ORAL ARGUMENT – 12/01/04
03-0824
BOWDEN ET AL V. PHILLIPS PETROLEUM

KAWAJA: I'm here today representing more than just the petitioners and royal owners. I'm here representing anybody that's been impacted by a cross action in Texas, and anybody with oil and gas leases in the State of Texas.

What the court decides today with respect to class action law and oil and gas law is important to everybody. And it affects a number of different areas of law. We are asking the court to reverse the CA's decision in Always(?) and to affirm the TC's class certification in Always(?).

I would like to discuss the first two issues in our briefs. This addresses first the interaction between the ____ actual approach of res judicata in a class action. And the second issue is whether a statewide class action of royalty owners who are paid under a proceeds provision is maintainable as a class action? And I think under the court's precedent it is.

I will rely on the briefs for our argument related to the third and fourth issues which address subclass 2 and subclass 3.

Turning to the first issue. Factually this case is pretty simple. There are three subclasses who have each been impacted and treated by Phillips in a different way. There are different affiliate transactions for each class.

The TC in its certification order limited the certification to the claims asserted in the case. They each allege a single breach of contract claim. And the court stated, This class does not include claims by class members that are not based on the foregoing plaintiffs.

In the appellate courts Phillips argued that, absent class members' claims that are not asserted, to be barred from res judicata and, further, that because they are subjecting absent class members to res judicata, that they are inadequate class representatives.

WAINWRIGHT: Are you asking for a separate rule of law on res judicata to apply to class actions as opposed to all other types of civil litigation?

KAWAJA: No. We are not. We are asking this court to apply the traditional rules of res judicata, the transactional approach. And when that is directly applied to a class action, it means unasserted claims if they are not subject to classified treatment they will not be barred in later litigation.

WAINWRIGHT: But what you're calling unasserted claims are claims that have been brought

in the lawsuit. They are just not included in the class certification. Correct?

KAWAJA: Actually it's hard to know what they mean by unasserted claims because...

WAINWRIGHT: What do you mean by that?

KAWAJA: Anything that's not alleged in the lawsuit. We have alleged breach of contract. There may be other claims, may be related to the contract, or may be broad claims, or misrepresentation claims to specific royalty owners. But those are things for which we haven't yet discovered class wide evidence. Our discovery to date reveals class wide evidence and uniform conduct with respect to certain breaches. And here the breach is of the duty to manage and administer the lease as a reasonably prudent operator. And part of that duty is to market the gas with diligence as a reasonably prudent operator. We have evidence of uniform ____ that that has been breached.

WAINWRIGHT: In civil litigation claims that are not brought in a lawsuit, but could have been brought after a final judgment in that litigation, they are going to be barred by res judicata. Why shouldn't that be the case with class litigation? You cited the statement in Beeson that rule 42 is never meant to be an exception to the rules of res judicata. But the rest of that sentence continues, and it says, or to provide a risk free method of litigation. I don't know the court should - in fact, I believe the court should not determine or direct what claims should be brought by plaintiffs. But once plaintiffs decide which claims they want to bring, which claims they want to pursue, then are you suggesting they should get another bite at the apple based on claims that were not asserted but could have been brought for claims that were not part of the class certification but could have been attempted to be included in the class certification?

KAWAJA: No.

WAINWRIGHT: It sounds like your argument is one where we'll try a certain claim, see if it works on a class wide basis, not we should have reserved the right to try another claim. And it sounds like several bites at the apple.

KAWAJA: No. I think if a claim is subject to class wide treatment and it could have been certified, then it should be subjected to res judicata. But it's premature to determine at this stage what's going to be precluded and what's not. Because the class hasn't even gotten notice of what claims are even being litigated.

NB3 and the LaPray decision, this court was focusing on the distinction between an B2 class and a B3 class, which this case was under the old B4 which is now B3. An injunctive class doesn't require notice to be issued. The B3 damages class like this case has safeguards built into the rule: you have notice of the claims that are being litigated; you have the opportunity to object to that; and also to participate. If you haven't got any of that - there's due process. I mean you can bar those claims that are not asserted. We're not asking for a second bite

at the apple later if the claim should have been treated as a class action claim.

