COMPARATIVE ANALYSIS OF STATE OIL AND GAS ROYALTY CLASS ACTION LITIGATION

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ABSTRACT

Class action suits are typically brought when it would be more efficient to resolve claims or liabilities together as a class in one action, rather than litigating each claim individually. Class actions help prevent possible inconsistent litigation involving common questions, similar events, or requests for similar relief, and can provide a useful tool for individuals whose financial situations make it difficult for them to seek relief on their own. However, class actions are costly to litigate in terms of expenses and time expended by class counsel. Typically, attorneys for the class will pay expenses in advance, which can be significant and, because class actions can take many years to litigate, attorneys often defer fees until the matter is settled. Further, the amount of payment can be unpredictable because district courts have broad discretion to determine the appropriate amount of attorney's fees. The North Dakota Supreme Court has stated it has a policy "to provide an open and receptive attitude toward class actions." However, class action litigation in North Dakota is difficult, particularly for plaintiffs. Although North Dakota has relatively common procedures for certifying a class and awarding attorney's fees, North Dakota law operates in a way to discourage class action litigation, especially in the context of oil and gas royalties. Litigation in this context typically centers around what costs, if any, can be deducted from royalties before they are valued and paid to royalty owners. Major oil producing states are split between two different approaches for oil and gas royalty calculation: the first marketable product doctrine and the at-the-well rule. The first marketable product doctrine has emerged as the majority approach and the at-the-well rule as the minority approach. This article will provide an overview of class action law in North Dakota, Texas, and Oklahoma by examining how each state certifies a class for litigation and awards attorney's fees when the class is successful. Additionally, the comparative analysis will explore how each of these states' decisions to adopt the first marketable

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product doctrine, or the at-the-well rule, for oil and gas royalty calculation impacts class action litigation in the state.

I. NORTH DAKOTA CLASS ACTION LAW

State class action law is primarily derived from the state rules of civil procedure.[1] State rules of civil procedure for class actions are typically modeled after the Federal Rule of Civil Procedure for class actions: Rule 23.[2] In North Dakota, the nation's second largest oil producing state, Rule 23 of the

1. Jane L. Dynes, *American Bar Association Survey of State Class Action Law, North Dakota,* AM. BAR ASS'N (2021).
2. *Id.*

North Dakota Rules of Civil Procedure governs class action suits.[3] The rule is based on the Model Class Action Rule, which was drafted by the National Conference on Uniform State Laws.[4] Besides North Dakota, Iowa is the only state to have adopted the model rule.[5] Prior to adopting the model rule, the rule was identical to Rule 23 of the Federal Rules of Civil Procedure.[6] However, the model rule still closely resembles the federal rule.[7]

A. CLASS CERTIFICATION

For a class to be certified in North Dakota, four requirements must be met.[8] Two requirements are necessary to commence a class action and an additional two requirements are needed to maintain the action.[9] For a class to be certified, the district court needs to find (1) "the class is so numerous or constituted that joinder of all members, whether otherwise required or permitted, is impracticable;" (2) the class shares a common question of law or fact; (3) the action provides "for the fair and efficient adjudication of the controversy;" and (4) "the representative parties will fairly and adequately protect the interests of the class."[10] The district court is required to make this determination without delving into the merits of the case.[11] If the four certification requirements are met, the court is required to certify the class with an order.[12]

The first requirement of class certification is that "the class is so numerous or so constituted that joinder of all members, whether or not otherwise required or permitted, is impracticable."[13] The determination of numerosity is made "in light of the particular circumstances of the case and generally, unless abuse is shown, the trial court's decision on this issue is final."[14] Classes generally have little trouble in meeting the numerosity requirement.[15] For

3. *Id.*; *Oil and Petroleum Products Explained; Where Our Oil Comes from*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/energyexplained/oil-and-petroleum-products/where-our-oil-comes-from.php (last visited Mar. 8, 2021).

4. Dynes, *supra* note 1.

5. *Id.*

6. *Id.*

7. *Id.*

8. N.D. R. CIV. P. 23(a)-(b).

9. *Id.*

10. N.D. R. CIV. P. 23(a)-(b)(2).

11. Howe v. Microsoft Corp., 2003 ND 12, ¶ 19, 656 N.W.2d 285.

12. N.D. R. CIV. P. 23(b)(1)(B).

13. N.D. R. CIV. P. 23(a)(1).

14. Werlinger v. Champion Healthcare Corp., 1999 ND 173, ¶ 12, 598 N.W.2d 820 (citing Horst v. Guy, 211 N.W.2d 723,727 (N.D. 1973)).

15. Dynes, *supra* note 1.

example, in *Peterson*,[16] 101 potential class members were sufficient, and in *Horst*,[17] a class of 48 members was sufficient to justify certification.

