Customer-Focused Competitive Effects Analysis and the Role of Transportation Costs

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Welcome to the Fall 2014 edition of our committee newsletter Transportation, Energy & Antitrust.

On October 29, the committee held a launch party for the Transportation Antitrust Handbook. The Handbook represents the culmination of over three years of hard work performed by many of you. I had the opportunity to thank many of you in person at the launch party, but extend my sincere appreciation to all the many contributors. The Handbook explores the important intersection between antitrust law and the transportation industries in the motor, rail, airline, and ocean shipping sectors. The Handbook provides in-depth coverage of antitrust enforcement in the United States and globally, including the evolving role of industry-specific regulators (such as the DOT and FAA). I hope you find it helpful in your practice and welcome any feedback you have about it. If you have not yet purchased a copy, it is available on through ABA Publishing.
This edition of Transportation, Energy & Antitrust features three articles. The first piece, by David Weiskopf and Robert Bourke, presents research findings about customer-focused unilateral competitive effects analysis that provides a novel and tractable approach for assessing potential competitive effects concerns in the context of a proposed merger. Their proposed approach is conceptually intuitive, relatively simple to implement, consistent with the Merger Guidelines, and, perhaps most importantly, focuses on the key question of whether a proposed merger will harm consumers.

The second article, written by Jonathan Blank, discusses the Fourth Circuit’s recent ruling in favor of CNX Gas Company, LLC, EQT Production Company, and Buckhorn Coal Company on a Rule 23(f) petition and its importance for class certification analysis of ascertainability and Wal-Mart v. Dukes commonality beyond the coal and gas industries.

And third, Christopher Taylor adds to the growing FTC merger retrospective scholarship by presenting an article, Petroleum Retrospectives at the Federal Trade Commission, which surveys the Commission’s merger retrospectives in the petroleum industry and provides valuable “lessons learned” from these studies.

The Transportation and Energy Industries Committee is looking forward to a very active Winter and Spring. Look for our upcoming program on November 20 on joint ventures. We will also be organizing a “must-see” panel discussion at the Spring Meeting regarding the role of mavericks Tesla, Uber and Airbnb. Stay tuned and happy reading!

Amanda Wait
Chair, Transportation and Energy Industries Committee
2014-15

Customer-Focused Competitive Effects Analysis and the Role of Transportation Costs

David A. Weiskopf and Robert C. Bourke

Introduction

Transportation costs generally play an important role in the exchange of goods and services among willing market participants. They are one of several types of transaction costs and are a measure of the costs involved in delivering a good or service from a supplier to a consumer. For example, the travel cost borne by a customer when traveling to a retailer or the shipping cost incurred in delivering a product from a manufacturer to a customer are measures of transportation costs. For customers traveling to a retailer, the transportation cost may include the cost of fuel, the opportunity cost of travel time, wear and tear on an automobile, and so forth. Such transportation costs are broadly analogous to shipping costs incurred when transporting a product from a manufacturer to a customer (e.g., the costs of...
operating a fleet of delivery trucks). Customers will naturally incorporate these explicit and implicit costs into their selection of a supplier of a good or service.

Transportation costs are often relevant along the geographic dimension of competition in a merger review, as recognized by the 2010 Horizontal Merger Guidelines: “[t]he scope of geographic markets often depends on transportation costs.” In this paper we propose a new approach that describes how customers’ evaluations of transportation costs in their purchase decisions can be considered in the assessment of the potential competitive effects of a merger.

Merger analysis often only implicitly considers transportation costs in focusing on the location of suppliers (or distributors) in relation to customers. Competitive effects are often assessed by the change in the number and sales (or capacity) share of a set of suppliers in relation to a set of consumers. This approach typically involves drawing circles around suppliers according to how far the suppliers ship their products (based on observed customer locations) and considering the effect of the merger on the concentration of available suppliers within that circle. The approach we present in the paper attempts to measure more directly the extent to which consumers’ supply options will be impacted by the proposed merger. Our approach looks at the location of each customer and considers how his or her supply options are affected by the merger by using transportation costs to narrow down the set of feasible suppliers in the pre- and post-merger environment. This approach involves evaluating the extent to which customers’ supply options may be reduced by a merger and thus has intuitive and logical appeal because it focuses directly on the relevant competitive effects question: Will the merger harm customers of the merged firm, and derivatively, competition in an appropriately-defined relevant antitrust market? To illustrate our approach, consider two extreme outcomes from a merger. At one extreme, if the merger does not change the number of choices available to the customer (e.g., if the customer has a choice of five individually-owned grocery stores in close proximity to her location both before and after the merger), then it can be reasonably presumed that the merger will not harm that customer. At the other extreme, if the merger alters the number of grocery store choices within a customer’s economically accessible “circle” of options from two to one, then it is likely that the merger will harm that consumer, absent efficiencies, entry, or other considerations that would offset the presumed harm.