O'NEILL: Is that a fact base determination or a liability theory base determination? It seems like your main complaint here is the affiliated transactions. Does that mean that all claims by class members complaining about affiliated transactions, whether based on fraud, breach of contract, any other legal theory would then be barred?

KAWAJA: Again it's hard to speculate in a vacuum because we don't know if those kinds of claims later asserted would have had class wide evidence. The decision of res judicata is...

O'NEILL: If it's the same evidence as here. Let's say this class stands, all three of these subclasses stand. It's based on class brought evidence of the contracts. Let's say you lose. Then what would prevent you from under your theory coming back again under a fraud theory based on the same evidence because it's class wide evidence?

KAWAJA: If it can be established that the fraud claim was subject to class wide proof...

O'NEILL: Which you say it would be because it would be the same proof as here.

KAWAJA: Then the defendant would have the benefit of res judicata. I think the court's concern below was whether subjecting to res judicata - take it one step further. Not only are the claims barred. But are you going to be an adequate class representative just because you are subjecting under res judicata? And no court has ever held that. You are entitled to - class representatives that's what they do. They bind absent class members. And that's federal law, Texas law, all around. Every CA has held that.

HECHT: But a lawyer who gives up most of his clients' claims may not be an adequate representative.

KAWAJA: It's strategy. If the class is getting notice due process is satisfied why can't you be subjected to res judicata. That's what the US SC says in Stevenson v. Dow, all the way back to Hansberry v. _____.

HECHT: Well one reason might be there are a little less than 3,000 members in subclass 1. Is that right?

KAWAJA: Approximately and maybe not all of them have adequate lease but's that's roughly the number we have.

HECHT: So they could - it would be hard, but you could join them all individually in the same suit.

KAWAJA: It would be complicated, but we could.

HECHT: And if you did, then all of their claims that they didn't bring would be barred.

KAWAJA: True.

HECHT: Why should the rule be different if it's a class?

KAWAJA: It shouldn't be. But the caveat that I'm asking the court to put on this, the qualification under the traditional approach is that, you've got to have a claim that could have been subjected to class wide conduct.

HECHT: I understand your argument. At the end of the day in one situation where they are all joined, there is one rule. At the end of the day when they are not joined and there's a class there's another rule. Why?

KAWAJA: I don't think I'm asking for another rule.

HECHT: The class member whose claims are barred or whose claims are not barred thinks he got a different rule.

KAWAJA: Let me point to another decision, which didn't make it into the briefs. It came out of the Dallas CA earlier this year. It's Grant Thornton v. ____ Trust Bank, 133 S.W.3d 342. A petition for review was filed in that case. And the Dallas CA probably has the most oral discussion than any of the other Texas appellate courts on the issue. And they declined to decide whether an unasserted claim was barred by res judicata. But they did state the following, and they affirmed the class certification. The court said, and the record here reflects that the TC considered the adequacy of the class representatives and the context of claims splitting, and authorized the class to proceed with safeguards designed to protect the absent class members whose noncertified claims may be affected by the outcome of the class action.

There is no problem with subjecting a class member to res judicata as long as due process is satisfied. And it could be a claim is certifiable and it's not asserted and it should have been. Its decision should be made in a later action when it's attacked by an absent class member, not by the CA and not by the TC.

If you look at the federal rules of civil procedure, which this court often does, and you look at the advisory committee's notes on rule 23. In 1966 they even made a comment that expressly reserved the right of a later court to decide whether an unasserted claim is precluded by res judicata.

OWEN: Subclass 1, you make a point of saying that Phillips admitted that it sold all of the gas at the wells. It seems to me that the inquiry is going to be what would a reasonably prudent marketer have done differently, or what price would it have received at the well? What is your evidence on that?

KAWAJA: That is was sold at the well?

OWEN: No. That the breach of the duty or the damages. In other words, it seems to me if the sale is at the well, under the proceeds clause the test is what price would a reasonably prudent marketer have received at that wellhead. And what is your evidence on that that's class wide as opposed to well by well?

KAWAJA: I think you're jumping to how would we calculate damages?

OWEN: I'm talking about breach and damages. It seems to me you are going to have to show well by well that at this wellhead there was a breach, at this wellhead there was a breach, and damages. So what's your evidence on both breach and damages wellhead by wellhead? How do you prove that class wide?