The second requirement for class certification is the commonality requirement.[18] Commonality can be met when the class's claims "arise from the same alleged misrepresentations and omissions made in . . . [an] Official Statement . . . ."[19] Further, when the legal questions at issue refer to standardized conduct by the defendants toward members of a proposed class, "a common nucleus of operative facts" is presented, and the commonality requirement is met.[20] The North Dakota Supreme Court has stated "that because only one question of law or fact is required to establish commonality, courts have classified it as easily satisfied . . . ."[21]

The third requirement for a class to be certified is whether the action provides "for the fair and efficient adjudication of the controversy."[22] To determine whether this factor is satisfied, the district court weighs thirteen factors.[23] The North Dakota Supreme Court has determined all factors do not have to be considered and noted "[n]o one factor predominates" in determining the certification of the class.[24] Thus, it is common for some factors to weigh in favor of certification, and others against it. The district court then employs its broad discretion to "weigh the competing factors and determine whether a class action will provide a fair and efficient adjudication of the controversy."[25] Finally, weighing the factors is done separately and independently from the merits of the claims.[26]

The final requirement for class certification is whether "the representative parties will fairly and adequately protect the interests of the class."[27] To satisfy this requirement, the district court must find three things: (1) "the attorney for the representative parties will adequately represent the interests of

16. Peterson v. Dougherty Dawkins, Inc., 1998 ND 159, 583 N.W.2d 626.

17. Horst v. Guy, 211 N.W.2d 723, 726 (N.D. 1973).

18. N.D. R. CIV. P. 23(a)(2).

19. *Peterson,* 1998 ND 159, ¶ 12, 583 N.W.2d 626 The class consisted of over 100 bondholders whose claims arose "from the same alleged misrepresentations and omissions made in the written Official Statement" provided by the investment bank.

20. Bice v. Petro-Hunt, L.L.C., 2004 ND 113, ¶ 11, 681 N.W.2d 74 (citing Werlinger v. Champion Healthcare Corp., 1999 ND 173, ¶ 16, 598 N.W.2d 820, 827) (holding class certification was proper because Petro-Hunt was "alleged to have calculated royalties for each plaintiff the same way regardless of lease language" which represented standardized conduct).

21. *Id.* ¶ 9.

22. N.D. R. CIV. P. 23(b)(2)(B).

23. N.D. R. CIV. P. 23(c)(1)(A)-(M) (outlining factors "the court must consider, and give appropriate weight to," to determine whether "the class action should be permitted for the fair and efficient adjudication of the controversy").

24. *Peterson*, 1998 ND 159, ¶ 14, 583 N.W.2d 626.

25. *Id.* ¶ 15.

26. Baker v. Autos, Inc., 2015 ND 57, ¶ 9, 860 N.W.2d 788.

27. N.D. R. CIV. P. 23(b)(2)(C).

the class[;]" (2) "the representative parties do not have a conflict of interest in the maintenance of the class action;" and (3) "the representative parties have or can acquire adequate financial resources . . . to assure that the interest of the class will not be harmed."[28] The first factor "is of critical importance" because the "adequacy of representation stem[s] from the need to protect the due process rights of absent class members."[29] Further, all class members do not need to meet the adequacy requirement because if one class member satisfies the requirement, the adequacy of representation is met.[30] Regarding the financial resources factor, North Dakota courts typically do not examine the financial resources of a class representative.[31] Without evidence to the contrary "an affirmative demonstration of willingness or ability to pay" is enough.[32] The North Dakota Supreme Court opined that class representatives are required to be able to "make the vigorous, conscientious and undivided effort required to fairly and adequately protect the interests of the class."[33] However, there has been "no case where the representative plaintiff's ability to fairly represent the class has been seriously challenged."[34]

If the district court determines the four requirements for class certification have been met, it will issue an order certifying the class.[35] Interlocutory appeals typically follow this decision and parties often expend considerable resources litigating such an order before ever reaching the merits of the claims.[36] Although decisions to certify a class are appealable, district courts receive broad discretion in determining whether to certify.[37] The North Dakota Supreme Court reverses the district court's decision only for abuse of discretion.[38] The "district court abuses its discretion only if it acts in an unreasonable, arbitrary, or unconscionable manner."[39] When reviewing orders

28. N.D. R. CIV. P. 23(c)(2)(A)-(C).

29. Werlinger v. Champion Healthcare Corp., 1999 ND 173, ¶ 22, 598 N.W.2d 820.

30. *Id.*

31. *Id.* ¶ 25.

32. *Id.*

33. Rogelstad v. Farmers Union Grain Terminal Ass'n, Inc., 226 N.W.2d 370, 375 (N.D. 1975) (quoting Hogmann v. Packard Instrument Co., 399 F.2d 711, 714 (7th Cir. 1968)).

34. Dynes, *supra* note 1.

35. N.D. R. CIV. P. 23(c)-(d) ("[t]he certification order must describe the class and state: (A) the relief sought; (B) whether the action is maintained with respect to particular claims or issues; and (C) whether subclasses have been created." The order must also provide the reasons for the ruling and specifically expand on its analysis of the "fair and efficient adjudication of the controversy" factors.).

36. Christine R. Fritze, *The Class Action Lawsuit In North Dakota—Does It Have Any Relevance For Royalty Owners?,* 89 N.D. L. REV. 203, 206 (2013).

37. Peterson v. Dougherty Dawkins, Inc., 1998 ND 159, ¶ 8, 583 N.W.2d 626.

38. *Id.*

39. Werlinger v. Champion Healthcare Corp., 1999 ND 173, ¶ 6, 598 N.W.2d 820.

granting certification of a class, the Supreme Court is guided by a "broad and liberal policy in favor of class actions in [the] state[.]"[40]

B. ATTORNEY'S FEES

Attorney's fees for representing a class are subject to the control of the district court.[41] In determining attorney's fees, "the district court is considered an expert, and its decision concerning the amount and reasonableness of attorney fees" is reviewed by the North Dakota Supreme Court for a "clear abuse of discretion."[42] The court is required to act as a fiduciary for the beneficiaries of the class common fund and must consider any claim for attorney's fees from the common fund as adverse to the interests of the class.[43] Class counsel for a successful class can receive fees from the common fund, not just claimed funds.[44] However, the actual monetary amount the class members receive can be a factor in determining the size of the attorney's fees awarded.[45] To determine the amount of attorney's fees for a successful class, the district courts are required to consider seven factors.[46] The district court needs to consider each factor, and because the court is considered an expert in awarding attorney's fees, its analysis is only overturned if it abuses its discretion.[47]

