Class Action Certification for Oil and Gas Lessors

GAS VALUATION FOR ROYALTY CALCULATIONS, AND RELATED LITIGATION ISSUES

KAREN KAHLE
STEPTOE & JOHNSON PLLC
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WHAT IS A ROYALTY?

• ROYALTY IS NON WORKING INTEREST, RIGHT TO FRUITS OF PRODUCTION BUT NO RIGHT TO WORK THE PROPERTY – THE RESERVED INTEREST

• CAN BE ‘IN KIND’ BUT USUALLY CASH
WHAT IS THE ROYALTY VALUATION POINT AND WHY DOES IT MATTER?

- POINT AT WHICH GAS IS VALUED FOR ROYALTY CALCULATION
- DETERMINED BY LEASE OR APPLICABLE STATE LAW, IF LEASE IS SILENT OR AMBIGUOUS
Examples of differing lease language

“Gross Proceeds”
“proceeds, if sold at the well, or if marketed by lessee off the leased premises, then market value at the well.”

“Proceeds”
“value of the raw gass at the mouth of the well”
“Net proceeds”
IT COSTS $ TO FIND GAS, GET IT OUT OF GROUND, PROCESS & TRANSPORT IT TO THE END-USER
SO - WHO SHOULD PAY ALL OF THESE COSTS?
LEASE IS NOT ALWAYS CLEAR SO COURTS HAVE CREATED RULES

• LESSEE ALMOST ALWAYS RESPONSIBLE FOR COSTS TO BRING GAS “TO THE WELLHEAD”
• HOW “AT THE WELL” LANGUAGE IMPACTS POST-PRODUCTION COST ALLOCATION
• FIRST MARKETABLE PRODUCT DOCTRINE
• IMPLIED COVENANTS WHEN LEASE IS SILENT OR AMBIGUOUS
THE PROCESS

• STANDARD LEASE DEVELOPED BY LESSEE
• TARGET AREA: LESSEE’S AGENTS TAKE LEASES OR LESSEE TAKES ASSIGNMENTS
• DEVELOPMENT
• GAS BEGINS TO FLOW, IS GATHERED, PROCESSED, TRANSPORTED
• GAS IS SOLD, ROYALTIES ARE PAID
DISPUTES OVER ROYALTIES

• LESSOR CLAIMS IMPROPER DEDUCTIONS TAKEN

• FACTORS: LEASE LANGUAGE AND IF SILENT/UNCLEAR, HOW LEASE TERMS IN DISPUTE ARE INTERPRETED BY JURISDICTION

• ISSUES: AT WHAT POINT IS GAS VALUED FOR ROYALTY DETERMINATION, ARE ACTUAL DEDUCTIONS CONSISTENT, AND ARE DEDUCTIONS CONVEYED TO LESSOR
AVOID DISPUTES

• NEW LEASES: DESCRIBE VALUATION POINT IN DETAIL AND HOW IT IS TO BE DETERMINED
• OLD ASSIGNED LEASES: UNDERSTAND LAW OF JURISDICTION AND HOW IT WILL APPLY TO LANGUAGE OF LEASES
• ASSESS BEFORE CALCULATING ROYALTIES
• TRANSPARENCY IN CALCULATION PROCESS
• WHAT DOES ‘MARKET VALUE AT WELL’ MEAN?

• DOES ‘FIRST MARKETABLE PRODUCT’ APPLY IN THIS JURISDICTION AND IF SO, WHAT DOES IT MEAN?

• WHAT ACTS/OMISSIONS SUPPORT PUNITIVE DAMAGES?
MARKET VALUE AT WELL

• NO AGREEMENT ON ITS MEANING
• POINT WHEN GAS CHANGES LEGAL CHARACTER FROM REAL TO PERSONAL PROPERTY
• NET-BACK CALCULATIONS
FIRST MARKETABLE PRODUCT

• BASED ON IMPLIED COVENANT - DUTY TO MARKET
• DILIGENTLY SEEK MARKET, OBTAIN BEST PRICE
PUNITIVE DAMAGES

• FACTORS DEEMED TO SUPPORT PUNITIVE AWARDS INCLUDE FRAUDULENT CONCEALMENT, FAILURE TO CALCULATE ROYALTY FROM ACTUAL SALES PRICE, FAILURE TO IDENTIFY COSTS DEDUCTED / METHOD OF DEDUCTION
JURISDICTIONAL BREAKDOWN

• APPLY FIRST MARKETABLE PRODUCT DOCTRINE (LESSOR FRIENDLY): WEST VIRGINIA (MOST EXTREME), COLORADO, KANSAS, OKLAHOMA, ARKANSAS

• HAVE HELD THAT ‘AT THE WELL’ IS EITHER AMBIGUOUS OR SILENT AS TO COST ALLOCATION
• ‘AT THE WELL’ MEANS POST-EXTRACTION COSTS MAY BE DEDUCTED: KENTUCKY, TEXAS, PENNSYLVANIA, LOUISIANA, MISSISSIPPI, NORTH DAKOTA, NEW MEXICO, MONTANA, CALIFORNIA, MICHIGAN
RECAP OF SAFEGUARDS

• NEW LEASE LANGUAGE CONSISTENT WITH HOW ROYALTIES WILL BE CALCULATED AND LAW OF JURISDICTION - EXPLICIT

• OLD LEASE LANGUAGE APPLIED CONSISTENTLY WITH LAW OF JURISDICTION

• TRANSPARENCY IN COMMUNICATIONS ABOUT ROYALTY CALCULATIONS
QUESTIONS?

KAREN.KAHLE@STEPTOE-JOHNSON.COM

(304) 231-0441

THANK YOU!