The two extremes discussed above illustrate an important metric in antitrust analysis, the diversion ratio. The diversion ratio from one product to another is the “fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product”. In the one extreme where the merger does not change the number of choices for the customer, the diversion ratio is likely to be zero or very low. By contrast, in the other extreme for which the merger causes a reduction in options from two to one, the diversion ratio will equal 100% or a similar very high number. In the absence of other information bearing on the diversion ratio, transportation costs can be used to evaluate the extent to which customers would switch to alternative competitive options by considering the set of suppliers to which a given customer could divert her purchases. Using this set of suppliers for each customer, the methodology described in this paper...
quantifies the number of suppliers to which each customer could divert purchases and, by aggregating over customers, develops a summary measure of the diversion ratio for a given set of customers. The diversion ratio, in conjunction with other information such as variable price-cost margins, can be used to make inferences regarding unilateral competitive effects using the Horizontal Merger Guidelines' “upward pricing pressure” (“UPP”) logic (i.e. everything else being equal, the higher the diversion ratio between the merging party’s products, the higher the likelihood of unilateral competitive effects from a merger).8

Although using customer and supplier location data in the context of antitrust analysis is commonplace, such data are generally used for the purpose of defining the relevant geographic market and assessing the competitive effects of a merger by focusing on customer locations in terms of a supplier’s “customer base” rather than on the locations of customers from the standpoint of their supply options. 9 We believe that the customer-focused competitive analysis described in this paper, particularly when used in conjunction with other information and analysis bearing on competitive effects (e.g., an assessment of entry barriers), can help illuminate whether a proposed merger raises concerns regarding competitive effects.

The remainder of the paper is organized as follows. First, we outline the step-by-step mechanics of implementing our customer-focused competitive effects analysis. Second, we provide an example of the methodology in practice using customer and supplier data. Third, we discuss the primary assumptions underlying our methodology, and last we provide a brief conclusion.

Description of the Methodology

The step-by-step methodology described in this section is applied to a merger of two retailers, and accordingly the relevant transportation costs are the travel costs incurred by customers when traveling to those retailers. However, the methodology can be applied more broadly, for example, in evaluating the competitive effects of a merger of manufacturers that ship a product to distributors and/or final customers. We note that there are several important underlying assumptions of our approach (discussed in some detail below), and in practice, we strongly suggest conducting sensitivity and robustness checks to validate the results of this methodology. We do not intend to suggest that the steps described below should be followed monolithically; rather, the steps are meant to convey the essence of the approach. The methodology involves the following four steps:

Step 1: Using information on customer locations for each of the merging parties and which facility each customer currently uses, determine the distance between each customer and the facility selected by the customer pre-merger.10

Step 2: Create a circle around each customer with a radius equal to the distance between the customer’s location (e.g., his or her residence) and his or her selected facility, and identify the number of unique suppliers within that circle, including the supplier selected by the customer.11 At this point, each customer will have a “competitive area” containing at least one facility (the facility he/she currently selects) and additional competing facilities if other suppliers have any locations
within the competitive area. In this context, competitors include the owners of all facilities selling goods or services which generally are substitutes for the customer's current purchases. These will be referred to as the competitive options for a given customer.

**Step 3:** Tabulate the change in the number of competitive options within each customer's competitive area due to the proposed transaction. Competitive options can be tabulated according to either the number of locations in the competitive area around a customer or the number of owners in the competitive area (which decreases the number of competitive options by adjusting for locations with common ownership). We generally focus on the latter tabulation, although the former may also be relevant. Computationally this means counting the number and percent of customers according to the number of pre- and post-merger competitive options available to them. An example of this type of tabulation is provided in Table 1 below. This stylized example focuses on customers who currently purchase goods or services from a facility of one of the merging parties. For example, according to the table, 31 customers of the facility (44.9% of all customers) experience no change in the number of competitive options post-merger.