North Dakota applies the American rule regarding the issue of attorney's fees, meaning every litigant is responsible for the cost of their own legal representation.[48] As a result, successful litigants are not entitled to recover attorney's fees unless authorized by statute or contract.[49] A recognized exception to this rule in class action suits is the common fund doctrine.[50] "The doctrine provides that a litigant who recovers a common fund for the benefit of others is entitled to reasonable attorney's fees from the fund as a whole."[51] The

40. *Peterson*, 1998 ND 159, ¶ 10, 583 N.W.2d 626.
41. N.D. R. CIV. P. 23(p)(1).
42. Ritter, Laber and Assocs., Inc. v. Koch Oil, Inc., 2007 ND 163, 740 N.W.2d 67.
43. *Id.* ¶ 35.
44. *Id.* ¶¶ 29, 33.
45. *Id.*
46. N.D. R. CIV. P. 23(p)(5)(A)-(F) (determining the amount of attorney's fees for a successful class requires the court to consider the following: "(A) the time and effort expended by the attorney in the litigation, including the nature, extent, and quality of the services rendered; (B) the results achieved and benefits conferred on the class; (C) the magnitude, complexity, and uniqueness of the litigation; (D) the contingent nature of success; (E) if attorney's fees and litigation expenses are awarded" for a judgement the court has determined vindicates "an important public interest," "the economic impact on the party against whom the award is made; and (F) the appropriate criteria in the North Dakota Rules of Professional Conduct.").
47. *Ritter*, 2007 ND 163, ¶ 28, 740 N.W.2d 67.
48. Mann v. N.D. Tax Comm'r, 2007 ND 119, ¶ 38, 736 N.W.2d 464.
49. *Id.*
50. *Id.*
51. *Id.*

purpose of the exception is to spread out the attorney's fees proportionately among those who benefit from the suit.[52] The North Dakota Supreme Court recognized the purpose of this exception in stating "persons who obtain the benefit of a lawsuit without contributing to its costs are unjustly enriched at the successful litigant's expense."[53] The court further stated the exception is consistent with the American rule because the expenses are spread out among those benefiting from the litigation rather than requiring the losing party to pay litigation costs.[54]

C. NORTH DAKOTA ROYALTY LITIGATION

In 1984 the North Dakota Tax Commissioner audited Koch Oil's financial records to determine whether the correct amount of gross production taxes and oil extraction taxes were paid for the years 1980 through 1983.[55] Different measuring techniques resulted in 137,822 barrels of unreported and untaxed oil, which the Tax Commissioner determined Koch was required to pay tax on in addition to a penalty and interest.[56] Koch filed an administrative complaint for a determination that the Commissioner's assessment was invalid.[57] The dispute eventually reached the North Dakota Supreme Court where the Court upheld the Commissioner's decision reasoning the Commissioner was entitled to "appreciable deference."[58]

The discovery of the unreported oil sparked a large class action suit against Koch on behalf of royalty and leasehold owners.[59] The class encompassed nearly 6,000 royalty and leasehold owners with interests in approximately 2,300 wells in the state.[60] The class alleged that the inaccurate measurement of oil led to the royalty for the entire class being calculated on a base amount that was too low.[61] The case resulted in four different appeals to the North Dakota Supreme Court.[62] *Ritter 1* and *2* focused on class

52. *Id.*

53. *Id.* (quoting Boeing Co. v. Van Germert, 444 U.S. 472, 478 (1980).

54. *Id.*

55. Koch Oil Co. v. Hanson, 536 N.W.2d 702, 704 (N.D. 1995).

56. *Id.* at 705 (measuring the oil purchased at the well through a "hand gauging method" but measuring it at pipeline shipping points with a meter).

57. *Id.*

58. *Id.* at 708.

59. Ritter, Laber and Assocs., Inc. v. Koch Oil, Inc., 2000 ND 15, 605 N.W.2d 153 ("Ritter 1").

60. *Id.* ¶¶ 2-3 (removing the case from the Southwest Judicial District of North Dakota to the U.S. District Court for the District of North Dakota, but the federal court concluded it lacked jurisdiction and remanded the case back to the Southwest Judicial District of North Dakota).

61. *Id.* (claiming the base amount was too low because, as the ND Tax Commissioner discovered, Koch failed to account for 137,822 barrels of oil in calculating their royalties).

62. Fritze, *supra* note 36, at 219.

certification.[63] In *Ritter* 1, the court concluded the district court did not abuse its discretion in analyzing the factors for certifying the class but found it did misapply the law in its analysis of the "joint or common interest" and "incompatible standards" factors for the "fair and efficient adjudication" requirement.[64] As a result, the court remanded to the district court, who again certified the class, and the Supreme Court affirmed the certification in *Ritter* 2.[65] In *Ritter 3*, the North Dakota Supreme Court upheld summary judgement for an unjust enrichment claim but determined the district court erred in granting a motion for a conversion claim because there were disputed issues of fact regarding whether Koch took more oil than what was reported and whether the plaintiffs were entitled to royalties from the extra oil.[66]

Ritter 4 addressed the award of attorney fees for class counsel after the class settled with Koch.[67] Prior to trial, the parties reached a final settlement agreement which provided for an $18 million common fund with payments set to be paid to class members per a mathematical formula.[68] In addition to the common fund, the plaintiffs asked the district court for attorney's fees, costs, and expenses totaling $6,740,952, but the district court awarded $4,671,124.[69] In addition to the $18 million common fund available for claims, the district court considered "the potential actual total distribution to the members of the class who had filed timely claims[]" when determining attorney's fees.[70] The plaintiffs argued on appeal the district court abused its discretion in awarding attorney's fees because it limited the amount distributed to class members who filed timely claims rather than based upon the

63. Ritter, Laber and Assocs., Inc. v. Koch Oil, Inc., 2000 ND 15, 605 N.W.2d 153; Ritter, Laber and Associates, Inc. v. Koch Oil, Inc., 2001 ND 56, 623 N.W.2d 424 ("Ritter 2").