KAWAJA: We're talking about subclass 1, which I argued conflicts with the Hankins holding. And under Hankins, I think a class action for proceeds lease holders is certifiable. The implied covenant to market that we allege protects the royalty owners is meant to protect the royalty owners themselves. And that's something this court has recognized several times.

The evidence on the breach of the duty is that a reasonably prudent operator would not have entered into a long term gas purchase contract with its affiliate for 15 years, and paid royalties based on that inner affiliate transaction.

There's evidence in the record that other companies pay royalties on the price received from a third party purchaser. There's also evidence that Phillips Petroleum Co., the lessee in this case, actually markets the gas in other areas of Texas. And they do exactly what we're asking them to do on behalf of this class, which is actively market the gas and pay them the royalties...

OWEN: But you have to show that there would have been a difference. And how do you that on a class wide basis as opposed to well by well?

KAWAJA: There would be a difference because the affiliate is actually actively marketing the gas for these royalty owners in the subclass.

OWEN: But at some point way down the line after it's been processed what's your proof to show that back at the wellhead where the proceeds lease provision kicks in that there was a breach of the duty, that they could have gotten a better price at the wellhead?

KAWAJA: There's testimony from one of Phillips employees that there was absolutely no reason why Phillips Petroleum Co. can't do what its affiliate does.

OWEN: What's the evidence that they could have gotten a better price? How do you prove that class wide as opposed to well by well?

KAWAJA: I think the fact that its affiliate, its subsidiaries actively marketing the gas and getting a higher price. I think the transfer price is just an artificial number. It's just on the books. It's just being a transfer and that's it. So that would be part of the proof that we would show breach of the duties and damages, that they could have gotten a higher price.

OWEN: Well how do you take that back to the well with transportation charges, any kind of a special charge between the well and point of delivery? How do you prove that?

KAWAJA: It can be accounted for. That's all stuff that is maintained. It's information that's maintained by Phillips. And we're saying the price that you received by the third party purchaser deduct that back if you have to. But the price that the third party pays for it is what's paid in an independent transaction, is what they are entitled to a royalty on, not this artificial price that is paid by a subsidiary. When you admit that you can actively and you can do what your subsidiary does, and they actually do it in other parts of the state, why shouldn't you do that for this group of royalty owners. There's no real explanation for why they make a difference between these two groups of royalty owners. Other companies do the same thing. So the damages calculation you would go back and deduct those things.

I think under Hankins the class is certifiable. In subclass 1 there are a number holdings that were made to find predominance wasn't satisfied. Each of them on legal errors that need to be reversed. The first one being that, the duty owed to the royalty owners is a fact question, which is absurd under all of Texas law. All this court's precedent, the duty is a question of law. It's never for the jury.

HECHT: I think you are right about that. But would it vary from lease agreement to lease agreement?

KAWAJA: No. I don't think so.

HECHT: Why not if some of them are expressed and some of them are implied?

KAWAJA: The duty is going to be consistent. The duty is, behave as a reasonably prudent operator and to market this gas with reasonable diligence.

HECHT: So it seemed to me as I was reading your brief that it comes down to your argument that whether it's express or implied it's going to be the same no matter what.

KAWAJA: Precisely. And to date, as much as they have protested about there being different express duties to market, they have yet to come up with a lease that says, we don't have to do this with reasonable diligence, that they have to do it with a higher standard or a lower standard. And they have yet to come up with anything that says we can self deal. If you found something like that, I don't think it would be enforceable. And the fact of the matter is, all of these lease terms are consistent. They are just phrased in a different way and they are stating the law. They are stating

what the law really is. Behave as a reasonably prudent operator. It's not changing the terms in anyway.

WAINWRIGHT: I have a question of res judicata. You agree that those principles apply to a defendant and counterclaims, too. Correct?

KAWAJA: Correct

WAINWRIGHT: Parker County v. Spindletop involved a class wide counterclaim. Let's assume that it was not dismissed for service issues, and technicalities. If Parker County had 6 defenses or counterclaims, and decided to bring one and lost on it, and that case was over and done. Could Parker county say well there are other unasserted defenses that I could have brought, and I now want to gin the lawsuit up again and try those defenses one at a time. Because I didn't assert them against the class in the initial lawsuit, and I wasn't sure if they were assertable class wide. Under your approach wouldn't Parker County be able to take that approach?

