques, and how those changes may affect property rights.

### A. OWNERSHIP OF SUBSURFACE MINERALS

Unlike virtually any other country in the world, in the United States, individuals (as opposed to the government) may own subsurface minerals.<sup>10</sup> Even in our country’s beginning, individuals have been laying claim to property. Ultimately, the law developed so the owner of the surface of land in America also held all rights to the subsurface, straight down to the center of the earth.<sup>11</sup> While the nuances of property law may vary from state to state, this general principle is true across the board.<sup>12</sup> Complete ownership of an entire tract of property is generally known as fee simple.<sup>13</sup>

As the years went by and less unclaimed property remained, states and localities began to develop methods for giving notice of ownership details to all others and proving ownership of real property. Today, property ownership, rights, and interests are typically recorded in the office of the county clerk where the property lies. These recorded interests include mineral leases, which notify the public that if a stated individual or entity owns the oil and gas interests underlying a given property, another individual or entity has contracted to produce the oil and gas.<sup>14</sup>

### B. HISTORY OF MINERAL EXTRACTION IN AMERICA

For centuries before our country was formed, it was known that the subsurface of land contained minerals, primarily coal, oil, and gas, which were useful for the creation of light and energy. By the mid-1800s, efforts

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10. *See generally* McCormick v. Union Pac. Res. Co., 14 P.3d 346, 346 (Colo. 2000).

11. *Id.* *See generally* Stuart S. Ball, *The Vertical Extent of Ownership in Land*, 76 U. PA. L. REV. 631, 684-89 (1928).

12. C.C. Marvel, Annotation, *Oil and Gas as “Minerals” Within Deed, Lease, or Licenses*, 37 A.L.R. 2D 1440, 1441-42 (1954); *see also* Ball, *supra* note 11, at 689.

13. 31 C.J.S. *Estates* § 12 (2012).

14. *See generally* LARRY L. SKEEN, *OIL & GAS LAW OF KENTUCKY, VIRGINIA, AND WEST VIRGINIA* §§ 3:1-3:6 (1994).

were underway in this country to reach and extract these underground minerals, using drilling and extraction techniques that have been modified and refined over the years.<sup>15</sup> As those involved in mineral extraction (now known as producers) became more experienced, particular geographic regions were identified as being rich sources of oil and/or natural gas. For example, mid-continent states, like Texas, Kansas, and Arkansas were areas found to be rich in oil, while large amounts of coal were found in Appalachian states, like West Virginia. Often the fee simple owner would have no interest in, nor the ability to extract, any coal, oil, or gas that may exist on his property. Thus, fee simple owners began severing or selling off various factions of their property to those better equipped to profit from ownership of those minerals. As severances and changes in property ownership occurred, notices of ownership and rights were filed in local records. As time passed, technologies for extraction of oil and natural gas improved, and property ownership became more and more complicated. In addition, beginning in the early part of the twentieth century, the government began regulating natural gas development and distribution, among other things in the industry.<sup>16</sup>

Originally, drilling into the subsurface to extract oil and gas simply went straight now into the earth, using percussion technology in the early 1800s and progressing to rotary drilling by the mid-nineteenth century.<sup>17</sup> Early in the twentieth century, producers began using directional or slant drilling on occasions when surface use directly above the formation sought to be explored and produced was not consistent with placement of a well.<sup>18</sup> In keeping with the theory of property ownership that the fee simple tract went straight down to the center of the earth, directional drilling presaged the potential for trespass and conversion of minerals from unowned or unleased property.<sup>19</sup>

This early technology allowed slant drilled wells to angle but without much curve.<sup>20</sup> It could take as much as two thousand feet for a vertical slant well to become horizontal. With improvements in technology, the

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15. *Where is Crude Oil Produced*, CONSUMER ENERGY REPORT, <http://www.consumerenergyreport.com/research/crude-oil/where-oil-is-produced/> (last visited Nov. 10, 2012).

16. *See The History of Regulation*, NATURALGAS, <http://naturalgas.org/regulation/history.asp> (last visited Feb. 1, 2013).

17. *See Oil Drilling*, SCIENCE CLARIFIED, <http://www.scienceclarified.com/Mu-Oi/Oil-Drilling.html> (last visited Oct. 19, 2012).

18. *See Directional and Horizontal Drilling*, NATURALGAS, [http://www.naturalgas.org/naturalgas/extraction\\_directional.asp](http://www.naturalgas.org/naturalgas/extraction_directional.asp) (last visited Oct. 19, 2012).

19. *Id.*; Ball, *supra* note 11, 684-89.

20. Thomas E. Stimson, Jr., *Oil Drillers Throw Curves*, POPULAR MECHANICS, Jan. 1950, at 161-64.

curves were tightened. Today, wellbores can more readily and quickly go from vertical to horizontal, allowing one well access to potentially thousands of acres of subsurface formations, not just those formations directly under the well.<sup>21</sup>

### C. OIL AND NATURAL GAS LEASES

Leasing of oil and gas rights by producers, as opposed to the outright purchase of mineral estates, has become much more prevalent. In its most basic sense, an oil and gas lease is a contract between the mineral owner, known as the lessor, who may or may not also be the surface owner, and an individual or entity, known as the lessee.<sup>22</sup> Ideally, oil and gas leases describe and set forth all material provisions in a way which is acceptable and agreeable to both lessee and lessor.<sup>23</sup> As a practical matter, however, this is rarely the case.<sup>24</sup> When disputes arise between the parties to an oil and gas lease, the parties, and the courts, must turn to regulatory, statutory, and common law to fill in the gaps in resolving their disputes.<sup>25</sup>

### D. BASIC LEASE PROVISIONS

It is impossible to include terms for all potential disputes between lessors and lessees. However, following are some basic provisions found in most oil and gas leases. The subsections below outline common provisions in mineral leases, including term, leased premises, delay rental, royalty, and pooling.

#### 1. *Term*

The “term” of a lease defines the periods of time and conditions under which a lease remains valid.<sup>26</sup> Most oil and gas leases have both a primary term and a secondary term.<sup>27</sup> The primary term is typically a fixed number of years and generally requires no production or exploration activity on the part of the lessee for the lease to remain valid.<sup>28</sup> On the other hand, the secondary term is the period following the conclusion of the primary term

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21. NATURALGAS, *supra* note 18.

22. Douglas Hah Gross, Annotation, *What Constitutes Reasonably Necessary Use at the Surface of the Leasehold by a Mineral Owner, Lessor, or Driller Under an Oil and Gas Lease or Drilling Contract*, 53 A.L.R. 3D 16, 24-42 (1973).

23. *See id.*

24. *See id.*

25. *See id.*

26. Awdish, *supra* note 7, at 69.

27. Mohan Kelkar, *The Effect of the Cessation of Production Clause During the Secondary Term of an Oil and Gas Lease*, 22 TULSA L.J. 531, 532 (1987).