64. Ritter, Laber and Assocs., Inc. v. Koch Oil, Inc., 2000 ND 15, 605 N.W.2d 153 (determining *Werlinger*, decided August 25, 1999, would have changed the district court's analysis on these two factors and needed to be considered by the court, but the district court did not have this guidance available when it certified the class on May 11, 1999. As a result, the North Dakota Supreme Court remanded the case for the district court to consider these factors in light of *Werlinger*.).

65. *Id.*; Ritter, Laber and Assocs., Inc. v. Koch Oil, Inc., 2001 ND 56, 623 N.W.2d 424 (considering the court's guidance in *Werlinger*, the district court again certified the class, which was unanimously affirmed when Koch appealed again).

66. Ritter, Laber and Assocs., Inc. v. Koch Oil, Inc., 2004 ND 117, 680 N.W.2d 634, 641 ("Ritter 3") (determining the unjust enrichment claim was precluded because the plaintiffs and Koch had an express contract defining the parties' relationships and rights; applying this rationale also to plaintiffs who did not contract directly with Koch, but contracted with another producer, who in turn, contracted with Koch).

67. Ritter, Laber and Assocs., Inc. v. Koch Oil, Inc., 2007 ND 163, 740 N.W.2d 67 ("Ritter 4").

68. *Id.* ¶¶ 4-5 (settling the conversion claim prior to trial).

69. *Id.* ¶¶ 6, 26 (requesting $6 million in attorney's fees, "costs of $634,952, an escrow fund of $106,000 for future litigation expenses, and an incentive payment to the class representatives of $180,000." The trial court, however, "allowed attorney fees of $3,930,172, costs of $634,952, an escrow fund of $106,000, and incentive payments of $75,000 to be divided equally among the named class representatives.").

70. *Id.* ¶ 29.

entire $18 million settlement fund.[71] The argument rested on the U.S. Supreme Court case of *Boeing*[72] where the Court concluded attorneys representing a successful class were entitled to fees from the common fund, not just claimed funds.[73] However, the North Dakota Supreme Court noted the *Boeing* court did not determine it would be improper for a court to consider not only the available settlement fund but also the amount of actual claims on the fund when determining attorney fees to award.[74] The court ultimately determined the district court did not abuse its discretion considering the relationship of the size of the attorney's fees awarded with the amount of funds distributed to class members filing timely claims.[75] The case was originally filed in 1996 and took four separate appeals until it was finally resolved. As a result, class counsel spent 11 years litigating the case before receiving any fees.

II. OIL AND GAS ROYALTY CALCUATION

The interpretation of lease terms is typically a matter of state law, and as a result, various oil and gas producing states have taken different approaches in interpreting royalty provisions in oil and gas leases.[76] For example, many oil and gas leases include the phrase "at-the-well" when discussing the calculation of royalties.[77] Some states view this lease language as indicating where the royalty percentage should be applied and calculated and are often referred to as "at-the-well" states.[78] Conversely, some states rely on an implied covenant imposing a duty on producers to bear all costs in producing a marketable product.[79] States following this approach are commonly referred to as "marketable product rule" states.[80] Although most oil and gas producing states recognize producers have an implied duty to market the product and pay exploration costs, "at-the-well" and "marketable product rule" states differ on when production ends and who pays post-production costs.[81]

71. *Id.* ¶ 30.
72. *See generally* Boeing Co. v. Van Gemert, 444 U.S. 427 (1980).
73. *Ritter*, 2007 ND 163, ¶ 31, 740 N.W.2d 67.
74. *Id.* ¶ 32.
75. *Id.* ¶ 36.
76. Matthew J. Salzman & Ashley Dillon, *Royalty Litigation Update – Where We Have Been, Where We Are, and Where We May Be Going, In Kansas and Beyond*, 62 ROCKY MTN. MIN. L. INST., Ch. 18, 18-3 (2016).
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.*

A. AT-THE-WELL RULE

The majority rule for calculating oil and gas royalties is the "at-the-well" rule which has been adopted by several oil and gas producing states including Louisiana, Mississippi, Texas, California, Montana, Kentucky, North Dakota, and Pennsylvania.[82] Under the rule, royalty owners claim the royalty when the oil or gas is captured at the well and becomes personal property.[83] Thus, these jurisdictions typically value the royalty at the time the oil or gas is severed from the wellhead.[84] Further, the only obligation producers have is to market production and get the best possible terms and price for the product.[85] Therefore, costs occurring after the severance of the product from the wellhead are considered "post-production" and can be proportionately deducted from the royalty.[86] Thus, oil producers reap a greater profit in these jurisdictions because the royalty payments are reduced.[87]

B. MARKETABLE PRODUCT DOCTRINE

The minority rule for calculating oil and gas royalties is the marketable product doctrine which has been adopted in Colorado, Oklahoma, Kansas, and West Virginia.[88] Under the doctrine, the lessee has the duty of preparing the oil or gas for market and incurs all costs in achieving this.[89] As a result, the royalty is valued when the product becomes marketable and the post-extraction costs cannot be deducted until this point.[90] Once the product is marketable, additional costs to increase marketability are split between the lessee and the lessor.[91] The rule can provide a basis for royalty disputes in jurisdictions where it is recognized due to uncertainty around what costs are necessary to make the product "marketable."[92] Thus, some believe this uncertainty is a major problem with the marketable product doctrine.[93] The disagreement about what costs can be deducted from the royalty to make the product "marketable" is the focus of many class action suits in marketable product

82. *Id.* at 18-1, 18-4.