KAWAJA: I don't think so.

WAINWRIGHT: How is that different from what you're arguing _____?

KAWAJA: If they had the opportunity to assert those counterclaims and to litigate them, and to present them as class wide defenses, then they should have.

WAINWRIGHT: And why should not that same rule apply to the other of the ____?

KAWAJA: It should.

WAINWRIGHT: If they have the opportunity to present them as you phrased it and litigate them, shouldn't it apply regardless of which side of the be(?) you are on?

KAWAJA: It would but I don't know what claims they are talking about that are certifiable. If they want to admit that these classes - there are other claims out there that are minimal(?) to class wide treatment and they should be certified. Let's go for it. But they are never going to do that. We don't even think that these claims are certifiable and they are breach of contract claims. This court over and again has indicated class actions are permissible in Texas, certain times they are not. Personal injury class actions we know just are not workable. But on the other end of the spectrum is a breach of contract class action. And that one generally is when you got uniform contracts, uniform duties, and uniform conduct.

There are numerous cases in Texas law where you may have some claims ___ certification and some person, the ____ v. ____ case is an example, where you had some claims which are not subject to class wide treatment. And when the plaintiffs tried to abandon those claims on appeal, this court declined to allow them to do so because there was a certification order and the

court believed that the class may have been entitled to notice that those claims were being dismissed and abandoned.

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RESPONDENT

POWELL: Let me try to answer J. Owen's question about subclass 1. There is no evidence that they have that would show a class wide variation in a marketing duty at the well. Here is what they say in their reply brief and this I think frames a couple of issues. It also frames an answer to J. Hecht's question. The petitioners say the royalty owners simply seek to be paid royalties based upon the first arms-length transaction not an affiliate transaction. The affiliate transaction takes place in the field at the well. It's based on an index price. It's exactly the same contract that a nonaffiliated company, ____ Oil company has on the same wells.

What they want to do is go to where Phillips gas marketing company, the marketing affiliate sells gas at the City of Garland, and the Sweeney refinery and at the tailgate of a plant that puts gas into the intrastate pipeline, and paid that price as the proper sales price. That is the first arms-length transaction, not an affiliate transaction.

In the case of these leases most of which are two-prong royalty clauses, that immediately destroys the class because they've now moved away from a sale at the wells, which is why proceeds are the proper payment. And they have moved to the tailgate of a plant after the gas has been used in the manufacture of gasoline or other products. Or a sale way off the lease and we're in to a market value determination, which is clearly a situation on base determination under this court's decision in Middleton. So none of this works when you get right down to it. And I think that's what the 14th court saw.

Now J. Hecht asked about the specific clauses. Over 80% of the leases in Fort Bend county have an express clause governing the marketing duty. The named plaintiffs' leases have a peculiar kind of clause. This clause is frequently throughout this set of leases.

OWEN: You gave us one example, an express marketing clause. It didn't seem to me it was all that different from what we have said is implied covenant. Are there any marketing clauses that are different?

POWELL: There are 4 different ones that we have identified and we didn't set them all out. They are set out in our brief in the CA. Let me speak to the one that we did give you. If you look at the second part of that clause it says that in no event shall the lessee be required to provide facilities other than the normal lease facilities, a separator on lease gathering, etc., etc. In other words your duty to market requires you only to provide facilities on the lease. Their argument in this case is, that Phillips should have carried out the same thing that its affiliate did. In other words, we should have built a plant. We should have built a cavern at the Sweeney refinery. We should have built a pipeline all the way to Garland, Texas from Fort Bend County, and marketed the gas actively

like Phillips Gas Marketing Company did. That clause negates that duty. We have no obligation to build facilities off this lease under that clause. Whether we do under an implied covenant to market, I don't know. But we certainly don't under that clause. There are other clauses in some of those contracts that say that as long as we get a contract that has a certain duration and has a provision for renegotiation and that is dependent upon some market index, then that satisfies the duty to market. We did that.

I don't think if you analyze that subclass 1, which I'm surprised that's the one they've picked on to talk about today. That one just doesn't hang together. You got the duty, the duty that they are trying to enforce. And they didn't do this right until the very last day of the class certification ____. Is a composite that's based on different express clauses and on the implied clauses.

