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Pennsylvania's Royalty Owners Action Report

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National Association of Royalty Owners, Pennsylvania Chapter (NARO-PA) Weighs-in on the Impact Fee

By: Trevor Walczak, Vice-President NARO-PA, & Bill Wilson, NE Regional Board Member NARO-PA

The recent passage of SB 1100/HB1950, the Impact Fee, is the first major action the state has taken to directly address the financial impact the Marcellus drilling activity has had on the state. Even with the state's Department of Revenue reporting that the Marcellus drilling companies have paid more than $1.1 billion in taxes since 2006, the Impact Fee gained popular support outside of the major natural gas production counties. Although the energy production companies support the local decision to implement the Impact Fee, the coupling of the new fee with the decreasing price for dry gas, will inevitably have a negative impact on leasing and production activity in the northeastern Marcellus. The National Association of Royalty Owners, PA chapter (NARO-PA), cautions county governments to closely consider the related detrimental impact on both, large energy company operations and local small business, when determining whether to implement the Impact Fee at this time.

While most Marcellus stakeholders opposed a severance tax, the Impact Fee bill was somewhat more palatable because of its proposed overhaul of the Oil and Gas Act of 1984 and the clarification it provided concerning how development is to proceed in Pennsylvania. Pennsylvania royalty owners feel the fee, estimated to equate to a 3% tax, strikes an acceptable level that will encourage continued development while ameliorating the desires for funding of both related and unrelated statewide environmental and developmental concerns, during stronger gas markets.

The Impact Fee debate was borne out of a desire by populists and their political representatives to redistribute the revenue from natural resources owned by citizens in one part of the state to others who had never sacrificed to attain such ownership. A steady campaign was undertaken by populist media outlets to spotlight a handful of incidents that reflected poorly on the drilling industry, while always coupling that negative press with the observation that Pennsylvania was the only major natural gas producing state without a severance tax. This steady campaign which minimized the potential long term benefit to the entire state (such as the current 40% reduction in costs to UGI's residential customers) gained popular support in areas that did not see immediate benefits from drilling. In counties where the drilling has greatly benefitted small communities, small businesses, and workers, the attempts to redistribute revenue to non-affected areas is widely rejected. While the Impact Fee promises some attractive payouts in the short term, they pale in comparison to the contributions already made to the communities involved.

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Unfortunately, casual observers did not recognize that issues created by the development in local communities were also being solved on the local level with the cooperation of drilling companies. These remedies rarely made headlines, and the populist support for redistribution of wealth continued to build, fueled by the misconception that the industry was not paying any taxes and the implication that drilling has negatively affected citizens outside the Marcellus Areas. Citizens not directly affected by drilling interpret this "FEE" as an improvement but many remain unsatisfied as it does not address their fiscal agenda,

In Bradford County, in 2010 alone, natural gas companies spent $340 million on road improvements. In 2012, the Impact Fee is estimated to generate $155 million. Included in that number is $23 million dedicated to eight agencies or programs for costs incurred related to gas drilling. After deducting the dedicated $23 million, 60% of the remaining $132 million will go to the counties experiencing Marcellus drilling and 40% will be distributed to counties not under Marcellus development. Pennsylvania royalty owners are concerned that the Impact Fee passage may cause companies operating in the Marcellus to abandon or otherwise sidestep their "Good Neighbor" practices that have turned impacts into improvements and provided local remedies to local problems. Pennsylvania NARO feels that without the continued "Good Neighbor" policies that drilling related companies have voluntarily demonstrated thus far, the 60/40 split will leave Marcellus counties shortchanged in their impact remediation efforts

Pennsylvania's chapter of NARO realizes there have been, and will continue to be, state costs associated with the increasing development of our gas resources and that there needs to be fees to cover those costs. However, the allocation of some of the fees makes one wonder about the thought process. Fee distributions to the Natural Gas Energy Development Program that are proposed to be $10 million in 2011 but shrink to $2.5 million in 2013 seem to be counter-productive in light of the current energy environment. When companies are leaving Pennsylvania for more profitable environments, we should be increasing not decreasing the development of new markets for our gas. Without new wells there will be decreasing revenues from the Impact Fee, but baring associated state layoffs proportional to the reduction, many costs will be more or less fixed. It would seem this aspect of the fee should be increasing over the next few years in an effort to sustain and build the industry here. Helping to fund the *Marcellus Works* bundle of bills should be a priority use of revenue.

Low natural gas prices are currently forcing many drilling companies to scale back operations in Pennsylvania. This reduction in drilling activity will result in fewer taxes and general funds revenues from the industry and the workers and royalty owners that are dependent on it. These decreases will not be offset by revenue generated by the Impact Fee or even the "Oft Praised Severance Tax", since both are entirely dependent on drilling and production. Revenue collected by the state through corporate taxes, sales taxes, employee withholdings, and income taxes resulting from wages and mineral owners' royalties, are the basis of the general fund.

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Pennsylvania's royalty owners commend the governor for providing consistent regulation for the development of the resources contained within the state's boundaries. We applaud the yearly allocation of $6,000,000 to DEP for costs incurred due to drilling activity. We feel a strong, well-funded regulatory body will protect all citizens of the Commonwealth.

Additionally, Pennsylvania's royalty owners embrace Chapter 33 of the bill, as it protects the rights of private property and royalty owners from the well-documented threats from over-reaching local governments, such as: exclusionary zoning, increased setbacks, noise regulations, fees, environmental regulations, and restrictions that are discriminately applied to oil and gas extraction, while not applied to other commercial and industrial activity.

1. Chapter 33 clearly defines the activities townships must allow as "reasonable development" of natural gas production within their borders if they want to receive Impact Fee revenues.

2. Chapter 33 requires applications for review by a municipality to be limited to 30 days for a permitted use and no more than 120 days for conditional use applications, preventing rogue townships from manipulating regulatory delays to thwart operations.

3. Chapter 33 also provides well operators and royalty owners a methodology to request an Attorney General review of a municipality's zoning regulations to determine if it is in accordance with the provisions addressed in this chapter, the MPC and judicial decisions of the Commonwealth and provides penalties through civil action for non compliance.

Since, Impact Fee revenues collected by the Public Utility Commission (PUC) will be somewhat dependent on well production rates, NARO-PA hopes the PUC sees the value of well meter certification. Without periodic certification by the Bureau of Weights and Measures, the state cannot be assured of accurate revenues.