<table>
<thead>
<tr>
<th>Change in Options</th>
<th>Number of Customers</th>
<th>% of Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 to 4</td>
<td>5</td>
<td>7.2%</td>
</tr>
<tr>
<td>4 to 3</td>
<td>12</td>
<td>17.4%</td>
</tr>
<tr>
<td>3 to 2</td>
<td>14</td>
<td>20.3%</td>
</tr>
<tr>
<td>2 to 1</td>
<td>7</td>
<td>10.1%</td>
</tr>
<tr>
<td>No Change</td>
<td>31</td>
<td>44.9%</td>
</tr>
<tr>
<td>Total</td>
<td>69</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

This type of summary provides evidence that is helpful in assessing the competitive effects of a merger. With these initial results, we can see both how widespread the competitive effects might be and, for those customers facing fewer independently-owned competitive options post-merger, how severe we might expect the competitive effects to be (based on the observation that, e.g., a “2 to 1” scenario suggests more competitive concerns than a “5 to 4” scenario). Suppose we tabulate the results and observe that most customers experience no change in the number of providers and those that do still have many options. In this instance, the preliminary conclusion might be that there are no competitive concerns. By contrast, if we observe that most customers experience a decrease in the number of options, and many of those are “3 to 2”s or “2 to 1”s, the preliminary conclusion would likely be a presumption of consumer harm (absent countervailing evidence).

Depending on available data, this step could include tabulating or filtering on other information beyond customer counts. For example, if the customer-level data contains additional information such as specific customer characteristics or a given customer’s volume of purchase, additional “cuts” of this tabulation can be
incorporated into the analysis, such as summing the volume of purchases rather than simply counting the number of customers for each set of options to account for the fact that certain customers purchase more than others.

**Step 4:** Estimate the average diversion ratio as the weighted-average diversion ratio across all customers. As an example of how the weighted average diversion ratio is computed, assume 40% of customers experience a “3 to 2” change in competitive options and another 60% experience a “5 to 4” change. The weighted average estimated diversion ratio would be $40\% \times 50\% + 60\% \times 25\% = 35\%$. This is based on the assumption that customers are equally likely to switch to any post-merger competitive option within their respective competitive area.

The estimated average diversion ratio calculated in Step 4 provides a summary measure of the diversion ratio by distilling the information in Table 1 into a single number. As this number increases, the potential for unilateral competitive effects increases as well, assuming everything else remains the same. When an estimate of the diversion ratio is combined with information on variable or incremental price-cost margins, the UPP test mentioned above can be implemented, and the potential for unilateral competitive effects assessed.

To illustrate how this methodology informs the competitive effects question, consider a benchmark case in which a set of customers does not have any competitive options within their circular competitive area. In this case, there would be no change in the number of options due to a merger. This would imply that the estimated average diversion ratio would equal 0% because in the event of a price increase to these customers, there would not be any switching to an alternative option. According to the UPP test in the Merger Guidelines, the Gross UPP Index (“GUPPI”) is approximately equal to the diversion ratio multiplied by the variable margin. If the diversion ratio is 0%, then the GUPPI straightforwardly equals 0%, and even absent a showing of cost savings from the transaction, the merger would not be expected to create any upward pricing pressure and hence would be competitively benign.

**Example Application of the Methodology**

In the following example, we demonstrate the four steps to implement the methodology described above. First, we use hypothetical customer and supplier geographic data to isolate the potential competitive options within a customer’s circular competitive area and assess the post-merger options available to each customer (as described in Step 1 and Step 2 above). Next, we provide a hypothetical stylized example of how to tabulate the results of available customer and supplier data to estimate the weighted average diversion ratio (as described in Step 3 and Step 4 above).

In Table 2, we show hypothetical geographic data for two customers and their potential alternative suppliers.
Table 2
Example of Customer and Supplier Geographic Data