28. *Id.* at 533.

and defines the circumstances under which the lease shall remain in force and effect.<sup>29</sup> A typical term provision in an oil and gas lease may read as follows: “This lease shall remain in force and effect for a [primary] term of – years (or months) and as long thereafter as substances covered by the lease are produced [secondary term].”<sup>30</sup> Courts generally agree that if the condition described for taking the lease into the secondary term is not met, the lease expires.<sup>31</sup>

## 2. *Leased Premises*

The lease should contain a full and complete legal description of the real property that is subject to the lease.<sup>32</sup> This description is often carried over from lease to lease as ownership and leasing rights change hands.<sup>33</sup> The description often includes metes and bounds language to help pinpoint the property’s boundaries.<sup>34</sup>

## 3. *Delay Rental*

A lessee usually need not explore or produce under a lease during its primary term.<sup>35</sup> Instead, a lease often includes a provision for payment of delay rentals to the lessor.<sup>36</sup> Consideration is then typically paid at the end of each year of the primary term in which no production has taken place.<sup>37</sup>

## 4. *Royalty*

Usually, the primary consideration for a lessor under an oil and gas lease is reservation of a royalty interest in all minerals produced under the lease.<sup>38</sup> This is typically expressed as a fraction or percentage, usually

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29. *Id.*

30. See generally *Checklist for Oil/Gas/Mineral Leases*, MICH. FARM BUREAU, <http://www.michfb.com/ecology/minerals> (last visited Nov. 10, 2012).

31. See generally Kelkar, *supra* note 27, at 532-37; see also MICH. FARM BUREAU, *supra* note 30.

32. See generally SKEEN, *supra* note 14, § 3:31.

33. *Id.*

34. *Id.*

35. See 55A TEX. JUR. 3D *Oil and Gas* § 344 (2012).

36. *Id.*

37. *Id.*

38. 38 AM. JUR. 2D *Gas and Oil* § 195 (2010). The various definitions of royalty include: an agreed return paid for oil or gas reduced to possession and taken from the leased premises; a share of the profits or proceeds from gas and oil operations; the landowner’s share of production, free of the expenses of production; that fractional interest in the production of oil or gas created by the owner of land, either by reservation when the mineral lease was entered into, or by direct grant to a third person; payment from the lessee oil production company to the lessor-landowner for oil extracted from the lessor’s property; or the compensation provided in the lease for

between an eighth and a quarter of the price received by the lessee from sale of oil or gas produced.<sup>39</sup> Disputes concerning calculation of royalty payments, including whether any of the post-production costs are taken from the reserved royalty interest, will be a major focus of this Article.<sup>40</sup>

### 5. Pooling

If the lessee anticipates combining the leased tract with other leased tracts for the purpose of forming a larger, single development unit, the lease may contain a provision defining how such “pooling” can occur, as well as how it will be reflected in royalty calculations.<sup>41</sup> In addition to provisions in individual leases, a number of states have laws regulating pooling.<sup>42</sup> Pooling has become more common as horizontal drilling technology has developed, because horizontal drilling often requires lessees to traverse the mineral interests of multiple lessors.<sup>43</sup>

This Article is most concerned with the disputes arising between lessors and lessees when lessees deduct post-production costs from lessor royalties.<sup>44</sup> As a practical matter, because most lessees are companies that make the drilling of oil or natural gas their business, it would be impractical for each company to write and execute a new, unique lease from scratch with every one of its lessors. Consequently, such companies often use form leases under which a significant number of the terms and provisions are

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the privilege of drilling for, and producing, oil and gas, and consisting of a share of the oil and gas produced or the profits therefrom but not a perpetual interest in the realty. A “royalty interest” means a property interest created in oil and gas, and its owner is entitled to a share of production, if, as and when there is production, free of the costs of production.

*Id.* (citing *Ramming v. Natural Gas Pipeline Co. of Am.*, 390 F.3d 366 (5th Cir. 2004) (referring to Texas law); *CIG Exploration, Inc. v. Hill*, 824 F. Supp. 1532 (D. Utah 1993), *judgment aff’d*, 83 F.3d 431 (10th Cir. 1996); *Texaco, Inc. v. Pigott*, 235 F. Supp. 458 (S.D. Miss. 1964), *judgment aff’d*, 358 F.2d 723 (5th Cir. 1966); *Baxley v. State*, 958 P.2d 422 (Alaska 1998); *Swaim v. Stephens Prod. Co.*, 196 S.W.3d 5 (Ark. 2004); *Armstrong Petrol. Corp. v. Tri-Valley Oil & Gas Co.*, 11 Cal. Rptr. 3d 412 (Cal. Ct. App. 2004); *Simson v. Langholf*, 293 P.2d 302 (Colo. 1956); *Hilliard v. Amoco Prod. Co.*, 688 So. 2d 1176 (La. Ct. App. 1996); *Davis v. Hardman*, 133 S.E.2d 77 (W. Va. 1963); *Mittelstaedt v. Santa Fe Minerals*, 954 P.2d 1203 (Okla. 1998); *Cartwright v. Cologne Prod. Co.*, 182 S.W.3d 438 (Tex. App. Corpus Christi 2006)).

39. Byron C. Keeling & Karolyn King Gillespie, *The First Marketable Product Doctrine: Just What Is the “Product”?*, 37 ST. MARY’S L.J. 1, 2 (2005).

40. *See infra* Parts II.E, V.

41. Awdish, *supra* note 7, at 70; *Oil and Gas Pooling: How it Works and How Forced Pooling Affects the Owner*, OIL-GAS-LEASES, <http://www.oil-gas-leases.com/oil-gas-pooling.html> (last visited Oct. 21, 2012).

42. *See generally* E. H. Schopler, Annotation, *Validity of Compulsory Pooling or Unitization Statute or Ordinance Requiring Owners or Lessees of Oil and Gas Lands to Develop Their Holdings as a Single Drilling Unit and the Like*, 37 A.L.R. 2D 434 (1954).

43. *See generally* OIL-GAS-LEASES, *supra* note 41.

44. *See infra* Parts II.E, V.

exactly the same or substantially similar from lease to lease.<sup>45</sup> In such leases, the royalty clauses usually include a method for calculation of the royalty fraction reserved; however, royalty interests are not always protected within the other provisions of the lease.<sup>46</sup> In such cases, courts have stepped in to apply “implied covenants,” which require a lessee to adhere to certain obligations for marketing or producing the gas drilled.<sup>47</sup> An implied covenant to market generally requires a lessee to operate for the common good of both parties where marketable quantities of gas have been found.<sup>48</sup> Often, reliance on implied covenants benefits the lessor because the lessee is obligated to market; therefore, post-production costs are largely its own responsibility. However, even when a lessor’s royalty rights are protected by lease provision, implied covenant, or other circumstances, the lessors often feel that a lessee is not providing the proper payments and address this concern through litigation.

#### E. ROYALTY PAYMENTS AND PRODUCTION COSTS: THE ARGUMENT

Regardless of lease terms and parties’ understandings of royalty calculations prior to drilling, disputes inevitably arise regarding: (1) how royalty payments are calculated, (2) the point at which production costs become transmission costs, and (3) who is responsible for these expenses. By and large, two schools of thought have formed to assess these costs: the “marketable product” rule and the “at the wellhead” rule. How courts have historically assessed this calculation can affect not only the value of a lessor’s royalty, but also its impact on certification of a class action.