83. Rachel M. Kirk, *Variations in the Marketable Product Rule from State to State*, 60 OKLA. L. REV. 769, 776 (2007).

84. *Id.* at 777.

85. *Id.* at 776.

86. *Id.* at 777.

87. Lindsey Scheel, *Oil and Gas Law – Rent or Royalties: North Dakota Joins the Majority of States in Adopting the "At the Well" Rule for Calculating Royalties on Oil and Gas Leases Bice v. Petro-Hunt, L.L.C.,* 2009 ND 124, 768 N.W.2d 496, N.D. L. REV. 919, 927 (2009).

88. *Id.*

89. Kirk, *supra* note 83, at 775.

90. *Id.*

91. Bice v. Petro-Hunt, L.L.C., 2009 ND 124, ¶ 16, 768 N.W.2d 496.

92. Salzman & Dillon, *supra* note 76, at 18-3—18-4.

93. Scheel, *supra* note 87, at 939-40.

jurisdictions.[94] As a result, the doctrine acts to encourage class action litigation as classes can continue to bring claims arguing several different post-productions costs are necessary to make the product "marketable."[95]

C. COMMONALITY AND ROYALTY CALCULATION

In "marketable product" states, the point at which the oil or gas becomes marketable is the primary focus of class action litigation and provides a strong basis for a class.[96] In these states, the commonality requirement is often a point of contention.[97] Many of these disputes center around the question of the point at which the oil or gas becomes a "marketable product."[98] A common basis for a claim in this context is that the "commonality" element is satisfied because the question of whether costs can be deducted from the royalties is a question that all members of the class share.[99] Producers, however, often argue these common questions do not exist for three main reasons: (1) different royalty provisions provide different bases for calculating royalties; (2) different sales and marketing agreements could be present for different wells in the class; and (3) differing qualities in the product can impact the "marketability" of the product.[100]

Some view the marketable product rule as undesirable because it can create an uncertain environment around calculating royalties because what costs are necessary to make the product marketable need to be determined on an individual basis.[101] Proponents of the "at-the-well" rule argue it ameliorates the uncertainties that exist in marketable product states by providing a uniform standard for royalty calculation.[102]

a. North Dakota Adopts the At-The-Well Rule

In *Bice v. Petro-Hunt*,[103] the North Dakota Supreme Court addressed the question of how to calculate a royalty based on royalty provisions in the lease using the phrase "market value at the well."[104] There, the class claimed Petro failed to pay them the proper amount of gas royalties because Petro deducted

94. Salzman & Dillon, *supra* note 76, at 18-3—18-4.
95. *Id.*
96. *Id.*
97. Pamela S. Anderson, *Update on Oklahoma Oil and Gas Royalty Litigation,* 3 OIL & GAS, NAT. RES. & ENERGY J. 1159, 1167 (2018).
98. *Id.*
99. *Id.*
100. *Id.*
101. Scheel, *supra* note 87, at 940.
102. *Id.*
103. 2009 ND 124, 768 N.W.2d 496.
104. *Id.* ¶¶ 18-19.

post-wellhead costs required to make the gas marketable.[105] The class requested the court adopt the first marketable product doctrine.[106] The court identified the problem with the first marketable product doctrine as determining when the product becomes "marketable."[107] The court reasoned that deducting post-production costs from the royalty is the only way to determine the market value of the gas at the well.[108] As a result, the court unanimously adopted the "at the well" rule and rejected the first marketable product doctrine.[109]

III. TEXAS CLASS ACTION LAW

Texas, the largest oil producing state in the nation, has drafted a class action rule nearly identical to the federal rule, but some details differ.[110] The most pertinent differences are how the trial court decides whether to certify the class and how Texas courts treat attorney's fees.[111] Further, Texas's adoption of the at-the-well rule for calculating oil and gas royalties makes the state a hostile environment towards class action suits in the oil and gas royalty context.[112]

A. CLASS CERTIFICATION

A threshold issue is whether the class is sufficiently defined based on the certification requirements.[113] A sufficiently defined class is needed to meet class certification prerequisites.[114] The Texas Supreme Court has stated

105. *Id.* ¶¶ 5, 8. Initially, extracted natural gas is referred to as "sour gas" because it contains hydrogen sulfide and other liquid hydrocarbons, which need to be extracted to transform the gas into a "marketable product," which is referred to as "sweet gas." Petro claimed it could deduct expenses associated with this process before calculating royalties.

106. *Id.* ¶ 10.

107. *Id.* ¶ 17 (supporting this assertion, the court stated that "marketable product" states themselves have been unable to outline a clear standard for determining when a product has become "marketable").

108. *Id.* ¶ 20 (reasoning "[s]ince the contracted for royalty is based on the market value of the gas at the well and the gas has no market value at the well, the only way to determine the market value of the gas at the well is to work back from where a market value exists").

109. *Id.* ¶ 21.

