

JAN 28 2020

SUPREME COURT OF PENNSYLVANIA

PENNSYLVANIA ENVIRONMENTAL :
DEFENSE FOUNDATION, :
Appellant :

v. :

No. 64 MAP 2019

COMMONWEALTH OF :
PENNSYLVANIA and Governor of PA, :
TOM WOLF, in his official capacity as :
GOVERNOR OF PENNSYLVANIA, :
Appellees :

PENNSYLVANIA ENVIRONMENTAL DEFENSE FOUNDATION
APPELLANT BRIEF

*Appeal from the order of the Commonwealth Court dated July 29, 2019
at No. 228 MD 2012*

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Received in Supreme Court

JAN 28 2019

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REPRODUCED RECORD

VOLUME ONE

Appellant's Exhibit A, Affidavit of John Quigley (with attachments)

Appellant's Exhibit B, State Forest Oil and Gas Lease dated January 8, 2009
(without attachments)

Appellant's Exhibit C, State Forest Oil and Gas Lease dated January 20, 2010
(without attachments)

Appellant's Exhibit D, State Forest Oil and Gas Lease dated May 10, 2010
(without attachments)

Appellant's Exhibit E, Streambed Oil and Gas Lease dated February 16, 2013
(without attachments)

VOLUME TWO

Appellees' Exhibit A, Affidavit of John Norbeck

Appellees' Exhibit B, Deposition of Daniel Devlin

Appellees' Exhibit C, Deposition of Stacie Amsler

I. STATEMENT OF JURISDICTION

The Pennsylvania Environmental Defense Foundation (“PEDF”) filed this case in Commonwealth Court under its original jurisdiction seeking relief under the Declaratory Judgments Act, 42 Pa.C.S. §§ 7531 – 7541. On July 29, 2019, the Commonwealth Court issued an opinion and final order on matters pending before it in this case. *PEDF v. Commonwealth*, 214 A.3d 748 (Pa. Cmwlth. 2019) (“*PEDF III*”) (copy attached hereto). Pursuant to 42 Pa.C.S. § 723(a), the Supreme Court has exclusive jurisdiction over this appeal of the final order issued by the Commonwealth Court under the Declaratory Judgments Act, 42 Pa.C.S. § 7532.

II. ORDER IN QUESTION

The text of the Commonwealth Court order denying PEDF’s application for summary relief, as Petitioner, and from which this appeal is taken (see attached copy) states:

AND NOW, this 29th day of July, 2019, Respondents’ application for summary relief is hereby GRANTED, and Petitioner’s application for summary relief is DENIED in accordance with the foregoing opinion.

III. SCOPE AND STANDARD OF REVIEW

This case is returning to this Honorable Court for a second time following this Court’s partial remand to the Commonwealth Court in 2017 to determine the constitutionality under the trust provisions of Article I, Section 27 of the Pennsylvania Constitution (“Article I, § 27” or “Section 27”) of the

Commonwealth's transfers of certain payments made under contracts for the extraction and sale of oil and gas on our State Forests – Section 27 trust assets – from the Oil and Gas Lease Fund to the General Fund to pay for general government operations. These transfers were mandated by Sections 1604-E and 1605-E of the Fiscal Code¹ and Section 1912 of the Supplemental General Appropriations Act of 2009.² As challenges to the constitutionality of statutes present pure questions of law, this Court's "standard of review is de novo, and [its] scope of review is plenary." *PEDF v. Commonwealth*, 161 A.3d 911, 929 (Pa. 2017) ("*PEDF II*").

This Court has established that when reviewing the constitutionality of Commonwealth actions under Article I, § 27, the proper standard of judicial review "lies in the text of Article I, Section 27 itself as well as the underlying principles of Pennsylvania trust law in effect at the time of its enactment." *Id.* at 930. In reviewing the Commonwealth Court's decision to grant summary relief in this case, this Court "may grant relief only if no material questions of fact exist and the right to relief is clear." *Id.* at 929 (citing *Jubelirer v. Rendell*, 953 A.2d 514, 521 (Pa. 2008)).

¹ 72 P.S. §§ 1604-E and 1605-E (directing, respectively, the transfer of \$60,000,000 in fiscal year 2009-2010 and \$180,000,000 in fiscal year 2010-2011 from the Oil and Gas Lease Fund to the General Fund). The funds transferred were primarily bonus payments made in 2009 and 2010 to obtain new oil and gas leases on various State Forest tracts. Note that Section 1605-E(b) also directed the transfer of an additional \$95,000,000 in fiscal year 2014-2015 from the Oil and Gas Lease Fund to the General Fund, but the sale of new State Forest oil and gas leases to generate bonus payments for this transfer did not occur.

² Act of October 9, 2009, P.L. 779, No. 10A, § 1912 ("The sum of \$143,000,000 is transferred from the Oil and Gas Lease Fund to the General Fund.")

In reviewing the Commonwealth Court's denial of PEDF's application for summary relief, this Court must consider the evidence in the light most favorable to the non-moving party and resolve all doubts as to the existence of a genuine issue of material fact against the moving party. *The Hospital & Healthsystem Ass'n of Pa. v. Commonwealth*, 77 A.3d 587, 602 (Pa. 2013). A fact is considered material if its resolution could affect the outcome of the case under the governing law. *Id.* This Court is not constrained by the Commonwealth Court's reasoning and may make its decision on any grounds, as long as the record supports the judgment. *Robinson Twp. v. Commonwealth*, 83 A.3d 901, 943 (Pa. 2013).

IV. STATEMENT OF QUESTIONS INVOLVED

1. Are payments other than royalties made under leases entered into by the Pennsylvania Department of Conservation and Natural Resources ("DCNR") consideration for activities necessary to permanently sever oil and gas from our State Forest and therefore part of the corpus of the public trust under Article I, § 27?

Appellant's Answer: Yes.

2. If not payment for the purchase of State Forest oil and gas, can payments made under the State Forest oil and gas leases still be part of the corpus of the public trust under Article I, § 27?

Appellant's Answer: Yes.

3. Did the Commonwealth Court err in concluding that one third of bonus and rental payments made under State Forest oil and gas leases can be transferred to the General Fund because:

a. These payments are solely for oil and gas exploration on our State Forest, not for the extraction and sale of the oil and gas;

b. The payments are not refundable;

c. Section 27 beneficiaries can be characterized as life tenants entitled to income and remaindermen;

d. DCNR has authority under the Conservation and Natural Resources Act (“CNRA”), 71 P.S. §§ 1340.302(a), to enter into leases of State Forest land for oil and gas extraction and sale;

e. Section 9 of the Principal and Income Act of 1947³ applies to the bonus and rental payments;

f. Lease payments designated as income can be used by the Commonwealth for general government operations, so the legislative actions mandating the transfer of \$383,000,000 in bonus payments to the General Fund are not facially unconstitutional; and

³ Act of July 5, 1947, P.L. 1283, as amended; formerly 20 P.S. §§ 3470.1 – 3740.15.

g. Section 27 allows the sale of trust assets to provide income to the Commonwealth to achieve an equitable balance between conserving our natural resources and providing income from the sale of those resources.

Appellant's Answer: Yes.

4. Are Sections 1604-E and 1605-E of the Fiscal Code and Section 1912 of the Supplemental General Appropriations Act of 2009, which transferred \$383,000,000 from the Oil and Gas Lease Fund to the General Fund, facially unconstitutional?

Appellant's Answer: Yes.

V. STATEMENT OF THE CASE

This Honorable Court has articulated the factual and procedural background of this case in its decision in the prior appeal. *See PEDF II*, 161 A.3d at 920-925. In that appeal, this Court vacated in its entirety the Commonwealth Court's order of January 7, 2015⁴ granting summary relief to the Commonwealth and denying PEDF's application for summary relief by reversing in part and remanding in part. *Id.* at 916.

As part of the remand, this Court articulated two specific questions to be answered by the Commonwealth Court. In discussing the first remand question, this Court states that:

⁴ *PEDF v. Commonwealth*, 108 A.3d 140 (Pa. Cmwlth. 2015) ("*PEDF I*").

the record on appeal is undeveloped regarding the purpose of up-front bonus payments, and thus no factual basis exists on which to determine how to categorize this revenue. While we recognize that the leases designate these payments, among others, as “rental payments,” such a classification does not shed any light on *the true purpose of the payment*, e.g., rental of a leasehold interest in the land, payment for the natural gas extracted, or some other purpose.

Id. at 935 (emphasis added). This Court instructed that:

On remand, the parties should be given the opportunity to develop arguments concerning *the proper classification, pursuant to trust law, of any payments called “rental payments” under the lease terms. To the extent such payments are consideration for the oil and gas that is extracted, they are proceeds from the sale of trust principal and remain in the corpus.* These proceeds remain in the trust and must be devoted to the conservation and maintenance of our public natural resources, consistent with the plain language of Section 27.

Id. at 936 (emphasis added).

In discussing the second question to be addressed on remand, this Court directed:

In construing Sections 1604-E and 1605-E, to the extent that the lease agreements reflect the generation of *revenue streams for amounts other than for the purchase of the oil and gas extracted*, it is up to the Commonwealth Court, in the first instance and in strict accordance and fidelity to Pennsylvania trust principles, to determine whether these funds belong to the corpus of the section 27 trust. In this regard, it must be remembered that the oil and gas leases may not be drafted in ways that remove assets from the corpus of the trust or otherwise deprive the trust beneficiaries (the people, including future generations) of the funds necessary to conserve and maintain the public natural resources.

Id. at 935-936 (emphasis added).

VI. SUMMARY OF THE ARGUMENT

In *PEDF II*, this Honorable Court determined that royalties paid under State Forest oil and gas leases are part of the corpus of the public trust established by Article I, § 27, and that Sections 1602-E and 1603-E of the Fiscal Code were facially unconstitutional because they directed the use of these royalties for non-trust purposes. This Court partially remanded the case to the Commonwealth Court to determine whether other payments made under the State Forest oil and gas leases were part of the corpus of the Section 27 trust. If so, transfers of such payments to the General Fund mandated by Sections 1604-E and 1605-E of the Fiscal Code and Section 1921 of the Supplement General Appropriations Act of 2009 would also be facially unconstitutional.

In evaluating these issues, this Court directed the Commonwealth Court to determine (1) the true purpose of “bonus” payments paid when the leases are executed and annual per-acre payments (referred to as rental payments) made prior to the generation of royalties; and (2) whether these payments, if not directly for the purchase of the oil and gas extracted, are nonetheless part of the corpus of the Section 27 trust.

As the State Forest oil and gas leases clearly and unequivocally state, the intent is to allow the lessee to enter State Forest land for the specific purposes of finding, extracting, removing and transporting the oil and natural gas to market for

sale. The bonus and rental payments are consideration paid for entering the State Forest lands to conduct all these activities, the purpose of which is to permanently sever the oil and natural gas from the State Forest and the corpus of the Section 27 trust. These activities are necessary to accomplish the purchase and sale of those trust assets.

The Commonwealth Court asserts in *PEDF III* that these payments are only for exploration because the Commonwealth retains these payments under the terms of the State Forest oil and gas leases even if lessees fail to produce any oil or gas. But nothing in the leases, contract law or Section 27 trust law supports this assertion. 214 A.3d at 773.

In denying PEDF's application for summary relief, the Commonwealth Court concluded that one third of the bonus and rental payments made under State Forest oil and gas leases are income and not part of the corpus of the Article I, § 27 trust, and can be distributed under the terms of Section 9 of Principal and Income Act of 1947. Therefore, Sections 1604-E and 1605-E of the Fiscal Code and Section 1912 of the Supplemental General Appropriations Act of 2009 transferring these funds to the General Fund are not facially unconstitutional under Article I, § 27. *Id.* at 774.

Rather than reviewing the true purposes of the bonus and annual rental payments made under the State Forest oil and gas leases, the trust purposes under Section 27, or the trust principles enunciated by this Court in *PEDF II* to determine

how to characterize bonus and rental payments, as directed by this Court, the Commonwealth Court applies common law cases and statutes governing trusts established for the specific purpose of *providing income* from property held in trust. The Commonwealth Court determined that the trust principle to be applied is Section 9 of the Principal and Income Act of 1947, and construed this provision to allow one third of bonus and rental payments to be income that can be used by the Commonwealth for non-trust purposes, with the other two thirds remaining as part of the Section 27 trust corpus.

In order to bring bonus and rental payments under the purview of the Principal and Income Act of 1947, the Commonwealth Court characterizes the current generation of beneficiaries of the Section 27 public trust as life tenants entitled to income for non-trust purposes, without any analysis of Article I, § 27 or its purposes, which clearly do not support this characterization.

The beneficiaries under Section 27 are all the people of the Commonwealth, including future generations. These beneficiaries, under the second sentence of Section 27, are the common property owners of the public natural resources, the corpus of the trust. Their interests are in common with all the people both alive today and future generations.

The common law cases and statutes relied on by the Commonwealth Court concern trusts and estates that specifically authorize the trustee to provide the life

tenant with income from the trust corpus. They apply only if the settlor or testator specifically authorized the trustee to lease or sell the natural resources for income for the life beneficiaries.

