



Public Hearing on Marcellus Shale – April 15, 2009

Testimony to: Pennsylvania House of Representatives Environmental Resources and Energy Committee

Presented by: Ross H. Pifer, J.D., LL.M., Director, Penn State Dickinson Agricultural Law Resource and Reference Center

Chairman George, Chairman Hutchinson, Members of the House Environmental Resources and Energy Committee, I thank you for the opportunity to appear before you today to discuss issues surrounding the development of the Marcellus Shale Play in Pennsylvania. My name is Ross Pifer, and I am the Director of The Agricultural Law Resource and Reference Center at The Penn State Dickinson School of Law. The Agricultural Law Center was established by the Pennsylvania Legislature in 1998, 3 P.S. §§ 2201-09, following the merger between The Pennsylvania State University and The Dickinson School of Law. The Agricultural Law Center is operated as a collaborative effort between The Penn State Dickinson School of Law, The Penn State College of Agricultural Sciences, and the Pennsylvania Department of Agriculture. The statutory purpose of the Agricultural Law Center is to serve the Commonwealth as a resource on issues related to agricultural law. This mission is accomplished through the provision of educational presentations and programs as well as the preparation of written materials and the maintenance of a Web site at www.dsl.psu.edu/centers/aglaw.cfm.

Since I began my position as Director of the Agricultural Law Center in March 2008, one of the primary issues, if not the primary issue, impacting the agricultural community in Pennsylvania has been the development of the Marcellus Shale Play. In response to the tremendous need and demand for information on this topic, the Agricultural Law Center has

provided and organized several educational programs and prepared a variety of written educational materials. The Agricultural Law Center has worked with Penn State Cooperative Extension on a number of projects to educate landowners, attorneys, governmental officials, and the general public on the constantly evolving legal issues surrounding the Marcellus Shale.

As Director of the Agricultural Law Center, I have provided presentations on natural gas leasing and landowner issues to audiences throughout the Commonwealth. I served on the planning committee and organized the legal track for the Pennsylvania Natural Gas Summit that was held in State College last December and was attended by nearly 300 individuals representing the spectrum of constituencies interested in Marcellus Shale development. The Agricultural Law Center also has planned and is hosting a program this evening, April 15, entitled *Natural Gas Drilling and Municipal Regulation: The Impact of Pennsylvania Supreme Court Case Law on Oil and Gas Act Preemption*. This program will be held in the Lewis Katz Building on Penn State's University Park campus and will be broadcast live via video teleconference to 13 locations throughout Pennsylvania. The program is being sponsored by the Governor's Center for Local Government Services, The Agricultural Law Resource and Reference Center, Penn State Cooperative Extension, and the Pennsylvania Local Government Training Partnership.

In addition to these educational programs, the Agricultural Law Center has created a Natural Gas Exploration Resource Area, www.dsl.psu.edu/centers/aglaw/gas.cfm, containing over 300 legal or legal-related links and resources on the Center Web site and has prepared a number of written materials which have been provided to attendees of educational sessions, posted on the Center Web site, and/or included in the Center newsletter, *The Agricultural Law Brief*. www.dsl.psu.edu/centers/aglaw/pastupdates.cfm. The Agricultural Law Center also has assisted Penn State Cooperative Extension with the preparation of several educational

publications including *Natural Gas Exploration: A Landowner's Guide to Leasing Land in Pennsylvania*, *Marcellus Shale: What Local Government Officials Need to Know*, and *Natural Gas Exploration: A Landowner's Guide to Financial Management*.

There are a number of legal issues that have arisen through the development of the Marcellus Shale Play. These issues have evolved as the development of the Play has progressed and, just to name a few of the many legal areas, include environmental regulation, road posting and bonding, and Oil and Gas Act preemption of municipal regulation. I will focus my brief comments today on three legal issues that directly impact landowners: (1) the negotiation of oil and gas lease agreements; (2) Pennsylvania Minimum Royalty Act litigation; and (3) the rights of surface owners where the natural gas estate and the surface estate have been severed.

(1) Negotiation of Oil and Gas Lease Agreements

Since the outset of the Marcellus Shale development, the primary legal issue facing landowners has been the negotiation of oil and gas leases with energy companies. As the lease agreement governs nearly all aspects of the relationship between the landowner and the energy company, it is important that landowners are educated and have effective legal counsel in order to adequately protect their interests. Many landowners, particularly in those regions of the state without a history of oil and gas development, were not familiar with the lease provisions necessary to protect their interests. Similarly, many attorneys who had no prior experience with oil and gas law were being called upon by clients for legal representation in the review and negotiation of lease agreements. Penn State Cooperative Extension took the lead in providing information to landowners as well as to their attorneys, and I have been pleased to work with them in this effort.