O'NEILL: What if all the clauses were the same?

POWELL: If all the clauses were exactly the same, that would be the situation I suppose if there were no express clauses.

O'NEILL: Or all express clauses that were the same.

POWELL: I think at that point you get into the very situation that J. Owen spoke of. If you're going to test whether an operator exercised its duties as a reasonably prudent operator, you have to look at all the facts and circumstances governing each exercise of that duty. For example, if a well is located a long distance away from another possible source, a prudent operator might tie on to whatever source is available. He might take a lower price if his gas is of a poor quality.

OWEN: Where is the point of your sale?

POWELL: At the current time, we say in subclass 1 is at the wells.

OWEN: Where do you resale it to?

POWELL: Phillips Gas Marketing sells it essentially during this class period time in three places: it sold it to the City of Garland...

OWEN: But where? Where is the point of resale?

POWELL: At the end left to the city of Garland's own distribution facility. It sold gas to the Phillips Petroleum Co refinery in Sweeney Texas. And there Phillips Gas Marketing maintained a cavern which permitted Phillips Gas Marketing to...

OWEN: So you resale to your affiliate and your affiliates resale to the end user. All occurs at the same point?

POWELL: No.

OWEN: Where does your resale to your affiliate occur?

POWELL: Phillips Petroleum sells to the affiliate in the field at the wells.

OWEN: The resale to your affiliate also occurs at the wellhead.

POWELL: Phillips as producer sells to Phillips Gas Marketing, the affiliate from the wells in the field. Phillips Gas Marketing then takes the gas...

OWEN: Alright. You say from the standpoint of the sale, you sale the gas at the wellhead to your...

POWELL: That's what we say. Yes. Now what their argument is, is that's wrong. We don't really. They call that a transfer price. They say the gas is really sold the first time when it's sold to a nonaffiliate.

OWEN: And the first time your nonaffiliate resales is is at the tailgate of the plant or at the city gate or...

POWELL: Right. Many miles away from the field. After the gas has been processed or transported substantial differences are stored to meet peak and demand.

O'NEILL: Can you imagine any sort of ability to make a determination of whether affiliate sales are a sham or a fraud on a class wide basis?

POWELL: I wondered about that. There is the challenge that if we're right you can never have a class...

O'NEILL: It seems that way.

POWELL: I don't think that's right. I do have a serious question as to whether you can have a big class action, a statewide class action that depends on a number of different marketing transactions. But if you had a field, a unit or a field where there were a number of wells, and all the gas were sold at the same time, perhaps on the same contract and all the leases are the same or there are some unitization where the obligation becomes uniform throughout the field, I think you could probably have - in fact there are class actions like that, that have been affirmed.

O'NEILL: But aren't you going to pretty much fail on numerosity then?

POWELL: They may not. J. Hecht mentioned there are 3,000 members in class 1. There are 3,000 leases in class 1. There may be 20 different people who have royalty interests in those

leases. We may be talking 25,000 actual members in the class. I don't think you're going to have - you're not going to have hundreds of thousands, or tens of thousands of people, but you certainly could have a substantial number of people. There are classes like that. Some of the cases that they point out.

OWEN: What if this were limited to a class where the leases were the same. It was a proceeds clause that didn't have express covenant or whatever they were. They were the same. And you all stipulated as you do here that the sales occurred at the wellhead. And everybody knew exactly what charges were backed out. So really the only consonant here that is really at issue is what price you are getting from your affiliate. And the evidence was that the price you were getting from your affiliate was about 10% less than what an arms-length seller would have gotten. Would that...

POWELL: There are circumstances. I'm not prepared to say that we're trying to kill class actions dead as a doornail in the oil and gas field. I do think you could have a situation like that where the proof was right.

OWEN: Is that their argument in this case? Assuming again that you got over the hurdles of the leases are the same. Is that essentially their argument in this case that you are selling at a lower profit to you so that your affiliate can take the higher profit.

POWELL: That's their argument at a very high level. But it seems to me that their argument for practical purposes and the evidence they put in was that they want to be paid a price based on sales a long distance from the field. And you would have to assume away then all the two-prong leases which is they put in...