The Commonwealth Court asserts that DCNR's statutory authority under the Conservation and Natural Resources Act to lease State Forest land for oil and gas extraction and sale provides authority for the Commonwealth, as trustee under Article I, § 27, to lease and sell oil and natural gas on our State Forest to generate income as part of the purposes of the Section 27 trust. A statute cannot redefine the purposes of the Section 27 public trust. A statute cannot give the Commonwealth the authority as trustee to use the corpus of the trust established by the Pennsylvania Constitution in a manner not authorized by the Constitution.

The Commonwealth Court concludes, without any examination of the Commonwealth's fiduciary duties under Article I, § 27, that one third of the bonus and rental payments should be characterized as income that the Commonwealth can use for its own non-trust purposes rather than the purposes established by the Section 27 trust, *i.e.*, conserving and maintaining our public natural resources. As a result, the Commonwealth Court concludes that Sections 1604-E and 1605-E of the Fiscal Code and Section 1912 of the Supplemental General Appropriations Act of 2009 are not facially unconstitutional.

The real purpose for the Commonwealth Court asserting that the relevant “trust principle” governing the use of bonus and rental payments is the Principal and Interest Act of 1947 becomes clear at the conclusion of the court’s opinion. The Commonwealth Court states that selling Section 27 trust assets to generate income for the Commonwealth achieves an “equitable balance” between the current and future generations of Pennsylvanians that fulfills the purpose of Article I, § 27.

The Commonwealth Court is thus attempting to add a new purpose to Article I, § 27, that of creating income for the Commonwealth from our public natural resources. This “new” purpose is completely counter to what the people of Pennsylvania intended in amending their Constitution to include Article I, § 27. They intended to stop the use of our public natural resources to make money, which had resulted in a legacy of degradation. Instead, our public natural resources are to be conserved and maintained.

PEDF respectfully requests that this Honorable Court find and declare that the bonus and rental payments received from State Forest oil and gas leases must remain in their entirety as part of the corpus of the Section 27 trust and used for trust purposes; and that Sections 1604-E and 1605-E of the Fiscal Code and Section 1912 of the Supplemental General Appropriations Act of 2009 are facially unconstitutional.

VII. ARGUMENT

A. THE TRUE PURPOSE OF BONUS AND RENTAL PAYMENTS IS TO PROVIDE CONSIDERATION FOR THE EXTRACTION, TRANSPORTATION AND REMOVAL OF OUR STATE FOREST OIL AND NATURAL GAS FOR SALE

This Honorable Court's direction to the Commonwealth Court as part of the remand in *PEDF II* was to give the parties the "opportunity to develop arguments concerning the proper classification, pursuant to trust law, of any payments called "rental" payments *under the terms of the leases*". This Court stated that "[w]hile we recognize that the leases designate these payments, among others, as 'rental payments,' such a classification does not shed light on the *true purpose of the payments*" 161 A.3d at 935-936 (emphasis added).

To determine the true purpose of those payments, the Commonwealth Court had to first look to the intent of the parties as set forth in the State Forest oil and gas leases themselves, which are contracts "controlled by the principles of contract law." *T.W. Phillips Gas & Oil Co. v. Jedlicka*, 42 A.3d 261, 267 (Pa. 2012); *Hutchinson v. Sunbeam Coal*, 519 A.2d 385, 389 (Pa. 1986). The fundamental rule in interpreting the meaning of a contract "is to ascertain and give effect to the intent of the contracting parties." *Murphy v. Duquesne University of The Holy Ghost*, 777 A.2d 418, 429 (Pa. 2001) (citing *Felte v. White*, 302 A.2d 347, 351 (Pa. 1973)). The intent of the parties to a written agreement "is to be regarded as being embodied in the writing itself." *Id.* (citing *Steuart v. McChesney*, 444 A.2d 659, 661 (Pa. 1982)).

The whole instrument must be taken together in arriving at contractual intent. *Id.* When a writing is clear and unequivocal, its meaning must be determined by its contents alone. *Id.* (quoting *Felte*, 302 A.2d at 351, and *East Crossroads Center Inc. v. Mellon Stuart Co.*, 205 A.2d 865, 866 (Pa. 1965)).

The terms of the DCNR leases entered into between 2009 and 2010, specifically define the purposes of the lease:

Department hereby leases to the Lessee all that certain tract of land known as ... the “leased premises,” *for the sole purposes of* (1) exploring, drilling, operating, producing, and removing of oil, gas and liquid hydrocarbons; and (2) at locations approved by the Department, laying pipelines and constructing roads, tanks, towers, stations, and structures thereon to produce, save, take care of, and transport extracted products.

DCNR Contract No. M-110001-15, State Forest Tract No. 001, January 20, 2010, § 1.01, **Appellant’s Exhibit C** (emphasis added); *see also* DCNR Contract No. M-110728-12, State Forest Tract No. 728, January 8, 2009, **Appellant’s Exhibit B**; DCNR Contract No. M-110002-10, May 10, 2010, § 1.01, **Appellant’s Exhibit D**.⁵

⁵ These exhibits are examples of the State Forest oil and gas leases entered into by DCNR in January 2009, January 2010 and May 2010 for its three State Forest lease sale; PEDF filed these same exhibits as part of its application for summary relief in Commonwealth Court.

Note that DCNR also receives bonus and rental payments when it enters into leases for the extraction and sale of oil and gas leases beneath publicly-owned streambed. DCNR similarly states that the purpose of such contracts is as follows:

The Department hereby leases to Lessee all that certain tract of land ... referred to hereinafter as the “leased premises,” *for the sole purposes of* directionally drilling wells for the production and removal of oil, gas and liquid hydrocarbons beneath the leased premises. This lease does not grant any right to withdraw water from or otherwise use the surface of the leased premises;

John Quigley, the DCNR Secretary at the time the when the 2010 State Forest oil and gas leases were executed, explains that the “bonus bid was designed to reflect the partial or potential value of the natural gas that would be extracted. The competitive ‘bonus bid’ component of the process was the basis upon which DCNR awarded the leases and granted access to the state forest for the purpose of extracting the publicly-owned natural gas resources.” Affidavit of John Quigley, **Appellant’s Exhibit A**, page 1-2. The payments made under the State Forest oil and gas leases are consideration for the clear and unequivocal purpose stated in the lease – to engage in the activities necessary to remove oil and gas from the State Forest so these trust assets can be sold.

Based on two State Forest lease sales completed via a competitive, sealed bid process, DCNR executed oil and gas leases in January 2009 and January 2010 with the companies that offered the highest bonus payments on the State Forest tracts offered for oil and gas extraction and sale. *Id.* DCNR then negotiated the bonus amount to be paid for oil and gas leases on additional State Forest tracts executed in May 2010. *Id.* Bonus payments for these leases were made when the leases were executed and deposited into the Oil and Gas Lease Fund consistent with the Oil and

DCNR Contract No. M-2102004, Streambed Tract No. 2004, February 15, 2013, § 1.01, **Appellant’s Exhibit E**, as an example of this type of lease; this was also an exhibit filed by PEDF in Commonwealth Court.

Gas Lease Fund Act.⁶ *Id.* Bonus payments totaling \$383 million were then transferred from the Oil and Gas Lease Fund to the General Fund via Fiscal Code and Supplemental General Appropriations Act provisions enacted in 2009 and 2010.

Id.

The bonus payments made under the 2009 and 2010 State Forest oil and gas leases also constituted the “rental” payment for the first year of the lease. *Id.*; *see also Appellant’s Exhibits B, C and D, § 3 (Rental).* The first-year bonus “rental” payment, as well as subsequent annual “rental” payments due on acreage not yet generating royalty payments from actual oil or gas production, secure the lessee’s continued right to commence oil or gas extraction on that acreage for another year. **Appellant’s Exhibits B, C and D, § 3.** These annual “rental” payments are no longer due on acreage that is producing oil or gas in paying quantities (*i.e.*, generating royalty payments). *Id.* When entering into an oil and gas lease for State forest land, a lessee agrees to make these fixed advance payments to the Commonwealth, as well as the royalty payments due when production commences, based on its assessment of the cost to produce oil and gas from the leased acreage and the anticipated market value of the oil and gas to be produced and delivered for sale.⁷

⁶ Act of December 15, 1955, P.L. 865, No. 256 (formerly 71 P.S. §§ 1331-1333), repealed by Section 20 of the Act of October 30, 2017, P.L. 725, No. 44.

⁷ DCNR’s leasing process is similar to the framework used by the Federal government to issue oil and gas leases. The purpose of the bonus bid has most recently been described in Section 10.3.2.1 (Minimum Bid and Bonus Bid Amounts) of the 2019-2024 National Outer Continental Shelf Oil and Gas Leasing Draft Proposed Program published by the U.S. Department of Interior on January

While the term of 2009 and 2010 State Forest oil and gas leases is ten (10) years, the lease “shall continue from year-to-year thereafter so long as oil or gas is produced in paying quantities from the leased premises, ... or as long as Lessee demonstrates to the Department’s satisfaction bona fide attempts to secure or restore the production of oil and gas by conducting drilling, or reworking operations on the leased premises.” *Id.*, § 1 (Lease Term). The lessee must “commence a well” on the leased State Forest acreage within five (5) years of the effective date of the lease and must proceed with “due diligence” to complete that well or the lease may automatically terminate in its entirety. *Id.* § 20 (First Well). The lessee may surrender acreage available under the lease for oil and gas extraction and sale, which

4, 2018 (the “DOI Report”) available at <https://www.boem.gov/NP-Draft-Proposed-Program-2019-2024/>. A bonus bid is described as follows:

For many years, the bid variable of the auction has been the bonus bid. This signature bonus is a cash payment required at the time of lease execution. A bonus bid is formulated by the bidder based on its perception of the expected profit, net of other payments ... The bonus bid is paid at the outset regardless of future activity or production, if any, so the lessee bears the risk of paying more than the lease is eventually worth, while the government bears the risk of accepting less than it is eventually worth. In contrast, the royalty has neither risk because it is based on actual production. A fiscal advantage of the bonus is that it is received by the government immediately; there is no delay of, possibly, a decade or more as with the royalty.

The DOI Report describes rental payments as follows:

Rental payments serve to discourage lessees from purchasing marginally valued tracts too soon since companies are hesitant to pay the annual holding cost to keep a low-valued or currently uneconomic leases in their inventory. Rental payments provide an incentive for the lessee to either drill the lease in a timely manner or relinquish it before the end of the initial lease period, thereby giving other market participants an opportunity to acquire these blocks in a more timely fashion.

would release the lessee from the obligation to make future annual “rental” payments for that acreage. *Id.*, § 35 (Lessee’s Termination).

The bonus and rental payments are the express consideration paid for the right to enter upon the State Forest to extract and remove the oil and natural gas so that it can be purchased. Consideration is defined as “a benefit to the party promising, or a loss or detriment to the party to whom the promise is made.” *Stelmach v. Glen Alden Coal Company*, 14 A.2d 127, 128 (Pa. 1940) (quoting *Hillcrest Foundation, Inc. v. McFeaters*, 2 A.775,778 (Pa. 1938), which cites *Williston on Contracts* (revised edition) Vol. 1, § 103C. The lessee paid the bonus and rental payments to be allowed to exercise the exclusive right to extract, remove and transport the oil and natural gas from our State Forest for the purpose of purchase.

Part of the Corpus of the Section 27 Trust

Activities such as extracting, moving, and transporting oil and natural gas all permanently sever those natural resources from the State Forest. The parties to the leases clearly intended for the bonus and rental payments to allow these permanent changes to be made to the trust assets. Pennsylvania trust law dictates that proceeds from the sale of trust assets are trust principal and remain part of the corpus of the trust. *PEDF II*, 161 A.3d at 935 (citing *McKeown’s Estate*, 106 A. 189, 190 (Pa. 1919)). When a trust asset is removed from the trust, all revenue received in exchange for the trust asset is returned to the trust as part of the corpus. *Id.* (citing

Bolton v. Stillwagon, 190 A.2d 105, 109 (Pa. 1963)). Based on these principles, the Supreme Court concluded that royalties paid under State Forest oil and gas leases “are unequivocally proceeds from the sale of oil and gas resources.” *Id.* As such, “[t]hey are part of the corpus of the trust and the Commonwealth must manage them pursuant to its duties as trustee.” *Id.* The extraction, transportation and removal of the oil and gas from our State Forest are integral to the sale of those resources. They are actions necessary for the ultimate purchase of those resources to occur.

At the time DCNR accepts the money from the lessee for the bonus payments, those payments are deposited into the Oil and Gas Lease Fund. *PEDF III*, 214 A.3d at 773. The intent of DCNR in receiving and depositing the payments is to immediately allow the lessee to enter State Forest lands for the sole purpose of exploration, extraction and removal of the oil and natural gas. **Appellant’s Exhibit A, B, C, D.**

This Court specifically held in *In re Bruner’s Will*, 70 A.2d 222 (Pa. 1950), that an oil and gas lease is intended for the removal of all the oil and natural gas and affirmed that all payments made under the oil and gas leases at issue, which included a bonus payment, receipts for the sale of oil produced and a payment for the assignment of the lease, were all principal remaining as part of the corpus of the trust, stating:

In reality, the *lease contemplates removal of all the oil and is in effect a sale*, with payment to be made as the mineral is removed. Obviously,

it was a sale of part of the principal of the trust and properly the moneys received therefrom belonged to the corpus.

