

**TESTIMONY OF BRADFORD COUNTY COMMISSIONER
CHAIRPERSON DOUGLAS MCLINKO**

Good Morning, I am Douglas McLinko, Chairperson of the Bradford County Board of Commissioners. I would like to thank the Senate Environmental and Energy Committee members and Chairman Yaw for allowing us the opportunity to testify today. Commissioner Miller and I are both strong supporters of the safe, responsible development of natural gas development and believe that it has been a blessing to our county.

First of all, I would like to thank the Senate for listening to our concerns regarding post production cost deductions from landowners' royalty payments. Unfortunately what is happening now is something that no one signed up for. Our constituents have shown us evidence of extraordinary post production cost in Bradford County, with deductions of 40 and 50% all the way up to as much as 90% from our landowners' royalty checks. Since the Kilmer case that pulled the safety net out from under the landowner, we have seen checks come with zero payment. We have seen retroactive charges being billed to land owners for tens of thousands of dollars where the property owners actually have a bill sent to them and they go without any royalty payments until it is paid in full. It has been three years since the Kilmer case and the state legislature has done nothing. I can assure you that if you think that this is just one area of our county you have been misled. I am getting an incredible amount of complaints from many, many landowners from all over our county.

The issue of extraordinary post production costs affects the entire Commonwealth. When you look at how much money is being deducted over extraordinary post production cost compared to other states, this is uncommon. When I talk to other commissioners across the United States there is outrage and

one company's name continues to come up. The problem is the incredible amount of money that is going to be leaving our state through the loss of sales tax, the loss of income tax, and the loss of many different revenues that the guaranteed 12 ½ percent minimum royalty would have provided. You should remember that with over 35,000 parcels in Bradford County, the vast majority of 14,000 parcels being one acre or less, and then you factor in the five to ten acres parcels consisting of the majority of landholders, a substantial number of our residents are being affected and they are certainly not getting rich. This affects working families and senior citizens. These are the people that pay taxes and own property. When you see senior citizens getting a check that starts at four hundred dollars and after post production costs are taken out by the gas company results in a net check of 60 dollars, it is just inexcusable. It has affected our farm community. We have seen Bradford Sullivan Farm Bureau holding town hall meetings with lawyers and accountants to help our farm families understand and plan a course of action. This practice is going on throughout the entire County of Bradford. We are getting complaints from all four corners and in between. When people receive their royalty check our office is inundated with calls and people stopping in to show us their payment statements in shock and disbelief. We have compiled and put in front of you seven different property owners check stub information in eight different units from the same company throughout the county and when you look and see what their gross check was, then look at the deductions and see what their net check was, you see as little as less than 2% on a 12.5% lease. However, not all companies are taking these extraordinary deductions, in fact some take zero or very little deductions. These companies could use old leases and the Kilmer case as an excuse but chose not to do what a few companies have done. I want to show you of all the units in our county, red is no deductions being taken and purple takes very little post production cost. The same companies that have made large post

production deductions a business practice in other states are now doing it in the Commonwealth. I can guarantee you that if left unaddressed these will not be the only companies doing this. There are also many operators who are mad at the heavy handed way a few companies are mugging the landowners, fearing that this will give the entire industry a black eye!

Bradford County is the most drilled on County in the State. With 12.5% guaranteed minimum royalty we and the property owners both felt there was a safety net when they signed these bad leases. As you may recall, the gas industry employed the land men to convince property owners to sign these leases. I have talked to other operators about this situation and they agree that some gas companies are taking advantage of the landowners. When they heard about the gross amount of unreasonable post production costs taken out by a few gas companies, other gas company operators told me they were appalled that some operators are choosing to gouge our citizens. We feel that a few companies may be twisting the definitions to justify taking extraordinary post production cost from royalty payments. This all has to be looked at by the legislature. The Commonwealth has done an outstanding job protecting our environment and our Gas Company operators also do a terrific job protecting our environment but I think the state has failed to look at the financial guarantees for our citizens. That is why we proposed the following resolution inpart:

NOW, THEREFORE, BE IT RESOLVED, that the Bradford County Commissioners request the Pennsylvania Legislature to clarify the Guaranteed Minimum Royalty Act (GMRA), 58 Pa. Stat. Ann. § 33, as to require a minimum payment of a twelve and a half percent (12.5%) royalty to landowners by not allowing post-production deductions which reduce the royalty payment to an amount below twelve and a half percent (12.5%) of

the revenue realized at the point of sale to a non-affiliated bona fide purchaser for fair market value.

