

THE GENERAL ASSEMBLY OF PENNSYLVANIA

HOUSE BILL

No. 1684 Session of 2013

INTRODUCED BY EVERETT, BAKER, MAJOR, PICKETT, METZGAR, GERGELY, MILLARD, JAMES, COHEN, MARSHALL, GINGRICH, GODSHALL, SWANGER, CLYMER, C. HARRIS, HESS, HEFFLEY, WATSON, M. K. KELLER, F. KELLER, SAYLOR, REESE, BARBIN, BOBACK, REGAN, HANNA AND PYLE, SEPTEMBER 16, 2013

AS REPORTED FROM COMMITTEE ON ENVIRONMENTAL RESOURCES AND ENERGY, HOUSE OF REPRESENTATIVES, AS AMENDED, MARCH 17, 2014

AN ACT

1 Amending the act of July 20, 1979 (P.L.183, No.60), entitled "An
2 act regulating the terms and conditions of certain leases
3 regarding natural gas and oil," prohibiting certain
4 deductions from royalties.

5 The General Assembly finds and declares as follows:

6 (1) The act of July 20, 1979 (P.L.183, No.60), known as
7 the Oil and Gas Lease Act, provides royalty owners with a
8 guaranteed minimum 1/8 royalty for oil, natural gas or gas of
9 any other designation removed or recovered.

10 (2) The act protects royalty owners from unfair or
11 deceptive leases or other contractual arrangements as a
12 legitimate exercise of the Commonwealth's police power.

13 (3) Despite this guarantee of a minimum return, lessees
14 have engaged in efforts to reduce the guaranteed minimum
15 royalty by transferring a share of postproduction, market-
16 enhancement and similar costs to royalty owners.

17 (4) In 2010, the Pennsylvania Supreme Court's decision

1 in Kilmer v. Elexco Land Services, Inc., 990 A.2d 1147, 1157
2 (Pa. Cmwlth. 2010), noted that the "General Assembly is the
3 branch of government best suited to weigh the public policies
4 underlying the determination of the proper point of royalty
5 valuation."

6 (5) It is within the legitimate police power of the
7 Commonwealth to clarify that any deduction for
8 postproduction, market-enhancement or similar costs should
9 never result in royalty owners receiving less than the
10 guaranteed minimum 1/8 royalty provided by the Oil and Gas
11 Lease Act.

12 The General Assembly of the Commonwealth of Pennsylvania
13 hereby enacts as follows:

14 ~~Section 1. The act of July 20, 1979 (P.L.183, No.60), known <--~~
15 ~~as the Oil and Gas Lease Act, is amended by adding a section to~~
16 ~~read:~~

17 ~~Section 1.4. Deductions from royalties.~~

18 ~~(a) General rule. A lease or other such agreement,~~
19 ~~conveying the right to remove or recover oil, natural gas or gas~~
20 ~~of any other designation, shall not allow for any severance or~~
21 ~~other production taxes or costs associated with producing,~~
22 ~~gathering, storing, separating, treating, dehydrating,~~
23 ~~compressing, processing, transporting, marketing or other~~
24 ~~marketing enhancements to be deducted from any royalty payable~~
25 ~~to a lessor if such deductions result in a royalty of less than~~
26 ~~one eighth calculated under the first marketable product~~
27 ~~doctrine.~~

28 ~~(b) Construction. Nothing in this act shall be construed to~~
29 ~~preclude enforcement of lease terms which result in a royalty of~~
30 ~~greater than one eighth calculated under the first marketable~~

1 ~~product doctrine.~~

2 ~~Section 2. The addition of section 1.4 of the act shall~~
3 ~~apply to all leases and other agreements that are entered into~~
4 ~~on or after September 20, 1979, and are subject to section 2 or~~
5 ~~3 of the act.~~

6 SECTION 1. SECTION 1.2 OF THE ACT OF JULY 20, 1979 (P.L.183, <--
7 NO.60), KNOWN AS THE OIL AND GAS LEASE ACT, IS AMENDED BY ADDING
8 A DEFINITION TO READ:

9 SECTION 1.2. DEFINITIONS.

10 THE FOLLOWING WORDS AND PHRASES WHEN USED IN THIS ACT SHALL
11 HAVE THE MEANINGS GIVEN TO THEM IN THIS SECTION UNLESS THE
12 CONTEXT CLEARLY INDICATES OTHERWISE:

13 * * *

14 "POSTPRODUCTION COSTS." ANY AND ALL COSTS INCURRED IN AND
15 ASSOCIATED WITH PROCESSING AND TRANSPORTING OIL, NATURAL GAS OR
16 GAS OF ANY OTHER DESIGNATION FROM THE POINT THE GAS IS BROUGHT
17 TO THE SURFACE TO THE POINT THE GAS ENTERS THE COMMERCIAL
18 MARKET, AN INTERSTATE TRANSMISSION SYSTEM OR THE SYSTEM'S POINT
19 OF USE. THESE COSTS SHALL INCLUDE, BUT ARE NOT LIMITED TO,
20 GATHERING, STORING, SEPARATING, TREATING, DEHYDRATING,
21 COMPRESSING, PROCESSING, TRANSPORTING, MARKETING OR OTHER
22 MARKETING ENHANCEMENTS TO OIL, NATURAL GAS OR GAS OF ANY OTHER
23 DESIGNATION, AND PROPORTIONAL COSTS OF SEPARATING AND MARKETING
24 ETHANE, PROPANE, BUTANE AND OTHER COMPLEX HYDROCARBONS.