70 A.2d at 225 (emphasis added).

The intent of the State Forest oil and gas leases in this case is to grant the lessee the right to enter the State Forest land solely to find, extract, and transport the oil and natural gas to market for sale in consideration of the bonus and annual rental payments. As this Court states in *PEDF II*, “[w]hen a trust asset is removed from the trust, all revenue received in exchange for the trust asset is returned to the trust as part of its corpus.” 161 A.3d at 935. Whether the form of the money received from the State Forest oil and gas leases is denominated bonus, annual rental or royalty, it is money from the conversion of a trust asset “impressed with a trust” that must be administered solely in the interest of the beneficiaries. *Bolton*, 190 A.2d at 109.

“Rental” and “bonus rental” are not defined terms in the State Forest oil and gas leases. When oil or gas is produced from the State Forest tract subject to the lease, the annual rental payments stop and royalty payments, based on the amount of oil or gas produced, takes their place. **Appellant’s Exhibits B, C and D**, § 3.03. The rental payments and the royalty payments are all directed toward the same purpose, to extract and sell the oil and natural gas, which severs those natural resources from the land.

If no oil or gas is actually found and removed, that does not change the intent of the parties or the purposes of the leases and the payments made thereunder at the

time of entering into the lease. At the time DCNR accepts the bonus and rental payments from the lessee, those payments are deposited into the Oil and Gas Lease Fund and the lessee immediately has the right to engage in activities to sever oil and gas from the State Forest.

The determination that the bonus and rental payments are to be treated the same as the royalty payments is supported by the long history of the extraction and sale of the oil and gas from our State Forests. The term “rent” in relation to the leasing of State Forest land for oil and gas extraction was used in the Oil and Gas Lease Fund Act enacted in 1955, which governed use of the Oil and Gas Lease Fund for more than 60 years – until the actions in this case led to its repeal in 2017. Section 1 of the Oil and Gas Lease Fund Act required that “[a]ll rents and royalties from oil and gas leases” of State Forest land (and certain other land owned by the Commonwealth) be deposited into the “Oil and Gas Lease Fund” to be “exclusively used for conservation, recreation, dams or flood control” purposes. Act of December 15, 1955, P.L. 865, No. 256, § 1 (copy attached to **Appellant’s Exhibit A**). Under Section 3 of the Oil and Gas Lease Fund Act, “[a]ll the moneys from time to time paid into the ‘Oil and Gas Lease Fund’ are specifically appropriated to [DCNR] to carry out the purposes of this act.” *Id.*, § 3. Thus, historically, up to the repeal of the Oil and Gas Lease Fund Act, both bonus and rental payments went into the fund to

be used by DCNR for to be able to meet its mission, conserving and maintaining the State forest. **Appellant's Exhibit A.**

With the adoption of Section 27 in 1971, the people of Pennsylvania made it clear that the Commonwealth must manage our State Parks and Forests as a trustee, not as a proprietor. Likewise, the Commonwealth must conserve and maintain our State Parks and Forest, including the oil, gas and other minerals found on these public lands, for the benefit of both current and future generations. When the Conservation and Natural Resources Act was enacted in 1995, DCNR was again authorized to lease our State Park and Forest land for the removal and sale of oil, gas and other minerals, but DCNR could only do so when consistent with its duties as trustee under Section 27 to conserve and maintain our State Parks and Forests for the benefit of current and future generations.

Nothing in a DCNR oil and gas lease gives the lessees the type of possessory interest in the State Forest land subject to the lease typically associated with rent (*e.g.*, when DCNR rents a cabin, camp site or picnic pavilion, the person renting those premises obtains exclusive possession). Section 23.01 of the State Forest oil and gas lease, entitled "Drilling Restrictions", states that "[u]nder the Department's multiple use policy, the surface and other portions of the leased premises are continuously used for recreation, conservation and other purposes, and many other Department-authorized activities may be in progress on the lands. Hence, Lessee

shall conduct its operations so as to minimize interference with the other Department-authorized activities on these State Forest lands....” **Appellant’s Exhibits B, C and D**, § 23.01. Thus, the lessee clearly does not have the right to exclusive use of the State Forest land subject to the lease.

Under Section 38 of the leases, entitled “Rights Reserved By Department”, Section 38.01 states, “Department reserves the right to use the leased premises in any and all respects not specifically limited by the terms of this lease.” *Id.*, § 38. Again, the lease expressly states that the lessee’s use of the State Forest land is not exclusive and only provides access for the specific purposes stated in the lease.

The Section 1.02 of the leases, their term is ten (10) years but if the initial well is drilled within the time required and oil or gas is produced, the lease “shall continue from year-to-year thereafter so long as oil or gas is produced in paying quantities from the leased premises,...or as long as Lessee demonstrates to the Department’s satisfaction bona fide attempts to secure or restore the production of oil and gas by conducting drilling, or reworking operations on the lease premises.” *Id.*, § 1.02. Again, the lessee’s use of the State Forest under this lease provision is limited to solely producing the oil and natural gas.

Wherefore, PEDF respectfully requests this Honorable Court to declare that the true purpose of the bonus and annual rental payments under the State Forest oil and gas leases is to provide consideration for the permanent severance of oil and gas

from our State Forest and, therefore, to declare these payments to be part of the corpus of the public trust under Article I, § 27.

B. EVEN IF NOT FOR THE PURCHASE OF STATE FOREST OIL AND NATURAL GAS, BONUS AND RENTAL PAYMENTS MUST BE PART OF THE CORPUS OF THE CONSTITUTIONAL TRUST

In addition to directing the Commonwealth Court to determine the true purpose of the bonus and rental payment under the State Forest oil and gas leases, this Honorable Court directed the Commonwealth Court to answer a second, albeit related, question in *PEDF II*. This Court asked whether such payments are part of the corpus of the Section 27 public trust even if their purpose is not for the purchase of the oil and gas extracted.

Specifically, this Court stated that “[i]n construing 1604 –E and 1605-E [of the Fiscal Code], to the extent that the lease agreements reflect the generation of revenue streams *for amounts other than for the purchase of the oil and gas extracted*, it is up to the Commonwealth Court, in the first instance and in strict accordance and fidelity to the Pennsylvania trust principles, to determine whether these funds belong in the corpus of the Section 27 trust.” 161 A.3d at 935-936 (emphasis added). This Court continued, stating that “[i]n this regard, it must be remembered that the Commonwealth, as trustee, has the constitutional obligation to negotiate and structure leases in a manner consistent with its Article I Section 27 duties. Oil and gas leases may not be drafted in ways that remove assets from the

corpus of the trust or otherwise deprive the trust beneficiaries (the people, including future generations) of the funds necessary to conserve and maintain the public natural resources.” *Id.*

As discussed above, the true purpose of bonus and rental payments is to allow the lessee to permanently sever the trust assets, *i.e.*, the State Forest oil and gas, by extracting, removing and transporting them from the State Forest for sale. These activities all result in the severance of these assets from the trust. By not construing the payments for activities necessary to sever the oil and gas to be a part of the corpus of the public trust, the trust beneficiaries are deprived of the full value of the severed trust assets.

The Commonwealth, as trustee under Section 27, has no specific authority to lease or sell the corpus of the trust. The fact that the mineral resources are part of the corpus of the trust does not provide the trustees with either the right or the need to use those resources for any purpose outside of the purposes of the trust.

The leasing of our State Forest for the extraction and sale of oil and gas, by its very nature, degrades, diminishes and depletes the corpus of the Section 27 trust. Leases executed by DCNR for the express purpose of exploring, drilling, operating, producing, transporting and removing oil, gas and liquid hydrocarbons from the State Forest, and laying pipelines and constructing roads, tanks, towers, stations, and

structures on the State Forest to produce, save, take care of, and transport extracted products, does not conserve and maintain the trust corpus.

In this case, PEDF has not challenged DCNR's execution of the additional leases for the extraction and sale of oil and gas on our State Forest in 2009 and 2010. Rather, PEDF is challenging the failure to use the money paid under those leases to restore the corpus of the Section 27 public trust and the rights of the beneficiaries to those trust assets.

DCNR has drafted the terms of the State Forest oil and gas leases at issue here, including the requirements for payments made under those leases. Those terms must be construed in compliance with the purpose of the Section 27 trust, which is to conserve and maintain the corpus of the trust, in this case, the public natural resources of the State Forest, and the people's right to the clean air, pure water and the preservation of the natural, scenic, historic and esthetic values of our State Forest. That means that DCNR, as trustee, has the fiduciary duty to both prevent and to remedy any degradation, diminution or depletion of our State Forest public natural resources, and the rights of the beneficiaries thereto.

If the bonus and rental payments provisions in the State Forest oil and gas leases are construed to allow these payments to be removed from the corpus of the Section 27 trust, DCNR will lose the ability to use this money to restore the corpus of the trust – our State Forest – and Article I, § 27 will be violated.

DCNR's use of the terms "lease" and "rental" in drafting its contract for the extraction and sale of State Forest oil and gas does not reflect the true nature of the contract.⁸ DCNR does not grant a possessory leasehold interest in the State Forest land and the upfront and annual payments are required to ensure that the extraction and sale of oil and gas is diligently pursued, not to pay "rent" for a leasehold interest. As discussed above, the actual terms of the lease make this clear.

State Forest oil and gas leases should not be interpreted in a manner that renders the upfront and annual payments unconstitutional. As the Supreme Court instructed in *PEDF II*, DCNR, as the trustee of our State Forest public natural resources, has a constitutional obligation to negotiate and structure the State Forest oil and gas leases in a manner consistent with its Article I, § 27 duties. *Id.* at 936. "Oil and gas leases may not be drafted in ways that remove assets from the corpus of the trust or otherwise deprive the trust beneficiaries (the people, including future generations) of the funds necessary to conserve and maintain the public natural resources." *Id.*

DCNR needs the bonus and annual rental payments made under the State Forest oil and gas lease to meet its obligations to conserve and maintain the State

⁸ DCNR's contracts use historical terms rather than terms that accurately characterize the nature of the activity and rights given based on the fact that the State Forest and the oil and gas being sold are trust assets and DCNR has a fiduciary duties as trustee under Article I, § 27 to conserve and maintain these trust assets. The contract terms should be revised accordingly if it executes any future contracts for this activity.

Forest. As former DCNR Secretary Quigley has observed, “There are two categories of impacts that needed to be addressed from the mandated leasing activity. Both flow from DCNR’s mandate to conserve and maintain the publicly owned State forest and park systems. The first is DCNR’s capacity to meet its mission. That must be understood in the context of the second – the impacts of natural gas development on the public lands.” **Appellant’s Exhibit A**, page 2.

To allow DCNR to structure its State Forest oil and gas lease to remove assets from the corpus of the trust allows it to treat our State Forest public natural resources as a proprietor rather than a trustee in violation of Article I, § 27. *Id.* at 932 (“the Commonwealth may not act as a mere proprietor, pursuant to which it ‘deals at arms[’] length with its citizens, measuring its gains by the balance sheet profits and appreciation it realizes from its resources operations’” (quoting *Robinson Twp.*, 83 A.3d at 956)).

Pennsylvania’s public natural resources are the “common property” of the people, both those living today and future generations. Thus, the people declared their common ownership of the public natural resources of the Commonwealth through the plain language of Section 27 and directed the Commonwealth to serve as the trustee over these trust assets for the purpose of conserving and maintaining them for the benefit of both current and future generations. As this Court found in *PEDF II*, the legislative history of Section 27 explained the significance of this

common property ownership of the people, declaring the Commonwealth's interests to be the trustee of public natural resources and not the proprietor of those public natural resources. *Id.*

For DCNR, the trustee of our State Forest trust assets under the Section 27, to interpret the meaning of bonus and rental payments affecting our State Forest in the contract it drafted in a way that allows use of these payments for its own purposes would be self-dealing and a violation of its Section 27 fiduciary duties. Well-established trust principles in place at the time Section 27 was enacted (as well as current trust principles) strongly admonish self-dealing by a trustee. The people of Pennsylvania would have understood this important principle when they declared themselves to be the common owners of the public natural resources within the Commonwealth and assigned the government to the role of trustee, not proprietor, of the environmental trust they created through Section 27.