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45. See *Assignment of Oil and Gas Leases Texas Form*, MONEYINOIL, <http://moneyinoil.com/legalform25.html> last visited Oct. 21, 2012) (providing a sample oil and gas form).

46. See *Iams v. Carnegie Natural Gas Co.*, 45 A. 54, 55 (Pa. 1899).

47. *Id.*

48. *Id.* In *Iams*, the following royalty clause was included in the lease:

In consideration of said grant and demise the said party of the second part agrees to give or to pay to the said parties of the first part the full equal one-eighth part of all the oil produced or saved from the premises, and to deliver the same, free of expense, into tanks or pipe lines, to the credit of the first parties; and, should gas be found in sufficient quantities to justify marketing the same, the consideration in full to the parties of the first part shall be five hundred (\$500) dollars per annum, payable semi-annually in advance, for the gas from each well, so long as it shall be sold therefrom, and gas free of cost, for household use on the premises, to be taken from a well on same.

*Id.* at 54. Based on this language, a jury held that the lessee obtained sufficient quantities of gas to justify marketing so that, once obtained, lessee was obligated to “operate for the common good of both parties, and to pay the rent or royalty reserved.” See *id.* at 55.

### 1. *At the Wellhead*

Jurisdictions adhering to an “at the wellhead” royalty payments and production costs are spearheaded by Texas courts. In essence, this rule grants a lessor claim to a royalty payment when gas arrives “at the wellhead,” at which point it is converted from real property to personal property.<sup>49</sup> This means the royalty percentage is valued at the point at which the gas is severed from the wellhead – all costs after that point are post-production costs, which *can* be deducted from a lessor’s royalty payment.<sup>50</sup> In making this determination, courts do not consider the quality of the product, but instead are only concerned with the location.<sup>51</sup> While an implied duty to market is sometimes addressed in the sense that the lessee is obligated to obtain a good price, it is not the basis for the calculation assessment.<sup>52</sup>

Although a significant number of courts have moved away from such a strict linguistic construction, a lease bearing the language “at the well” or “at the wellhead” warrants at least a cursory review of this calculation method.<sup>53</sup> Historically, courts have placed great weight on the use of the language – and accordingly, more production cost responsibility – on the lessor.<sup>54</sup> As shale leases are entered, a lessee using this language must consider whether use of “at the wellhead” language will allow them to apply post-production costs against royalty percentages. Similarly, a lessee will have to consider whether using that language will allow it to apply costs against royalties in a pooling agreement, where theoretically, all royalties are treated equally. Unfortunately, the trend is leading away from use of the “at the wellhead” rule and toward prohibiting application of post-production costs against lessors’ royalty interest.<sup>55</sup>

### 2. *Marketable Product*

Jurisdictions applying the marketable product rule for royalty calculation rely heavily on the existence of a lessee’s implied covenant to market.<sup>56</sup> In essence, this duty requires a lessee to obtain the best price

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49. Keeling & Gillespie, *supra* note 39, 2-3.

50. *Id.*; Brian S. Wheeler, *Deducting Post-Production Costs When Calculating Royalty: What Does the Lease Provide?*, 8 APPALACHIAN J.L. 1, 5 (2008).

51. *See* Keeling & Gillespie, *supra* note 39, at 4.

52. *See id.* at 4-5.

53. *Id.*

54. *Id.*

55. *Id.* at 5.

56. Rachel M. Kirk, *Variations in the Marketable-Product Rule from State to State*, 60 OKLA. L. REV. 769, 774 (2007).

possible on marketable quantities of gas.<sup>57</sup> The marketable product rule obligates a lessee to bear all costs incurred in making gas “marketable,” pursuant to this implied covenant.<sup>58</sup> Obviously, this rule is much more beneficial to the lessor than to the lessee, as a lessor’s royalty will be much larger where costs are not applied to his retained interest. This rule is followed in a number of traditional oil and gas states, notably Arkansas<sup>59</sup> and Kansas.<sup>60</sup> Kansas courts have explained that the implied covenant to market instills a duty on the lessee to prepare the drilled gas for market.<sup>61</sup> Accordingly, the costs associated with that duty are also borne by the lessee, not the lessor.<sup>62</sup> When applied in fact, even where royalty payments are to be paid at the wellhead in accordance with a lease term, the lessee may not deduct transportation or compression costs from that payment.<sup>63</sup>

Of the Appalachian states, West Virginia courts have discussed this issue most extensively. West Virginia has essentially prohibited any deductions of post-extraction costs from the lessor’s royalty payment.<sup>64</sup> This rule is applied very liberally and always in favor of the lessor. As such, unless a lease includes an express provision that the calculation of a royalty payment requires the deduction of costs past the point of extraction, a lessor is entitled to a royalty percentage that does not reflect these expenses.<sup>65</sup> And even in that case, a lessee may end up covering all costs. In particular, in *Estate of Tawney v. Columbia Natural Resources, LLC*,<sup>66</sup> a class action suit brought by lessors claiming insufficient royalty payments, the West Virginia Supreme Court of Appeals held that “at the well” type phrases were not sufficient to allow lessees to shift post-production costs onto lessors.<sup>67</sup> This plainly exemplifies the liberal, pro-lessor view of oil and gas lease analysis in Appalachia.

It seems courts are trending toward the marketable product rule when assessing the validity of royalty calculations, so the prudent lessee in a shale

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57. *Id.* (citing *Mittelstaedt v. Santa Fe Minerals, Inc.*, 954 P.2d 1203, 1211 (Okla. 1998)).

58. *Id.* at 775 (citing MAURICE H. MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 85, at 214-15 (2d ed. 1940)).

59. *See generally* *Clear Creek Oil & Gas Co. v. Bushmiaer*, 264 S.W. 830 (Ark. 1924) (holding the prices prevailing at the nearest place gas can be sold is market value, and the lessee bears the transportation and distributing charges); *Hanna Oil & Gas Co. v. Taylor*, 759 S.W.2d 563 (Ark. 1988) (holding lessee could not deduct costs of compressing gas for delivery).

60. *See generally* *Gilmore v. Superior Oil Co.*, 388 P.2d 602 (Kan. 1964).

61. *Id.* at 606-07.

62. *Id.*

63. *See id.*

64. *Estate of Tawney v. Columbia Natural Res., LLC*, 633 S.E.2d 22, 30 (W. Va. 2006).

65. *Wellman v. Energy Res. Inc.*, 557 S.E.2d 254, 265 (W. Va. 2001).

66. 633 S.E.2d 22 (W. Va. 2006).

67. *Estate of Tawney*, 633 S.E.2d at 30.

region should assume it will be held responsible for post-production costs.<sup>68</sup> Contractual language to the contrary may help share the burden with lessors in some states. However, fact that covenants to market are being more readily implied demonstrates that royalty calculation decisions are trending in favor of lessors.