110. Stephen Gardner, *American Bar Association Survey of State Class Action Law*, *Texas*, AM. BAR ASS'N, (2021); *see also* U.S. ENERGY INFO. ADMIN., *Oil and Petroleum Products Explained; Where our Oil Comes From*, https://www.eia.gov/energyexplained/oil-and-petroleum-products/where-our-oil-comes-from.php (last visited Mar. 8, 2021).

111. Stephen Gardner, *American Bar Association Survey of State Class Action Law, Texas* AM. BAR ASS'N (2021).

112. Fritze, *supra* note 36, at 215.

113. Intratex Gas Co. v. Beeson, 22 S.W.3d 398, 404 (Tex. 2000) (reasoning the requirement is necessary because "[a]n imprecise class definition. . . undermines judicial economy and efficiency, thereby interfering with one of the primary purposes of class-action suits.").

114. *Id.* at 408.

"[o]nly with a properly defined class can the explicit class-certification provisions be examined appropriately."[115] When defining a class, the district court needs to identify the class members by objective criteria and should not conduct any analysis into the merits of the case.[116] As a result, the class must be "presently ascertainable by reference to objective criteria" for the class to be sufficiently defined.[117] Further, a class definition should not involve an inquiry into each separate class member's state of mind to determine class membership.[118] This additional requirement placed on class certification by the Texas Supreme Court, prior to the statutory prerequisites, has created a type of "strict scrutiny" for class certification.[119] As a result, the class certification process in Texas is more rigorous than in comparable oil producing states like North Dakota and Oklahoma where there is no such standard.

After the class is properly defined, Texas courts need to find four prerequisites are met: "(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 the interests of the class."[120] Texas district courts are required to "perform a rigorous analysis" to determine whether all prerequisites to certification have been met.[121] After the prerequisites are met, the court must find one of three criteria are met.[122] First, the action can be maintained if:

> the prosecution of separate actions by or against individual members of the class would create a risk of (A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or (B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests . . . ."[123]

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115. *Id.*

116. *Id.* at 403-04 (explaining the class definition will not fail just because "every potential class member cannot be identified at the suit's commencement." However, for the class certification to proceed, the class definition "must meet a minimum standard of definiteness").

117. *Id.* at 403; Gardner, *supra* note 110.

118. Ford Motor Co. v. Sheldon, 22 S.W.3d 444, 454 (Tex. 2000).

119. Gardner, *supra* note 110.

120. TEX. R. CIV. P. 42(a).

121. BMG Direct Mktg., Inc. v. Peake, 178 S.W.3d 763, 777 (Tex. 2005).

122. TEX. R. CIV. P. 42(b).

123. TEX. R. CIV. P. 42(b)(1)(A)-(B).

The action can also be maintained if "the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole . . . ."[124] Finally, an action can be maintained if:

> (3) the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to these issues include:
>
> (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions;
>
> (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class;
>
> (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and
>
> (D) the difficulties likely to be encountered in the management of a class action.[125]

B. ATTORNEY'S FEES

Claims for attorney's fees must be made by motion and notice must be provided to the class members.[126] The defendant, or any member of the class, can make objections to the motion for attorney's fees awards.[127] The court is required to hold a hearing to make findings of fact or conclusions of law.[128] Attorney's fees in class action cases in Texas used to be calculated using either a percentage or a lodestar method.[129] However, after tort reform in 2003 only the lodestar method is permissible.[130] The lodestar figure is determined by "multiplying the number of hours reasonably worked times a reasonable hourly rate."[131] To make these determinations, the court considers several factors outlined in the Texas Disciplinary Rules of Professional

124. TEX. R. CIV. P. 42(b)(2).
125. TEX. R. CIV. P. 42(b)(3)(A)-(D).
126. TEX. R. CIV. P. 42(h)(1).
127. TEX. R. CIV. P. 42(h)(2).
128. TEX. R. CIV. P. 42(h)(3).
129. Gardner, *supra* note 111.
130. *Id.*
131. TEX. R. CIV. P. 42(i)(1).

Conduct.[132] However, the final award of attorney's fees must range from "25% to 400% of the lodestar figure."[133] In addition, in cases of non-cash awards the attorneys for the class can only receive the same proportion of cash and non-cash awards as the class members do.[134] Texas's statutory cap on attorney's fees is a notable departure from the federal class action rule and is something Oklahoma and North Dakota have excluded from their class action law. As a result, class counsel for a successful class in Texas will immediately have a cap placed on the amount they will be compensated; an amount that will fluctuate greatly depending on the resulting lodestar figure calculation.

C. TEXAS CALCULATION OF ROYALTIES

Texas follows most states in applying the at-the-well rule, meaning the oil and gas royalty is calculated based on its "market value at the well."[135] These royalties are exempt from production expenses but are subject to post-production costs, which usually includes taxes, treatment to make the product marketable, and transportation costs.[136] The Texas Supreme Court defined "market value" as "the price a willing seller obtains from a willing buyer."[137] Further, oil royalty owners have the "burden to prove market value at the well."[138]

IV. OKLAHOMA CLASS ACTION LAW

Like Texas and North Dakota, Oklahoma class action law is closely modeled after the federal class action rule.[139] As a result, Oklahoma courts often look to federal authority in their analysis of class action related issues.[140] Oklahoma certifies a class in a similar manner as North Dakota and Texas in that they require certain "prerequisites" to be met before the class action can commence and additionally require one of a few requirements for

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132. *Id.*; *see also* TEX. DISC. R. PROF. CONDUCT 1.04(b) (outlining factors the court considers in arriving at a "reasonable" fee).