The Supreme Court describes the trustee's role in managing real estate assets held in trust in *Bolton, supra*, a case decided just a few years prior to the adoption of Section 27. In *Bolton*, a cemetery association managed a fund, as trustee, "for the perpetual care and preservation of the grounds and the repair and renewal of buildings and property connected with the cemetery." 190 A. 2d at 106. The cemetery association had invested money held in the fund in two real estate mortgages that became delinquent. Certain officers and directors of the cemetery

association subsequently acquired the real estate secured by these mortgages and obtained a mortgage from the cemetery association in the amount that the association had invested in these properties. *Id.* at 106-107. Upon making some improvements, the purchasers sold a portion of the real estate for their personal profit and obtained a release from the cemetery association of the mortgage on that portion of the real estate without paying any consideration to the association. *Id.*

The Supreme Court in *Bolton* found that the officers and directors of the cemetery association that purchased the real estate failed to recognize that they held the real estate as trustees for the beneficiaries of the perpetual care fund (the holders of cemetery lots). The Supreme Court describes the trustee duties as follows:

The assets of the perpetual care fund were held by the officers and directors as trustees for the association. Whether these assets were in the form of cash, mortgages, real estate or any other form, they were assets of the perpetual care fund and, as such, were impressed with a trust. 'Where the relation of trustee and cestui que trust has once been established as to certain property in the hands of the trustee, no mere change of trust property from one form to another will destroy the relation'. [] It is, therefore, our conclusion that the real estate purchased at judicial sale was held by the officers and directors of the association as trustees, and their duties and liabilities must be measured as such. 'The trustee is under a duty to the beneficiary to administer the trust *solely in the interest of the beneficiary*' Sec. 170, Restatement of Trusts 2d. (Emphasis supplied.) In the case at bar, there is no questioning the fact that appellees bought the real estate for the purpose of securing personal profits. This action clearly constituted a breach of their duty as trustees of the perpetual care fund.

Id. at 109 (citations omitted; emphasis in original).

The bonus and annual rental payments made under the State Forest oil and gas leases, even if not payment for the purchase of the oil and gas, are still “impressed with a trust” and not the property of the Commonwealth. The Commonwealth, as trustee, cannot use Section 27 trust assets for its own benefit. To allow the Commonwealth to enter into leases for the sale of our State Forest trust assets to generate advance payments that the Commonwealth can then use for its own benefit, violates the Commonwealth’s fiduciary duties to act solely in the interest of the trust beneficiaries. This duty mandates that the bonus and annual rental payments remain part of the corpus of the Section 27 trust and be used to conserve and maintain the people’s public natural resources.

WHEREFORE, for the reasons set forth above, PEDF respectfully request this Honorable Court to declare the bonus and annual rental payments under the State Forest oil and natural gas leases, even if not for the purchase of the oil and gas, remain part of the corpus of the Section 27 trust.

C. THE COMMONWEALTH COURT ERRED IN AUTHORIZING THE TRANSFER OF ONE THIRD OF BONUS AND RENTAL PAYMENTS TO THE GENERAL FUND

This Honorable Court in *PEDF II* provided instruction on the proper standard of review and principles under Article I, § 27 that should guide review of the issues on remand, stating:

When reviewing challenges to the constitutionality of Commonwealth actions under the trust provisions of Section 27, the proper standard of

judicial review lies in the *text of Article I Section 27 itself* as well as the *underlying principles of trust law* in effect at the time of its enactment. [A court] must therefore carefully examine the contours of [Article I, § 27] to identify the rights of the people and the obligations of the Commonwealth guaranteed thereunder.

161 A.3d at 930 (emphasis added).

With respect to the guiding principles to be applied under Article I, § 27, this Court established that the third clause of Section 27 “establishes a public trust, pursuant to which the natural resources are the corpus of the trust, the Commonwealth[] is the trustee, and the people are the named beneficiaries. [] The terms “trust” and “trustee” carry their legal implications under Pennsylvania law at the time the amendment was adopted.” *Id.* at 931-932 (footnote and citation omitted). This Court also concluded that the public natural resources within the Article I, § 27 trust include “the state forest and parks lands leased for oil and gas exploration and, of particular relevance in this case, the oil and gas themselves.” *Id.* at 931.

Regarding the Commonwealth’s duties as trustee under Article I, § 27, this Court established the following:

As trustee, the Commonwealth is a fiduciary obligated to comply with the terms of the trust and with standards governing a fiduciary’s conduct. The explicit terms of the trust require the government to “conserve and maintain” the corpus of the trust. [] The plain meaning of the terms to conserve and maintain implicates a duty to prevent and remedy the degradation, diminution or depletion of our public natural resources. As a fiduciary, the Commonwealth has a duty to act toward

the corpus of the trust – the public natural resources – with prudence, loyalty, and impartiality.

Id. at 932 (quoting *Robinson Twp.*, 83 A.3d at 956-957). In further describing the fiduciary duties of the Commonwealth as trustee of the Article I, § 27 trust, this Court states that the duty of loyalty under Pennsylvania trust law “imposes an obligation to manage the corpus of the trust to accomplish the trust purposes for the benefits of the trust’s beneficiaries.” *Id.* (citing *Metzger v. Lehigh Valley Trust & Safe Deposit Co.*, 69 A. 1037, 1038 (Pa. 1908)); *In re Hartje’s Estate*, 28 A.2d 908, 910 (Pa. 1942); and the Restatement (Second) of Trusts § 186.

The Commonwealth Court in *PEDF III* acknowledged the above standards of review and Article I, § 27 trust principles, but did not apply them to answer the questions of the remand order. Instead, the Commonwealth Court started from the belief that Article I, § 27 authorizes the sale of trust assets to generate income. 214 A.3d at 761. From that assumption, the Court determined that the Principle and Income Act of 1947 should be applied to define how bonus and annual rental payments should be allocated. *Id.* at 774. From there, the Court concluded that one third of the upfront bonus and annual rental payments is income that can be transferred to the General Fund. *Id.*

The Commonwealth Court bases this conclusion on the erroneous assumptions and determinations discussed below, all of which have no support in

Article I, § 27, in applicable Pennsylvania trust law, or in the terms of the leases themselves.

1. The Commonwealth Court Erred in Concluding that Bonus and Rental Payments Are Solely for Oil and Gas Exploration

The Commonwealth Court in *PEDF III* states that “[t]hrough bonuses and rental payments are made in anticipation of extraction, these payments relate directly to the lessee’s ability to secure the lease and the right to explore for oil and gas on the property” and “were not ‘received as consideration for the permanent severance’ of the natural resources from the land.” *Id.* at 773.

The Commonwealth Court does not explain how this determination comports with the express provisions of the State Forest oil and natural gas leases. These leases all specifically state that their sole purpose is “(1) exploring, drilling, operating, producing, and removing of oil and gas and liquid hydrocarbons; and (2) at locations approved by the Department, ... laying pipelines, and constructing roads, tanks, towers, stations, and structures thereon to produce, save, take care of, and transport extracted products.” **Appellant’s Exhibit C**, § 1.01; *see also Appellant’s Exhibits B and D*. This purpose allows the lessee to sever the oil and natural gas from the State Forest land subject to the lease and to transport and remove those resources from the State Forest. The Commonwealth Court acknowledged the terms of the lease in *PEDF III*, 214 A.3d at 771, but ignored those terms in reaching its conclusion.

The bonus and rental payments under the lease are to secure the right to enter the land for the sole purpose stated in the lease, not just to secure the lease, or just to explore for oil and gas. The activities authorized by the leases sever trust assets from the State Forest by extracting, moving and transporting the oil and gas so it can be sold.

2. The Commonwealth Court Erred in Characterizing the Payments as Rent Because They are Not Refundable

The Commonwealth Court concludes bonus and rental payments “were received as rent or payment on a lease and were not ‘received as consideration for the permanent severance’ of natural resources from the land.” *Id.* at 773. The Commonwealth Court bases this conclusion on evidence presented indicating that “the Commonwealth is entitled to keep this money regardless of production, even when the lease is terminated.” *Id.*

The fact that the State Forest oil and gas leases do not require the return of the bonus and rental payments to the lessee if no oil or gas is found or extracted does not alter the true purpose of these payments, which is established when the parties execute the lease. The fact that bonus and annual rental payments are made in advance of actual production does not mean these payments are for a purpose other than the parties intended as written in the lease. The Commonwealth Court’s assertion that these payments are made merely “in anticipation” of extraction of oil and gas or for the “right to explore” is not supported by the plain language of the

leases themselves. *Id.* The intent of the parties under the terms of the lease is clearly and unequivocally to permanently sever the oil and gas from the State Forest.

The lessee pays the advance bonus and annual payments for the right to enter the State Forest to carry out the specific purpose of the lease as of the time the payments are made. Upon payment, the lessee has the right to sever the natural resources from the land by extracting, transporting, moving, and doing whatever else it takes to get the oil or gas to where it can be sold.

DCNR provided testimony that bonus and rental payments made under State Forest oil and gas leases have always been and continue to be deposited into the Oil and Gas Lease Fund when these payments are received. *Id.* DCNR and its predecessors were authorized since 1955 to use bonus and rental payments, along with royalties, exclusively for conservation, recreation, dam and flood control projects on State Forest and Park land as authorized by the Act. After the adoption of Article I, § 27, DCNR was required to use these funds under the Act exclusively for projects that conserved and maintained the State Forest and Park public natural resources. The fact that advance bonus and annual rental payments were not refundable did not alter the purpose for which these funds could be and were used.

3. The Commonwealth Court Erred in Characterizing Section 27 Beneficiaries as Life Tenants Entitled to Income and Remaindermen

To reach the conclusion that the trust revenue is income, the Commonwealth Court first makes the assumption that the current and future generations of Pennsylvanians who are beneficiaries under Article I, § 27 are life tenants entitled to income from the trust and remaindermen, respectively. Specifically, the Commonwealth Court determined, with respect to the Section 27 beneficiaries, that “today’s generation represents life tenants or life beneficiaries of the trust and tomorrow’s generation represents the remainder interest.” *Id.* at 761.

The Commonwealth Court stated that “[i]t is necessary to make this analogy [of life tenants and remaindermen] because the origin of the law concerning present and future interest rights lies in the common law doctrine of ‘waste’ and ‘open wells’.” *Id.* The Commonwealth Court provides an extended discussion of these doctrines to conclude that when a trustee is authorized to sell or lease oil and gas interests held in trust for income, income from new wells belongs to life tenants. *Id.* at 761-765.

Applying the concepts of life tenants entitled to income and remaindermen to the rights of the Section 27 beneficiaries is without any foundation. Nothing in the trust provisions of Article I, § 27 creates life tenants entitled to income from the

corpus of the trust or authorizes the trustee to lease or sell our State Forest oil and gas public natural resources to generate income for those life tenants.

The second sentence of Article I, § 27 states that “Pennsylvania’s public natural resources are the common property of all the people, including generations yet to come.” The third sentence of Article I, § 27 requires the Commonwealth, as trustee, to conserve and maintain the people’s public natural resources “for the benefit of all the people.” The beneficiaries’ rights to the public natural resources under Section 27 are rights held in common by all the people, both living today and in future generations. Nothing in the plain language of Article I, § 27 can be reasonably construed as authority to treat “today’s generation” of Pennsylvanians as life tenants entitled to income from the Section 27 trust assets.

In construing and applying Article I, § 27, “the fundamental rule of construction which guides [a court] is that the Constitution’s language controls and must be interpreted in its popular sense, as understood by the people when they voted on its adoption.” *PEDF II*, 161 A.3d at 929 (citing *Ieropoli v. AC & S Corp.* 842 A.2d 919,925 (Pa. 2004)). Towards this end, courts “must avoid reading the provisions of the Constitution in any ‘strained or technical manner’” and “must favor a natural reading that avoids contradictions and difficulties in implementation, which completely conforms to the intent of the framers, and that reflects the views of the ratifying voter.” *Robinson Twp.*, 83 A.3d at 943 (citing *Jubelirer*, 953 A.2d at 528,

and *Commonwealth ex rel. Paulinski v. Isaac*, 397 A.2d 760, 766 (Pa. 1979)). The Commonwealth Court's reading of Article I, § 27 as creating life tenants entitled to income violates all these principles.

4. The Commonwealth Court Erred in Relying upon DCNR's Authority to Lease under CNRA in Interpreting Section 27

In order to overcome the fact that nothing in Article I, § 27 authorizes the Commonwealth, as trustee, to lease or sell our State Forest oil and natural gas, *i.e.*, part of the corpus of the Section 27 trust, to generate income, the Commonwealth Court cites the Conservation and Natural Resources Act as providing such authority under Article I, § 27. The Commonwealth Court asserts that "the Commonwealth, as the trustee of Pennsylvania's public natural resources, has the power to convert or lease State forest lands. Pa. Const. art. I, § 27; Section 302(a)(6) of the CNRA, 71 P.S. § 1340.302(a)(6) (authorizing DCNR to enter oil and gas leases on State forest lands and other Commonwealth-owned resources)." *Id.* at 764.

However, a provision of the Conservation and Natural Resources Act enacted in 1995 authorizing DCNR to lease State Forest lands for oil and gas extraction and removal cannot provide constitutional authority for the trustee to lease and sell our Section 27 trust natural resources for income. To the contrary, the authority given to DCNR by the CNRA, as the trustee of our State Forest, to lease State Forest lands for oil and gas extraction and sale must be exercised consistent with DCNR's fiduciary duties as the trustee under Article I, § 27. The Commonwealth Court's use

of the CNRA to establish the Commonwealth's right to sell trust assets under Article I, § 27 turns the relationship between statutes and the Constitution on its head.