### III. CLASS CERTIFICATION

Lessees may have multiple leases out for drilling in multiple locations at any given time, and courts are often asked to certify a class of lessors and allow uniform decision of the royalty-payment issue across that class.<sup>69</sup> Courts in such circumstances must determine whether such lessors and their claims are situated such that a class should be certified. Certification requirements are relatively uniform across the oil-rich regions, but assessment of those requirements is not. As companies lease more and more property for the purposes of horizontal drilling, courts will undoubtedly have to decide whether or not to certify lessor-classes claiming that a company has not properly issued royalty payments across the board. Determining how courts are likely to assess class certification motions in the future requires an examination of the class action certification process, as well as how courts have applied that process in similar situations.

Class actions arose as a useful form of pleading because they allow a large group of plaintiffs to bring suit against a single person or entity with hopes of resolving the same or very similar concerns.<sup>70</sup> In order to be certified as a class action, under the Federal Rules of Civil Procedure, as well as under the majority of state rules, a class must satisfy both Rule 23(a) and (b).<sup>71</sup> Federal Rule of Civil Procedure 23(a) states:

One or more members of a class may sue or be sued as representative parties on behalf of all members only if: (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

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68. Kirk, *supra* note 56, at 780 (explaining Wyoming, Michigan, Nevada, Arkansas, Kansas, Colorado, West Virginia, and Oklahoma have adopted the marketable product approach); *see also* MICH. COMP. LAWS ANN. § 324.61503(b) (West 2012); NEV. REV. STAT. ANN. § 522.115(b) (West 2011); WYO. STAT. ANN. § 30-5-304 (2012).

69. *See generally* SEECO v. Hales, 22 S.W.3d 157 (Ark. 2000); Shockey v. Chevron U.S.A., No. 98,063 (Okla. Ct. App. Apr. 4, 2003) (not for publication); Duhe v. Texaco, Inc., 779 So. 2d 1070 (La. Ct. App. 2001); John B. McArthur, *The Class Action Tool in Oilfield Litigation*, 45 U. KAN. L. REV. 113 (1996).

70. FED. R. CIV. P. 23 advisory committee's notes.

71. FED. R. CIV. P. 23(a)-(b).

claims or defenses of the class; and (4) the *representative parties* fairly and adequately protect the interests of the class.<sup>72</sup>

The requirements of this rule are generally referred to as numerosity, typicality, commonality, and adequate representation.<sup>73</sup> If a court finds that numerosity, commonality, typicality, and adequate representation have been met, it must then determine the type of the class.<sup>74</sup> Under Federal Rule of Civil Procedure 23, there are three types:

(b) *Types of Class Actions*. A class action may be maintained if Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

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72. FED. R. CIV. P. 23(a) (emphasis added).

73. *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 613 (1997).

74. *Id.*

(D) the likely difficulties in managing a class action.<sup>75</sup>

Certification under Rule 23(b)(1) and/or (2) is typically requested when equitable relief – primarily, a class-wide injunction – is sought.<sup>76</sup> When damages – money – are sought, certification under Rule 23(b)(3) is typically requested.<sup>77</sup> Almost universally, lessors seeking class certification in royalty dispute actions seek money damages and thus, certification under Rule 23(b)(3).<sup>78</sup>

The majority of states have based their class action legislation on Federal Rule of Civil Procedure 23, with several adopting the relevant provisions in their entirety. This includes the Appalachian states (West Virginia, Pennsylvania, and Ohio), and traditional oil and gas states (Texas, Oklahoma, Kansas, and Arkansas).<sup>79</sup> While courts must address all certification requirements when a class action motion is made, this Article will focus on the commonality analysis, under both Rule 23(a) and (b)(3), among lessors claiming improper calculation of royalty payments. In essence, in order to produce the oil and gas underlying any given surface, a company must own or lease one hundred percent of the oil and gas interests underlying that property.<sup>80</sup> Accordingly, a company is likely to have many leases taken out on many different tracts of land at any given time.

In addition, a court considering a certification motion must ensure that the commonality between class members' claims predominates over any individual claims the members may have.<sup>81</sup> As a result, methods used by individual courts to determine, commonality are important. How courts have handled this determination and what facts each court is willing to consider, play a large part in whether or not commonality is found to be sufficient.

#### IV. THE COURT'S COMMONALITY ASSESSMENT

Courts typically set a low threshold for finding commonality in most requests for class certification.<sup>82</sup> Predominance of those common issues, at

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75. FED. R. CIV. P. 23(b).

76. *Amchem Prods., Inc.*, 521 U.S. at 614-16.

77. *Id.*

78. *Id.*

79. *See* W. VA. R. CIV. P. 23(a); PA. R. CIV. P. 1702(1)-(5) (requiring that a “class action provides a fair and efficient method for adjudication of the controversy under the criteria set forth in Rule 1708” as well); OHIO R. CIV. P. 23(a); TEX. R. CIV. P. 42(a); OKLA. STAT. tit. 12, § 2023.A; ARK. R. CIV. P. 23(a).

80. *See* SKEEN, *supra* note 14, § 3:7.

81. *Simpson Housing Solutions, LLC v. Hernandez*, 347 S.W.3d 1, 16-16 (Ark. 2009); *see* 59 AM. JUR. *Parties* § 73 (2012).

82. *Georgine v. Amchem Prods., Inc.*, 83 F.3d 610, 627 (3d Cir. 1996).

least in theory, calls for a closer examination and a higher threshold. It is not enough that common questions exist; rather, those common questions must pervade a significant aspect of the pending litigation.<sup>83</sup> Because of this second step, courts often cursorily find commonality while more thoroughly scrutinizing predominance.<sup>84</sup> On the other hand, to the dismay of the party opposing class certification, many courts will gloss over the predominance analysis required by Rule 23(b)(3) and simply hark back to its Rule 23(a) commonality findings, simply restating them in the Rule 23(b)(3) framework.<sup>85</sup> For example, the Appalachian states of Ohio,<sup>86</sup> Pennsylvania,<sup>87</sup> and West Virginia have, for the most part, adopted Federal Rule of Civil Procedure 23 to certify class actions in their own courts.<sup>88</sup> Therefore, “federal authority is an appropriate aid to interpretation of the Ohio rule.”<sup>89</sup> As noted above, the commonality requirements are not difficult to satisfy. “If there is a common nucleus of operative facts, or a common liability issue, the rule is satisfied.”<sup>90</sup>

For example, in Pennsylvania, the common question of fact means the facts must be substantially the same so that proof as to one claimant would be proof as to all.<sup>91</sup> But it is also a strong policy of Pennsylvania that decisions applying the rules for class certification should be made liberally and in favor of maintaining a class action.<sup>92</sup> Likewise, West Virginia and Ohio have adopted the federal rule for class certification and all three states maintain that “‘the threshold of ‘commonality’ is not high,’ and ‘requires only that resolution of the common questions affect all or a substantial number of the class members.’”<sup>93</sup>

Rule 23(b)(3) classes are the most frequent type requested by lessors. The Appalachian states thus require a prospective class to demonstrate that the common questions predominate – just like the federal rule.<sup>94</sup> In determining whether common questions predominate, they “must represent

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83. *Amchem Prods., Inc.*, 521 U.S. at 624.