My fellow Commissioners in Sullivan and Susquehanna counties have also unanimously passed similar resolutions asking for the legislatures help.

If the State does not intervene in this matter, we could see this problem spread across the Commonwealth and also affect State owned property. If this continues, our State game lands are going to be seeing extraordinary costs taken from them. As I stated earlier our land owners had the guaranteed minimum royalty when they signed these leases and they understood that the royalty could not fall below 12.5%. We believe that that GMRA was instituted for times like today and that is why the legislature put that guaranteed minimum of royalty into law to protect the small property owners from the large multi-billion dollar Gas Companies.

When you investigate this problem you will find that it affects all property owners. The Legislature needs to look at not only the impact on large property owners but how it affects small property owners consisting of working families and retired people. This is not just about the people of Bradford County it's about the entire Commonwealth of Pennsylvania and many areas of our country are watching what we do here today. When you look at this incredible practice of gouging property owners, there is no excuse for this. If it is not stopped right now, it is going to affect many working families and many retired people that these royalties would have helped. The lack of this tax revenue from these royalties is going to affect everybody, people in Philadelphia and in Pittsburgh because that money goes into the general fund of Pennsylvania. I believe it would be very irresponsible if we do not speak out against this practice and request the legislature remedy it now.

While Pennsylvania welcomes Gas Companies, we are not going to stand by and let our people who have signed leases have their royalties taken back by extraordinary post production deductions. Many of our citizens are now disillusioned with the unkept promises made by a few Gas Companies. Support for natural gas development remains strong in Bradford County. However, they want this problem resolved.

In closing, I have travelled the US and discussed Marcellus Shale with other elected officials. I do not think that Harrisburg gets enough credit for the wonderful job of the Marcellus Shale development. I have seen numerous other problems in other states, but Governor Corbett's Administration and the House and the Senate have done a good job in demanding safe and responsible development and protection of the environment. Now it is time to protect the financial end of it, not just for land owners but also for counties, municipalities and the entire Commonwealth of Pennsylvania.

With us today is Smithfield Township Supervisor Jackie Kingsley. Mrs. Kingsley is representing personally as well as for the community in her the experience with extraordinary high deductions from royalty checks.

**TESTIMONY OF BRADFORD COUNTY COMMISSIONER
VICE CHAIRMAN DARYL MILLER**

Good Morning, I am Daryl Miller, Bradford County Commissioner. I would like to thank the Senate Environmental Resources and Energy Committee members and Chairman Yaw for allowing us the opportunity to testify today, especially during this busy budget time.

I am a strong supporter of the safe, responsible natural gas development taking place in our county, bringing with it economic prosperity and job creation.

Let me begin my testimony by citing that in 1979 our State Legislature created a piece of legislation entitled "The Guaranteed Minimum Royalty Act". I won't pretend to know the exact reason the State Legislature created this piece of legislation. My opinion is, that it had something to do with landowners/leaseholders receiving something less than 12 1/2 percent for gas and oil removed from beneath their land. In 2010, a decision handed down by the Pennsylvania Supreme Court, in the *Kilmer v. Elexco* case which basically opened the door for a couple of gas companies to decide they were going to take an extremely high portion of those royalties back from landowners in the form of post-production costs. Prior to and early on in the gas exploration activity taking place in our county, we had landowners who were approached by land men going around door to door trying to get landowners to sign gas leases. In many instances, they were promised that it didn't matter what they signed or what the wording was in the lease that the State guaranteed them a 12 1/2 percent minimum royalty. As we have seen over the last year and a half or so, that 12 1/2 percent has been reduced dramatically in many instances to the point of just a percent or two left of the landowner portion.

At the Federal Court level a similar type of case was heard called the *Kropa v Cabot Oil & Gas Corp* which addressed two things. The definition of royalties, and that land men were going around telling landowners that they would receive no more than \$25 an acre, only to find out later that the land men were signing leases for much more than that. The judge in the *Kropa* case basically said that they were deferring to the State Supreme court regarding the royalty issue, but did

however allow the case to go forward regarding the fraudulent activity of the land men.