OWEN: If the consonant is in there, the consonant that causes the damages is your margin or profit, and that's uniform across the sales, why wouldn't that be easily provable through a class action?

POWELL: I think a class action could be derived on the right facts. And I think you would have to do as you said, you would have to prove which they have never done that nonaffiliated sales in the field, in the same vicinity under the same marketing conditions were higher. And for example, in this record we proved to the contrary throughout the state. This is a huge...

OWEN: What if you proved that your marketing affiliate was buying gas from you and other sources and the price they paid you was consistently 10% less than what they paid...

POWELL: That would be a good class wide...

OWEN: Is there any evidence of that here?

POWELL: No. In fact the evidence is directly to the contrary. The evidence is that this contract was negotiated by a nonaffiliate, Nipon(?) Gas Company, a subsidiary of a Japanese

company.

OWEN: Is this just regarding subclass 1?

POWELL: Subclass 1. They negotiated the contract. The price is based on index prices less .10. The index prices are Houston ship channel index prices. This is not at the Houston Ship channel, and this is raw gas at the wellhead.

O'NEILL: But that goes to the merits.

POWELL: That goes to the merits. I'm trying to answer the question, was there evidence in the record of that kind? There is no evidence in the record of that kind. In fact the evidence is all to the contrary. The evidence is that a nonaffiliated company owning 50% interest in the very same wells sold their gas to Phillips Gas Marketing Company on the same contract for the very same price. So the most comparable sale is exactly the same as this sale. So there is no evidence of what you asked about.

O'NEILL: Let me ask you about the res judicata question. It strikes me that a large piece of that would be advisory.

POWELL: Here is the way I think that should be looked at. I don't disagree that the res judicata effect of a judgment is to be determined in the next case. And I think that's well established law and that's the argument they make. However, in determining whether the issue of adequacy is met at the time the class is certified, I think it is highly appropriate as the CA did here, to look to see what kind of res judicata risk the class representatives are willing to visit upon the heads of the absent class members.

O'NEILL: Which of course begs the question, begs the ultimate question when it does arise. Really what the CA is saying is just failure to consider what the ruling might be on the res judicata effect down the road is the analysis. What strikes me about the CA's statement is that any claim that arguably is not appropriate for class certification that might be barred by res judicata automatically makes the class representative inadequate. And that just can't be.

POWELL: I don't know - I think you have to look at the nature of the case. But look at the nature of this case. This is a suit on a long term continuing contract where there is a long term relationship between royalty owners or landowners and the oil company. And if you are going to bring - and let's even narrow it more. Let's say that the gist of the complaint, which is the gist of the complaint throughout this, is that we didn't get paid enough royalty on the very gas that was produced from the wells on my property from Feb. 1995 to the present. So a certain package of gas, certain production.

To narrow it as narrowly as I think we might narrow it, any claim that has to do with whether I got paid the right amount of royalty, once that question has been litigated ought

to be closed. Otherwise, you never have any closure to an ongoing transaction. There may be ½ dozen different reasons why someone could theorize that we didn't pay the right amount of royalty. What the plaintiffs want to do in this case, what I think attracted the CA's attention, was the plaintiffs want to litigate one theory as to why they didn't get enough royalty during that period of time on that very package of gas. And they don't want anything else for it. So they want to be able to come back after say they lose this theory in subclass 1, and say well now we think you didn't measure the gas correctly, which is a huge issue in the gas field out there. Did you measure the gas appropriately? And we don't think you did and so now you didn't pay us enough royalty because you didn't measure the gas appropriately. The very same gas, the very same royalty payments.

Our position, and I think a position of any defendant is when you - and this to me is well established law, where you have a contract and you're suing on a transaction under that contract. Once that's done, then all other breaches of that contract are merged...

O'NEILL: I understand. But again there's a big issue about this and it's really largely undecided. And so how can you just say that the class rep is inadequate based on an undecided question. I understand the concept of willingness to abandon the claims, which of course presumes that the ultimate determination is that they are abandoned. It seems like an awfully broad holding by the CA that if you give up any potential, possible, conceivable claim you're just inadequate.

POWELL: There may be a continuum. But it seems to me that this holding is exactly right, because you picked one theory as to why there might not be enough royalty, and that's what you want to litigate.

