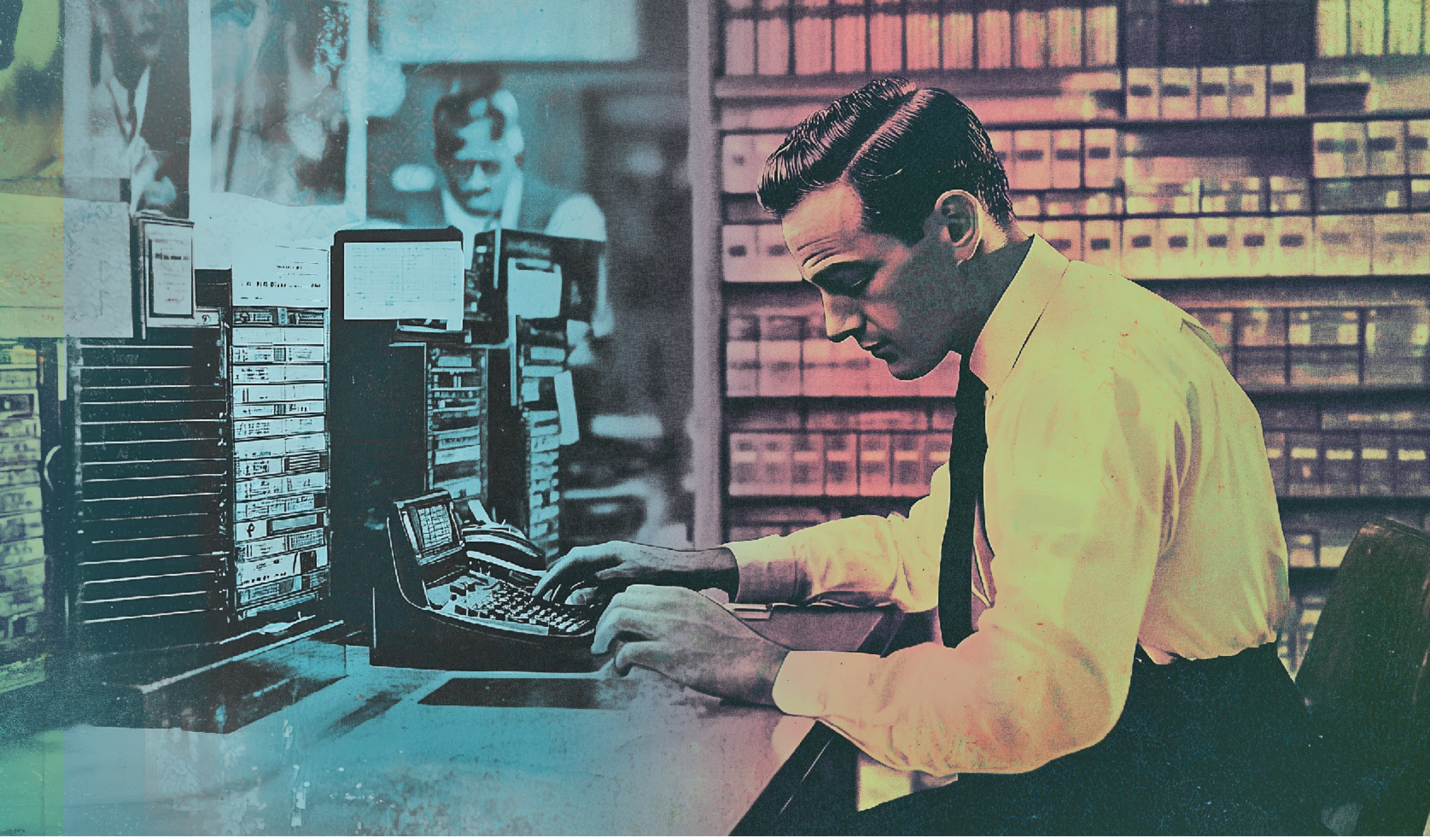

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Avoiding a *Cline*-Style Judgment

Mitigating class action risks of interest on late payments

Accounting is hard. Oil and gas accounting is harder. And royalty accounting is harder still. The myriad of interest-creating documents, agreements for how accounting or payment gets done, the potential for take-in-kind, and the laws governing payments and deductions make it no easy feat to properly account for smaller assets, let alone larger ones. Of those challenges, the last one — the laws regarding royalty payments — has returned to the forefront as a risk to producers.

While the various state laws on this subject differ in some ways, nearly all set standards for when producers — or whoever is responsible for making royalty payments — must pay, the information shared with the interest owner for each payment, the types of deductions permitted and the penalties for failing to comply with the law.[1] Historically, litigation surrounding these laws has addressed failure to pay or timely pay, disputes about the amount owed, allegations of improper deductions, not sending the required information with each payment and the interest owed because of noncompliance — an interest percentage serving as the primary penalty for most statutes.

Recently, a new spin on this type of litigation has developed: the failure to automatically pay interest on allegedly late payments. In *Cline v. Sunoco*,[2] Perry Cline filed a class action alleging Sunoco Inc. had violated Oklahoma's Production Revenue Standards Act, which governs the payment of royalties in Oklahoma.[3] Cline argued Sunoco had a duty to automatically pay statutory interest on late payments without waiting for a royalty owner to request the interest.[4] The court agreed, finding Sunoco's payment practices violated the PRSA.[5] Worse still, the court certified the case as a class action, in part because the producer had a "uniform policy of not paying interest."[6] Ultimately, the court awarded $75 million in compensatory damages and $75 million in punitive damages[7] — a huge payday for the members of the class to say the least.

