

IN THE COURT OF COMMON PLEAS OF THE 34th JUDICIAL DISTRICT
SUSQUEHANNA COUNTY BRANCH - CIVIL ACTION - LAW

HERBERT KILMER, ET AL., Plaintiff

NO. 2008-57

VS.

ELEXCO LAND SERVICES, INC., and
SOUTHWESTERN ENERGY
PRODUCTION COMPANY, Defendant

FILED
MAY
2009
SUSQUEHANNA
COUNTY

Michael J. Gathany, Esquire and Laurence M. Kelly, Esquire, Kelly & Kelly - for the Plaintiffs;

Kevin M. Gormly, Esquire, Lambert & Martineau and Myron B. De Witt, Esquire, De Witt & Cordner - for the Defendants.

OPINION

Vanston, PJ., March 16, 2009:

This opinion is written subsequent to this court's receipt of the Plaintiffs' Notice of Appeal to the Superior Court of Pennsylvania.

Kilmer's entered into an oil and gas lease with Elexco which provides, in relevant part

"Lessor shall receive as its royalty one eighth (1/8) of the sales proceeds actually received by Lessee from the sale of such production, less the same percentage share of all post-production costs, as defined below, and this same percentage share of all production, severance and ad valorem taxes. As used in this provision, Post-Production Costs shall mean

(i) all losses of produced volumes (whether by use as fuel,

- line loss, flaring, venting or otherwise) and
- (ii) all costs actually incurred by Lessee from and after the wellhead to the point of sale, including, without limitation, all gathering, dehydration, compression, treatment, processing, marketing, and transportation costs incurred in connection with the sale of such production.

For royalty calculation purposes, Lessee shall never be required to adjust the sales proceeds to account for the purchaser's costs or charges downstream from the point of sale."

58 P.S. Sec. 33 provides

"A lease or other such agreement conveying the right to remove or recover oil, natural gas or gas of any other designation from lessor to lessee shall not be valid if such lease does not guarantee the lessor at least one-eighth royalty of all oil, natural gas or gas of other designations removed or recovered from the subject real property."

Plaintiffs filed a Complaint for Declaratory Judgment seeking to invalidate their lease with Elexco, asserting that the subtraction of "post-production" costs reduces their royalty to less than one-eighth. Following the close of the pleadings, both sides filed Motions for Summary Judgment.

Both parties agree that there are no Pennsylvania appellate cases on point. This writer is aware of a number of similar actions pending in the United States District Court for the Middle District of Pennsylvania. That court, however, has not rendered a decision as of this writing.

Both parties also agree that "production" costs incurred by the lessee may not reduce the royalty. These are the costs of getting the gas out of the ground. "Post-production" costs are those incurred after getting the gas out of the ground until it is delivered to a wholesale purchaser. And, unfortunately, the statute does not define the term "royalty".

The Defendant has made a persuasive argument that the custom in the oil and gas trade throughout the country is to include "post production" costs in calculating the royalty. It is not necessary, however, to address the "custom in the trade".

The statute in question does not prohibit the inclusion of "post production" costs to calculate the one-eighth royalty. The parties are, therefore, free to negotiate how that royalty shall be calculated, so long as the net result is not less than one-eighth. This they did.