O'NEILL: Would your answer be different if this were an opt-in class. If the representative was trying to make it opt-in would that take care of it?

POWELL: I think that raises an interesting question, which after LaPray whether notice makes a difference here. And going along with that, if opt-in would make a difference. I think it would certainly make it better. But that sort of begs the question under Bernal that the class has to meet all the requirements of rule 42 at the time the class is certified, not after notice is given, and not after the absent class members have exercised their rights to opt out or opt in.

The class that's certified has to meet the requirements of rule 42 right now when the certification order is entered. And you can't rely on what class members might do or might not do after they receive notice and depending upon what the notice says and the choices they make to clean it up.

O'NEILL: In examining the adequacy issue at the certification hearing, if it's determined that we're going to make this an opt-in class, or an opt-out class, but the class notice or definition is going to say this is all there can ever be relating to price from this period forward, would that then satisfy adequacy?

POWELL: I don't know. I don't know what particular provision there would be. But it would seem to me that a class representative who came in and made all those proposals would look like that he or she has in fact thought about the issue that we're all wrestling with here.

Your honor said you don't think these issues are decided. And I agree there is a lot of scholarly writing and courts are writing about this. I think that in Shine(?) the court made the comment that a class that in order to be certified requires all the class members to give up something like consequential damages, raises a significant issue of superiority.

JEFFERSON: The US SC suggests that there can be class action on alleging an employer's discrimination and yet individual claims could be litigated. They are not barred by the resolution of that class. How is this different?

POWELL: I think that the causes of action are very different. The Cooper case says that a claim that there is a systematic pattern of discrimination once tried and lost does not answer the question as to whether there was unlawful discrimination against one or two individuals. And those individuals have the right to come in because their cause of action is different. The elements of the cause of action are very different. It may very well be that they can prove complete cases of discrimination against themselves without being able to prove a pattern of discrimination within the company. So I think the causes of action as explained in Cooper are very different there. Here, the cause of action has got to come from the oil and gas lease. Now whether it comes from an express or an implied covenant it doesn't come from a statute. It doesn't come from a general rule of law. The push and pull in these royalty owner cases, and I think we've got a good example of it this morning.

OWEN: There are lots of issues. We could have severance tax issues. We could have measurement issues. We could have - as you know lots of issues that go into royalty. Are you saying that every issue that could be litigated about the royalty payments, if it were just be suing you, I would have to raise in that lawsuit for that time period.

POWELL: I think that's right.

JEFFERSON: Then how can you have a class action in these cases at all even under the unitization theory?

POWELL: At that point people have to - you have to give notice and people have to understand that anything they have, if anybody's got a claim that things are wrong, they need to investigate it and they need to get it in the case, or they need to come in - I mean one of the interesting issues here, which to me is a huge issue, is what happens to all these individualized issues? I mean they are in the action. They may be carved out of the class, but it seems to me that you have to consider - I think the predominance test is testing the class issues verses the individual issues in the action.

WAINWRIGHT: Are you suggesting that in a case where claims splitting is occurring, in order to attempt to certify a class, that notice has to be given to the class members that there are certain claims they will never be able to bring, and that needs to be some type of effective notice. Because as we know most members of a class don't know what's going on with the lawsuit.

POWELL: That's right. I think you have to be very explicit and then you get into the cases that say that if any absent class member in his right mind would opt out, then this is probably not a good class ____ because it is not a superior way of handling these issues.

OWEN: I have a question about subclass 2. You argue, well it's ambiguous. I know you moved for summary judgment on ambiguity and loss. Should an appellate court look at whether the provision is ambiguous or not in deciding whether to certify? For example if we were to conclude that the clause is not ambiguous, should we take that into account in deciding whether the class should be certified or not?

POWELL: I think then you would just be saying that the CA made an error of law. What the CA did I think was completely appropriate. They looked at the class plan and concluded that they trial judge...

OWEN: What if they disagreed with the trial judge? The CA looked at the lease and said this is not ambiguous. Should that be taken into account?

POWELL: Then you are making a merits decision, which seems to me on an interlocutory appeal. And I suppose you could bind the trial judge by doing that. But all you are really reviewing is what the trial judge did with respect to class certification. I don't know that the appellate court has before it at the time, whether the trial judge was right or wrong on that question. That issue didn't come up.

