In Putative Class Action, Fifth Circuit Holds that Texas Operators Must Seek Best Price Available in Calculating Royalties Under Proceeds Lease

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Operators in Texas have a duty to market their gas and seek the best reasonable price available for purposes of calculating and paying royalties under a "proceeds lease," according to the U.S. Court of Appeals for the Fifth Circuit in a February 20, 2019 ruling.[1] The case involved a royalty dispute between Devon Energy Production Co. (DEPCO) and a putative class of royalty owners of natural gas wells operated by DEPCO in the Barnett Shale gas field.

Royalty owners alleged that DEPCO sold the gas to a subsidiary, Devon Gas Services (DGS), at an "artificial price" and passed along an unreasonably high gas processing fee to the royalty owners. The owners claimed that DEPCO intentionally lowered the purchase price of the gas at the wellhead by 17.5 percent (the amount of the gas processing fee) and, thus, provided lower royalty payments to the owners because DEPCO used a lower price to calculate the owners' royalties. The owners claimed DEPCO used this systemic pricing model for all gas processed through Devon's Bridgeport Gathering System, which services all of DEPCO's wells in the Barnett Shale. The owners further argued that they all held Class Lease forms, which carried an implied duty to market under Texas law. The owners maintained that DEPCO breached its implied duty to market the gas when it artificially lowered the price of the natural gas that it sold to DGS.

DEPCO, in opposition, argued that the Class Leases at issue were not all the same and that the district court improperly assumed that the same "duty to market" applied to all of them. Based on *Dvorin v. Chesapeake*, DEPCO argued that the district court had a duty to review each Lease individually, including all ancillary documents associated with said Leases, to determine if a duty to market existed. Upon review of the record and the district court's decision, the Fifth Circuit found DEPCO's argument to be unavailing. Unlike *Dvorin*, where all of the lease forms at issue were different, here the Fifth Circuit found that all nine Lease forms were the same and that the duty to market applied equally to all of them. Further, the *Dvorin* court did not require, as DEPCO argued, that every potential ancillary document be located and reviewed before determining whether a group of leases imposed the same implied duty to market. In *Dvorin*, there were other clauses in the Leases that modified the royalty clauses. In this case, no such clauses existed. Simply put, the Fifth Circuit refused to accept DEPCO's argument. The court found that, under Texas law, no difference existed between the implied duty to market and any express duty to market that may be set forth in a lease. Both require reasonableness – the operator must take "reasonable" steps as a "reasonably prudent operator" to market the gas. Pursuant to this duty, DEPCO owed the owners the "...best current price reasonably available."

The Fifth Circuit went on to analyze certain class certification issues arising from the Leases. At the end of the day, the court reversed and remanded the matter back to the district court for further review of the evidence relating to the Leases to determine whether sufficient additional evidence existed to support a finding that the breach of the duty to market and damages from any said breach could be ascertained on a class-wide basis.

[1] Seeligson v. Devon Energy Production Co., L.P. 2019 WL 852060 (5th Cir.).