Royalty checks are being reduced by substantial amounts to landowners in our county, dropping payments well below the 12 ½ percent guaranteed minimum. This is being done by a couple of companies operating in our county through deductions for items such as transportation, gathering, compression, dehydration and third party costs. If you take a leaseholder that is supposedly receiving a 12 ½ percent royalty and they are only ending up receiving about a percent and a half or two percent, this means about 80 percent of their royalty payment, is being reduced because of post-production costs. A couple of gas companies are saying that they are sharing 7/8 of these post production costs, does this mean that these costs account for 80 to 85 percent of their cost of doing business?

If you take the last six months of last year from Bradford County alone according to DEP statistics, there was 286 billion cubic feet of natural gas produced from our county. What I am going to do is purposely minimize the amount of money being referred to here leaving our County and our State. If you take that DEP gas production figure and it's selling for \$2.50 per thousand cubic feet, and assume only 1/3 of the leaseholders in the County are being affected, and their royalty checks are being reduced by 33% because of post production costs, you come up with a number of about \$10,000,000. That is \$10,000,000 of royalty money not circulating within our economy, leaving our County, and State. There are no sales or personal income taxes collected on that \$10,000,000.00. As this Shale play matures and as this spreads across the State, because the Marcellus Shale occupies 2/3 of the State of Pennsylvania, it's not just going to be \$10,000,000 that's leaving our County and State, it's going to be tens or hundreds of millions of dollars that is leaving our State economy.

Bradford County has over 35,000 separate parcels of land. The overwhelming majority of them are ten acres or less. These people are small landowners who are working families and senior citizens trying to make ends meet. They are looking at this as a little bit of extra income. They simply what to be treated fairly!

Let me sum my testimony up this way. What we are asking, is for the State Legislature to address the issue of determining the definition of what a royalty is, and where that valuation takes place. In the *Kilmer* case, that essentially is what the Justices said in their decision in footnote 14 of that case; and I will read:

“We note that the general assembly is the branch of government best suited to weigh in on public policies underlying the determination of the proper point of royalty valuation in the deregulated gas industry. However, until the General Assembly acts to specify the point of valuation we must interpret the statute as written prior to deregulation.”

Today we brought with us, one of our Solicitors, Jonathan Foster, Jr. who worked with other legal council on our resolution 2013-04 which was passed on May 28, 2013 asking the State Legislature to define what the intent of the 1979 piece of Legislation. Our solicitor’s and additional counsel, believe it is within the legislature’s ability to define what their intent was. It is not meant to in any way infringe upon the contract rights.

Again, I want to thank the Environmental Resources and Energy Committee for hearing our testimony. I want to thank Chairman Yaw for inviting us.

Thank you.

ATTORNEY JONATHAN FOSTER JR. PROPOSED TESTIMONY

In 1979 the Pennsylvania State legislature regulated gas lease contracts between landowners and energy companies by setting forth a minimum royalty amount in an effort to protect landowners from being subject to gas lease agreements which do not fairly compensate the landowners for the oil or gas taken from their property. This minimum royalty provision is outlined in the 1979 Guaranteed Minimum Royalty Act (GMRA), 58 Pa STAT. ANN. §33 which states under the heading Guarantee of minimum royalties that “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.” The GMRA was not challenged on a constitutional basis and remains valid law.

The Supreme Court of Pennsylvania in Kilmer v. Elexco Land Services, 605 Pa. 413, 990 A.2d 1147 (2010) observed that the Legislature had failed to define the term “royalty” in the GMRA and stated under footnote 14 that “We note that the General Assembly is the branch of government best suited to weigh the public policies underlying the determination of the proper point of royalty valuation in the deregulated gas industry. However, until the General Assembly acts to specify the point of valuation, we must interpret the statute as written, prior to deregulation.”

The Supreme Court of Pennsylvania expressly stated “until the General Assembly acts.” The purpose of the Bradford County Commissioners resolution was to ask the General Assembly to act now. The intent of the 1979 Guaranteed Minimum Royalty Act (GMRA) to provide a minimum twelve and half percent (12.5%) has not been achieved due to ambiguity in the original legislation. Bradford County is asking the General Assembly to clarify existing legislation. Bradford County is not asking the legislature to regulate anything more than what is already subject to existing law. The Pennsylvania natural gas industry has undergone exponential growth and change in the past few years. Bradford County is asking the state legislature to update outdated legislation so that is consistent with what is currently taking place with the evolution of the Pennsylvania oil and gas industry.