Some of the legal issues relevant to landowners at the time of lease negotiation are the delineation of any limitations on the use of the surface estate, the method of valuation for property damages, indemnification for liabilities incurred by the landowner, restoration of the drilling site, and protection of water supplies. Landowners also should be educated as to the various potential payment terms, the primary and secondary terms of the lease agreement, general concepts of pooling and unitization, and whether the lease agreement encompasses storage rights and the transportation of foreign gas via pipelines across the leased property. Finally, landowners should understand whether the lease agreement includes the right to natural gas contained in all geologic strata or only to specifically delineated strata.

(2) Pennsylvania Minimum Royalty Act litigation

The interpretation of Pennsylvania's Minimum Royalty Act, 58 P.S. §§ 33, is the subject of extensive litigation at the present time. This statutory section states that an oil or natural gas lease "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." The statute, however, does not define at what stage this royalty will be calculated. Historically, the general practice within the industry has been to subtract the post-production costs before the royalty has been calculated. Numerous landowners have filed lawsuits claiming that the use of this practice fails to guarantee that lessors will receive at least a one-eighth royalty. On this basis, the landowners are seeking a declaration that the leases are not valid.

Minimum Royalty Act litigation is pending in both state and federal courts with at least 17 cases pending in the United States District Court for the Middle District of Pennsylvania alone. This is an issue upon which there has been no Pennsylvania case law. On March 3, 2009,

the Court of Common Pleas of Susquehanna County ruled that the Minimum Royalty Act did not prevent the parties from contacting in the lease agreement that post-production costs would be factored into the royalty calculation. *Kilmer v. Elexco Land Services, Inc., and Southwestern Energy Production Co.*, Civil Action 2008-57 (Susquehanna Co.). This case has been appealed to the Superior Court at Docket Number 464 MDA 2009, and on April 6, a Petition for Extraordinary Relief was filed with the Pennsylvania Supreme Court requesting immediate review of the petition to provide guidance to the various federal and state courts addressing this issue.

With regard to the pending federal litigation, argument on a motion to dismiss was heard on September 16, 2008, but a ruling has not yet been issued, before the United States District Court for the Middle District of Pennsylvania in *Kropa v. Cabot Oil & Gas Corp.*, Civil Action 3:08-cv-00551 (M.D. Pa. filed Mar. 25, 2008). Additionally, argument has been scheduled for motions to dismiss in the following three cases on May 29, 2009: *Lauschle v. The Keeton Group, LLC*, Civil Action 4:08-cv-01868 (M.D. Pa. filed Oct. 9, 2008), *Beach v. MK Resource Partners, II*, Civil Action 4:08-cv-01950 (M.D. Pa. filed Oct. 24, 2008), and *Hooker v. The Keeton Group, LLC*, Civil Action 4:08-cv-2091 (M.D. Pa. filed Nov. 19, 2008). In the United States District Court for the Western District of Pennsylvania, argument is scheduled on a motion to dismiss today, April 15, 2009, in *Frederick v. Range Resources – Appalachia, LLC*, Civil Action 1:08-cv-00288.

(3) The Rights of Surface Owners Where the Natural Gas Estate and the Surface Estate Have Been Severed

Many Pennsylvania landowners own the surface estate of the real estate, but do not own the rights to natural gas in the subsurface estate. Each of these owners has paid valuable

consideration for their respective ownership interests, and each expects to be able to exercise their ownership rights. The interplay between these competing ownership rights and the siting of a gas well upon a severed estate can cause conflict. Since subsurface natural gas rights generally are considered to be dominant over the rights in the surface estate, the owner of the natural gas rights is entitled to reasonable use of the surface estate to extract natural gas. The determination of what is considered to be reasonable use is dependent upon the specific facts of each case. Often, the energy company and the surface owner will have different viewpoints on what constitutes reasonable use.

One method of resolving this potential conflict is through the use of some form of a surface use agreement. As the owner of the dominant estate, however, the energy company is under no legal obligation to enter into such an agreement. As a practical matter, the energy company normally establishes the terms of use of the surface estate. For the surface owner to play a role in limiting the surface usage, the surface owner must take some type of affirmative action such as negotiating a surface use agreement, filing an objection to the drilling permit application, or filing litigation to stop what is alleged to be unreasonable use of the surface estate.

I once again thank you for the opportunity to appear before this Committee. For questions or additional information, I can be reached as listed below.

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