To be sure, this was a bad day for Sunoco. But it was also a bad day for other producers. They now found themselves in the crosshairs of litigants seeking to replicate the outcome in *Cline*, namely finding producers that did not pay interest at the same time as late payments. Litigation of this type has appeared in other oil and gas producing jurisdictions that have laws like the PRSA. Fortunately, *Cline* and other recent cases provide lessons for producers. In this article, we discuss the recent litigation trends and identify some best practices that may help to minimize exposure.

Emboldened by the promise of class certification, and the potential for large judgments in favor of the plaintiff-class, plaintiffs have filed *Cline*-style class actions across oil and gas producing states. In

1 *See, e.g.*, Colo. Rev. Stat. § 34-60-118.5; Mont. Code Ann. § 82-10-103; N.D. Cent. Code § 47-16-39.1; N.M. Stat. Ann. §§ 70-10-1, *et. seq.*; Okla. Stat. tit. 52, §§ 570.1 *et. seq.*; Tex. Nat. Res. Code §§ 91.402, *et. seq.*; Wyo. Stat. Ann. §§ 30-5-301 *et. seq.*
2 479 F. Supp. 3d 1148 (E.D. Okla. 2020).
3 *See id.* at 1155.
4 *See Cline v. Sunoco Inc.*, 2019 U.S. Dist. LEXIS 212587, at *7 (E.D. Okla. Dec. 10, 2019).
5 *See id.* at *19 (holding PRSA required Sunoco to automatically pay statutory interest on late payments).
6 *Cline v. Sunoco Inc.*, 333 F.R.D. 676, 683 (E.D. Okla. 2019).
7 *Cline*, 479 F. Supp. 3d at 1181-82.

these cases, plaintiffs have taken the position that, so long as the class can show that a producer has a propensity not to pay statutory interest, class certification is appropriate. Courts are divided, however, on whether they are willing to accept such arguments.[8]

Moreover, whether courts are willing to — or should — accept arguments attempting to import concepts based on one state's payment statute into another state remains unclear. What is clear, however, is that producers should take care to review the relevant statutory requirements for each state in which they operate and ensure that their accounting practices conform to those requirements.

For example, unlike Oklahoma's payment statute, Wyoming's payment statute provides for a safe harbor for escrow accounts.[9] Thus, if a producer has suspended royalty payments because the producer is unable to make payment, locate the owner, etc., a producer can transfer those funds into an interest-bearing escrow account to ensure compliance with the statute and avoid paying statutory interest on the suspended funds. Different still, the payment statutes of Colorado and Texas do not require payment of interest when there is a title defect or some other issue as to the interest owner's identity or location,[10] and further, they require the interest owner to place the payor on notice before filing legal action and provide for an opportunity to cure.[11] In addition, Texas' statute permits a payor to withhold payment without interest if the interest owner fails to sign a division order.[12]

As many producers operate in multiple states, it is important for producers to identify the applicable statutory requirements for each state in which they operate, educate their employees on those requirements, and implement practices — to the extent administratively feasible — that permit the producer to substantially comply with those requirements. This may involve a review of the producer's current accounting system and its ability to identify "late" payments and calculate interest on those payments. This may also entail a review of available accounting system "add-ons" that would aid in streamlining such determinations and calculations.

Additionally, it may be beneficial for producers to adopt additional documentation measures for payments made as the result of prior period adjustments. For example, in states where federal lands cover extensive areas and require unit agreements approved by the U.S. government, an interest owner's legal entitlement to a certain amount of proceeds can change due to the government's approval of, or revision to, a federal unit agreement. Producers may be able to reduce their exposure by documenting the reason for a PPA whether because of federal unit revisions or adjustments made to prices, costs or volumes — both through correspondence with interest owners — as well as documenting PPAs in their accounting systems. This would allow producers to easily identify activity in a specific accounting month that is due to a PPA, as opposed to a new payment to interest owners.

Given the strict timetables of many states' royalty payment statutes, and the complexities of oil and gas accounting, it may be impossible for producers to perfectly comply with statutory requirements each month. However, by examining the relevant statutory requirements, reviewing their accounting capabilities, and implementing additional procedures, producers may be able to minimize exposure and avoid a Cline-style judgment. ▲

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8 *See, e.g.*, Order Granting Plaintiff's Motion for Class Certification, *Colton v. Carbon Creek Energy LLC*, Case. No. 2:22-CV-00150-ABJ, ECF No. 70 (filed D. Wyo. Aug. 15, 2024) (granting class certification under Wyoming's royalty payment statute), *but see Belmont v. BP Am. Prod. Co.*, 2015 U.S. Dist. LEXIS 179003, at *30-33 (D. Wyo. Jan. 8, 2015) (denying class certification under Wyoming's royalty payment statute).

9 Wyo. Stat. Ann. § 30-5-302.

10 Colo. Rev. Stat. § 34-60-118.5(3); Tex. Nat. Res. Code § 91.402(b)(1).

11 Colo. Rev. Stat. § 34-60-118.5(7); Tex. Nat. Res. Code § 91.404.

12 Tex. Nat. Res. Code § 91.402(e).