84. *See generally id.*

85. *See, e.g.,* *Hamilton v. Ohio Sav. Bank*, 694 N.E.2d 442, 452 (Ohio 1998).

86. *Marks v. C.P. Chem. Co.*, 509 N.E.2d 1249, 1252 (Ohio 1987).

87. *Foodarama Supermarkets v. Am. Ins.*, 43 Pa. D. & C.4th 467, 495-96 (Pa. Ct. Com. Pl. 2000).

88. *See Marks*, 509 N.E.2d at 1252.

89. *Id.*

90. *Hamilton*, 694 N.E.2d at 452.

91. *Foodarama Supermarkets*, 43 Pa. D. & C.4th at 495.

92. *Johnson v. Walsh*, No. 09073504, 2011 Phila Ct. Com. Pl. LEXIS 317, at \*10-11 (Pa. Ct. Com. Pl. Dec. 2, 2011).

93. *See, e.g., In re W. Va. Rezulin Litig. v. Hutchison*, 585 S.E.2d 52, 67 (W. Va. 2003) (quoting *Jenkins v. Raymark Indus. Inc.*, 782 F.2d 468, 472 (5th Cir. 1986)).

94. *See Schmidt v. Avco Corp.*, 473 N.E.2d 822, 824 (Ohio 1984).

a significant aspect of the case and they must be able to be resolved for all members of the class in a single adjudication.”<sup>95</sup>

The existence of individual questions of fact is not fatal, but it is essential that there be a predominance of common issues, shared by all the class members, which can be justly resolved in a single proceeding.<sup>96</sup> The standard for showing predominance is more demanding than that for demonstrating commonality, but not so strict as to vitiate the policy favoring certification of class actions.<sup>97</sup> So long as a class shows that “adjudication of the common issues in the particular suit has important and desirable advantages of judicial economy compared to all other issues, or when viewed by themselves,” they are likely to survive certification scrutiny.<sup>98</sup> In essence, the common issues need not be dispositive, as long as a single common issue overrides the remaining individual questions.<sup>99</sup>

Clearly, states have relied heavily on the federal rule to certify class actions, including traditional oil and gas states such as Texas, Kansas, Oklahoma, and Arkansas.<sup>100</sup> Many courts in oil and gas states have had the opportunity to assess the commonality and certify classes in property-based contexts. However, the traditional oil and gas states have had significant opportunity to examine commonality and class certification where lessors claim that their royalty payments have not been properly calculated.<sup>101</sup> Accordingly, determining how Appalachia and other developing regions, such as those in North Dakota and Wisconsin, will find commonality between lessors claiming insufficient royalty payments in the shale context requires a review of how Appalachian courts and the traditional oil and gas states have found commonality among such lessors in the past.

## V. HISTORICAL REVIEW OF COMMONALITY ASSESSMENT IN LANDOWNER ROYALTY DISPUTES

Courts have applied a variety of rules to analyze virtually identical commonality and predominance requirements, yet they have been unable to agree on a unified method for determining commonality where lessors allege insufficient royalties.<sup>102</sup> Courts in the oil-rich midwest regions of the

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95. *Id.* at 825.

96. *Braun v. Wal-Mart Stores, Inc.*, 24 A.3d 875, 894 (Pa. 2011); *Perrine v. E.I. DuPont De Nemours & Co.*, 694 S.E.2d 815, 859 (W. Va. 2010).

97. *Rezulin*, 585 S.E.2d at 67.

98. *Id.* at 72.

99. *See id.*

100. *See generally* Kirk, *supra* note 56.

101. *See, e.g.*, cases cited *infra* Part V.

102. *See infra* Part V.A-C.

United States have explored multiple frameworks for determining commonality and predominance in these landowner-royalty cases.<sup>103</sup> Interestingly, courts relying on “at the wellhead” determinations of royalty payments have often relied on the express language of a lease to determine commonality.<sup>104</sup> Other courts, relying more heavily on the marketable product rule to calculate royalty payments and cost-allocation, are more apt to use the existence of any common implied covenants within the putative class members’ leases.<sup>105</sup> Increasingly though, courts are taking a more liberal hybrid approach, applying virtually any available facts to find that commonality exists.<sup>106</sup>

As drilling in the shale regions expands, so has related litigation. Accordingly, it stands to reason that lessors in the shale-laden states will increasingly inquire into the validity of royalty calculations. As is the case in other claims when class certification has been assessed, the states are likely to follow jurisdictional precedent. That review demonstrates that a court’s assessment of commonality is often in-line with how that court decides the substantive issue of royalty calculations – examining express lease provisions or applying implied covenants in a broader way.

#### A. COMMONALITY IN THE EXPRESS LANGUAGE OF A LEASE

When courts are faced with class certification motions from lessors claiming improper royalty calculations, some tend to look to the specific lease provisions that include calculation of costs “at the wellhead” or other similar language.<sup>107</sup> For example, the United States District Court for the Eastern District of Arkansas denied class certification based on the express language of lease provisions.<sup>108</sup> In *Riedel v. XTO Energy, Inc.*,<sup>109</sup> the court noted that individualized inquiries into the leases were necessary in order to determine whether the agreements were common form contracts.<sup>110</sup> Although the plaintiffs had issues in common, those common questions did not predominate over individual issues based on the express terms of the contracts.<sup>111</sup> In contrast, the Supreme Court of Kansas examined the express language of royalty provisions in various leases, in conjunction

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103. *See infra* Part V.A-C.

104. *See infra* Part V.A.

105. *See infra* Part V.B.

106. *See infra* Part V.C.

107. *See generally* *Riedel v. XTO Energy, Inc.*, 257 F.R.D. 494 (E.D. Ark. 2009).

108. *Id.* at 496.

109. 257 F.R.D. 494 (E.D. Ark. 2009).

110. *See generally* *Riedel*, 257 F.R.D. at 512-13.

111. *Id.*

with the defendant gas company's treatment of those royalty provisions, to find commonality among lessors in *Waechter v. Amoco Production Co.*<sup>112</sup>

In *Tana Oil & Gas Corp. v. Bates*,<sup>113</sup> the Court of Appeals of Texas certified a class based on identical lease language concerning payment of royalties on gas production.<sup>114</sup> The foregoing analysis has been applied to class certification motions for suits over royalty disputes from deep drilling, rather than horizontal drilling, because lease language tends to be form-based.<sup>115</sup> Similar language used across the land is bound to affect a commonality determination, especially where the issue at hand is addressed expressly in each lease. Interestingly, this Texas court used express lease provisions to find commonality, just as it used the same express provision to calculate the royalty substantively.<sup>116</sup>

#### B. USE OF IMPLIED COVENANTS TO ASSESS COMMONALITY

In contrast with those examining the express royalty terms of a lease, some courts use the presence of implied covenants to find predominant, common issues between oil and gas lessors. These courts often coincide with those that apply the marketable product rule to the substantive claims for insufficient royalties. Under this view, courts often rely on the fact that a defendant gas company is subject to an implied covenant to market to find that all lessors claiming improper royalty payments have sufficiently common issues to certify a class.<sup>117</sup>

For example, the Kansas Court of Appeals affirmed certification of a class based on an implied covenant to market in *Farrar v. Mobil Oil Corp.*<sup>118</sup> Specifically, the court held:

in a purported class action claiming improper calculation of royalties, there is no need to examine individual lease formation and the intent of the parties thereto for purposes of determining predominance of common issues or manageability in certification proceedings where there has been shown a systematic common course of conduct by an oil and gas lessee in calculating royalties payable.<sup>119</sup>

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112. 537 P.2d 228, 245 (Kan. 1975).