The assertion that any legislative modification to the GMRA would necessarily be unconstitutional if applied to existing leases is unfounded. This view is based upon a simplistic reading of the constitutional prohibitions against impairment of contracts by the government. Yet, as long ago as 1983, in Energy Reserves Group, Inc. v. Kansas Power and Light Co., 103 S.Ct. 697 (1983), the United States Supreme Court recognized that this prohibition is not absolute and that it must be balanced against a state's interest to "safeguard the vital interests of its people." The Supreme Court in that case also noted that highly regulated industries have less ability to object to future regulation impacting contracts and that the elimination of unforeseen windfall profits is a legitimate state interest for these purposes.

Bradford County is only asking the General Assembly to pursue a course of action to safeguard the vital interests of the citizens of the Commonwealth and as specifically recommended by the Pennsylvania Supreme Court when it noted "... that the General Assembly is the branch of government best suited to weigh the public polices underlying the determination of the proper point of royalty valuation." Bradford County has clearly identified a problem which the legislation can address as it did in 1979. The General Assembly is in the position to determine the best course of action to protect citizen landowners as the legislature did in 1979. Bradford County respectfully requests the General Assembly to clarify the 1979 legislation or take other appropriate action to address an issue which is impacting the citizens of Bradford County and the Commonwealth of Pennsylvania as a whole.

In 1979, when the GMRA was passed, the legislature recognized that the landowner had little bargaining power versus the energy industry. However, they also recognized the energy industry companies are necessary to extract the oil and gas from the typical landowner's property given the company's resources and therefore wanted to provide the landowner protection through legislation. It is such bold steps that are needed now by the General Assembly.

At a minimum, the GMRA could be corrected to protect the royalties to be obtained under new leases. Even though the Kilmer decision was decided more than three years ago, there has been no effort to address this issue by the legislature.

As a result of the action of a few Gas Companies taking advantage of the interpretation of royalty in the Kilmer decision, the legislature must take action now to restore the guaranteed 12 ½ percent minimum royalty.

Bradford County cannot enact legislation to address the problem concerning postproduction deductions from their residents with gas leases. This is a State problem and the County Commissioners are asking the State Legislature to use the State's legal resources to examine the issue and come up with a solution. The Commissioners are asking their State Legislators to consider adopting legislation that will address the issue to clarify the definition of royalty as was suggested by the Pennsylvania Supreme Court in their Court Decision.

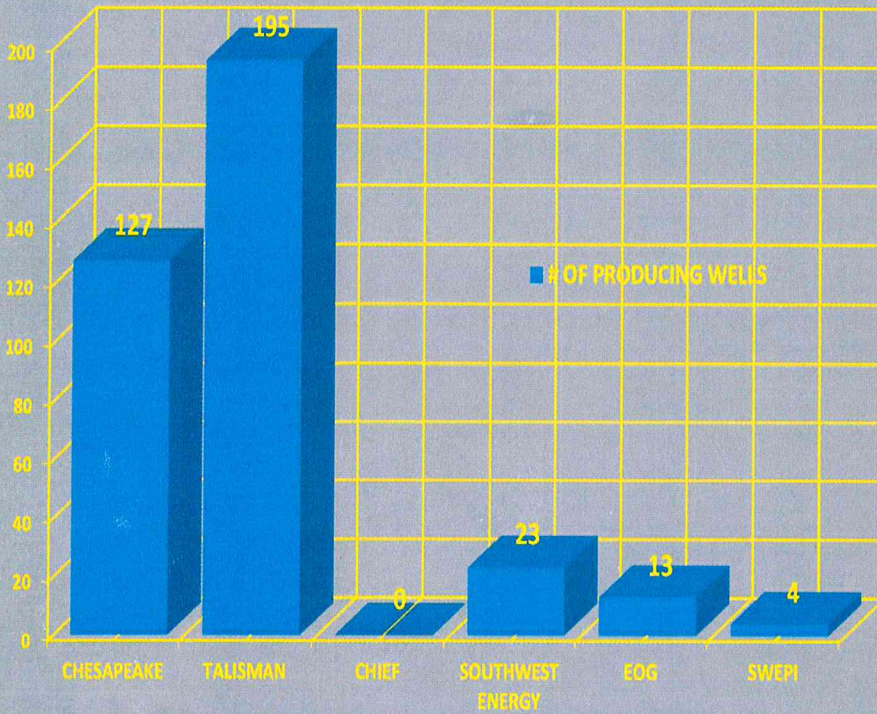
Bradford County does not want to interfere with the private contract rights of individuals. They just want to protect their residents to guarantee the twelve and half percent (12 ½%) minimum royalty that the State Legislature required in 1979. The State Legislature has already intervened on behalf of Pennsylvania property owners to guarantee that they receive just compensation for their oil, gas, and mineral rights. The Courts have said that this legislation has not kept up with current technology and needs to be brought up to date. We are asking them to help their citizens solve a problem that the legislature created and has a serious financial impact on the residents, the local, county, and state revenues. The state legislature worked with the energy industry to pass Act 13 updating the out of date Oil and Gas Act. Bradford County is asking the legislature to again work with the energy industry on the issue of post-production costs and their impact on royalties received by landowners.