Pennsylvania's royalty owners very much appreciates the much needed overhaul of the environmental standards contained in the Oil and Gas Act of 1984 that is provided by the bill. Some of the updates to the act which we support include:

- The expansion of the drillers' zone of presumed liability, from 1,000 to 2,500 feet, taking into account increased pressures encountered in drilling, fracking, and producing Marcellus wells.
- The required disclosure of chemicals used during the hydraulic fracturing process and the publication on FracFocus.org, to add validity to the information that is already being voluntarily disseminated by responsible companies.
- The increase in Civil penalties to $75,000 for drillers who violate regulations.
- Improved bond levels for drillers based on the length of well bores and the number of wells the company operates.

NARO-PA has actively advocated for the increase of standards to a responsible level that protects our safety, health, and environment. We commend the legislature and the Corbett administration for these common-sense environmental standards which stop short of discouraging development, while taking a necessary leap forward to protect our most valuable assets, our air, water, and lands. We look forward to working with the administration, the legislature, and regulatory agencies in the future, as we endeavor to improve the prospects for the responsible development of our domestically produced energy resources. ●

Gas drilling companies state how they would be affected by Bradford County gas impact fee

BY THE TOWANDA REVIEW
Published: March 9, 2012

Under HB 1950, which was signed into law last month, counties in Pennsylvania can choose to levy an impact fee on gas drilling companies. The Daily Review asked several gas drilling companies a series of questions to find out how they would be affected if such an impact fee were levied in Bradford Sullivan counties. The questions were posed to Chesapeake Energy Corp., Talisman Energy USA Inc., Chief Oil & Gas, Southwestern Energy Co., and EOG Resources Inc.. All of the companies, except EOG Resources, supplied written answers to the questions. Printed below are the highlights of their answers:

1) If a gas impact fee, as authorized by HB 1950, is levied in Bradford and Sullivan counties, will it cause your company to cut back on its drilling activity in those two counties?

Chesapeake Energy: We do not anticipate that enactment of the fee will substantially change the level of activity focused in Bradford County. Several weeks ago, Chesapeake announced a reduction in rig count in the dry-gas areas of the Commonwealth which includes Bradford County. The market price of natural gas was the determining factor in that decision.

Talisman Energy USA: Due to historically low gas prices, Talisman has already made the decision to move more than $800 million out of Pennsylvania in 2012 to liquid-rich plays that offer a higher return on investment. We have already reduced our rig count from 11 to three and there is potential for a further reduction in activity. While the primary driving factor behind these decisions is the price of natural gas, Talisman has also taken into consideration an impact fee. As natural gas prices rebound, Talisman will revisit investment decisions. Because Pennsylvania competes with shale plays around the world for capital, the impact fee will be a factor in determining future investment in the Marcellus.

Chief Oil & Gas: The impact fee will not cause Chief Oil & Gas to cut back on our development activity in Bradford or Sullivan Counties, but the lower price of gas could have an effect.

Southwestern Energy: As a standalone, the impact fee will not materially impact our current activity in Bradford County. However, all decisions about our future operations will be reviewed with the impact fee in mind and this fee will have a build upon effect and the burden could ultimately become too great for our company influencing our operations in the future.

2) If the gas impact fee is levied in Bradford and Sullivan counties, will it cause your company to cut back on the amount of major road construction projects that it is undertaking in those two counties?

Chesapeake: Chesapeake stands by its commitments to local municipalities and PennDOT, regardless of whether the fee is implemented or not.

Talisman: Talisman will continue road upgrades and reconstruction where it is necessary to access new and existing well pads in our operating area. We expect to spend less on road construction in 2012 due, in part, to a decrease in our drilling activity and the significant investment made in roads over the past few years. Talisman has spent more than $60 million on roads since 2008. If an impact fee is levied, Talisman will look to partner with local officials to determine the best path forward for addressing road construction.

Chief: Chief has improved 80 miles of road in 2011 and will continue to repair and maintain the roads that we utilize for our operations to ensure that safety of everyone using them. This commitment will not be changed if an impact fee is levied in Bradford & Sullivan counties.

Southwestern: The proposed impact fee will not stop us from repairing road damage caused by our operations. The way we address major road reconstruction will be affected by the proposed fee and will likely decrease as the impact fee is meant to address this type of project.

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3) If the gas impact fee is levied in Bradford and Sullivan counties, will it cause your company to cut back on the amount of charitable donations it is making in those two counties?

Chesapeake: The scope of our community-giving program will vary from year to year based on company activity, natural gas prices and the overall financial success of the company. Chesapeake has been and will continue to be a dedicated and active supporter of community events, charitable organizations and public institutions in Bradford County and all the communities where we operate.

Talisman: Talisman is committed to delivering positive economic and development opportunities and providing long-term benefits for communities where we operate. Charitable donations will continue to be a key component of that commitment.

Chief: Chief is very proud of its philanthropic efforts in support of local Pennsylvania communities...We will continue to support programs that help meet the unmet needs in the communities where we are operating.

Southwestern: No. We are members of the community and we will continue to support our neighbors in need. Charitable contributions are key part of our philosophy of being a good neighbor, not a business decision.

4) What will be the financial impact on your company if a gas impact fee is levied in Bradford and Sullivan counties?

Chesapeake: The reach-back provision in the law, which will assess a fee on all unconventional wells drilled in Pennsylvania to date, will have a significant economic impact this year. On an ongoing basis, we expect the impact fee (combined with other state taxes and operational costs in Pennsylvania) will be competitive with other states where we operate and will enable Pennsylvania to successfully compete for capital investment.

Talisman: We cannot provide you at this moment with specifics on economic impact for Bradford County. The current fee is $240,000 per well paid over 15 years and $45,000/well for the first year. As a result, the financial impact to Talisman is between $15-20 million/year over the next few years.

Talisman supports a fee in principle, particularly when a significant share of the revenues would go back to counties where we operate to address impacts directly related to natural gas development, including infrastructure improvements. However, we are disappointed that this fee as passed does not take into account the current economic realities of natural gas business. Talisman has already announced a significant reduction in activity and investment in Pennsylvania for 2012, and we feel this fee as enacted, will further hurt an industry that has been responsible for significant job creation in the state and provided billions of dollars in investment and tax revenue.