Although a trustee is empowered to exercise discretion with respect to the proper treatment of the corpus of the trust, "that discretion is limited by the purpose of the trust and the trustee's fiduciary duties, and does not equate to mere subjective judgment." *Id.* at 933 (citing *Robinson Twp.*, 83 A.3d at 978, *Struthers Coal & Coke Co. v. Union Trust*, 75 A. 986, 988 (Pa. 1910) and *In re Sparks' Estate*, 196 A.48, 57 (Pa. 1938)). The trustee may use the assets of the trust "only for purposes authorized by the trust or necessary for the preservation of the trust; other uses are beyond the discretion conferred, even where the trustee claims to be acting solely to advance other discrete interests of the beneficiaries." *Id.* (citing *Metzger*, 69 A. at 1038; *see also Hartje's Estate*, 28 A.2d at 910 (denying the trustee's power to give an unrestricted bond that was neither necessary nor appropriate to carrying out the purposes of the trust)). The Conservation and Natural Resources Act cannot change the limitations on the trustee's use of the assets of the trust under the terms of Article I, § 27.

The Commonwealth Court also refers to Justice Baer's concurring and dissenting opinion in support of its contention that the Commonwealth has authority under Art. I, § 27 to lease State Forest land for oil and gas extraction to generate income, stating that the drafters of Section 27 contemplated "the continued, but

judicious, use of the resources rather than ‘some form of environmental absolutism.’” *PEDF III*, 214 A.3d at 765 (quoting Justice Baer in *PEDF II*, 161 A.3d at 947). The Commonwealth Court also relies on the substitution of the word “conserve” for “preserve” by the legislature in drafting the language of Section 27 to mean that the “drafters did not intend to freeze the current status of the natural resources nor to prevent the Commonwealth’s ability to utilize the resources.” *Id.* at 769. Nothing in the plain language of Article I, § 27 or its legislative history supports this assumption and the Commonwealth Court again violates the principles of construction set forth above in reading Article I, § 27 to authorize the sale of trust assets to generate income.

The paramount principle that guides interpretation of the provisions of a trust is the settlor’s intent. The Supreme Court summarized this well-established principle in *In re Trust Estate of Pew*, 191 A.2d 399, 405 (Pa. 1963), a few years before Article I, § 27 was adopted, stating:

It is still hornbook law that the pole star in every trust (and in every will) is the settlor's (or testator's) intent and that intent must prevail. It would certainly be unreasonable to construe the proviso as intending to destroy or effectually nullify what has always been considered the inherent basic fundamental right of every owner of property to dispose of his own property as he desires, so long as it is not unlawful [].

(Citations omitted).

Nothing in the language of Article I, § 27 or its history indicates that the people of Pennsylvania intended to authorize the leasing or sale of their public

natural resources to generate income. To construe their intent as supporting the sale of their trust assets for this purpose would be to directly contradict their express purpose stated in Section 27, which is to conserve and maintain their public natural resources.

5. The Commonwealth Court Erred in Applying Section 9 of Principal and Income Act of 1947 to Lease Payments

After making the erroneous determinations discussed above, the Commonwealth Court relies on Section 9 of the Principal and Income Act of 1947 to conclude that one third of the upfront bonus and annual rental payments under the State Forest oil and gas leases is income. 214 A.3d at 765-767. The Commonwealth Court explains that the primary purpose of the Principal and Income Act of 1947 and its 1945 predecessor was “to abolish the common law’s ‘open mine’ or ‘open well’ doctrine.” *Id.* at 765. The Commonwealth Court quotes Section 9 of the act as stating, in relevant part:

Where any part of the principal consists of property in lands from which may be taken timber, minerals, coal, stone, oil, gas or other natural resources, and the trustee, or tenant is authorized by the terms of the transaction by which the principal was established ... to sell, lease or otherwise develop such natural resources ... and no provision is made for the disposition of the net proceeds ... one third of the net proceeds, if received as rent or payment on a lease, or as royalties, shall be deemed income, and the remaining two thirds thereof shall be deemed principal to be invested to produce income ... Such proceeds if received as consideration for the permanent severance of such natural resources from the land, payable otherwise than as rents, or royalties, shall be deemed principal to be invested to produce income.

Nothing in this section shall be construed to abrogate or extent any right, which may otherwise have accrued by law, to a tenant to develop or work such natural resources for his own use.

Id. at 767 (emphasis in original).

Under Section 9, the first question to be resolved is whether the trust in question specifically authorizes the trustee to lease or sell the natural resource that are part of the corpus of the trust for income. In construing this provision, as well as the common law, the Commonwealth Court had to recognize that “the paramount principle that guides interpretation of the trust provisions is the expressed intention of the testator as reflected in the governing instrument.” *Id.* at 768.

Section 27 is the governing trust instrument in this case. However, as discussed above, the Commonwealth Court fails to discuss the fact that Section 27 does not authorize the Commonwealth, as trustee, to lease our State Forest for oil and gas extraction or to sell these trust assets to generate income for life beneficiaries.

6. The Commonwealth Court Erred in Asserting that Lease Income Can Be Transferred to the General Fund

After concluding that one third of the upfront bonus and annual rental payments made under State Forest oil and gas leases are income under the Principal and Income Act of 1947, the Commonwealth Court concludes that “[b]ecause proceeds designated as ‘income’ are not required to remain in the corpus of the Section 27 trust and [to be] used solely for the conservation and maintenance of our

public resources, this money may be appropriated for General Fund purposes.” 214 A.3d at 774 (citing *PEDF II*, 161 A.3d at 936). The Commonwealth Court states that “an accounting is necessary to ensure that only one-third of the proceeds allocable to income are removed for non-conservation purposes and that the funds designated as principal are ultimately used in accordance with the trustee’s obligation to conserve and maintain our natural resources.” *Id.* (citing *PEDF II*, 161 A.3d at 939).

Nothing in *PEDF II* states that any proceeds designated as income do not need to be used for trust purposes and can be transferred to the General Fund for general government operations. For the reasons discussed in the above sections, the Commonwealth Court has ignored this Court’s direction and mandate in *PEDF II* to evaluate revenue streams under the leases for amounts other than for the purchase of the oil and gas extracted, “in strict accordance and fidelity to Pennsylvania trust principles, to determine whether the bonus and rental payments belong in the corpus of the trust.” 161 A.3d at 936. As stated above, this Court provided instruction to the Commonwealth Court in this regard, stating that

it must be remembered that the Commonwealth, as trustee, has a constitutional obligation to negotiate and structure leases in a manner consistent with its Article I Section 27 duties. Oil and gas leases may not be drafted in ways that remove assets from the corpus of the trust or *otherwise deprive the beneficiaries (the people including future generations) of the funds necessary to conserve and maintain the public natural resources.*”

Id. (emphasis added).

Beyond the Commonwealth Court's failure to acknowledge or discuss the fact that Article I, § 27 provides no express authority to lease or sell part of the corpus of the public trust for income, it also fails to examine the relevant trust principles established in *PEDF II* to even consider the possibility that payments other than royalties required by the State Forest oil and gas leases must still be used solely for trust purposes.

DCNR's specific fiduciary duty under Section 27 is to conserve and maintain the corpus of trust – our State Forest trust assets – for the benefit of the beneficiaries. When DCNR, as trustee, enters into a contract for the extraction and removal of the oil and gas from our State Forest and the sale of these trust assets, it authorizes degradation, diminution and depletion of trust assets. For DCNR, as trustees, to then treat payments made under such contracts as income for its own use, whether through transfers to the General Fund or direct appropriations for its own operations, DCNR violates its specific fiduciary duties as trustee. The duty of loyalty, which “imposes an obligation to manage the corpus of the trust so as to accomplish the trust's purpose, for the benefit of the trust's beneficiaries,” is particularly important in this regard. *Id.* at 932. DCNR, as trustee, “can properly exercise such powers and only such powers as (a) are conferred upon [it] in specific words by the terms of the trust, or (b) are necessary or appropriate to carry out the purposes of the trust and

are not forbidden by the terms of the trust.” *Id.* at 932-933 (quoting the Restatement (Second) of Trusts § 186).

The Commonwealth Court’s determination that the revenue from the bonus and rental payments are income, and that the Commonwealth can use that income for General Fund purposes, would radically change Section 27. While the Commonwealth “must act affirmatively via legislative action to protect the environment” and the people’s rights under Section 27, including their right to have their public natural resources conserved and maintained, *id.* at 933, the Supreme Court has long recognized that, when enacting legislation to regulate a constitutional right,

such regulations are to be subordinate to the enjoyment of the right, the exercise of which is regulated. The right must not be impaired by the regulation. It must be regulation purely, not destruction. If this were not an immutable principle, elements essential to the right itself might be invaded, frittered away, or entirely excised under the name or pretense of regulation, and thus would the natural order of things be subverted by the principle subordinate to the accessory.

Robinson Twp., 83 A.3d at 944 (quoting *Page v. Allen*, 58 Pa. 338, 347 (1868)).

The trust principles established in *PEDF II* clearly prohibit the Commonwealth, as trustee of our public natural resources, from using trust resources for any purposes beyond the terms of the constitutional trust. The Commonwealth would clearly violate Article I, § 27, and its fiduciary duties thereunder, as well as the inalienable rights of the people under Article I, § 25, by leasing our State Forest

for oil and gas extraction and sale for the purpose of obtaining income for itself, as trustee. The Commonwealth has no proprietary interest in the State Forest oil and gas that would allow such action. To do so would be for the Commonwealth as trustee to be acting in its own interests.

For all the reasons articulated above, the proceeds from the bonus and rental payments must remain as part of the corpus of the trust and be used to conserve and maintain our State Forest trust assets. The Commonwealth Court findings and conclusions discussed above, if left standing, authorize the Commonwealth to use payments made under existing State Forest oil and gas leases for the purpose of obtaining income to pay for general government expenses and to execute new State Forest oil and gas leases for the same purpose. This result will eviscerate the very public natural resources that the people of Pennsylvania sought to conserve and maintain in amending their Constitution to include Article I, § 27; and will sanction violation of the Commonwealth's duties as trustee thereunder.

7. The Commonwealth Court Erred in Attempting to Balance the Conservation of our Public Natural Resources Required by Section 27 with Use of those Resources to Generate Income

In its final analysis, the Commonwealth Court states that allocating one third of the bonus and rental payments made under State Forest oil and gas leases based on the Principal and Income Act of 1947 fulfils the Section 27 purpose "*while also allowing today's generation of Pennsylvanians to benefit in other ways from the*

revenue produced.” 214 A.3d at 774 (emphasis added). The Commonwealth Court continues by asserting that the allocation of proceeds in accordance with the Principal and Income Act of 1947 “reflects an *equitable balance between the needs of present and future generations of Pennsylvanians.*” *Id.*

Through these final statements, the Commonwealth Court makes clear its purpose for basing its entire analysis on the assumption that the beneficiaries under the Section 27 trust are income life beneficiaries and remaindermen. The Commonwealth Court wants to use a statute – the Principal and Income Act of 1947 – to redefine Article I, § 27. The Commonwealth Court wants to graft a second purpose onto Article I, § 27, that of generating income for the Commonwealth by selling our Section 27 trust assets. The Commonwealth Court asserts that this income “allows today’s generation of Pennsylvanians to benefit in other ways from the income produced.” Although the Commonwealth Court does not point to the provision in Section 27 requiring the Commonwealth, as trustee, to conserve and maintain the trust assets “for the benefit of the people” as authority for this statement, it hints of that argument. But this Court in *PEDF II* found specifically that the phrase “for the benefit of all the people” in Section 27 “does not confer upon the Commonwealth a right to spend proceeds on general budgetary items.” 161 A.3d at 934.

The Commonwealth Court's adding a new purpose to Article I, § 27, that of selling our public natural resources for income, is in direct opposition to the reason why Article I, § 27 was adopted. The purpose of this constitutional amendment, as articulated in the history provided by this Court in *PEDF II*, was to stop degrading our public natural resources for industrial development. 161 A.3d at 918. The history of abuse of our natural resources – both our forests and our minerals – provides an important reminder of why the people of Pennsylvania voted overwhelming in support of amending their Constitution to add Article I, § 27. As this Court stated:

It is not a historical accident that the Pennsylvania Constitution now places citizens' environmental rights on par with their political rights. Approximately three and a half centuries ago, white pine, Eastern hemlock, and mixed hardwood forests covered about 90 percent of the Commonwealth's surface of over 20 million acres. Two centuries later, the state experienced a lumber harvesting industry boom that, by 1920, had left much of Pennsylvania barren. "Loggers moved to West Virginia and to the lake states, leaving behind thousands of devastated treeless acres," abandoning sawmills and sounding the death knell for once vibrant towns. Regeneration of our forests (less the diversity of species) has taken decades.

Similarly, by 1890, "game" wildlife had dwindled "as a result of deforestation, pollution and unregulated hunting and trapping." ...

The third environmental event of great note was the industrial exploitation of Pennsylvania's coalfields from the middle of the nineteenth well into the twentieth century. ... The result, in the opinion of many, was devastating to the natural environment of the coal-rich regions of the Commonwealth, with long-lasting effects on human health and safety, and on the esthetic beauty of nature. ...

The drafters of the Environmental Rights Amendment recognized and acknowledged the shocks to our environment and quality of life ...

161 A.3d at 916-917. The people of Pennsylvania understood the need to provide constitutional protection of their State Forest public natural resources to ensure they would be conserved and maintained for future generations. The Commonwealth Court's assertions to the contrary must be reversed.