<table>
<thead>
<tr>
<th>Customer ID</th>
<th>Customer Latitude</th>
<th>Customer Longitude</th>
<th>Supplier ID</th>
<th>Supplier Latitude</th>
<th>Supplier Longitude</th>
<th>Travel Distance (KM)</th>
<th>Change in Number of Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer X</td>
<td>38.90</td>
<td>77.04</td>
<td>Current Supplier</td>
<td>38.86</td>
<td>77.15</td>
<td>10.8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>38.90</td>
<td>77.04</td>
<td>Merger-Partner Supplier</td>
<td>38.95</td>
<td>77.10</td>
<td>8.1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>38.90</td>
<td>77.04</td>
<td>Alternative Supplier 1</td>
<td>38.15</td>
<td>77.25</td>
<td>8.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>38.90</td>
<td>77.04</td>
<td>Alternative Supplier 2</td>
<td>38.91</td>
<td>76.98</td>
<td>4.9</td>
<td></td>
</tr>
<tr>
<td></td>
<td>38.90</td>
<td>77.04</td>
<td>Alternative Supplier 3</td>
<td>38.72</td>
<td>77.28</td>
<td>6.6</td>
<td></td>
</tr>
<tr>
<td></td>
<td>38.90</td>
<td>77.04</td>
<td>Alternative Supplier 4</td>
<td>38.89</td>
<td>77.13</td>
<td>7.8</td>
<td></td>
</tr>
<tr>
<td>Customer Y</td>
<td>37.99</td>
<td>78.15</td>
<td>Current Supplier</td>
<td>38.13</td>
<td>77.99</td>
<td>21.6</td>
<td></td>
</tr>
<tr>
<td></td>
<td>37.99</td>
<td>78.15</td>
<td>Merger-Partner Supplier</td>
<td>37.42</td>
<td>78.14</td>
<td>6.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>37.99</td>
<td>78.15</td>
<td>Alternative Supplier 1</td>
<td>37.92</td>
<td>78.12</td>
<td>7.6</td>
<td>No Change in # of Suppliers (4 to 4)</td>
</tr>
<tr>
<td></td>
<td>37.99</td>
<td>78.15</td>
<td>Alternative Supplier 2</td>
<td>37.92</td>
<td>78.02</td>
<td>13.6</td>
<td></td>
</tr>
<tr>
<td></td>
<td>37.99</td>
<td>78.15</td>
<td>Alternative Supplier 3</td>
<td>37.90</td>
<td>78.12</td>
<td>10.4</td>
<td></td>
</tr>
</tbody>
</table>

For each customer, we have crossed out any suppliers that are outside of the competitive area defined by the customer’s current supplier. What remain are each customer’s potential alternative suppliers. In the above example, both customers have four suppliers in their circular competitive area (including the current supplier). However, Customer Y has no facilities of the merger-partner supplier within her circle and hence has no change in the number of potential alternative suppliers post-merger. On the other hand, Customer X does have a facility of the merger-partner supplier within her circle and thus she will have one less independently-owned option post-merger.

Once the potential number of pre- and post-merger options available to each customer has been calculated in the manner shown above, the next steps are to tabulate the results and to estimate the weighted average diversion ratio:19
Table 3
Example Summary of Post-Merger Change in Competitive Options Including the Diversion Ratio

<table>
<thead>
<tr>
<th>[A] Change in Options</th>
<th>[B] Number of Customers</th>
<th>[C] % Share of Customers</th>
<th>[D] Number of Post-Merger Options</th>
<th>[E] Contribution to Diversion Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 to 1</td>
<td>5</td>
<td>8.8%</td>
<td>1</td>
<td>8.8%</td>
</tr>
<tr>
<td>3 to 2</td>
<td>7</td>
<td>12.3%</td>
<td>2</td>
<td>6.1%</td>
</tr>
<tr>
<td>4 to 3</td>
<td>3</td>
<td>5.3%</td>
<td>3</td>
<td>1.8%</td>
</tr>
<tr>
<td>5 to 4</td>
<td>4</td>
<td>7.0%</td>
<td>4</td>
<td>1.8%</td>
</tr>
<tr>
<td>6 to 5</td>
<td>3</td>
<td>5.3%</td>
<td>5</td>
<td>1.1%</td>
</tr>
<tr>
<td>7 to 6</td>
<td>5</td>
<td>8.8%</td>
<td>6</td>
<td>1.5%</td>
</tr>
<tr>
<td>8+ to 7+</td>
<td>11</td>
<td>19.3%</td>
<td>7+</td>
<td>2.8%</td>
</tr>
<tr>
<td>No Change in # of Suppliers</td>
<td>19</td>
<td>33.3%</td>
<td>–</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>57</strong></td>
<td><strong>100.0%</strong></td>
<td>–</td>
<td></td>
</tr>
</tbody>
</table>

Estimated Average Diversion Ratio 23.7%

In Table 3, we have tabulated the change in the number of competitive options within each customer’s competitive area from the proposed transaction. The change in competitive options is shown in column [A], the share of customers is shown in column [C], and the number of post-merger competitive options is shown in column [D]. We then use these results to estimate the weighted average diversion ratio by first multiplying column [C] by (1/column [D]) then summing the resulting values (as shown in column [E]).