25 SECTION 2. SECTION 1.3 OF THE ACT, ADDED JULY 9, 2013
26 (P.L.473, NO.66), IS AMENDED TO READ:

27 SECTION 1.3. ROYALTY GUARANTEED.

28 [A LEASE OR OTHER SUCH AGREEMENT CONVEYING THE RIGHT TO
29 REMOVE OR RECOVER OIL, NATURAL GAS OR GAS OF ANY OTHER
30 DESIGNATION FROM THE LESSOR TO THE LESSEE SHALL NOT BE VALID IF

1 THE LEASE DOES NOT GUARANTEE THE LESSOR AT LEAST ONE-EIGHTH
2 ROYALTY OF ALL OIL, NATURAL GAS OR GAS OF OTHER DESIGNATIONS
3 REMOVED OR RECOVERED FROM THE SUBJECT REAL PROPERTY.]

4 (A) LEASE VALIDITY.--A LEASE OR OTHER AGREEMENT CONVEYING
5 THE RIGHT TO REMOVE OR RECOVER OIL, NATURAL GAS OR GAS OF ANY
6 OTHER DESIGNATION FROM THE LESSOR TO THE LESSEE SHALL NOT BE
7 VALID IF THE LEASE DOES NOT GUARANTEE THE LESSOR AT LEAST ONE-
8 EIGHTH ROYALTY OF ALL OIL, NATURAL GAS OR GAS OF OTHER
9 DESIGNATIONS REMOVED OR RECOVERED FROM THE SUBJECT REAL
10 PROPERTY. DEDUCTIONS FROM A LESSOR'S ROYALTY OF SEVERANCE OR
11 OTHER TAXES OR FEES AND COSTS COMMONLY KNOWN AS PRODUCTION COSTS
12 OR COSTS RELATED TO PRODUCTION ARE PROHIBITED.

13 (B) UNCONVENTIONAL GAS WELL ROYALTY CALCULATION.--WITH
14 RESPECT TO UNCONVENTIONAL GAS WELLS, THE DEDUCTION OF
15 POSTPRODUCTION OR ANY OTHER COSTS, INCLUDING THIRD PARTY COSTS,
16 SHALL NOT BE TAKEN IF THE DEDUCTION RESULTS IN A ROYALTY OF LESS
17 THAN ONE-EIGHTH OF THE VALUE OF LESSOR'S SHARE OF THE
18 PRODUCTION. FOR THE PURPOSE OF ROYALTY CALCULATIONS FOR
19 PRODUCTION FROM UNCONVENTIONAL GAS WELLS, THE ROYALTY
20 CALCULATION SHALL BE BASED ON THE PRICE RECEIVED BY THE LESSEE
21 AT THE POINT AT WHICH THE PRODUCTION ENTERS THE COMMERCIAL
22 MARKET AND OWNERSHIP TRANSFERS TO A BUSINESS ENTITY NONRELATED
23 TO THE LESSEE IN AN ARM'S-LENGTH TRANSACTION. IN THE CASES WHERE
24 THAT POINT OF SALE OR USE OF THE PRODUCTION IS NOT THE RESULT OF
25 AN ARM'S-LENGTH TRANSACTION BETWEEN UNRELATED BUSINESS ENTITIES,
26 THE LESSEE SHALL HAVE THE BURDEN TO PROVE THAT THE ROYALTY
27 CALCULATION AND ROYALTY PAID ARE BASED ON THE FAIR MARKET VALUE
28 OF THE PRODUCTION FOR THE RELEVANT TIME PERIOD.

29 SECTION 3. NOTHING IN THIS ACT SHALL BE CONSTRUED TO REQUIRE
30 THE RETROACTIVE RECALCULATION OR REPAYMENT OF ROYALTY PAYMENTS

1 MADE PRIOR TO THE EFFECTIVE DATE OF THIS ACT AND NO LEASE SHALL
2 BE INVALIDATED FOR DEDUCTIONS TO ROYALTIES FOR POSTPRODUCTION
3 COSTS THAT RESULTED IN ROYALTIES OF LESS THAN ONE-EIGHTH OF THE
4 VALUE OF THE LESSOR'S SHARE OF THE PRODUCTION MADE PRIOR TO THE
5 EFFECTIVE DATE OF THIS ACT. THIS ACT SHALL APPLY TO ALL EXISTING
6 AND FUTURE LEASES AND OTHER AGREEMENTS TO REMOVE OR RECOVER OIL,
7 NATURAL GAS OR GAS OF ANY OTHER DESIGNATION IN THIS
8 COMMONWEALTH.

9 Section 3 4. This act shall take effect immediately.

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