Southwestern: If passed the impact fee will cost us several million dollars per year [in Bradford County] and will increase as our operations grow, which ultimately will influence our future plans in the area.●

MSC Statement on Comprehensive Shale Gas Legislation

"With resolution and greater certainty at hand, it is time to build a stronger Pennsylvania and power our region with clean, American natural gas" - MSC president Kathryn Klaber

Canonsburg, PA - Marcellus Shale Coalition (MSC) president Kathryn Z. Klaber issued the following statement upon the passage of H.B. 1950 through the Pennsylvania General Assembly:

"The Marcellus Shale Coalition has steadfastly advocated for a modernized oil and natural gas regulatory framework to further protect the Commonwealth's environment while encouraging the safe development of abundant and clean American natural gas. This legislation builds upon, and further strengthens, the collaborative efforts undertaken over the past several years, ensuring that Pennsylvania has industry-leading, world-class shale gas regulations on its books.

"The legislation, while not perfect, provides the industry greater certainty to operate across Pennsylvania and takes a balanced approach to further strengthening the Commonwealth's forward-leaning health, environmental, and safety regulations, incorporating many of the recommendations of the Marcellus Shale Advisory Commission – a broad-based group of interests across industry, government, and the conservation community. Without question, it will further increase costs, in terms of both time and resources, at a time of historically-low natural gas prices, which will affect decisions made into the future.

"With resolution and greater certainty at hand, it is time to build a stronger Pennsylvania and power our region with clean, American natural gas."●

Bradford County Commissioners Oppose Impact Fee Legislation

By: Eric Deabill

Updated: February 15, 2012

Towanda, Bradford County - Governor Tom Corbett has signed historic legislation involving natural gas drilling but lawmakers from one county say they're not in favor of it.

What makes this story more interesting is that the lawmakers are both from the Republican party.

On Monday, Governor Tom Corbett signed the first comprehensive re-write of the state's oil and gas act in decades.

Part of the bill allows counties to impose an impact fee on gas drilling but officials in Bradford County say they don't know if they want to go along.

Commissioners now have 60 days to act on the impact fee."I personally believe this is bad for our county," Commissioner Doug McLinko said.
McLinko calls the legislation a "job killing" bill.
He says it will drive natural gas companies to other states.

"I've had different industries tell me they're going to re-evaluate their position in Pennsylvania because of the huge up-front cost of his," Commissioner McLinko said. "We've also had other ones that are going to downsize even further."

With Bradford County leading the state in the number of natural gas wells, the county stands to gain more than $10 million from instituting an impact fee.

McLinko says the problem is Bradford County has already gotten tens-of-millions more in road work, business and property tax growth without it.

"When you get into the bill, it really is a bit of a slap in the face when you look at $400 million they've put in our roads," McLinko said. "They're dangling free money in front of our townships and counties but everything that is free does not necessarily come without a cost."

McLinko's fellow republican commissioner Daryl Miller is also speaking out against the impact fee.

"Home heating costs are probably at their all-time low because of what is taking place right here and what do we do? Lets tax it!" Miller said.

"This is a cash-grab to send to the rest of the state," McLinko said.

While they're at odds with people in their own party, the Bradford County majority commissioners say they have to do what is best for their taxpayers.

"Harrisburg passed 1950, this bill, which really in my opinion is gonna set us back to 1950," Commissioner McLinko said.●

UGI's 'Commonwealth Pipeline' would spread shale wealth through Pennsylvania

By **DONALD GILLILAND, The Patriot-News**

Natural gas from the Marcellus Shale might be coming directly to the midstate. A $1 billion natural gas pipeline has been proposed to run from Lycoming County south through the midstate. If built as proposed, the 200-mile pipeline would go south to the Baltimore and Washington markets. A partnership between a UGI Corp. subsidiary and two other energy companies floated the proposal last week.

The 30-inch Commonwealth Pipeline would pass "somewhere east of Harrisburg and west of Lancaster," UGI spokesman Peter Terranova said. "It really runs right through the heart of the UGI central Pennsylvania market," Terranova said.

It would transport 7.8 million cubic feet of natural gas per day. At current rates, that's $5.1 million worth of gas a day.

Two of the three companies are expected to become the "anchor shippers" on the line: Valley Forge-based UGI Energy Services Inc. and Capitol Energy Ventures Corp., a subsidiary of a company that provides gas to Washington, D.C. The third company - Inergy Mid- stream, of Kansas City, Mo. - would build the line and run it.

The companies hope to have the line constructed and in service in 2015. There are many steps between now and then, and the proposal will undoubtedly face opposition from foes of shale drilling.

The pipeline is expected to cross and interconnect interstate pipelines along its route, providing direct access to new markets for Marcellus gas producers, according to a company news release. All interstate pipelines are open access, meaning if a new company wants to connect and use them, the owner cannot say no.

"Our goal in participating in this project is to bring gas produced in Pennsylvania directly to the major markets in central and eastern Pennsylvania," said Bradley Hall, president of UGI Energy Services.

Later this month, the companies plan to announce an "open season" for the proposal, which is the first step in the regulatory process. One industry insider equated it to "putting the toe in the water." Usually lasting 30 to 60 days, an "open season" offers customers the opportunity to contract for capacity in the line. Those contracts help prove to regulators the project is necessary.

Terranova said the two "anchor shippers" expect to contract for 40 percent to 45 percent of the line capacity, so the project would need other customers for the remaining 55 percent to 60 percent.

There have been open seasons for projects that never were built because there wasn't sufficient demand, but that's unlikely here, according to industry observers.

Washington is a huge market for natural gas, and there are multiple gas-fired power projects proposed in southern Pennsylvania, northern Maryland and Virginia. Terranova said the project is "obviously" aimed at the power generation market.

If there's enough interest, the project enters the "pre-filing" phase in which the Federal Energy Regulatory Commission is put on notice. Then the clock starts ticking for the companies to notify landowners and municipalities, hold public meetings, obtain permits and begin gathering environmental data.

That process typically takes six months to a year, after which an official filing is submitted to the commission. The commission then determines if the project is necessary and in the public interest. It's at this stage that questions about the potential environmental impact come to the fore. But if recent action at the commission is any guide, the path might be relatively clear for the Commonwealth Pipeline.

The 39-mile MARC1 pipeline project through Bradford, Sullivan and Lycoming counties was proposed to run north-south, connecting the Millennium pipeline that runs across southern New York, and the Tennessee and Transco pipelines that run east across Pennsylvania into New Jersey. The highly productive Marcellus gas fields sit in between.