133. TEX. R. CIV. P. 42(i)(1).

134. TEX. R. CIV. P. 42(i)(2).

135. Salzman & Dillon, *supra* note 76, at 18-11, 18-14.

136. Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118, 122 (Tex. 1996) (noting this general rule can be modified by the parties by agreement).

137. *Id.* In Texas, there are two methods to determine the market value at the well: the use of comparable sales and the work-back method. "A comparable sale is one that is comparable in time, quality, quantity, and availability of marketing outlets." Courts prefer this method, but will use the work-back method, which "involves subtracting reasonable post-production marketing costs from the market value at the point of sale[]" when the compatible sales method is unavailable.

138. *Id.*

139. Michael E. Smith, *American Bar Association Survey of State Class Action Law, Oklahoma,* AM. BAR ASS'N (2021).

140. *Id.*

the class to be maintained.[141] However, unlike Texas, Oklahoma places no specific cap on an award of attorney's fees for successful classes and even provides a method for class counsel to enhance their fee.[142] Further, for calculating oil and gas royalties, Oklahoma is one of the few states to adopt the first marketable product doctrine.[143] As a result, classes in Oklahoma have a stronger basis for bringing claims against oil producers as opposed to North Dakota and Texas, as classes can continue to test what costs can be shifted to producers to make the product "marketable."[144]

A. CLASS CERTIFICATION

To certify a class, Oklahoma courts must first find four prerequisites exist:

> "[t]he class is so numerous that joinder of all members is impracticable; [t]here are questions of law or fact common to the class; [t]he claims or defenses of the representative parties are typical of the claims or defenses of the class; and [t]he representative parties will fairly and adequately protect the interests of the class."[145]

In determining whether the numerosity requirement is met, the class size by itself is not determinative because courts are required to look at the facts of each case individually.[146] However, the class does need to be adequately defined to meet the numerosity requirement.[147] Notably, this requirement is part of the numerosity prerequisite and is not a threshold requirement prior to the prerequisites like in Texas.[148] After the prerequisites are met, the court must find one of three additional requirements is met.[149] Where certification is a close call, Oklahoma courts typically view certification as appropriate early in the case because the order of certification can always be revised.[150]

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141. OKLA. STAT. tit. 12, § 2023(A)-(B) (2021).

142. *Id.* § 2023(G) (providing that the court may appoint an attorney to represent the class on the issue of attorney's fees). The "fair and reasonable fee for class counsel" is based on several factors outlined in § 2023(G)(4)(e)(1)-(13).

143. Fritze, *supra* note 36, at 217.

144. *Id.* at 215-17.

145. OKLA. STAT tit. 12, § 2023(A) (2021).

146. Martin v. Hanover Direct, Inc., 135 P.3d 251, 255 (Okla. Civ. App. 2005).

147. KMC Leasing, Inc., v. Rockwell-Standard Corp., 9 P.3d 683, 689 (Okla. 2000).

148. *Id.* (noting adequately defining a class is not a preliminary requirement on its own like in Texas, but the Oklahoma Supreme Court has stated that "failure to adequately define a class defeats the numerosity requirement . . ." of class certification).

149. OKLA. STAT tit. 12, § 2023(B) (2021).

150. Smith, *supra,* note 139; *see also* Perry v. Meek, 618 P.2d 934, 940 (Okla. 1980).

B. ATTORNEY'S FEES

Like North Dakota and Texas, district courts in Oklahoma have broad discretion in determining attorney's fees because the reasonableness of the fees is unique to each case's facts and circumstances.[151] A claim for attorney's fees is made by motion, and a class member or a party whom payment is sought from, can object to the motion.[152] In considering the motion, the court holds an evidentiary hearing "to determine a fair and reasonable fee for class counsel."[153] In making the determination, the court acts as a fiduciary on behalf of the class.[154] Acting in this capacity, the court can appoint an attorney, independent of class counsel, to represent the class in a hearing relating to attorney's fees or it can refer the matter to a referee.[155] Although Oklahoma's class action statute does not explicitly require the lodestar method for calculating attorney's fees, like Texas, the Oklahoma Supreme Court has determined that an initial step in determining attorney fees is reviewing class counsel time records to determine a base or lodestar fee.[156] Under this method, the lodestar fee is determined by multiplying counsel's hourly rate by the amount of time spent on the case.[157] Additionally, this base fee can be increased or enhanced by the consideration of certain factors.[158] The size of the enhancement is based on the application of the following factors:

(1) time and labor required;

(2) the novelty and difficulty of the questions presented by the litigation;

(3) the skill required to perform the legal service properly;

(4) the preclusion of other employment by the attorney due to acceptance of the case;

(5) the customary fee;

151. Parsons v. Volkswagen of America, 2014 OK 111, ¶ 9, 341 P.3d 662.
152. OKLA. STAT tit. 12, § 2023 (G)(3) (2021).
153. *Id.* § 2023(G)(3)-(4)(a) (2021).
154. *Id.* § 2023(G)(4)(b) (2021).
155. *Id.* § 2023(G)(4)(c) (2021).
156. *Volkswagen of America*, 2014 OK 111, ¶ 10, 341 P.3d 662.
157. *Id.*
158. *Id.*

(6) whether the fee is fixed or contingent;

(7) time limitations imposed by the client or the circumstances;

(8) the amount in controversy and the results obtained;

(9) the experience, reputation and ability of the attorney;

(10) whether or not the case is an undesirable case;

(11) the nature and length of the professional relationship with the client;

(12) awards in similar causes; and

(13) the risk of recovery in the litigation.[159]

Further, in cases where the class is awarded non-cash forms such as "coupons" or "discounts on future goods or services," attorney's fees are awarded in cash and noncash forms in the same proportion as the class receives.[160] However, attorney's fees in every case need to have a reasonable relationship to the amount in controversy.[161] The opportunity to receive an enhancement in attorney's fees is a notable difference between attorney's fees for class counsel in North Dakota and Texas. Not only does Oklahoma not place a cap on fees, it also provides a mechanism in which class counsel can increase its fee from the base amount provided by the lodestar calculation.[162] As a result, this difference provides a significant incentive for attorneys in Oklahoma to take on class action litigation, an incentive that does not exist in North Dakota, and is even more remote in Texas where attorney's fees are capped before litigation even begins.