113. 978 S.W.2d 735 (Tex. App. 1998).

114. *Tana Oil & Gas Co.*, 978 S.W.2d at 738, 742.

115. *See id.* at 741-42.

116. *Id.*

117. *Smith v. Amoco Prod. Co.*, 31 P.3d 255 (Kan. 2001).

118. 234 P.3d 19 (Kan. 2010).

119. *Farrar*, 234 P.3d at 31.

Being one of the states that have traditionally calculated royalties based on the marketable product rule, Kansas kept its commonality assessment in line with its substantive analysis.<sup>120</sup>

Similarly, the New Mexico Supreme Court upheld certification of a class based solely on the existence of an implied duty of marketability.<sup>121</sup> In *Davis v. Devon Energy Corp.*,<sup>122</sup> the court held that when such a duty is implied in law, it does not require reliance on individualized evidence of the parties' express agreements and thus provides sufficient commonality to certify a class.<sup>123</sup> Again, the existence of implied responsibility was sufficient to connect the leases as a class.<sup>124</sup>

Courts have even used the existence of implied covenants to deny certification of a class.<sup>125</sup> In *Stirman v. Exxon Corp.*,<sup>126</sup> the United States Court of Appeals for the Fifth Circuit reversed the district court's certification of a class based on an implied covenant to market.<sup>127</sup> The district court had found commonality based on the "reasonably prudent operator standard" of the implied covenant to market.<sup>128</sup> However, the Fifth Circuit held the class certification order was an abuse of discretion because the law regarding implied covenants to market was not uniform across the jurisdictions involved in the case.<sup>129</sup> That lack of uniformity created individual issues that predominated over common issues.

### C. A HYBRID EXAMINATION: EXPRESS LANGUAGE AND IMPLIED COVENANTS

While some certification decisions have been made by depending solely on the express language of the leases and others have been made by focusing specifically on the existence of an implied covenant, still other courts have applied hybrid methods. These courts tend to assess and consider a variety of approaches taken by courts in drill-heavy regions to determine whether or not a class of lessors should be certified. Accordingly, they end up applying a myriad of methods to certify a class. These hybrids demonstrate that, where a court is liberally approaching class

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120. *See id.*

121. *Davis v. Devon Energy Corp.*, 218 P.3d 75, 84-87 (N.M. 2009).

122. 218 P.3d 75 (N.M. 2009).

123. *Davis*, 218 P.3d at 84-87.

124. *Id.*

125. *See, e.g., Stirman v. Exxon Corp.*, 280 F.3d 554, 566 (5th Cir. 2002).

126. 280 F.3d 554 (5th Cir. 2002) (emphasis added).

127. *Stirman*, 280 F.3d at 556.

128. *Id.* at 559-60 (quoting Feb. 22, 2001 Order at 2, *Stirman v. Exxon*, 280 F.3d 544 (5th Cir. 2002) (No. SA-99-CA-0763)).

129. *Id.* at 566.

certification, it tends to examine any means possible of finding common predominant issues.

For example, the Supreme Court of Texas has expanded beyond its own express-language view to consider implied covenants as well.<sup>130</sup> In *Bowden v. Phillips Petroleum Co.*,<sup>131</sup> the Texas Supreme Court denied certification of one class based on a duty to market because some leases contained express clauses as to the duty to market, and some did not.<sup>132</sup> The *Bowden* court also denied certification to a second class based on reasonableness of fees under “percentage of the proceeds” contracts, because the class included both proceeds and market value leases.<sup>133</sup> The royalty owners asserted that the contracts established a duty to administer the lease as a reasonably prudent operator under both lease forms, but the court held that “market value leases provide an objective basis for calculating royalties independent of the price the lessee actually obtains,” while proceeds leases relied on implied covenants, so commonality was lacking.<sup>134</sup> However, the *Bowden* court did agree to certify a third class based on the uniform language of pricing provisions in Gas Royalty Agreements.<sup>135</sup>

Similarly, the Supreme Court of Arkansas affirmed class certification based on the defendant’s course of conduct in allegedly defrauding the class members.<sup>136</sup> In *SEECO, Inc. v. Hales*,<sup>137</sup> certification was not expressly based on contract language or implied covenants, but the court did confirm that individual differences in the language of the leases were not sufficient to override the common scheme or prevent class certification.<sup>138</sup> The court noted that its order would not eliminate the need for each class member to show reliance on the alleged fraud.<sup>139</sup> However, the alleged fraudulent scheme of the defendant constituted a “single course of fraudulent conduct,” which served as a common starting point for the claims of all class members.<sup>140</sup>

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130. *Bowden v. Phillips Petrol. Co.*, 247 S.W.3d 690, 708-09 (Tex. 2008).

131. 247 S.W.3d 690 (Tex. 2008).

132. *Bowden*, 247 S.W.3d at 690, 708-09.

133. *Id.* at 694-95.

134. *Id.* at 707, 709.

135. *Id.* at 702-08.

136. *SEECO, Inc. v. Hales*, 954 S.W.2d 234, 240-41 (Ark. 1997).

137. 954 S.W.2d 234 (Ark. 1997).

138. *SEECO, Inc.*, 954 S.W.2d at 237 (“The evidence produced by the plaintiffs indicates: an alleged overall scheme and course of conduct by the defendants designed to defraud the members of the proposed class as a group irrespective of the type of oil and gas lease or the volume of production from the leases.”).

139. *Id.* at 240-41.

140. *Id.*

Undoubtedly, when a class certification request is brought before a court, a lessee will struggle to know exactly what factors may play into the determinations of commonality and predominance, even in the face of these three approaches. In one instance, the specific language used in the express terms of each lease may be reviewed and, if the language used to calculate royalty payments is sufficiently similar, a court may find a common question that predominates over any individual payment issues.<sup>141</sup> In another instance, a court may ignore express language and instead determine whether, in that jurisdiction, the lessee was subject to an implied duty to market the gas produced such that all lessors' improper royalty claims are common and can be considered together.<sup>142</sup> In still other situations, the court may justify examination of *both* express terms of the lease *and* any existing implied covenants.<sup>143</sup>

However, while all of these options exist, it is apparent that these trends tend to coincide with a jurisdiction's method of determining the substantive royalty calculations claims. Accordingly, courts likely will apply similar logic to substantive royalty claims and commonality for class certification of those claims in Appalachian shale leases. However, before concluding how courts are likely to rule, it is also helpful to consider how those courts have addressed commonality in a similar arena – that of general contract-based claims – to determine whether a greater trend exists.