The MARC1 is to be built by the same company -

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Inergy - that would build and operate the Commonwealth Pipeline. The MARC1 was expected to cross more than 100 streams, many of them high quality. It would go through 41 wetlands, clear over 300 acres of forest and require the destruction of more than 200,000 mature trees. It essentially opens up unbroken forest and turns it into an industrial zone, said Bridget Lee, an attorney with Earthjustice in New York. Earthjustice and environmental groups such as the Sierra Club pleaded for a full environmental review of the proposal.

The Environmental Protection Agency agreed with the environmental groups, but the Energy Regulatory Commission granted approval without that review.

"It is certainly not a good precedent," said Jan Jarrett, president of the environmental group PennFuture. The Commonwealth Pipeline would extend from the terminus of the MARC1, south through the midstate. Lee and Jarrett both said they believe a full environmental impact study should be conducted.

If the energy commission approves the project, the companies will acquire the ability to exercise eminent domain to secure rights-of way through the intended route. Industry insiders say that is the option of last resort because it usually takes longer and is much more expensive than negotiating directly. It's also often a public relations nightmare. Jarrett suggested midstate lawmakers might see firsthand what they've wrought. "Compressor stations will need to be built along the pipeline route, typically every 40 to 100 miles," Jarrett said.

The recently passed Marcellus legislation is widely known for instituting a fee on drilling. But it also "requires local governments to allow compressor

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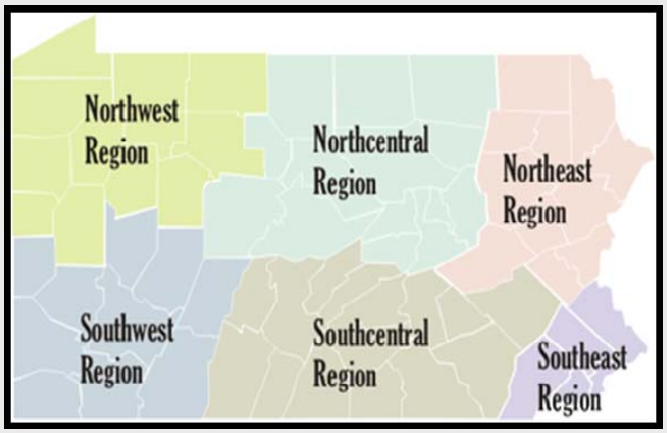

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stations in agricultural and industrial zones and as a conditional use in residential zones," Jarrett said.

"Pipelines must be allowed in all zones, including residential zones," she said. "So, if legislators in this area thought that Act 13 does not affect their constituents, they're about to find that that it certainly does."

Conversely, the pipeline also fulfills what many of those same lawmakers have urged: the use of Pennsylvania gas within Pennsylvania. That sets it apart from other Marcellus pipeline projects, said Terranova.

Unlike projects currently under construction, which are primarily backed by gas producers to get their product out of the remote northeast and to a New England market, this line is backed by utilities that distribute to gas consumers and represent demand from the south.

"This is a project where you have two significant utilities stepping up," Terranova said, "and we're confident we'll get others stepping up to pull the gas south."

David Black, president and CEO of the Harrisburg Regional Chamber, said getting cheap gas out of the Marcellus fields into the midstate "would be great for our region." The area could use that "gas advantage" to attract companies to the area.

"Companies that use gas tend to be higher-paying manufacturing companies," Black said. "Combine that with the high-tech advantage we have, and we could be more globally competitive than we are today."

"I think it would be a great advantage for us," Black said.●

Environmentalist not deterred in their attempts to shut-down gas infrastructure

By Nicole Jacobs

The passing of Act 13 restricting municipal interference with the rights of landowners to develop their natural resources on their properties, has forced the opposition to clean-burning natural gas to get a little more creative in their attempts to halt natural gas development.

With the help and training of the Clean Air Council, the latest attempt to stop all natural gas development involves efforts to halt infrastructure development. A proposed M1-S compressor station in Sullivan County, to be built on the south end of the Marc-1 transmission line, generated a DEP hearing based on the requests of only five people in the entire county. It goes without saying the request was not made by the property owners who negotiated with Central New York Oil and Gas to have the structure placed there.

What's more is not one of these five individuals who cared so much about spending taxpayer dollars to make sure the Department of Environmental Protection heard their arguments even bothered to show up for last month's hearing. Instead, testimony predominantly came from individuals not residing in Sullivan or even Lycoming County. They came from Philadelphia, York, Lancaster and even Oklahoma to tell the landowners of Sullivan County what to do with their land, and to attempt to sway the DEP into ignoring their scientific research and local support of the project, in hopes of producing a denial of the application.

But, that's how the opposition movement works. First, they find the few individuals in the county who are not supportive of development. Then, they have a training session to scare attendees with information taken out of context and teach them how to testify, i.e. package a lot of emotional appeal and throw in some numbers the CAC will provide you with. Then, they fill the hearing room with people from outside of the area to ask off the wall questions and confuse those members of the community actually there to learn something. Lastly, the same individuals testify at each hearing with a couple of the newly trained residents.

While the DEP has been sticking to the science when making their decision, this packs a huge wallop in the media because the hearings create the assumption residents are not in favor of development or infrastructure and companies are disliked in the community. This could lead to complications in future negotiations and has led to personal attacks on those residents leasing pipeline right of ways or selling property for compressor stations.

It's also causing delays in production, as gas from your land cannot get to market without this needed infrastructure.

It's happened with Laser, Chief and Central New York Oil and Gas, and on March 22 we'll see a repeat with a Southwestern compressor station for a gathering line system. It is important landowners leasing infrastructure, in a production unit, or with the hopes of one day being included in one, turn out to these hearings to stand up for their property rights.

Will you be at Herrick Township Volunteer Fire Co., 6149 Herrickville Road in Wyalusing on March 22 at 6 pm to put an end to this nonsense and make sure the infrastructure is built to get your gas to market?●

Is Marcellus Shale Gas a "Mineral?"
The Pennsylvania Superior Court thinks it May Be

Written by Michelle R. O'Brien, Esq. of The O'Brien Law Group

Since late 2011, there has been much confusion and speculation among landowners, oil and gas attorneys, and gas companies questioning who actually owns the natural gas being extracted from the Marcellus Shale. A recent decision by the Pennsylvania Superior Court in *Butler v. Charles Powers Estate*, 29 A.3d 35 (2011) is the cause of this confusion. But, to understand the reason for the confusion, we must start in the past, the distant past ...