D. SECTIONS 1604-E AND 1605-E OF THE FISCAL CODE AND SECTION 1912 OF THE SUPPLEMENTAL GENERAL APPROPRIATIONS ACT OF 2009 ARE UNCONSTITUTIONAL

Based on its view that one third of the bonus and rental payments made under State Forest oil and gas leases are income and that "proceeds designated as 'income' are not required to remain in the corpus of the Section 27 trust and [be] used solely for conservation and maintenance of our public natural resources," the Commonwealth Court concludes that "this money may be appropriated for General Fund purposes." 214 A.3d at 774. Based on that conclusion, the Commonwealth Court further determines that "Sections 1604-E and 1605-E of the Fiscal Code and Section 1912 of the Supplemental General Appropriations Act of 2009, which directed the transfer of money from the [Oil and Gas] Lease Fund to the General Fund, are not facially unconstitutional under Article I Section 27 of the Pennsylvania Constitution." *Id.* Those conclusions are in error and must be reversed.

To fulfill the mandated transfers to the General Fund under Section 1604-E and 1605-E of the Fiscal Code, DCNR was required to lease an additional 65,000 acres of State Forest land for oil and gas extraction and sale to generate bonus

payments in the amount of \$240,000,000. Likewise, Section 1912 of the Supplemental General Appropriations Act of 2009 transferred \$143,000,000 in bonus payments made under State Forest oil and gas leases to the General Fund rather than allowing these funds to be used to conserve and maintain the public natural resources of our State Forests and Parks as required by Article I, § 27 and the Oil and Gas Lease Fund Act. *PEDF II*, 161 A.3d at 922; *see also Appellant's Exhibit A*, page 1.

DCNR needs all the bonus and rent payments, as well as the royalty payments, to fulfill its fiduciary duty under Article I, § 27 to conserve and maintain our State Forest trust resources. Former DCNR Secretary, John Quigley, stated it succinctly,

DCNR's loss of the proceeds of the lease sales meant that the agency would not be able to adequately study, manage, or attempt to mitigate the impacts of the development that would result from the leasing activity. The effect was a very serious diminution of the agency's capacity to fulfill its legislatively mandated mission of conserving and maintaining the public natural resources for the benefit of all the people, including generations yet to come.

That diminution of capacity came at the worst possible moment because of the scale of natural gas development that DCNR was facing in the state forest. DCNR natural gas leases cover extraction from all geologic horizons ... the total state forest acreage that was available for shale gas development after the 2008 lease was approximately 660,000 acres.

Appellant's Exhibit A, page 3; *see also PEDF II*, 161 A.3d at 922-923.

As noted previously, this Court in its partial remand in *PEDF II* states that “[i]n construing 1604–E and 1605-E [of the Fiscal Code], to the extent that the lease

agreements reflect the generation of revenue streams for amounts other than for the purchase of the oil and gas extracted, it is up to the Commonwealth Court, in the first instance and in strict accordance and fidelity to the Pennsylvania trust principles, to determine whether these funds belong in the corpus of the Section 27 trust.” *Id.* at 935-936. In doing so, the Supreme Court emphasizes that “the Commonwealth, as trustee, has the constitutional obligation to negotiate and structure leases in a manner consistent with its Article I Section 27 duties” and advised that “oil and gas leases may not be drafted in ways that remove assets from the corpus of the trust or otherwise deprive the trust beneficiaries (the people, including future generations) of the funds necessary to conserve and maintain the public natural resources.” *Id.*

The Commonwealth Court’s conclusion regarding the challenged legislative transfers was not based in strict accordance and fidelity to Pennsylvania’s trust principles applicable to review of their constitutionality under Article I, § 27. It was based on the false assumption that Article I, § 27 authorizes leasing and sale of our public natural resources to generate income for use by the Commonwealth.

The Commonwealth Court did not consider the constitutional obligation of DCNR to negotiate and structure its State Forest oil and gas leases consistent with its Article I, § 27 duties. The Commonwealth Court did not evaluate whether these leases had been drafted in ways that improperly removed assets from the corpus of

the trust or otherwise improperly deprived the trust beneficiaries of the funds necessary to conserve and maintain their public natural resources.

Had the Commonwealth Court followed the Supreme Court's instructions, it would have concluded that the Commonwealth cannot transfer any proceeds from payments made under the State Forest oil and gas leases to the General Fund for non-trust general government purposes, and found Sections 1604-E and 1605-E of the Fiscal Code and Section 1912 of the Supplemental General Appropriations Act to be facially unconstitutional.

VIII. CONCLUSION

For the reasons set forth above, PEDF respectfully requests that this Honorable Court reverse the Commonwealth Court's order and grant PEDF's application for summary relief. PEDF requests that this Honorable Court find and declare that all proceeds from State Forest oil and gas leases, including payments designated as upfront bonus and annual rental payments, are part of the corpus of the public trust under Article I, Section 27 of the Pennsylvania Constitution. PEDF further requests this Honorable Court declare that Sections 1604-E and 1605-E of the Fiscal Code and Section 1912 of the Supplemental General Appropriations Act of 2009 are facially unconstitutional under Article I, Section 27 of the Pennsylvania Constitution.



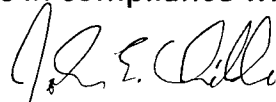
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SUPREME COURT OF PENNSYLVANIA

PENNSYLVANIA ENVIRONMENTAL :
DEFENSE FOUNDATION, :
Petitioner :
 :
v. :
 :
COMMONWEALTH DEPARTMENT : **64 MAP 2019**
OF CONSERVATION AND NATURAL :
RESOURCES, and CINDY ADAMS DUNN, :
in her official capacity as SECRETARY, :
Respondents :
 :

CERTIFICATE OF COMPLIANCE WITH PA. R.A.P. 127

I hereby certify that the Appellant's Brief is in compliance with Pa. Rule of Appellate Procedure 127.



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Dated: January 28, 2020

SUPREME COURT OF PENNSYLVANIA

**PENNSYLVANIA ENVIRONMENTAL
DEFENSE FOUNDATION,
Appellant**

v.

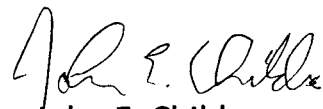
**COMMONWEALTH OF PENNSYLVANIA,
and
GOVERNOR WOLF, in his official capacity
as GOVERNOR,
Appellees**

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No. 64 MAP 2019

CERTIFICATION OF COMPLIANCE WITH LIMIT OF 14,000 WORDS

The Appellant, Pennsylvania Environmental Defense Foundation, hereby certifies that the Appellant's Brief is within the limit of 14,000 words, as required by Pa.R.A.C. 2135(a).


John E. Childe

Attorney for Appellant

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214 A.3d 748 (Pa.Cmwlt. 2019)

PENNSYLVANIA ENVIRONMENTAL DEFENSE FOUNDATION, Petitioner

v.

COMMONWEALTH of Pennsylvania, and Governor of Pennsylvania, Thomas W. Corbett, Jr., in his official Capacity as Governor, Respondents

No. 228 M.D. 2012

Commonwealth Court of Pennsylvania

July 29, 2019

Argued: December 12, 2018

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ORIGINAL JURISDICTION

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Howard G. Hopkirk, Sr. Deputy Attorney General, Harrisburg, for Commonwealth of Pennsylvania.

BEFORE: HONORABLE MARY HANNAH LEAVITT, President Judge, HONORABLE RENÉE E. COHN JUBELIRER, Judge, HONORABLE ROBERT SIMPSON, Judge, HONORABLE P. KEVIN BROBSON, Judge, HONORABLE ANNE E. COVEY, Judge, HONORABLE MICHAEL H. WOJCIK, Judge, HONORABLE ELLEN CEISLER, Judge

OPINION

WOJCIK, JUDGE

This case returns to us following the Pennsylvania Supreme Court's remand in *Pennsylvania Environmental*

Defense Foundation v. Commonwealth, 640 Pa. 55, 161 A.3d 911 (2017) (*PEDF II*). Before this Court for disposition are the parties' cross-applications for summary relief in this declaratory judgment action filed in our original jurisdiction.[1] Petitioner Pennsylvania Environmental Defense Foundation (the Foundation)[2] and Respondents Commonwealth of Pennsylvania and Tom Wolf in his official capacity as Governor of Pennsylvania (collectively, Commonwealth) seek declaratory relief under the Declaratory Judgment Act[3] as to whether money received from payments due under leases for the extraction and sale of oil and gas on State forest lands, including bonuses and annual rental payments, are part of the corpus of the environmental public trust established by Article I, Section 27 of the Pennsylvania Constitution (Environmental Rights Amendment), and if so, whether various fiscal enactments appropriating those funds for non-trust purposes are unconstitutional under Section 27. The Foundation argues that bonuses and rental payments are part of the corpus trust; the Commonwealth argues that they are not. For the reasons that follow, we grant the Commonwealth's application upon determining that one third of the proceeds constituting bonuses and rental payments are not part of the corpus trust, and thus, the challenged fiscal enactments are not facially unconstitutional. We deny the Foundation's application.

I. PROCEDURAL HISTORY

We begin by summarizing the Supreme Court's opinion in *PEDF II* and

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its directives to this Court on remand.[4] In *PEDF II*, the Supreme Court examined the constitutionality of legislative enactments to The Fiscal Code[5] relating to funds generated from the leasing of State forest and park lands for oil and gas exploration and extraction. The Supreme Court began its analysis by closely examining the contours of the Environmental Rights Amendment, which provides:

The people have a right to clean air, pure water, and to the preservation of the natural, scenic, historic and esthetic values of the environment. Pennsylvania's public natural resources are the common property of all the people, including generations yet to come. As trustee of these resources, the Commonwealth shall conserve and maintain them for the benefit of all the people.

Pa. Const. art. I, § 27. The Supreme Court determined that Section 27 "establishes a public trust, pursuant to which the natural resources are the corpus of the trust, the Commonwealth is the trustee, and the people are the named

beneficiaries." *PEDF II*, 161 A.3d at 931-32.

The Supreme Court continued that the "public natural resources" referenced in Section 27 "include the [S]tate forest and park lands leased for oil and gas exploration and ... the oil and gas themselves." *PEDF II*, 161 A.3d at 931. "[S]tate parks and forests, including the oil and gas minerals therein, are part of the corpus of Pennsylvania's environmental public trust." *Id.* at 916.

The Commonwealth is the trustee and not the proprietor of public natural resources. *PEDF II*, 161 A.3d at 932. As trustee of the public natural resources, the Commonwealth has the duty to act toward the corpus of the trust with loyalty, impartiality and prudence. *Id.* at 932 (citing *Robinson Township v. Commonwealth*, 623 Pa. 564, 83 A.3d 901, 956-57 (2013) (plurality)). This includes the "duty to prohibit the degradation, diminution, and depletion of our public natural resources." *Id.* at 933. In addition, the Commonwealth "must act affirmatively via legislative actions to protect the environment." *Id.* at 933 (citing *Robinson Township*, 83 A.3d at 957-58).

The Supreme Court also reviewed the history of the laws relative to oil and gas funds and the recent legislative transfers. Briefly, in 1955, the General Assembly enacted the Oil and Gas Lease Fund Act ("Lease Fund Act"),[6] which has since been

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repealed,[7] requiring "[a]ll rents and royalties from oil and gas leases" of Commonwealth land to be deposited in the "Oil and Gas Lease Fund" ("Lease Fund") to be "exclusively used for conservation, recreation, dams, or flood control or to match any Federal grants which may be made for any of the aforementioned purposes." *Former* Section 1 of the Lease Fund Act, *formerly* 71 P.S. § 1331. Neither rents nor royalties were defined therein. The Lease Fund Act specifically appropriated all money in the Lease Fund to the Department of Forests and Waters to carry out the purposes of the act and provided the Secretary of Forests and Waters with the discretion to determine the need and the location for projects. *PEDF II*, 161 A.3d at 919-20; *former* Sections 2 and 3 of the Lease Fund Act, *formerly* 71 P.S. § § 1332, 1333.

With the enactment of the Conservation and Natural Resources Act ("CNRA"),[8] the Department of Conservation and Natural Resources ("DCNR"), replaced the Department of Forests and Waters as the relevant entity for purposes of the Lease Fund. Section 101 of the CNRA(b)(1), 71 P.S. § 1340.101(b)(1); Section 301 of the CNRA, 71 P.S. § 1340.301; Section 304 of the CNRA 71 P.S. § 1340.304; *see former* 71 P.S. § 1333. The CNRA altered the Lease Fund Act "to provide that 'all moneys'

paid in to the Lease Fund were 'specifically appropriated to' the DCNR." *PEDF II*, 161 A.3d at 920 (quoting *former* 71 P.S. § 1333). The CNRA empowered DCNR "to make and execute contracts or leases in the name of the Commonwealth for the mining or removal of any valuable minerals that may be found in State forests" if the DCNR determines that it "would be for the best interests of this Commonwealth." 71 P.S. § 1340.302(a)(6).

Pursuant to this authority, DCNR entered into oil and gas leases for natural gas extraction. Of significance here, in 2008, DCNR began lease sales of State forest land in the Marcellus Shale region of northcentral Pennsylvania. "The Marcellus Shale leases dramatically increased the money flowing into the Lease Fund." *PEDF II*, 161 A.3d at 920.