BRADFORD COUNTY MARCELLUS OBSERVER

GAS WELL PRODUCTION JANUARY-DECEMBER 2012

JANUARY - JUNE 2012



PRODUCING WELLS [362]

WELL INVENTORY

3,527,600.0 cf³ Daily Avg. Output

AVERAGE PRODUCTION DAYS [144]

TOTAL PRODUCTION FOR THE PERIOD

167,109,704,000.0 cf³

HIGHEST = 1,490,916,000.0 cf³ / 184 DAYS

LOWEST = 13,000.0 cf³ / 1 DAY

PA DEP OIL & GAS MANAGEMENT OIL & GAS REPORTS

JULY - DECEMBER 2012

PRODUCING WELLS [609]

WELL INVENTORY

1,776,955,550.0 cf³ Daily Avg. Output

AVERAGE PRODUCTION DAYS [165]

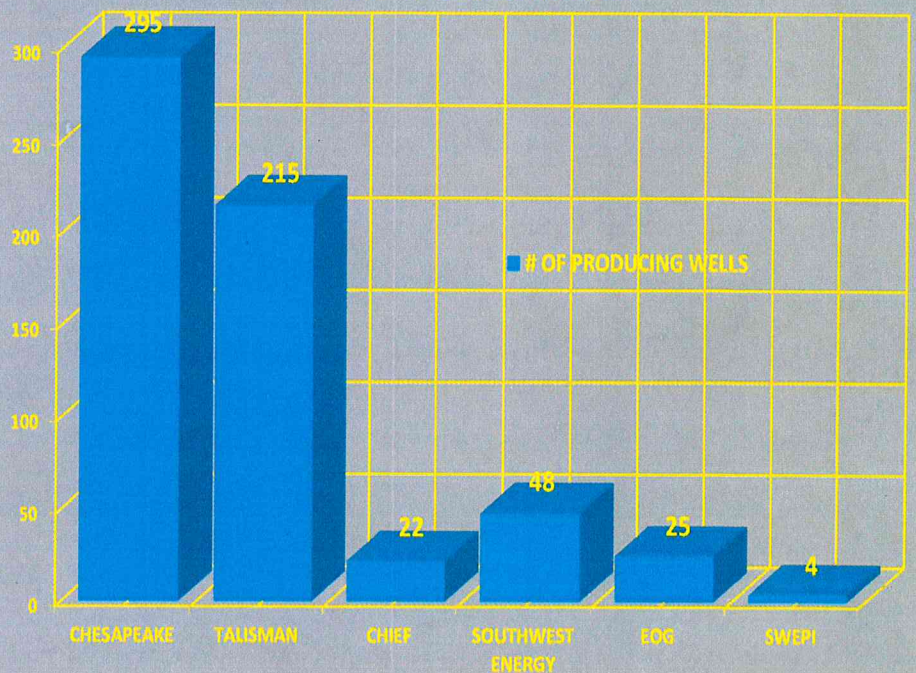
TOTAL PRODUCTION FOR THE PERIOD

285,658,053,600.0 cf³

HIGHEST = 1,508,240,000.0 cf³ / 184 DAYS

LOWEST = 42,000.0 cf³ / 1 DAY

PA DEP OIL & GAS MANAGEMENT OIL & GAS REPORTS





BRADFORD COUNTY MARCELLUS OBSERVER

May 2013

WELLS PERMITTED

2,715 MARCELLUS WELLS (1/1/00 - 4/30/13)