In 1882, the Pennsylvania Supreme Court decided a case titled *Dunham and Shorrt v. Kirkpatrick*, 101 Pa. 36 (1882). Out of this decision, and a subsequently decided case, *Highland v. Commonwealth of Pennsylvania*, 161 A.2d 390 (Pa. 1960), came a cornerstone rule of Pennsylvania oil and gas law known as the "Dunham Rule." The Dunham rule provides that "[i]f, in connection with the conveyance of land, there is a reservation or an exception of 'minerals' without any specific mention of natural gas or oil, a presumption, rebuttable in nature arises that the word 'minerals' was not intended by the parties to include natural gas or oil." *Highland*, 161 A.2d 390 at 398. Based on the Court's decisions in both *Dunham* and *Highland*, lawyers for more than a century have been drafting deeds intended to sever the oil, gas, coal and mineral rights to property, using very specific conveyance and severance language.

The application of the Dunham Rule was questioned in the recent *Butler* case. The Butler case arose when John and Mary Josephine Butler brought a quiet title action on their 244 acre property located in Apolacon Township, Susquehanna County, Pennsylvania. The Butlers were asking the court to interpret a provision in an 1881 deed reserving to the Charles Powers Estate "one-half of the minerals and Petroleum Oils" underneath the 244 acre property. The heirs of the Charles Powers Estate, William and Craig Pritchard, challenged the Butler's claim that they owned the natural gas rights under the 244 acre property.

The Butler's invoked the Dunham Rule to support their claim that because the 1881 reservation did not specifically reference "gas" or "natural gas," they were the rightful owners of 100% of the natural gas rights underlying their property. The Pritchard's countered this claim, arguing that the reservation at issue was included in a deed drafted and recorded in 1881, one year before the Dunham case. They argued that prior to the *Dunham* case, reserving "minerals" in a deed included the reservation of natural gas. The Pritchard's argument is further supported by the Pennsylvania Supreme Court's decision in *U.S. Steel Corporation v. Hoge*, 468 A.2d 1380 (Pa. 1983) which held that the owner of the coal in which coal bed gas is found is also the owner of that coal bed gas and the right to recover and develop it.

The trial court in the *Butler* case found in favor of the Butler's, holding that the Dunham Rule applied in this situation and therefore the gas rights were never severed from the surface rights and the ownership remained with the Butlers. On appeal, the Pennsylvania Superior Court disagreed with the trial court, finding that there are additional questions of fact which need to be addressed at the trial level before the appellate court can issue its opinion. The Superior Court remanded the case to the trial court for additional expert testimony on the following questions: (1) does Marcellus Shale constitute a "mineral?"; (2) does Marcellus Shale gas constitute the type of conventional natural gas contemplated in the *Dunham* and *Highland* cases?; and (3) Is Marcellus Shale similar to coal to the extent that whoever owns the shale, owns the shale gas?

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The Superior Court's decision was appealed to the Pennsylvania Supreme Court on October 7, 2011 but as of March 8, 2012, the Supreme Court has not decided if it will hear the appeal.

The good news for some landowners is that the outcome of the *Butler* case will only affect properties where there is a severance of "mineral" rights in the chain of title with no specific severance of the "gas" or "natural gas" rights. The bad news is, because of Pennsylvania's long history of coal and other mineral mining, many property chains do include severance of subsurface rights and in many cases, the rights were severed prior to the Court's decision in *Dunham*.

In addition to causing confusion regarding the status of Pennsylvania law, until the issues presented in the *Butler* case are decided, there may be many other practical effects caused by the uncertainty. For example, until these open issues are decided, it is not unreasonable to expect that properties with a severance of "mineral" rights in the chain of title will be all but impossible to lease to a gas company. Any royalties payable on properties with severance of minerals in the chain of title may see these royalties held in escrow until the Court issues a decision, or development of these properties may be delayed completely. Further, property values may be in limbo because potential buyers, sellers, banks and appraisers cannot determine the value of a property without knowing who is the rightful owner of the Marcellus Shale gas rights underlying a property.

So, the question of the day is, now what? My best advice for now is to sit tight and stay tuned. When the Butler case is decided, it will be big news potentially having a major impact on Pennsylvania law. ●

Estate and Inheritance Tax Update

Pennsylvania Inheritance Tax

By Lester Greevy & John Shoemaker, Greevy & Associates

The Pennsylvania Department of Revenue is in the process of changing the way royalty owners pay the Pennsylvania Inheritance Tax. In 2003, the Department issued letter ruling INH-03-008, which directed royalty owners to list non-producing mineral interests on the inheritance tax return, at a value of zero because the minerals had "no ascertainable value". The Department's chief counsel re-issued that letter ruling in 2008.

INH-03-008 has recently disappeared from the Department's website. The Department says that the letter ruling is still good law, but will now only apply under very narrow circumstances—such as when the gas company drills a dry hole.

According to the Department, there will soon be new guidance on the issue. The Department is considering various methods of valuation and will suggest, or perhaps mandate, one or more method in a tax bulletin. The specified method of valuation will likely depend on whether the mineral interest is producing or non-producing.

For producing properties, the Department is leaning strongly toward the income approach, i.e., reducing to present value. For non-producing properties, the Department is considering several different approaches, including the lease-bonus method and the comparable sales method. It seems that the comparable sales method will be the Department's preferred method, especially as more data becomes available.

The new rules will become available at http://www.revenue.state.pa.us.

The upshot is that royalty owners—or, more accurately, their estates—will almost certainly need to provide some manner of documented mineral valuation. But it doesn't mean they should hire an appraiser now, because the appraisal is only valid as long as the conditions on which it is based haven't changed. Also, a full, traditional appraisal may not be necessary. At any rate, the valuation would need to be made within three to nine months after the date of death.

Another upshot is that a tax on non-producing mineral interests would mean that royalty owners may owe a tax on an asset that isn't generating cash to pay the tax. Life insurance may be a good idea for royalty owners who anticipate the possibility of liquidity problems.