The next step in this example would be to translate the results to an assessment of competitive effects. The diversion ratio of roughly 24% could be coupled with information on variable margins to estimate UPP and determine whether the UPP test suggests cause for concern and possibly a deeper inquiry. As another example of how this information could be used to inform a competitive effects assessment, an antitrust enforcement agency could contact the customers projected to experience “2 to 1”s and “3 to 2”s and evaluate whether the suggested competitive concerns are valid. This would also be a highly useful sensitivity test of the assumptions of the methodology, a topic we address in the next section.

Main Assumptions of the Methodology

In this section, we discuss three underlying assumptions and also suggest ways in which these assumptions can be relaxed. One assumption inherent in our methodology is that the set of competitive options for each customer is homogenous. In the example discussed above, this assumption boils down to making the mechanical assumption that customers are equally likely to divert purchases to every retailer in the customer’s competitive area. This assumption is unlikely to be valid in many instances because products and services are often
differentiated and the degree of differentiation among them may be dynamic over time. Therefore, it might be the case that certain options are qualitatively different than a customer's selected option. For example, alternative suppliers might vary along a number of dimensions, including quality, clientele served, and price. If the product (or service) is differentiated, the analysis can be modified to account for the fact that different facilities might not be “true” alternative options. In cases where the extent of product differentiation is modest to moderate, the homogeneity assumption can be relaxed, for example, by using supplier sales shares to weight the likelihood of a given customer switching to a particular competitive option. In situations where product differentiation is severe enough to suggest that the products are not substitutes, one can remove the alternative option altogether from the list of alternatives within a customer’s competitive area.

Another assumption of our methodology is that only options within a customer’s competitive circle are competitive options for the customer. An extreme manifestation of this is customers with no alternative options located within their circle (i.e. closer to the customer than the current supplier). These customers would experience no change in the number of competitive options post-transaction. If a non-trivial number of customers are in this situation, one runs the risk of underestimating the number of competitive options for these customers. However, to address this limitation, the analysis can be rerun using competitive circles with radii greater than the distance to the current selected supplier. Not only would this avoid potentially underrepresenting competitive options, it also would provide a sensitivity test on the analysis.

The final primary assumption is that we assume travel distance is the appropriate way to determine a customer’s reasonable set of competitive alternatives. We effectively assume that the closeness or proximity of facilities, measured by travel distance, is a reasonable way of determining which options are close substitutes for a customer. However, for instance, travel time rather than travel distance might be a more accurate way to ascertain which competitive options are truly feasible for a given customer. More broadly, we are also assuming travel costs are a primary driver of customer choice.

**Conclusion**

The customer-focused unilateral competitive effects analysis described in this paper provides a novel and tractable approach for assessing potential competitive effects concerns in the context of a proposed merger. By using a methodology that relies on a customer's transportation costs as a component in the competitive effects assessment, our approach adds value to the competitive effects analyses currently used in merger analysis. Particularly, our approach is conceptually intuitive, relatively simple to implement, consistent with the Merger Guidelines, and, perhaps most importantly, focuses on the key question of whether merger will harm consumers.

1 Dr. Weiskopf is an executive vice president at Compass Lexecon and an adjunct professor at Johns Hopkins University, and Mr. Bourke is an economist at Compass Lexecon. This paper benefited tremendously from comments provided by two of our Washington, DC colleagues, Jonathan Bowater and Loren Smith. The approach described in the paper was originally developed on matters that Dr.
Weiskopf worked on with Drs. David Scheffman and Mary Coleman.


3 This approach relies on the assumption that transportation costs inform a customer’s decision as to which supplier to choose.

4 A relevant antitrust market includes a set of products and geographic area for which a hypothetical monopolist could enact a small but significant non-transitory price increase and not have this price increase avoided by customer substitution or arbitrage. (Merger Guidelines, § 4.1 – 4.2)

5 The logic of presumed consumer harm in the “2 to 1” example above is captured in the Merger Guidelines articulation of upward pricing pressure (“UPP”). In the evaluation of unilateral competitive effects, UPP is the result of internalizing the competitive constraint that each merging party imposes on the other merging party pre-merger. (Merger Guidelines, § 6.1)

6 Merger Guidelines, § 4.2

7 For example, other types of information that could inform estimates of the diversion ratio include supermarket and other types of scanner data that can be used to estimate own and cross-price elasticities of demand.