## VI. CONTRACT-BASED CLASS ACTIONS

When asked to certify a class in cases involving breach of contract claims, Appalachian courts will often maintain a low threshold for commonality and even cede its existence, where the contracts are substantially the same.<sup>144</sup> Specifically, “[c]laims arising from interpretations of a form contract generally give rise to common questions.”<sup>145</sup> Moreover, “[c]ourts . . . generally find that a wide variety of claims may be established by common proof in cases involving similar form documents or the use of standardized procedures and practices.”<sup>146</sup>

The inclination to find predominance of common issues in standard-form contract cases was reiterated by the Supreme Court of Ohio in

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141. See discussion *supra* Part V.A.

142. See discussion *supra* Part V.B.

143. See discussion *supra* Part V.C.

144. *Dearlove v. Genzyme Transgenics Corp.*, 70 Pa. D. & C.4th 314, 324 (Pa. Ct. Com. Pl. 2004); *Shaver v. Standard Oil Co.*, 623 N.E.2d 602, 605 (Ohio App. 1993) (“By providing standardized lease agreements which were uniformly imposed on the dealers by [the lessee, appellants meet] the threshold requirement of commonality.”).

145. *Janicik v. Prudential Ins. Co.*, 451 A.2d 451, 457 (Pa. 1982).

146. *Cope v. Metro. Life Ins. Co.*, 696 N.E.2d 1001, 1004 (Ohio 1998).

*Hamilton v. Ohio Savings Bank*.<sup>147</sup> In *Hamilton*, the Supreme Court of Ohio held that a “class action . . . is appropriate where the claims arise from standardized forms or routinized procedures, notwithstanding the need to prove reliance.”<sup>148</sup> Thus, there is a likelihood that commonality in proposed classes where identical contracts are at issue will be found.<sup>149</sup> But disparate contracts will not necessarily preclude class certification, provided that the underlying legal issues are substantially the same or where similar practices are used.<sup>150</sup>

When one Ohio trial court denied a motion for class certification based upon a finding that predominant commonality was lacking due to differing contracts, the Court of Appeals of Ohio found an abuse of discretion and certified the class.<sup>151</sup> “Although [appellee] used different contracts, there was clearly a ‘common nucleus of fact.’”<sup>152</sup> The *Hadley* court emphasized a preference to grant commonality liberally by certifying the proposed class, even where individual contracts contained certain discrete terms.<sup>153</sup> Likewise, Pennsylvania courts have found commonality based on different contracts so long as “the relevant contractual provisions raise common questions of law and fact and do not differ materially.”<sup>154</sup> West Virginia has followed similar principles, stating “a common nucleus of operative fact or law is usually enough to satisfy the commonality requirement.”<sup>155</sup>

The West Virginia Supreme Court of Appeals has also stated that proposed class members must present evidence that the terms of the alleged contract were ascertainable and definitive in nature.<sup>156</sup> In cases where later refinement of the issues reveals that seemingly similar contractual provisions merit differing interpretations, the court may create appropriate subclasses.<sup>157</sup> However, these subclasses do not defeat the original determination that commonality is present.

When applied to lessor class actions for insufficient royalty payments, these liberal decisions imply that other courts would find commonality just as easily in lease contracts. Even in contract-based claims regarding

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147. 694 N.E.2d 442, 452 (Ohio 1998).

148. *Hamilton*, 694 N.E.2d at 456.

149. *See id.*

150. *See generally* Estate of Reed v. Hadley, 839 N.E.2d 55, 62 (Ohio App. 2005).

151. *Id.*

152. *Id.*

153. *Id.* at 62-63.

154. *Dearlove v. Genzyme Transgenics Corp.*, 70 Pa. D. & C.4th 314, 324 (Pa. Ct. Cm. Pl. 2004) (citing *Janicik v. Prudential Ins. Co.*, 451 A.2d 451, 457 (Pa. 1982)).

155. *State of W. Va. ex rel. Chemtall Inc. v. Madden*, 607 S.E.2d 772, 781 (W. Va. 2004).

156. *Ways v. Imation Enters. Corp.*, 589 S.E.2d 36, 43 (W. Va. 2003).

157. *Janicik v. Prudential Ins. Co.*, 451 A.2d 451, 457 (Pa. 1982).

different individual contracts, these courts have consistently found that, so long as there is a common nucleus of operative fact, this prerequisite is easily satisfied.<sup>158</sup> When this liberality is considered alongside the growing trend to find commonality in property-based lessor class actions, it seems clear that shale lessees should expect similar treatment from courts.<sup>159</sup>

As noted earlier, Rule 23(b)(3) requires putative class members to demonstrate that the questions of law or fact common to the class predominate over any questions affecting only individual members.<sup>160</sup> While Appalachian courts will allow a permissive application of commonality in breach of contract claims, sporadically this same group of courts will set a higher threshold for predominance in those same scenarios.<sup>161</sup> In Ohio, standardized contracts have been a strong indicator of commonality. Differing contracts have warranted evidence of a common nucleus of operative fact, but the predominance requirement is construed more narrowly. In *Hinkston v. Sunstar Acceptance Corp.*,<sup>162</sup> the Court of Appeals of Ohio held that where “each transaction is different, depending on such things as the business practice of [the seller] and the customer’s ability to negotiate, an individual inquiry into each transaction is necessary.”<sup>163</sup> The *Hinkston* court concluded that predominance was not met, because questions affecting individual class members predominated over common questions.<sup>164</sup>

Importantly, the mere existence of differing forms of contracts does not defeat predominance without any indication as to the materiality of any differences.<sup>165</sup> When answering the predominance question in a contract-based certification motion, courts often examine each of the contracts in question and determine whether the common elements of the contracts are more pervasive than the differences.<sup>166</sup> The existence of boilerplate language in these contracts is also used to establish predominance of

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158. See *Chemtall*, 607 S.E.2d at 781.

159. Compare Part V.A-C, with Part VI.

160. See generally *Kirk*, *supra* note 56.

161. See *supra* Part IV.

162. Nos. C-990681, C-990701, 2000 WL 1886388 (Ohio Ct. App. Dec. 29, 2000).

163. *Hinkston*, 2000 WL 1886388, at \*16.

164. *Id.*

165. *Estate of Reed v. Hadley*, 839 N.E.2d 55, 64 (Ohio Ct. App. 2005).