Federal Estate Tax

President Obama's budget proposal for 2012 calls for returning the lifetime exemption for the federal estate tax, and the tax rate, to 2009 levels—$3.5 million per individual and 45%, respectively. The current law provides for a $5 million dollar lifetime exemption per individual and a top rate of 35%, for the years 2011 and 2012. The Obama proposal would de-unify the gift tax exemption, and reduce it to $1 million per individual.

Portability is also an option under the current law. Portability allows married couples to aggregate their lifetime exemptions of $5 million each, effectively making the exempt amount $10 million for married couples. President Obama's proposal would make the portability option permanent.

The current estate tax law is scheduled to sunset in 2013 if not extended or modified, meaning that the lifetime exemption will revert to $1 million per individual. This also means that the top marginal rate would be 60% for some individuals.●

Check out the NARO-PA Chapter website:

http://www.naro-us.org/Pennsylvania

NARO members can log in to the members only message board to get reliable information about natural gas drilling in Pennsylvania.

- Research archived PENNROAR newsletters.
- Post a story of interest
- Visit the NARO Store for gas & oil publications
- Browse other state chapters to find out what's happening in other plays

Getting More for *All* Your Natural Resources:

Don't forget about your forest's value in the quest for natural gas

By: Trevor Walczak, Forester, Walczak Lumber Co., Inc

Before the Marcellus Shale boom, Pennsylvania's forest products industry, which produces $5.5 billion annually, was the states recognized natural resource powerhouse. While the housing bust has weakened the resource, landowners need to be reminded not to overlook its value on their way to natural gas production on their properties.

Here are some tips to help you get more from your forest during the gas boom:

1. Leases and pipeline agreements often can include language such as: *an appraisal shall be constructed by a qualified third party forester and Lessee shall pay Lessor the said appraised present value of such timber prior to harvesting.* This ensures you are adequately reimbursed for timber value on your property.
2. Often times, these agreements also allow for the landowners to retain these same forest products as firewood for personal use or as wood products for sale, if there is adequate volume or values. This gives the opportunity to "double-dip" on the resource.

If you choose to reserve your wood, keep in mind:

1. When meeting with the company representatives, *before the operations begin*, clearly define:
    a. **The size of the trees you would like to reserve.** Typically, clearing crews chip or grind all portions of the tree smaller than the main stem's diameter of 6 inches. This is not an exact measurement made on each tree as they process it, but rather an "educated guess" of diameter, so be understanding if the results are a little either side of the mark.
    b. **The place you would like the wood stacked.** Clearly define a location which will not interfere with on-going natural gas operations, but in a place that is still easily accessible, if you have plans to later market the wood products.
3. If marketing your wood, remember, the more a buyer has to invest into accessing, sorting and moving the wood, the less you may receive for the resource. Typically, different products like pulpwood, firewood, palletwood, and sawlogs will all be mixed together in the pile, so be realistic in your expectations:
    a. "Stumpage" refers to the value of standing timber in the forest, while a "log price" refers to the value of an individual log, at the landing, ready to load, or delivered to the sawmills yard. The difference between the stumpage and the log price is the loggers cost of getting that tree into a sellable product.
    b. Selling all of the products together "by the load" simplifies the process of marketing your wood, but does not let you take advantage of higher priced sawlogs that may be inside the pile. It may be a viable option if there are no "grade logs" which yield valuable lumber for flooring or furniture.
    c. The initial stumpage appraisal can act as a guide for estimating the value of all of the wood in the pile, but it does not account for wood that has been damaged in processing or for short-runs in volumes due to crew's excessively chipping.
    d. To best maximize their resource, landowners may chose to work closely with a sawmill, pulpmill, or logger who is willing to sort through the piles and work on a "percentage" of the value of the "log price" received on their sale to the sawmill. Pulpwood or firewood can either be sold on a "rate-per-ton" or on a price "by the load." These values will vary regionally depending on access to markets and cost of processing.
    e. As always, when working with forest products, make sure the terms of the sale are agreed to in writing, insurance for all workers on-site has been provided, and agreements have been made for timing of the operation and retirement of the site.

As the Marcellus shale boom is helping to keep farms and hunting clubs intact, it is also taking the pressure off our valuable hardwood forests to sustain property ownership. Ideally, without this pressure, landowners may become more inclined to explore sustainable forestry practices which improves forest composition, wildlife habitat and maximizes a forest's return over time.●

Why Join the National Association of Royalty Owners Pennsylvania Chapter?

By: Daniel Simonsen, NARO-PA Northwest Regional Board Member &
Trevor Walczak, Vice-President, NARO-PA

The mission of NARO is to encourage and promote exploration and production of minerals in the United States while preserving, protecting, advancing and representing the interests and rights of mineral and royalty owners through education, advocacy and assistance to our members, to NARO chapter organizations, to government bodies and to the public.

1. Strength in numbers for the rights of royalty owners. Ever notice how much everyone talks about "special interest groups" and their influence? As mineral owners, we all have rights that are being compromised by environmental activists, our local, state and federal governments and sometimes, though rarely, even the gas companies we've partnered with. As individuals we may not have much influence, but together, we can protect our rights.

2. What you stand to lose is far greater than the cost of membership. More than any time before, this administration in Washington D.C. has had the oil and gas industry in its crosshairs. Tax deductions available to royalty owners, like the Depletion Allowance, have been at the top of the chopping block year after year. Capital gains rates, the rate at which royalty income is taxed, has also been proposed to be doubled, from its current 15% rate, in the government's war on prosperity. NARO lobbies in Washington D.C. on a regular basis to keep these provisions and rates where they belong. We have been successful since we represent thousands of mineral owners. We are engaged and we are voters, but we need to keep the pressure on.

3. Access to a statewide and nationwide network of like-minded folks dealing with the same issues you deal with as a royalty owner. Compare experiences. Learn what questions to ask when you are approached by company representatives. Expand your knowledge of operations from just your neighborhood with one company to learn about operations state and nationwide with many different operators and to understand how companies are dealing with other mineral owners.

4. Keeps you current on the issues. The Pennsylvania Chapter publishes a bi-monthly e-newsletter, the *Pennsylvania Royalty Owners Action Report*, otherwise known as *PennROAR*. Read in-depth analysis of legislation, court cases, industry news, tips on leasing, and how it all affects you as a mineral owner. The national association publishes a monthly magazine which summarizes the events happening in every oil and gas producing state with a NARO chapter and includes great estate planning tips and topics of interest.