O'NEILL: My question was very similar as to subclass 2. An argument can be made that the GRA's, whether or not they require proceeds on natural gas liquids is ambiguous or not. If we were to determine that it's not ambiguous, and it does require - or it can be determined based on the plain language of the contract, would that then be a certifiable class?

POWELL: Not that subclass 2, because the much more interesting issue in that class is the intra class antagonism. That class completely dissolves into classes of winners and users. I like to capture that. That's the Lake Wolv____(?) class where all of the gas is above average in the plaintiff's view. And it's not. Some people are going to get less and some people are going to get more. There is no conflicting evidence in the record on that subject matter. That is a matter of math.

OWEN: Should we let all of that proceed on a class action ambiguity determination? At the outset an appellate court says this isn't ambiguous.

POWELL: I would like to be able to bring up questions like that in class certification

proceedings. It does strike me as the law apparently exist that you would be rendering a decision on the merits in the course of an interlocutory appeal on class certification. I've always maintained that this is not ambiguous. The other side clearly maintained in the TC that it is ambiguous and the trial judge said he is going to submit the question to the jury, which I think is what caught the CA's attention.

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REBUTTAL

KAWAJA: We said the TRA's were unambiguous. If you look at vol. 3 of the clerk's record, that's where our opposition to the motion for summary judgment is. And we simply said, their interpretation is unreasonable. The TC denied their summary judgment motion and presumably found their interpretation was not reasonable.

HECHT: Well then why is he going to submit it to the jury?

KAWAJA: The question to the jury is...

HECHT: The question to the jury is what does this mean? Why would you ask that if it's not ambiguous?

KAWAJA: The question is, is did Phillips breach its duties to the royalty owners? Not is it ambiguous? Not what does it mean?

OWEN: It's either you calculate MCF or MMBTU. Which is it?

KAWAJA: The way it's stated is if you think that they've breached the duty, then you include an after gas liquids in the formula, not necessarily asking them should it be an MCF or a BTU? The bigger question the he raises about the interclass antagonism doesn't exist either. He says there is no conflicting evidence in the record. And I beg to differ because there is.

The evidence was conflicting. There was evidence that perhaps for one month that they showed in the record that one of the class representatives may have sustained a minimal loss, one month out of this now 10 year period...

OWEN: You've got a volume of gas and either the liquids are included or they are not. It seems like they are going to be winners and losers just like he said.

KAWAJA: Overall though they are probably all going to benefit because the quality of the gas is not going to be consistent necessarily from month to month so there may be a fluctuation. But in the end you are going to benefit overall from this. So they showed the TC evidence about 1 month for this particular class representative. The TC has the discretion to decide the facts on conflicting evidence and it did.

OWEN: To the extent one class member gets paid more here, it necessarily takes away from the other class member doesn't it?

KAWAJA: They didn't prove the conflict. It's speculation at best when you show just one month...

OWEN: There's just one pot of money right? And isn't the issue how it's split up among royalty owners?

KAWAJA: No. The gas is being delivered. It's raw gas and they are paid royalties right here on the raw gas. Then they are separating the gas from the liquids and the subsidiary is selling the natural gas liquids and then the dry gas, and no royalties are being paid for the sale of the liquids. And that's very substantial. What we're say is that there should be a royalty on the dry gas and on the natural gas liquids, not on this.

O'NEILL: But that's only if the payment is based on the transaction at the plant as opposed to at the well. Right?

KAWAJA: That particular issue doesn't come in to subclass 2 I don't think. This is because we are interpreting the lease language of the GRA's which says you are entitled to royalties based on the sale of gas, and the components of natural gas to people other than lessees.

SIDE A, TAPE 1 RUNS OUT

... we are entitled to royalty payment on the sale of natural gas. Some class members may receive more in damages than others, but the fact that there may be different damage inquiries doesn't defeat class certification. It's not fatal. The third conflict is the speculation at best. And it was within the TC's discretion to resolve the fact issues in our favor. The CA simply disagreed and disregarded the evidence in our favor that showed it would be a gain for class members. And so if it wasn't so profitable for Phillips they wouldn't be arguing about this so hard. They are saying some people are going to be at a loss and so let's just take it and nobody gets anything. That doesn't make any sense.