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Pennsylvania Court Issues First Decision Interpreting the Pennsylvania Minimum Royalty Act

In a first-impression decision consistent with the position of oil-and-gas operators in dozens of pending state and federal cases, a Pennsylvania state court has concluded that the Pennsylvania “Minimum Royalty Act,” 58 P.S. § 33, does not preclude lessees from deducting a landowner’s share of “post-production” costs before paying royalties where the lease allows such a deduction.

Over the past year, numerous landowners in Pennsylvania have sued their oil-and-gas lessees claiming that “post-production” deductions in a lease violate the Minimum Royalty Act. The Act guarantees landowners at least a one-eighth royalty on oil or gas removed or recovered from their property, but it is notably silent on “post-production” deductions. Many leases, like the one involved in *Kilmer v. Elexco Land Services, Inc., and Southwestern Energy Production Company*, No. 2008-57 (Susquehanna Co.), allow for a deduction of post-production costs in calculating the royalty payable to the landowner.

The view offered by defendant natural-gas producers is that, while the Act guarantees a one-eighth royalty measured at the wellhead without deducting any “production” costs, it does not speak to any potential allocation of post-production expenses, and producers and lessors are free to contract with respect to those post-production expenses.

In *Kilmer*, plaintiffs and defendants filed cross-motions for summary judgment regarding the issue of whether the Act precludes lessors from deducting post-production costs from royalty payments where the lease clearly provided for such a deduction. On March 3, 2009, the Honorable Brendan J. Vanston of the Court of Common Pleas of Wyoming County, Pennsylvania (specially sitting in Susquehanna County) granted defendants’ motion, denied plaintiffs’ motion and concluded that the Minimum Royalty Act “does not preclude parties from contracting that ‘post-production’ costs be factored into the determination of the amount of royalty payable under [an] oil or gas lease”

Judge Vanston agreed with the position advanced by K&L Gates lawyers on behalf of lessees in this and dozens of other pending cases in Pennsylvania state and federal courts regarding the proper interpretation of the Minimum Royalty Act.¹ The order in *Kilmer* is the first from any court in Pennsylvania on this issue, and it will likely lead to the first appellate review of the issue.

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Judge Vanston did not write an accompanying opinion.

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