

PUBLICATION

"Where's My Stuff?" Complex Accountability in the Payment of Royalties

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Underpayment of royalties continues to represent a hot topic in oil and gas litigation. Property owners who enter into royalty agreements dream of enjoying riches at the hands of companies with the resources to explore for, produce and market minerals. By nature, a royalty owner's rights are passive. The royalty owner generally has an interest in a stipulated fraction of production free of production costs, if and when production occurs, and has no obligation or right to participate in the operations related to exploration, production or marketing. The royalty owner merely waits for the check to come in the mail. Difficulties inevitably arise when a royalty owner receives a check that appears inadequate, either by comparison to previous checks from the same company or to checks from another company or to checks he sees his neighbor receiving. Royalty payments may slow even as the production of minerals appears to increase. The instinctive reaction: assume manipulation by the oil and gas company. Landowner disappointment, however, often flows from a failure to read or understand basic mineral lease terms. Royalty owners, believing that oil companies use various tactics to cheat them of their due, increasingly are turning to the courts.

Individual royalty agreements govern the parties' respective rights, and the terms of individual agreements -- much less their proper interpretation -- can vary significantly, a point recently noted by the U.S. Court of Appeals for the Tenth Circuit in connection with the decertification of two class actions based on lack of commonality. See *Chieftan Royalty Co. v. XTO Energy, Inc.*, 2013 WL 3388629 (10th Cir. July 9, 2013) and *Wallace B. Roderick Revocable Living Trust v. XTO Energy, Inc.*, 2013 WL 3389469 (10th Cir. July 9, 2013). In these lawsuits, royalty owners typically seek full production pricing, sales, cost deductions and services information to quantify the full extent of underpayments, with the discovery process representing the tool for obtaining such information. Needless to say, this represents a costly endeavor for the litigants.

In the end, in many cases, the agreement between the parties *expressly allows* the very practices alleged by the royalty owner to be the source of the perceived underpayment. Further, by their very nature, royalty interests lend themselves to complex accounting; in most cases, an oil or gas production unit is made up of multiple tracts of land, necessitating a mathematical formula to calculate each owner's share of the production proceeds. Valid reasons exist for maintaining the privacy of what and how other royalty owners are paid. The expense of production (and resulting profit) may vary legitimately from company to company and geographic region to geographic region. Nevertheless, the proliferation of royalty underpayment litigation is unlikely to wane in the near future. Accountability in these cases may be complex, but it is not inescapable.