8 This conclusion assumes either the absence of price discrimination or an “average” effect of price discrimination if it is present.

9 Despite our focus on developing a methodology to assess unilateral competitive effects, many aspects of the approach and learnings are also relevant for market definition.

10 The two primary methods for measuring a customer’s distance to the merging party’s facility are geodetic distance (i.e. “as the crow flies” distance) and driving distance. Data availability often dictates which of these two methods should be used. Geodetic distances are generally simpler to calculate because they require only latitude and longitude coordinates for each customer and each facility as inputs. Latitude and longitude coordinates can be estimated from standard address information using commonly-available software such as ArcGIS. In contrast, driving distance calculations require more sophisticated algorithms and/or mapping services such as Google Maps but provide the benefit of providing a closer approximation to actual travel costs.

11 Below, we discuss that one of the assumptions of this formulation of our methodology is that only options within a customer’s competitive circle are competitive options for the customer. This assumption can be relaxed to include competitive options outside of the competitive circle.

12 One could also consider travel time rather than travel distance as the approach for determining which competing suppliers should be included in the competitive area.

13 See § 4.1 of the Merger Guidelines for a more formal definition of product substitutability. Adjusting the breadth of suppliers of substitutable products can provide a useful sensitivity test on our results.

14 The weighted-average diversion ratio is the sum over all customers of \[1/(n-1)*s\] where “n” is the pre-merger number of providers available to a customer and “s” is the share of customer that experience a specific change in number of competitive options (e.g., the percentage of customers that experience a change from 5 to 4 options).

15 This assumption is discussed in more detail below.

16 We note that there is no incentive to increase price in this instance, however, because the merger does not affect the ownership of any competitive options available to the set of customers (by assumption).


18 Note that the latitude and longitudes were pulled somewhat randomly from the Washington, D.C. area for illustrative purposes only.
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19 Please note that the hypothetical data in Table 2 are not related to the hypothetical data in Table 3.

20 The quantitative analysis reflected in Tables 2 and 3 can be performed for very large numbers of customers across numerous suppliers as long as high-quality address data are available and the analyst has access to and familiarity with software such as SAS or STATA.

Fourth Circuit Natural Gas Decision Underscores Importance of Ascertainability and Dukes Commonality Analysis

Jonathan Blank

On August 19, 2014, the United States Court of Appeals for the Fourth Circuit ruled in favor of CNX Gas Company, LLC, EQT Production Company, and Buckhorn Coal Company on a Rule 23(f) petition. The Court vacated and remanded the U.S. District Court for the Western District of Virginia’s certification of five classes relating to property rights and gas royalty litigation. While the opinion is important for the coal and gas industry, it is equally noteworthy for its class certification analysis of ascertainability and \textit{Wal-Mart v. Dukes} commonality.

Highlighting recent Supreme Court jurisprudence on class certification and the stringent requirements of Rule 23 of the Federal Rules of Civil Procedure, the Fourth Circuit concluded that the district court’s analysis “lacked the requisite rigor to ensure the requirements of Rule 23 were satisfied by any of the certified classes.” The Court considered the ascertainability and commonality requirements of Rule 23 with respect to both the district court’s decisions to certify (1) “ownership classes,” and (2) “royalty underpayment” classes.

The Court began with an analysis of the district court’s decision to certify the “ownership classes,” in which plaintiffs sought a declaration that class members are the true owners of certain mineral property rights. The Fourth Circuit explained that Rule 23 requires the district court “to rigorously analyze whether the administrative burden of identifying class members in the ownership cases would render class proceedings too onerous,” and noted that the plaintiffs bear the “burden of proof . . .  to demonstrate the prospective classes’ compliance with Rule 23(a)’s commonality requirement.” The Court held the Plaintiffs’ burden applied to both ascertainability and commonality requirements of Rule 23 as well as the remaining Rule 23 prerequisites.

Speaking to the ascertainability requirement (i.e., that class members be readily identifiable), the Court found that the lower court’s reliance on submissions to a regulatory board “glossed over” the reality that ownership of property rights are dynamic and fluid, resulting from conveyances postdating submissions to a regulatory agency. The Appellate Court further noted that such ownership changes are not necessarily easily addressed by reference to land records, which in and of itself may be a complicated process, and one further obfuscated by “numerous heirship, intestacy, and title-defect issues.” The Court concluded that