5. Access to professional expertise: legal, financial, tax, natural resource management, oil and gas industry, government, and more… NARO-PA has great professionals who all volunteer their skills to bring our membership the best information needed to maximize their mineral estate.

6. Practical education. The state and national conventions provide the most intense learning opportunity out there for mineral owners. Conventions consist of multiple days of presentations covering the most up-to-date topics from the top experts in the field. Conventions are in great destinations suitable for family vacations. Often, NARO-PA hosts regional town hall meetings where newcomers can get a taste of what NARO-PA membership is all about.

7. Socially enjoyable. The state and national conventions are also the best place for meeting like-minded individuals, sharing stories, and making life-long friends in great vacation locations. The national convention has even been referred to as feeling like a "family reunion" since many mineral owners have attended for ten and twenty years. Many NARO members are now even passing the membership torch to the next generation of mineral managers in their family. We hope our state chapter conventions begin to take the same form.

8. Professional Education through the Certified Mineral Manager program. The CMM program offers unique educational opportunities and credentials for those individuals wishing to improve their mineral management skills for personal or job-related use, including those who wish to provide such professional services to others. The program is administered by the NARO Foundation and is available at two levels of study: the Associate and the Professional level. The Professional Level Certification is structured for the individual who is currently, or plans to be, involved in any aspect of management, administration, or development of oil and gas properties.

9. Tax deductible. Do you have your mineral estate in a corporation? If so, NARO membership is a tax deductible expense. Even expenses from attending the conventions apply!

10. Find the right balance of environmental regulations. The Marcellus Shale boom has exposed many shortcomings in current Pennsylvania oil and gas law. Proposed revisions to these rules range from practical regulation to veiled attempts to shut the entire exploration and production down. Big regulatory changes are on the forefront, like the expansion of *Conservation Law* to the Marcellus. NARO-PA will be at the front of this debate representing the rights of the often overlooked mineral owners, but we need your help in building this organization up. •

Yaw Quiet Title Bill Approved by Senate

HARRISBURG – Legislation to assist landowners who, through no fault of their own, cannot gain ownership of their subsurface mineral, oil and gas rights, has been approved today by the Senate, according to State Senator Gene Yaw (R-23), the bill's sponsor.

Senate Bill 1324 would amend the Action to Quiet Title law in Pennsylvania to provide for a 'rebuttable presumption' that mineral, oil and gas rights have been abandoned in favor of a surface owner after a 50 year period of nonuse.

"The legal principle known as an Action to Quiet Title has been an integral part of Pennsylvania law for at least 100 years," Yaw said. Senate Bill 1324 simply gives the surface owner, after 50 years, a slight advantage at the start of a court case to clarify the ownership question. This bill does not change the fact that the plaintiff landowner still must prove his case, in court, by a preponderance of the evidence just as the plaintiff can, and is required, to do today."

The legislation was amended in committee to exempt fee interests, including deeds and long-term leases for coal and other minerals and oil and gas reserved or acquired by a duly recorded conveyance. In addition, the amendment further defined the "exercise of subsurface rights."

"I have had numerous constituents contact me regarding title problems with their subsurface rights, which go back well over 100 years," Yaw added. Senate Bill 1324 takes nothing away from any subsurface owner, who has a legitimate ownership interest. Anyone who has such an interest would need to deliberately ignore all of the notice provisions in the law in order to be negatively impacted."●

NARO ALERT!

President Obama will be in Oklahoma this week. He is scheduled to be in Cushing, OK on Thursday to have a photo op at the huge tank farm where he will claim credit for the increase in domestic oil and gas production and that he got Trans-Canada to build the new pipeline (XL southern leg) from Cushing, OK to Texas Gulf Coast.

Here is some of what the President said on March 15th 2012.

THE PRESIDENT: The question -- there's a question before Congress I want everybody to know about. The question is whether or not we should keep giving $4 billion in taxpayer subsidies to the oil industry.

AUDIENCE: No!

THE PRESIDENT: The oil industry has been subsidized by you, the taxpayer, for about a hundred years -- 100 years. One hundred years, a century. So some of the same folks who are complaining about biofuels getting subsidies, or wind or solar energy getting subsidies, or electric cars and advanced batteries getting subsidies to help get them off the ground, these same folks -- when you say, why are we still giving subsidies to the oil industry –- "well, no, we need those." Oil companies are making more money right now than they've ever made. On top of the money they're getting from you at the gas station every time you fill up, they want some of your tax dollars as well. That doesn't make any sense. Does it make sense?

AUDIENCE: No!

THE PRESIDENT: It's inexcusable. It is time for this oil industry giveaway to end.

He is talking about YOUR percentage depletion as a subsidy!

Current Trends in Marcellus Shale Development

By Attorney Dale A. Tice, Marshall, Parker & Associates

Those of us who were working on oil and gas law way back in 2008 remember the heady days of the Marcellus gas leasing boom. Before the major oil and gas companies had shown any interest in the Marcellus, a number of smaller, independent drilling companies were leasing acreage in the core areas as rapidly as possible. The *New York Times* quoted one commentator who described the leasing land grab as a "feeding frenzy."

Thanks to the efforts of the Penn State Cooperative Extension, many landowners were aware of the potential pitfalls in the leasing process and realized that the leasing frenzy created an opportunity to negotiate favorable lease terms. Landowners in the hot spots were often presented with offers to lease from multiple companies, each trying to establish a dominant leasehold position. It was this intense competition for prime Marcellus acreage that placed educated landowners in a fortunate posture from which to negotiate, and those of us working with landowners became accustomed to seeing long lists of landowner-friendly addenda attached to gas leases.

The times they are a-changin'. At this point in 2012 several long-term trends have become apparent that are significantly impacting Marcellus landowners. The large majority of the land available in the prospective areas of the Marcellus has been acquired by the gas companies; the leasing boom has come and gone. The major oil and gas companies recognize the critical importance of unconventional shale gas for our nation's energy future and have invested heavily in Pennsylvania Marcellus, with the result that various sections of the core acreage are now held by a handful of dominant players.

A very significant result of the Penn State educational blitz was that landowners realized the importance of requesting a gas lease with a straight five-year term, with no option to extend the lease for an additional five-year term. In order to keep these leases from terminating, the gas companies need to get the acreage drilled and begin producing natural gas. A key goal of the gas companies now is to keep the acreage that is leased "held by production" so the five-year leases don't expire.