2,723 ALL WELLS

WELL INVENTORY

2,026 (ALL WELLS)

1,981 (MARCELLUS WELLS ONLY)

WELLS DRILLED TO DATE

NON-MARCELLUS WELLS (30) MARCELLUS (1,162)

WELLS SPUD

(1,119) WELLS SPUD BETWEEN 1/1/00 - 12/31/12

(396) WELLS SPUD BETWEEN 1/1/11 - 12/31/11

(164) WELLS SPUD BETWEEN 1/1/12 - 12/31/12

(43) WELLS SPUD BETWEEN 1/1/13 - 4/30/13

PA DEP OIL & GAS MANAGEMENT

OIL & GAS REPORTS



NATURAL GAS RELATED WATER FACILITIES

51 WATER WITHDRAWALS

113 WATER IMPOUNDMENTS

826.49 MILES OF TEMPORARY WATER LINES

GAS LINES

INTERSTATE GAS LINES

130.18 MILES OF INTERSTATE LINES BUILT(TENNESSEE & CNYO&G)

14.63 MILES OF INTERSTATE PROPOSED

GATHERING LINES

389.26 MILES OF PROPOSED GATHERING LINES

503.28 MILES OF BUILT GATHERING LINE

COMPRESSORS

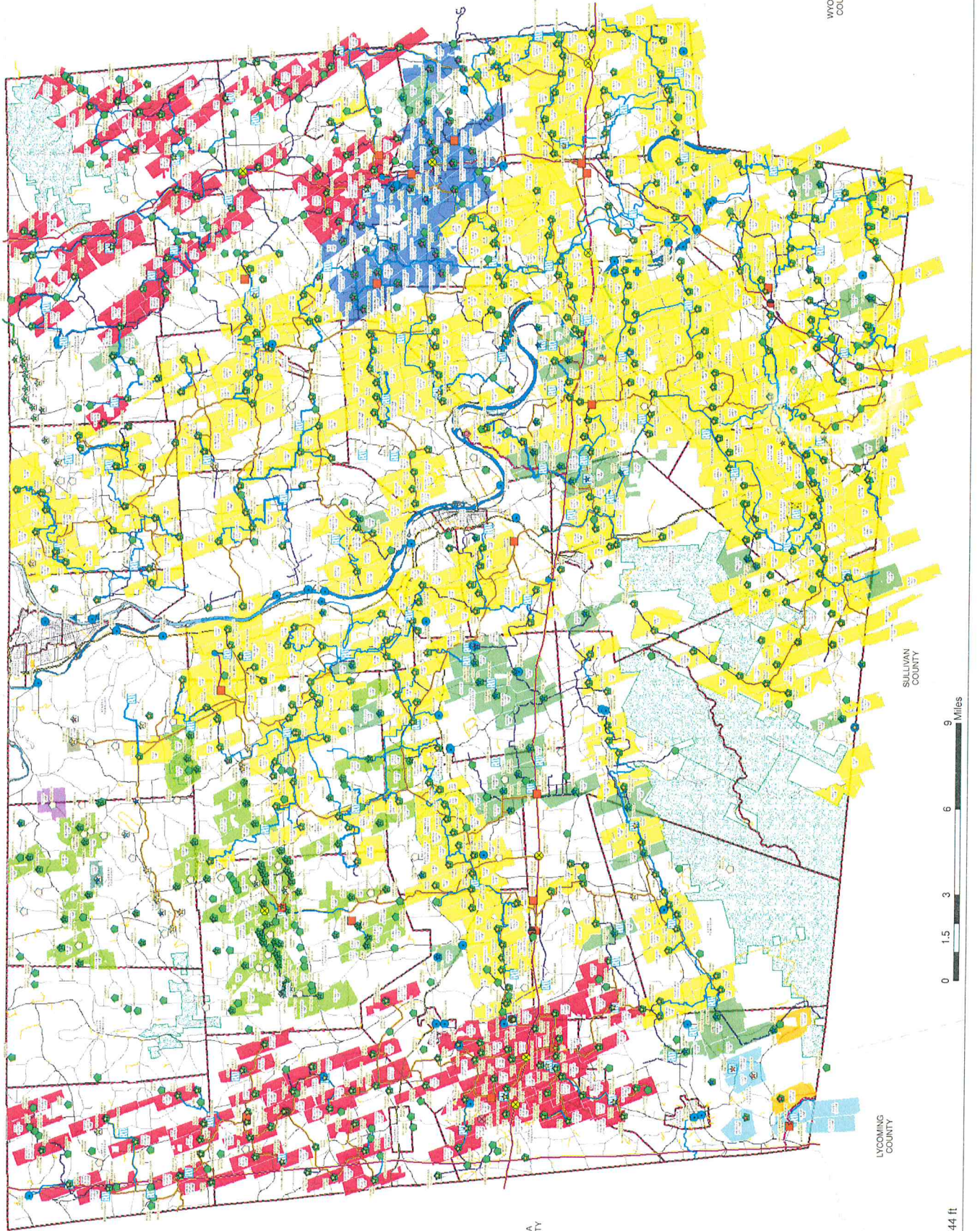
(15) BUILT (6) PROPOSED



BRADFORD COUNTY OVERALL GAS ACTIVITY - MAY 2013

CHEMUNG COUNTY

BROOME COUNTY



Legend
 DEP Wells April 2013
ORGANIZATION
 * CHESTERFIELD AFFILIATES LLC
 * CHEF OIL & GAS LLC
 * CTNA ENERGY & GAS CO LLC
 * ENERVEST OIL LLC
 * EOG RESOURCES INC
 * RANGE RESOURCES AFFILIATES LLC
 * SOUTHWESTERN ENERGY PROD CO
 * SWEP
 * TALAMAN ENERGY USA INC
 * UNKNOWN OPI
 * WACO LLC

Bradford County Natural Gas Database
Feature Type
 HORIZONTAL GAS WELL
 VERTICAL GAS WELL