159. *Id.*; *see also* § 2023(G)(4)(e)(1)-(13).
160. *Id.* § 2023(G)(4)(f).
161. *Volkswagen of America*, 2014 OK 111, ¶ 10, 341 P.3d 662.
162. OKLA. STAT tit. 12 § 2023(G)(4)(e)(1)-(13) (2013).

B. OKLAHOMA CALCULATION OF ROYALTIES

Oklahoma is one of the few oil and gas producing states that has adopted the marketable product rule for calculating oil and gas royalties.[163] In Oklahoma, oil and gas producers have a duty to produce a "marketable product" without cost to the royalty owner.[164] However, after the "marketable product" has been obtained producers may deduct post-production costs from the royalty.[165] Most of the litigation thus results from determining whether, or when, the product is "marketable."[166] In 1992, the Oklahoma Supreme Court in *Wood* announced the state would follow the marketable product route when it stated "in Oklahoma the lessee's duty to market involves obtaining a marketable product."[167] Then, six years later, the Oklahoma Supreme Court in *Mittelstaedt*[168] refined the state's approach in determining producers are prohibited from deducting costs associated with making the gas marketable.[169] Specifically, the court determined "transportation, compression, dehydration, and blending costs" cannot be deducted from the royalty because "such costs are associated with creating a marketable product."[170] However, the court further determined these costs could be deducted from the royalty if the producer can prove "(1) that the costs enhanced the value of an already marketable product, (2) that such costs are reasonable, and (3) that actual royalty revenues increased in proportion with the costs assessed against the nonworking interest."[171] As a result, some royalty interests can be burdened by post-production costs, and in other cases they may not.[172]

Since *Mittelstaedt*, Oklahoma courts have stated that the "question of where and when particular gas is marketable is not settled in Oklahoma."[173] The reason for the unsettled nature is that there is still no bright-line or "categorical" rule for when post-production costs can be deducted from royalties.[174] Due to the uncertainty around when the product becomes

163. Anderson, *supra* note 97.
164. *Id.*
165. *Id.*
166. *Id.*
167. Wood v. TXO Prod. Corp., 854 P.2d 880, 883 (Okla. 1992). The court determined that if producers wanted royalty owners to share in the costs required to make the product "marketable" they could provide for it in the lease contract. If they do this, the court reasoned "a royalty owner can make an informed economic decision whether to enter into the oil and gas lease or whether to participate as a working interest owner." Without the "marketable product" rule the court reasoned royalty owners would in effect "be sharing the burdens of working interest ownership without the attendant rights."
168. Mittelstaedt v. Santa Fe Minerals, Inc., 1998 OK 7, 954 P.2d 1203.
169. *Id.*
170. *Id.* ¶ 2.
171. *Id.*
172. *Id.*
173. Strack v. Continental Resources, Inc., 2017 OK CIV APP 53, ¶ 31, 405 P.3d 131.
174. *Id.*

"marketable," there remains a strong basis in Oklahoma for classes to sue producers, but because "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," class certification could be difficult.[175] Nonetheless, potential classes in Oklahoma have a strong basis to bring claims regarding what costs are required to make a product "marketable;" a basis that classes in "at-the-well" states lack. In North Dakota and Texas, the at the well rule forecloses the opportunity to test what costs can be shifted to producers because these states have already determined producers have no duty to create a "marketable product" as the royalty is valued "at-the-well."[176] As a result, Oklahoma provides ample opportunities for class action suits where North Dakota and Texas generally discourage or foreclose the suits altogether.

V. CONCLUSION

Class action litigation can be a time consuming and expensive process for both members and counsel. Class counsel typically expend considerable time and resources before receiving any fees or even reaching the merits of the case. Classes in Oklahoma have an advantage over those in North Dakota and Texas because of its decision to depart from most states in adopting the marketable product rule. This decision provides a strong basis for royalty owners to collectively challenge what costs producers are required to incur to make a product marketable. Without this rule, royalty owners in states like North Dakota and Texas lack an attractive basis to bring a claim against producers because their royalties are calculated "at-the-well" allowing producers to deduct post-production costs.

Additionally, Oklahoma provides class counsel the chance to enhance their base fee through the application of several factors—incentives both North Dakota and Texas lack. Texas goes a step further and places a statutory cap on the amount class counsel can recover when their class is successful. Texas also requires a rigorous analysis to determine whether a class is properly defined even prior to examining the prerequisites to class certification. Consequently, Oklahoma is among the most attractive states to bring royalty class action suits, while Texas is among the most hostile. Although North Dakota provides fairly standard class certification procedures and does not place a cap on attorney's fees, royalty owners still lack a strong basis to bring claims against producers because of the North Dakota Supreme Court's

175. *Id.*
176. Kirk, *supra* note 83, at 776.

decision to adopt the "at-the-well" rule. Thus, producers in North Dakota face little class action litigation risk in the oil and gas royalty context.