Residents of the core areas of the Marcellus are living with the results of the race to hold land by production. Drilling activity has taken off in the years following the leasing boom and as wells are completed and go online, natural gas production from unconventional shale has increased significantly. However, as the supply of methane natural gas has increased, the price of natural gas has consequentially dropped. This trend toward lower prices for "dry" natural gas has occurred just as the price of oil and natural gas liquids has spiked.

How are these long-term trends impacting Pennsylvania royalty owners? What we see now are strategies from the gas companies to hold more land with less drilling. The standard 640 acre production unit seen in earlier leases has been abandoned for much larger pooled production units, in some cases over 1,200 acres. As the size of the production unit increases, more land is held by production and fewer leases will expire.

Landowners with expiring leases who hope to sign a new lease face a vastly different leasing environment. Competition for new leases is no longer the norm. Many landowners will instead be dealing with the one gas company that holds the dominant position in their area. And without competition for leases, landowners will be in a far less advantageous position from which to negotiate. Provisions that landowners and their lawyers have become accustomed to seeing in leases, such as a Pugh clause or royalties paid without deductions for post-production costs, may be difficult to obtain. Some property owners with land outside the core areas for Marcellus development may find no interest in leasing their acreage. Although the gas companies were willing to lease over a broad area during the height of the leasing frenzy, leasing activity now is much more targeted in the areas where drilling activity is focused.
In fact, Marcellus acreage no longer appears to be the hot commodity. As the market has been flooded

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with unconventional shale natural gas and the price has plummeted, the gas industry has shifted focus to areas such as Ohio and North Dakota where higher priced oil and "wet" gas with associated liquids such as butane or propane may be found.

But there may be a silver lining to this dismal cloud of bad news for Pennsylvania royalty owners. Although low-priced natural gas may dim the prospects for Marcellus development in the short-term, the big picture over the long-term looks increasingly bright. We are just beginning to see a huge shift in national policy away from coal and imported oil toward use of natural gas for electricity production and even natural gas vehicles. Energy independence for our nation finally appears within reach. Ultimately, what is driving this shift is cheap natural gas.
Pennsylvania royalty owners need to keep their chin up and look forward to the day when Marcellus natural gas is powering our nation's energy future.●

First 11 Dimock Homes Sampled by EPA Show no Health Concerns

BY LAURA LEGERE (STAFF WRITER)

The first 11 Dimock Twp. water supplies tested by the U.S. Environmental Protection Agency did not reveal levels of contamination that could present a health concern, but the samples indicated the presence of arsenic and other compounds that will require further tests at some homes, the agency said Thursday.

Agency officials hand delivered test results to residents whose wells were sampled during the week of Jan. 23 and will meet again with the families individually to review the results and answer questions. The first test results reported Thursday represent about a sixth of the data collected by the EPA over weeks of sampling in a 9-square-mile area of Dimock where the agency is investigating the potential impact of nearby natural gas drilling on water supplies.

"EPA conducted those reviews and found no health concerns," he said.

The natural gas industry said that the results confirm that their operations have not affected drinking water. George Stark, a spokesman for Cabot Oil and Gas Corp., the firm drilling extensively in the township, said the company is "pleased that data released by EPA today on sampling of water in Dimock confirmed earlier findings that Dimock drinking water meets all regulatory standards."

Financial Woes Shake the DRBC

3 of the 5 commission members have either shrunk payments or stopped paying.

By Sandy Bauers Philidelphia Inquirer Staff Writer

The financial noose is tightening for the Delaware River Basin Commission, the arbiter of whether natural gas drilling will occur in the watershed. Pennsylvania, which is upset that the commission has yet to authorize drilling, has withheld two quarterly payments to it. A state budget document shows Pennsylvania froze its allocation in January, reducing its payments to the DRBC by 40.7 percent this fiscal year.

Meanwhile, New York has steadily shrunk its payments over the last few years, and in its proposed 2013 budget, it will pay about 40 percent of its agreed-upon fair share of the commission's revenue.

This is causing worry that the commission - a national model formed by a federal compact 50 years ago - could fall apart. If the funding woes continue, "this revered agency would have to start cutting staff," said Jeffrey Featherstone, a Temple University professor and former deputy executive director at the commission. "It would be on a death cycle."

Two other commission member states, New Jersey and Delaware, have paid or are expected to. Although New Jersey had threatened to withhold funding last year if drilling regulations weren't passed, it didn't. But because of political wrangling at the national level, the federal government - the commission's fifth member - has failed to pay its portion every year but one since 1998. Its cumulative shortfall is now more than $9 million.

Maya van Rossum, the Delaware riverkeeper, said it seems clear Pennsylvania's failure to pay "is arm-twisting because of the gas drilling regulations." She called it a "myopic" strategy given the commission's proven value to the river basin and the states in it by regulating water withdrawals, maintaining water quality, and managing droughts and flood mitigation. "Frankly, it's going to result in putting us right back into the water wars," she said. The commission was formed as a way to broker disagreements among the four states about how to divvy up the river water.

Commission executive director Carol R. Collier said she was "worried . . . we're really in a nonsustainable situation." Payroll makes up nearly 80 percent of the budget, and the commission has been tightening its belt for years. Collier said she was trying to convince the federal Office of Management and Budget "that there is not only a contract that they need to adhere to," but how cost-effective the commission's work is.

Pennsylvania Department of Environmental Protection spokesman Kevin Sunday said $400,000 in DRBC funding was frozen when Gov. Corbett called for cuts. "We felt the DRBC could absorb this one-time reduction . . . and still be able to meet its core mission," he said. He said now that New York and the federal government were shortchanging their payments, Pennsylvania was paying far more than its 25 percent fair share of the DRBC budget.

Corbett's proposed budget for next year restores the state's fair share of commission funding, minus 5 percent. That "is in line with the present economic situation and the governor's call to cut spending by 5 percent," Sunday said. The governor went lighter with cuts to the Susquehanna River Basin Commission, which has been issuing permits for water withdrawals related to natural gas drilling. It was cut by only 10 percent.

And the Susquehanna commission, unlike the Delaware commission, is allowed to charge fees, which amounted to about half its $12 million budget in 2010. That's more than double the $5.6 million the Delaware commission plans to spend this year. The commission had declared a moratorium on drilling in the Delaware basin until regulations could be adopted. They were proposed in December 2010 but the process stalled in November, when a meeting to vote on revised regulations was canceled.●