 COMMUNICATION TOWER
 COMPRESSOR STATION
 METER STATION
 SUBSTATION
 TAP LOCATION
 DEHYDRATOR
 GROUNDWATER WITHDRAWAL
 WATER INFILTRATION
 SURFACE WATER WITHDRAWAL
 WATER TRANSFER PAD
 WATER PUMP STATION
 WATER TREATMENT FACILITY
 WATER WITHDRAWAL
 TEMPORARY FLUIDS PROCESSING
 WATER/AIR STORAGE FACILITY
 NATURAL GAS POWER PLANT

Natural Gas Lines
 Waterlines
Line Type
 GATHERING - PROPOSED
 GATHERING - BUILT
 SERVICE - BUILT
 STORAGE - BUILT
 TRANSPORT - PROPOSED
 TRANSPORT - BUILT
 WELL LINE - PROPOSED
 WELL LINE - BUILT

Production Units
COMPANY NAME
 CHEF OIL & GAS
 BELDEN & BLAKE
 CHESTERFIELD AFFILIATES
 EOG
 SOUTHWESTERN ENERGY
 EAST RESOURCES
 FORTUNA ENERGY
 GREAT LAKES ENERGY PARTNERS
 RANGE RESOURCES
 SWEP
 WACO

State Game Lands



1 in = 6,744 ft



May 8, 2013

SUMMARY OF DEDUCTIONS

<u>Land Owner</u>	<u>Total Gross</u>	<u>Net</u>	<u>Deductions*</u>	<u>% Deduction</u>	<u>12.5% Lease Yield</u>
#1	\$ 4,906.	\$1,069.	\$3,837.	78.21%	2.72%
#2	496.	82.	414.	83.39%	2.08%
#3	6,476.	5,292.	1,184.	18.28%	10.22%
#4	1,357.	338.	1,019.	75.10%	3.11%
#5	11,909.	7,963.	3,946.	33.13%	8.36%
#6	1,163.	144.	1,019.	87.64%	1.55%
#7	757.	89.	668.	88.22%	1.47%

Compiled from eight different production units

*No deductions for back-up withholding (Federal Income Tax)