The oil and gas leases generated funds in the form of royalties, rents and bonuses. *PEDF II*, 161 A.3d at 920. Per the lease terms, royalties are paid when gas is extracted, with the payment based upon the amount of marketable gas extracted.

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Id. at 921. The rents are comprised of annual rental fees, an example of which ranged from \$20-35 per acre, in addition to large initial "bonus payments" ranging in the millions of dollars. *Id.*

In determining whether those payments constituted part of the trust corpus, the Supreme Court opined that, "pursuant to Pennsylvania law in effect at the time of enactment, proceeds from the sale of trust assets are part of the corpus of the trust." *PEDF II*, 161 A.3d at 933 (citing *In re McKeown's Estate*, 263 Pa. 78, 106 A. 189, 190 (1919) ("Being a sale of assets in the corpus of the trust, presumptively all the proceeds are principal. ...")). "Pennsylvania trust law dictates that *proceeds from the sale of trust assets* are trust principal and remain part of the corpus of the trust." *PEDF II*, 161 A.3d at 935 (citing *McKeown's Estate*, 106 A. at 190) (emphasis added). "When a *trust asset is removed from the trust*, all revenue received in exchange for the trust asset is returned to the trust as part of its corpus." *PEDF II*, 161 A.3d at 935 (citing *Bolton v. Stillwagon*, 410 Pa. 618, 190 A.2d 105, 109 (1963)) (emphasis added).

Ultimately, the Supreme Court determined that "all proceeds from the sale of our public natural resources are part of the corpus of our environmental public trust and that the Commonwealth must manage the entire corpus according to its fiduciary obligations as trustee." *PEDF II*, 161 A.3d at 939. The Supreme Court held that "royalties - monthly payments based on the gross production of oil and gas at each well - are unequivocally proceeds from the sale of oil and gas resources." *Id.* at 935. As such, funds

generated from royalties are part of the corpus and must be committed to furthering the purposes, rights and protections afforded under Section 27, i.e., to conserve and maintain our natural resources. *Id.* at 935. "They are part of the corpus of the trust and the Commonwealth must manage them pursuant to its duties as trustee." *Id.* Consequently, the Supreme Court ruled that legislative enactments relating to the use of royalties in the Lease Fund were facially unconstitutional because they diverted proceeds from the sale of oil and gas, i.e., royalties, to non-trust purposes in violation of Section 27.[9] *Id.* at 938-39.

However, the Supreme Court was less clear on how to categorize other revenue streams from State forest oil and gas leases, i.e., rents and bonuses, stating that "the record on appeal is undeveloped regarding the purpose of up-front bonus payments, and thus no factual basis exists on which to determine how to categorize this revenue." *PEDF II*, 161 A.3d at 935. The Supreme Court recognized that the leases designate bonuses and other annual payments as "rental payments," but stated that "such a classification does not shed

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any light on the true purpose of the payment, e.g., rental of a leasehold interest in the land, payment for the natural gas extracted, or some other purpose." *Id.* Thus, the Supreme Court remanded the matter to this Court for further proceedings. *Id.*

In this remand, the question before us is whether the proceeds generated from rents and bonuses under the oil and gas leases must be devoted to the conservation and maintenance of our public natural resources, or may be used for other purposes without violating the Environmental Rights Amendment. More particularly, we are tasked with determining the constitutionality of Sections 1604-E and 1605-E of The Fiscal Code,[10] and Section 1912 of the Supplemental General Appropriations Act of 2009,[11] which directed that certain money deposited into the Lease Fund be transferred to the General Fund to pay for government operations in 2009 and 2010. None of these enactments indicate on their face whether the funds transferred related to royalties, rents, or bonus bid payments, or some combination of the three. *See PEDF II*, 161 A.3d at 923 n.11.

As the Supreme Court instructed, the constitutionality of these acts "depends on whether they result from the Commonwealth's faithful exercise of its fiduciary duties vis a vis our public natural resources and any proceeds derived from the sale thereof." *PEDF II*, 161 A.3d at 939. The Supreme Court opined that "the legislature's diversion of funds from the Lease Fund (and from the DCNR's exclusive control) does not, in and of itself, constitute a violation of

Section 27." *Id.* Rather, "the legislature violates Section 27 when it diverts proceeds from oil and gas development to a non-trust purpose without exercising its fiduciary duties as trustee." *Id.*

The Supreme Court directed:

In construing Sections 1604-E and 1605-E, to the extent that the lease agreements reflect the generation of revenue streams for amounts other than for the purchase of the oil and gas extracted, it is up to the Commonwealth Court, in the first instance and *in strict accordance and fidelity to Pennsylvania trust principles*, to determine whether these funds belong in the corpus of the Section 27 trust.

PEDF II, 161 A.3d at 935-36 (emphasis added). More particularly, we must adhere to *private trust principles*. *Id.* at 933 n.26.

The Supreme Court elaborated that, although Section 27 creates a public trust, the "'public trust doctrine' does not set forth universally applicable black letter law and that Pennsylvania has no established public trust principles applicable to Section 27." *Id.* "At most, the public trust doctrine provides a framework for states to draft their own public trust provisions, which (like many trust instruments) will

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ultimately be interpreted by the state courts." *Id.* The Supreme Court instructed that Pennsylvania's "private trust principles provide ... the necessary tools to properly interpret the trust created by Section 27." *Id.*

Further, the Supreme Court directed:

On remand, the parties should be given the opportunity to develop arguments concerning the proper classification, pursuant to trust law, of any payments called 'rental payments' under the lease terms. *To the extent such payments are consideration for the oil and gas that is extracted, they are proceeds from the sale of trust principal and remain in the corpus. These proceeds remain in the trust and must be devoted to the conservation and maintenance of our public natural resources, consistent with the plain language of Section 27.*

Id. at 936 (emphasis added).

Finally, the Supreme Court emphasized that "the proper standard of judicial review *lies in the text of Article I, Section 27 itself as well as the underlying principles of Pennsylvania trust law in effect at the time of its enactment*." *PEDF II*, 161 A.3d at 930 (emphasis added). In accordance with these remand instructions, we review the

matter before us.

II. ISSUE

On remand, the parties developed the record and now present their cross-applications for summary relief.[12] The crux of the matter is whether bonuses and rental payments set forth in the Commonwealth's oil and gas leases are compensation for the sale of natural resources and, thus, part of the corpus trust that must be used to conserve and maintain those natural resources, or income that may be used for General Fund purposes under the Environmental Rights Amendment.[13]

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III. DISCUSSION

A. Contentions

1. The Foundation's Position

The Foundation contends that bonus and rental payments from the Commonwealth's oil and gas leases are part of the corpus of the Section 27 environmental trust. The leases make no distinction between bonuses and rental payments and royalty payments. These payments are all consideration for the purchase of oil and gas. Under trust principles in effect when Section 27 was adopted, when a lease authorized the complete removal of oil and gas from the leased premises, *all* of the proceeds were considered payments for the sale of oil and gas and remained part of the corpus or principal. *See* Petitioner's Amended Application for Relief at 12-13 (citing *In re Bruner's Will*, 363 Pa. 552, 70 A.2d 222 (1950) and *Blakley v. Marshall*, 174 Pa. 425, 34 A. 564 (1896)). The trust established by Section 27 does not authorize the trustee to allocate proceeds from the sale of Pennsylvania's public natural resources for purposes other than the conservation and maintenance of those resources. Thus, the Commonwealth's fiscal enactments authorizing the transfer of corpus funds for non-trust purposes are facially unconstitutional under Section 27.

2. Commonwealth's Position

The Commonwealth contends that up-front bonus bid payments and rental payments do not constitute compensation for sale of the trust principal. The bonus payment is money paid by the highest bidder to obtain the lease in a formal bid process. Rental payments are due on an annual basis and secure the lessee's right to explore for oil and gas. Neither payment is consideration for the severance of natural resources from the land. Rather, under common law, they are consideration for an inchoate title for the right to explore for oil and gas. This is supported by the fact that DCNR retains any bonus bid payments and rentals

received even when no oil or gas is produced. If the exploration for oil and gas is unsuccessful, no estate vests in the lessee and the lease terminates at the end of the lease's primary term.

Royalty payments, on the other hand, are directly related to the extraction of oil and gas, and only become due and owing if oil or gas is extracted. Royalty payments represent proceeds from the extracted oil and gas and are consideration to DCNR for those public natural resources.

Under current statutory law, rent is to be allocated as trust income, not as trust principal. *See* Section 8145(a) of the Pennsylvania Uniform Principal and Income Act (2002 Act), 20 Pa. C.S. § 8145(a). Only refundable deposits for rent shall be applied to principal. *See* Section 8145(b)(1) of the 2002 Act, 20 Pa. C.S. § 8145(b)(1). Neither bonuses nor rent payments are refundable at the termination of DCNR's leases. Thus, they are income, not trust principal.

Thus, the Commonwealth avers that, because bonus-bid and rent payments are not compensation for the sale of trust assets, they are not corpus of the trust and the appropriation of those funds does not violate Article I, Section 27 of the Pennsylvania Constitution.

B. Fundamentals of Oil and Gas Leases

We begin our discussion with an examination of oil and gas leases and the interests conveyed therein. America's foray into oil and gas extraction began in Pennsylvania

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in the early 1850s. The first oil well in the United States was established on Oil Creek (present-day Oil Creek State Park), Cherrytree Township, Venango County, Pennsylvania, and the first gas well was bored in Erie, Pennsylvania. Eugene Kuntz, *A Treatise on the Law of Oil and Gas* § 1.6 (1987). The basic instrument of the petroleum industry is the oil and gas lease. Robert E. Sullivan, *Handbook of Oil and Gas Law* 69 (1955). The first oil lease entered in America occurred in 1853 in Pennsylvania. Kuntz § 1.32. "[T]he Commonwealth has a history of leasing its land to private parties for oil and gas exploration dating back to 1947." *PEDF II*, 161 A.3d at 919.

1. A Lease is a Contract

Since then, the area of law dealing with oil and gas leases has burgeoned. "[T]here have been many and radical developments in the industry with corresponding changes in the contracts employed to define the respective rights of land owners and operators and the laws and decisions have kept pace with these advances." *Appeal of Baird*, 334 Pa. 410, 6 A.2d 306, 310 (1939). As our Supreme Court has

recognized, the traditional oil and gas 'lease' is unique and "far from the simplest of property concepts." *Brown v. Haight*, 435 Pa. 12, 255 A.2d 508, 510 (1969). At its core, "a lease is in the nature of a contract and is controlled by principles of contract law." *T.W. Phillips Gas & Oil Co. v. Jedlicka*, 615 Pa. 199, 42 A.3d 261, 267 (2012). Accordingly, it must be construed "in accordance with the terms of the agreement as manifestly expressed, and '[t]he accepted and plain meaning of the language used, rather than the silent intentions of the contracting parties, determines the construction to be given the agreement.'" *Id.* (citation omitted).

2. Interests Conveyed

Typically, the landowner, as the oil and gas lessor, has three distinct interests in the land and the minerals contained therein: (1) a possessory interest in the surface except insofar as it may interfere with drilling operations; (2) a right to receive bonus, rentals and royalties under the lease; and (3) the possibility of reverter in the minerals in place. Sullivan at 69.

The tenant, or oil and gas lessee, acquires a possessory interest in the minerals. *Id.* The tenant is able to use only so much of the surface as may be necessary for drilling operations. *Id.* His possession of the mineral estate is contingent upon discovery and production. *Id.* Many cases have considered the interests of lessees under oil and gas leases in various contexts. *Baird's Appeal*, 6 A.2d at 310. It is helpful in this context in determining the nature of the payments exchanged for that interest.

"In the case law[,] oil and gas 'leases' have been described as anything from licenses to grants in fee." *Brown*, 255 A.2d at 510. Initially, Pennsylvania classified the lessee's interest as an incorporeal hereditament, not a conveyance of title. *Funk v. Haldeman*, 53 Pa. 229, 241 (1866) (a grant of the right to search for or "experiment for oil" and take all the minerals in the land of another, yielding a royalty to the grantor, is an incorporeal hereditament). Later cases consistently held that the title conveyed in an oil and gas lease is inchoate, and is initially for the purpose of exploration and development. *Burgan v. South Penn Oil Co.*, 243 Pa. 128, 89 A. 823, 826 (1914); *Calhoon v. Neely*, 201 Pa. 97, 50 A. 967, 968 (1902); *Venture Oil Co. v. Fretts*, 152 Pa. 451, 25 A. 732 (1893); *see also Sabella v. Appalachian Development Corp.*, 103 A.3d 83, 101 (Pa. Super. 2014); *Hite v. Falcon Partners*, 13 A.3d 942, 945 (Pa. Super. 2011);

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Jacobs v. CNG Transmission Corp., 332 F.Supp.2d 759, 772 (W.D. Pa. 2004).

