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February 18, 2009

Colorado House Committee
Agriculture, Livestock, and Natural Resources

HAND DELIVERY

Re: House Bill 09-1194
Cause of Action Accrual as to Royalty Obligation

To the House Committee Members:

I have been requested to provide a position to your Committee pertaining to House Bill 09-1194 defining the accrual date as to any cause of action upon discovery of a breach of royalty obligation.

Let me begin by identifying myself as attorney practicing law in Steamboat Springs, Colorado, where I have done so continuously since 1986. A significant portion of my practice involves the representation of mineral owners who have entered into oil and gas leases and are receiving royalties. I must also comment that our law practice also includes representation of oil and gas industry clients and the comments set forth herein are not intended to be biased one way or the other, but instead provide a point of view of a practicing lawyer who attempts to analyze these types of issues in a nonpartisan way.

As this Committee is no doubt aware, House Bill 09-1194 is a legislative response to the Opinion of the Colorado Supreme Court published on June 9, 2008 in BP America Production Company v. Patterson, 185 P.3d 811 (Colo. 2008). This Colorado Supreme Court Opinion reversed the previous Opinion of the Colorado Court of Appeals in Patterson v. BP America Production Company, 159 P.3d 634 (Colo. App. 2006).

Patterson, *supra* ultimately did not involve any dispute pertaining to the applicable Statute of Limitations as the parties agreed that the six (6) year Statute of Limitations set forth in C.R.S. §13-80-103.5(1)(a) was the appropriate measure of

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time in which to file a Complaint initiating a lawsuit involving these types of claims. Rather, the parties disagreed as to the applicable accrual provision.

BP argued that each claim for any underpayment of royalty accrued when the monthly payment that was alleged underpaid came due. In contradistinction, David Patterson, *et al.* (Plaintiffs) who were class action Plaintiffs characterized their cause of action as one of breach of an express or implied contract concluding that claims did not accrue until under-payments were actual discovered. The Colorado Supreme Court ultimately decided that claims for monthly under-payments should be considered to have accrued on the date the royalties became due and not upon the actual discovery of a breach.

House Bill 09-1194 is a legislative response to define the accrual of commencement of the running of the Statute of Limitations to royalties to begin on the date that the breach was discovered or should have been discovered by the exercise of due diligence.

While an advantage of the existing law as articulated by the Colorado Supreme Court in Patterson, *supra*, is that such provides a date certain which is easy to calculate and can be said to simplify issues pertaining to defining the commencement of the Statute of Limitations as such applies to claims for under-payment of royalties, this commentator is less than optimistic that opposition to the pending bill will have the desired effect. It would be my prediction that while now existing law would certainly limit exposure to claims for six years in the past, it will instead create more litigation as savvy Plaintiff Lawyers will seek other causes of action to avoid this accrual analysis.

Before commenting further, analysis of certain realities need to be identified. It is often the case that the recipients of royalty payments have great difficulty even understanding and appropriately digesting the accounting type information provided to them at the time royalty payments are made. Even experienced legal counsel and accountants are often mystified in any attempt to understand provided financial information at the time royalty payments are being made so as to determine whether the royalty payments are in fact accurate. This is not only a problem for the recipient of royalties, but also creates an unnecessary level of distrust by the public pertaining to the oil and gas industry itself. To be sure, the vast majority of those in the oil and gas industry are honest and have no difficulty in paying royalty

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owners what is owed to them under their respective contracts. However, the information that is provided to royalty owners is often so complicated and confusing that many of the general public are left with the impression, typically false, that they are being cheated by the industry. This unnecessarily creates barriers between the public and industry that benefits no one. The hallmark of bookkeeping and accounting rests upon transparency and not obstruction. It is upon this backdrop that the accrual issue must be analyzed.

Accordingly, by affixing a date certain as to the accrual of the Statute of Limitations under circumstances where even many well trained professionals cannot analyze information to determine whether or not the correct royalty payment is being made, while providing a simple "black and white" Statute of Limitations deadline, may create unintended consequences. Simply put, as the law now exists such might unwittingly invite unnecessary lawsuits because of inflexibility pertaining to the Statutes of Limitation as interpreted by the Colorado Supreme Court in Patterson. At a minimum, declaratory judgment type suits will be filed to preserve claims even if it is less than clear that there is an underpayment issue. Moreover, the increased legal costs to both royalty owners and industry will do little to promote confidence in the other. In fact, it will probably increase acrimony.

The existing law does nothing to promote the type of transparency pertaining to bookkeeping and accounting necessary to well run industry. By adopting House Bill 09-1194, honest and trustworthy industry representatives are encouraged to make their royalty calculations easier to comprehend and discernable for reason that by providing more straightforward information arguments pertaining to when a Statute of Limitations begins to run will leave industry far less vulnerable to litigation than those that provide information that can be easily analyzed.

Because of the significant amounts of monies that are paid annually for royalty, all of these issues are not in any fashion inconsequential. Rightly or wrongly, many who receive royalties perceive that they are not receiving what they ought to be paid because of difficulty understanding the written materials provided at the time royalty is paid. This is unfair. It is certainly unfair to royalty owners, but is also unfair to those in the oil and gas industry that make good faith efforts to provide to royalty recipients all monies that are due to them. The law should be crafted in such a way to promote transparency and minimize the likelihood of litigation. It is important to

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understand that it is the role of the Colorado Supreme Court is to analyze existing statute consistent with the law. It is an unfortunate reality of appellate law that sometimes the results reached by appellate courts, while true in their legal analysis, sometimes do not result in law that is fair or benefits the parties and society as a whole. Luckily, the legislature has the absolute ability, particularly as such pertains to Statutes of Limitation which are by definition created by the legislature and a product of statute, to act in a way and in an environment unconstrained by limitations placed upon our appellate courts.

In conclusion, it is the opinion of this commentator that House Bill 09-1194 is the type of legislation that ought to be enacted because it is consistent with both the interests of industry and interests of the recipient of royalties. By putting the onus on royalty owners to file suit within a prescribed time after a breach is discovered or discovered by the exercise of reasonable diligence such in the long run will protect industry members that are acting consistent with their leases, who ought to have no fear in providing the financial information being sought as to royalty calculations in a way that would be easily understood for reason that by providing simple and straight forward financial information the Statute of Limitations begins to accrue sooner as opposed to later. On the other hand, those that are producing information which tends to be difficult to understand are punished because the Statute of Limitations will begin run later as opposed sooner.

Ultimately, any of the "us vs. them" mentality does not do service to the oil and gas industry as a whole, whether that be industry or royalty recipients. The relationship between industry and those that receive royalty interests is at the very heart of our oil and gas industry. Laws that strengthen this relationship ought to be embraced. For the reasons set forth above, I would urge this Committee to pass House Bill 09-1194 and make efforts to adopt this as our law in Colorado involving this point.

Sincerely,

Ralph A. Cantafio
FOR THE FIRM

RAC/sm