166. *Id.* at 64 (“[A] claim will meet the predominance requirements when there exists a generalized evidence which proves or disproves an element on a simultaneous, class-wide basis, since such proof obviates the need to examine each class member’s individual position.” (citation omitted)); *Janicik v. Prudential Ins. Co.*, 451 A.2d 451, 456 (Pa. 1982) (“[C]lass actions may be maintained even when the claims of members are based on different contracts so long as the relevant contractual provisions raise common questions of law and fact and do not differ materially.” (citation omitted)).

common issues in courts.<sup>167</sup> In essence, to determine that “class certification is improper simply because members of the proposed class signed different contracts” is considered an erroneous analysis.<sup>168</sup>

Although some differing language is used in the respective rules for class action certification and maintenance across the Appalachian states, these courts actually address the issue in somewhat similar fashions. In each state, commonality bears a low threshold, often meriting only a cursory glance to acknowledge that at least a single common question of law and fact exists among the members of the proposed class.<sup>169</sup> This is especially true in cases where there is a single form contract, although disparate contracts do not necessarily preclude certification so long as they are fundamentally similar.<sup>170</sup> The consideration for predominance is generally stricter than that for commonality, yet not applied in a comfortably consistent manner across, or even within, the states. Provided that one or more of the claims at issue stem from a “common nucleus of operative fact,” courts will often maintain classes in the interest of efficient adjudication.<sup>171</sup>

## VII. COMMONALITY FOR CLASS CERTIFICATION IN LANDOWNER ROYALTY DISPUTES

While review of class certification trends demonstrates that states largely apply the same rules and requirements as Federal Rule of Civil Procedure 23 to certify a class, how those jurisdictions go about supporting the existence of each requirement is not so uniform. The methods by which these jurisdictions choose to analyze the common issues at play in any given class action are not consistent, and they generally depend on how a court would assess the substantive royalty claim underlying the certification request. Accordingly, a party should examine how the courts may calculate royalties to determine whether it is likely to certify a class. Moreover, parties may take hints from the way other contract-based claims have been handled.

In the growing context of horizontal drilling, whether or not a pooling agreement exists, all evidence points to the likelihood that courts will apply

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167. See *State ex rel. Metro. Life Ins. Co. v. Starcher*, 474 S.E.2d 186, 189 (W. Va. 1996) (“[T]he breach of contract claim . . . [is] based upon proof of the standard form documents utilized by the defendant in its processing . . . and the standardized rules, procedures and conduct of the defendant in handling these matters.”).

168. *Hadley*, 839 N.E.2d at 66.

169. See *supra* Part IV.

170. See, e.g., *Hadley*, 839 N.E.2d at 64.

171. See *State of W. Va. ex rel. Chemtall*, 607 S.E.2d, 722, 781 (W. Va. 2004).

the implied covenant to market against any lessee and find that all leases bearing similar language under which the lessee is subject to this covenant will have common issues. Additionally, these trends show that while predominance of those common issues can be hard to establish, it is not impossible. Moreover, the rigor a court may employ in assessing predominance in any particular case cannot be comfortably predicted. Where pooling agreements exist to link lessors, however, it may be more easily established.

The growing trend in royalty calculation assessment leans toward use of the marketable product rule.<sup>172</sup> Impliedly, this means, as long as the implied covenant to market is applicable, lessees will be required to pay royalties without deductions for production and transportation costs, regardless of differences in leasing and pooling structures in horizontal drilling. States like West Virginia have not only adopted the marketable product rule, they have made it expressly clear that lessees are not able to transfer the costs of production or transportation onto lessors, regardless of the inclusion of “at the wellhead” language in any given lease provision.<sup>173</sup> The fact that such adamant holdings exist demonstrates that implied covenants and other surrounding circumstances will play a large part in commonality determinations for class certification as well.

As courts in the shale regions face more and more putative class actions for claims of improper royalty payments, they will have a plethora of information to ponder in determining whether or not the lessors bring common, predominant claims to the table. They will be able to review traditional methods of examining royalty calculation claims from traditional oil and gas states, as well as in other shale regions. They will have the opportunity to consider express terms and provisions included in their leases, as well as the existence of any implied covenants underlying each lease. Additionally, they will be able to compare property-based class action requests with those that are contract-based. This review demonstrates that while a variety of methods have been applied in the past, a clear trend is forming: courts are construing commonality and predominance liberally and using far reaching information to certify a class, rather than restrict their review to specific, narrow facts.

In the context of property-based royalty payment claims, courts are considering express language, implied covenants, and other surrounding circumstances, rather than adhering only to an examination of express terms of a lease or only applying covenants implied in law. Where commonality

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172. *See supra* Part V.

173. *See Estate of Tawney v. Columbia Natural Res., LLC*, 633 S.E.2d 22, 30 (W. Va. 2006).

exists between the express language of a royalty term, such as a calculation made “at the wellhead,” courts are often willing to certify classes as long as this language constitutes a predominant, common nucleus of operative fact within the lessors’ claims.<sup>174</sup> Certification also occurs where predominant commonality exists because the lessee is subject to implied covenants to market or produce the gas drilled from the lessors’ property.<sup>175</sup> This indicates that as the Appalachian shale region continues to develop, lessors filing suit, who are bound by form leases containing identical or substantially similar royalty clauses, are likely to be certified as a class. It also shows that where the lessees are obligated to market or produce the gas drilled as implied by law, lessors claiming that their royalties are calculated incorrectly will be able to certify a class, regardless of lease language. Certification may be met at an even lower threshold when the common leases also contain pooling agreements, because it can be argued that the lessee has essentially created a contract establishing commonality between those specific lessors.<sup>176</sup> And as review of contract-based class actions shows, courts are willing to certify where terms are merely similar, rather than identical.<sup>177</sup>

In those contract-based claims, commonality is also found on the basis of party’s duty or prior practices.<sup>178</sup> Admittedly, property-based claims are not always handled the same as the contract-based claims even though a lease is a form of contract.<sup>179</sup> However, the fact that courts are handling both genres with similar liberality demonstrates that they are not likely to except shale or other horizontal drilling leases from this trend. Accordingly, a lessee should expect that if lessors bring a claim for improper royalty calculations as a class action, the existence of form royalty provisions, pooling agreements, standard protocols for issuing royalty payments, as well as statutory and common law covenants, can all be used to establish a class.

## VIII. CONCLUSION

This Article has reviewed general principles of oil and gas leases, as well as the legal theories applied to royalty calculations. The Article has also examined how courts have traditionally certified a class of lessors alleging insufficient royalty payments and how that process may mirror or

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174. *See supra* Part V.A.

175. *See supra* Part V.B.

176. *See supra* Part II.D.5.

177. *See* Part VI.

178. *See* Part VI.

179. *Compare* Part V, *with* Part VI.

differ from the certification of other contract-based claims. Most importantly, this Article has demonstrated that when all of these factors are considered, courts are likely to apply the same principles to certify a lessor class in shale royalty disputes, regardless of the differences that the horizontal drilling form presents.

Shale drilling methods differ significantly from past drilling methods and have the potential to reach many mineral interest owners from a single well pad. Also, the use of pooling agreements is more prevalent, unifying lessors even more than in the past. In conjunction with growing trends that apply the marketable product rule and liberally construe the commonality requirement of class certification, there can be no doubt that a lessee will need to construe its royalty payment just as it has in the past. Technology may have evolved to benefit production, but this evolution is unlikely to affect the percentages owed or the costs allocated to the average lessor upon production.