Regardless of how the interests are classified, the general purpose of an oil and gas lease is to secure the right to explore and develop the property with the expectation of receiving large returns from the royalties payable on production. Sullivan at 72. Once oil or gas is discovered, captured, and removed, it becomes the property of the lessee. *Brown*, 255 A.2d at 512; *Venture Oil Co. v. Fretts*, 25 A. at 735. The lessee obtains a fee simple determinable estate. *Brown*, 255 A.2d at 512; *Venture Oil*, 25 A. at 735. The lessee's right to extract oil or gas becomes vested. *Venture Oil*, 25 A. at 735. If no oil or gas is produced, no estate vests. *Id.*

3. Consideration

In order for the contract to be valid, there must be consideration conveyed. *Shedden v. Anadarko E. & P. Co., L.P.*, 635 Pa. 381, 136 A.3d 485, 490 (2016) (citing *T.W. Phillips Gas*, 42 A.3d at 267). The same holds true with oil and gas leases. *Id.* There are various forms of consideration paid by a lessee for the privilege of exploring for and producing oil and gas such as royalties, rentals, bonuses, and interest. Our focus on remand is on rentals and bonuses.

a. Rentals

"The term 'rental' as used in standard oil and gas leases, refers to the consideration paid to the lessor for the privilege of delaying drilling operations." Sullivan at 126 n.9. Sometimes, this is referred to as a "delayed rental." The term "rent" has also been used to describe a flat sum to be paid for each producing well. George G. Bogert, *The Law of Trusts and Trustees* § 827 (rev. 2019). Typically, rents do not depend on the discovery or production of oil and gas, but rather represent compensation for the time to explore. Sullivan at 125 n.4.

Standard oil and gas leases provide for rents for a set number of years until oil and gas is discovered. Sullivan at 104. This affords the lessee time to explore and develop the property. *Id.* at 104. If oil or gas is not found within that set time, the lease automatically terminates. *Id.* Therefore, it is incumbent for the tenant to secure the testing, development and operation of the leased premises for oil and gas purposes during the set term. *Id.* The purpose of the rent is to compensate the landowner for this exploration time because he is not receiving royalties. *Id.* Typically, once oil or gas is discovered in paying quantities, payments from rentals convert to royalties.

b. Bonuses

As oil and gas leases became more lucrative, it became common practice to pay a bonus, i.e., "a substantial sum initially as an inducement to the landowner to grant the lease." Sullivan at 108. The amount varies depending upon

the prospective value of the land for oil and gas purposes.
Id.

"The word 'bonus' has a definite meaning in the oil and gas industry. It is defined ... as a premium paid to a grantor or vendor, and strictly in the cash consideration or down payment paid or agreed to be paid for the execution of an oil and gas lease." Sullivan at 126 n.9. A bonus is a sum paid for the execution of the lease, representing its market value, or to be paid later out of the lessee's share of the production of a well. Bogert § 827.

In Pennsylvania, bonus provisions in mineral leases have served different purposes. In some cases, the bonuses were due and owing based upon actual production. *See Burgan* (the lease required lessee to pay a bonus if the first well drilled produced 50 barrels of oil per day for 60

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days); *Akin v. Marshall Oil Co.*, 188 Pa. 614, 41 A. 748, *aff'd sub nom. Stone v. Washington Oil Co.*, 188 Pa. 602, 41 A. 1119 (1898) (bonus payable if gas discovered and produced in paying quantities); *Nelson v. Eachel*, 158 Pa. 372, 27 A. 1103 (1893) (a bonus in the form of a judgment note was payable only upon production); *Brushwood Developing Co. v. Hickey*, 16 A. 70 (Pa. 1888) (bonuses were based on the amount of oil extracted); *see also Wilson v. Philadelphia Co.*, 210 Pa. 484, 60 A. 149, 150 (1904) (bonus due upon the completion of the first well).

In other cases, the bonuses were given for the right to explore or enter the lease, but were not based on the actual production of oil and gas. *See Brandon v. McKinney*, 233 Pa. 481, 82 A. 764 (1912) (a bonus was paid for the lease); *Glasgow v. Charters Oil Co.*, 152 Pa. 48, 25 A. 232 (1892) (bonus paid for the right to explore and develop the land); *see also Carnegie Natural Gas Co. v. Philadelphia Co.*, 158 Pa. 317, 27 A. 951 (1893) (the lessee forfeited an existing lease and entered a new lease by paying a bonus).

In some cases, the bonus payment was split for a dual purpose. *See McMillin v. Titus*, 222 Pa. 500, 72 A. 240, 243 (1909) (one bonus was given as consideration for the initial right to occupy the premises and explore for oil; the other bonus was payable only if oil or gas was found in paying quantities); *Smiley v. Gallagher*, 164 Pa. 498, 30 A. 713 (1894) (part of the bonus was to be paid when the lease was delivered, part of the bonus was to be paid out of the first oil produced).

Bonuses have also been used as part of a competitive bidding process in securing oil and gas leases. *See Parry v. Miller*, 247 Pa. 45, 93 A. 30, 32 (1915); *Lenau v. Co-exprise, Inc.*, 102 A.3d 423, 425 (Pa. Super. 2014).

4. Duty to Explore and Drill

In addition to paying consideration, early cases imposed a duty upon the lessee to explore during the lease term or risk loss by abandonment. *See Baird's Appeal*, 6 A.2d at 311; *Venture Oil*, 25 A. at 735. Later cases backed away from this premise, particularly where the lease provided for rentals and bonuses as compensation for a set term. *See Hite*, 13 A.3d at 946 (delay rental payment relieved the company of any obligation to develop the leasehold during the primary term, but not beyond). Such payments ensured that the lessor would be compensated for the lessee's delay or default in exploring and developing the property. *Ray v. Western Pennsylvania Natural Gas Co.*, 138 Pa. 576, 20 A. 1065, 1066 (1891) (the payments "were intended not only to spur the operator, but to compensate [the lessor] for the operator's delay or default").

Next, we examine whether rents and bonuses in the Commonwealth's oil and gas leases constitute income or principal pursuant to Pennsylvania trust principles in effect at the time of Section 27's enactment. *PEDF II*, 161 A.3d at 930.

C. Pennsylvania Trust Law

Under trust law, the question of the relative rights between present and future interests, particularly with regard to rents or bonuses under oil and gas leases, is a complex one.[14] As our Supreme Court instructed,

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we must adhere to Pennsylvania trust law principles at the time of Section 27's enactment. To understand trust law as it stood in 1971, we begin by examining fundamental trust elements and common law doctrines relating to mineral leases.

I. Common Law

a. Basic Trust Elements

The basic elements of a trust include the trust instrument, which is the document, which expresses the testator's intent and sets forth the trust terms. Bogert § 1. The trust property or corpus is the interest in property, real or personal, tangible or intangible, which the trustee holds, subject to the rights of another. *Id.* The settlor of a trust is the person who intentionally causes it to come into existence. Bogert § 2. The beneficiary or *cestui que trust* is the person for whose benefit the trustee holds the trust property. *Id.* The beneficiary of a public or charitable trust is the public. Bogert § 27. At common law, where the testator creates a life estate, a life tenant is entitled to income derived from the corpus, but not to assets representing the corpus itself, which is reserved for the beneficiaries in remainder or

"remaindermen." Bogert § 27.

As the Supreme Court in *PEDF II* established, the trust instrument here is Section 27; the trust property is Pennsylvania's public natural resources; the Commonwealth is the trustee; and the people of Pennsylvania - both current and future generations - are the beneficiaries. 161 A.3d at 932-33. Pennsylvanians have both a present and future interest in the trust. In essence, today's generation represents life tenants or life beneficiaries of the trust and tomorrow's generation represents the remainder interest. It is necessary to make this analogy because the origin of the law concerning present and future interest rights in minerals lies in the common law doctrines of "waste" and "open wells." 18 A.L.R.2d 98, § 2.

b. Waste and the Open Well Doctrine

"Waste" refers to "the spoil or destruction of the estate." *Irwin v. Covode*, 24 Pa. 162, 164 (1854). Natural resources, which can be extracted and depleted, are considered "wasting assets." Bogert § 827; Robert A. Wyler, Jr., *The Apportionment of Proceeds from Depletable Natural Resources Held in Trust*, 18 *Hastings L.J.* 391, 397-98 (1966); Restatement (Second) of Trusts § 239 (Am. Law Inst. 1959). It was regarded as "waste" for a life tenant to open a new mine or well and take minerals therefrom, unless the right to do so was expressly or by implication granted by the settlor. *Appeal of Eley*, 103 Pa. 300, 307 (1883);

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Marshall v. Mellon, 179 Pa. 371, 36 A. 201, 201 (1879); *Westmoreland Coal Co.'s Appeal*, 85 Pa. 344, 346 (1877). "The reason why tenants for life, as a general rule, cannot open and operate new mines, is because it would be a lasting injury to the inheritance" *Eley's Appeal*, 103 Pa. at 307. In other words, it would permanently injure the reversionary interest in the estate.

Conversely, under what is commonly referred to as the "open mine" or "open well" doctrine, it was not considered "waste" for a life tenant to continue working a mine or well that was opened by the former owner. *Irwin*, 24 Pa. at 165; *accord Neel v. Neel*, 19 Pa. 323, 327 (1852) ("as to all tenants for life, the rule has always been that the working of open mines of all sorts is not waste"). Indeed, a life tenant was permitted "to operate previously opened mines, and work the same even to exhaustion." *Eley's Appeal*, 103 Pa. at 307. "The tenant for life has the usufruct of the whole land, and takes the whole profit that can be derived from it in following out the use made of it by the donor." *Neel*, 19 Pa. at 327-328.

The open well doctrine addressed trusts that made no

provision for a trustee to sell or convert the lands. 18 A.L.R.2d 98, § 2. The reasoning behind the doctrine was that if a life tenant opened new wells or new mines, he would be "wasting" or injuring the estate, whereas if he simply continued to use the wells or mines already opened by the testator, he is merely enjoying the use of the estate in the same manner in which it was enjoyed when the estate came into being. *Bruner's Will*, 70 A.2d at 224.

Under the doctrine, a life tenant was entitled to all the proceeds, including royalties, from an oil well drilled or a coal mine opened during the testator's lifetime. *Bruner's Will*, 70 A.2d at 224 (citing *McFadden's Estate*, 224 Pa. 443, 73 A. 927 (1909)). If a well or mine was not opened, but trustees were nevertheless empowered by the trust instrument to lease the minerals, the same principle of law applied. *Id.* However, if no wells were drilled or mines opened and no power was given to lease, all proceeds from the lease were considered as principal, not income. *Id.* In short, if the mine was open, all proceeds were treated as income; if unopened, they were treated as principal. Austin Wakeman Scott, *The Law of Trusts* § 239.3 (3d ed. 1967); Kuntz § 8.2.

For years, the open well doctrine served as an "aid in the construction and interpretation of documents pertaining to mineral rights." *Doverspike v. Chambers*, 357 Pa. Super. 539, 516 A.2d 392, 395 (1986). For example, in *Eley's Appeal*, the Supreme Court applied the open well doctrine to a trust that gave the executors the power "to lease the coal" with the consent of six-tenths of the owners. 103 Pa. at 300. The Court determined that this gave the life tenants the same rights over unopened mines that they would have had if the mines had been opened and operated in testator's lifetime. *Id.* at 305. The Supreme Court considered whether distributions accrued from the coal lease, which included royalties and rents, should be treated as principal or income. *Id.* It opined:

The word income means the gain which accrues from property, labor or business. In its ordinary and popular meaning, it is strictly applicable to the periodical payments, in the nature of rent, which are usually made under coal and other mineral leases, and we have no doubt it was used in that sense by the testator. In the absence of any provision, express or implied, that the payments in the nature of rent shall be accumulated for the ultimate benefit of those in remainder, it would be a strained and unnatural construction of the will to hold

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that he intended to give appellants only the annual interest on the installments of rent.

Id. at 306. Thus, the *Eley* Court determined the "produce of

the mines ... whether in royalties, or in whatever other way it is produced," including rents, formed the profit of the estate and was payable to the life tenant as income and did not form corpus. *Id.* at 307 (emphasis added).

Shortly thereafter, in *Appeal of Wentz*, 106 Pa. 301 (1884), the Supreme Court reaffirmed that where the governing instrument granted the trustee the power to lease the estate, it was the equivalent to an open mine. There, a testator directed by his will that his executor should "collect and pay all the income" arising from his estate both real and personal to his wife, with the remainder to his children and their children. 106 Pa. at 301. Significantly, the will authorized the executors to sell or lease the estate, which was chiefly valuable for coal mining purposes but had never been mined or developed during testator's lifetime. 106 Pa. at 301. Although the mines were not open during the testator's life, the Court held that the wife, i.e., the life tenant, was entitled to the income arising from the estate, which included rents and royalties arising under the mining leases. *Id.* at 307. The Court explained that, because the executors had the power to sell or lease testator's real estate, this power included the ability to lease the coal in a mine on the estate, even if unopened. In other words, the "power to lease, as well as sell" a testator's estate was equivalent to an open mine during the testator's life. *Id.* at 307.

In *Blakley*, the Supreme Court again applied the doctrine. There, the settlors established a trust conveying a life estate in the land with the remainder in fee for their children and appointed themselves as life tenants and trustees for those in remainder. There were no wells opened on the estate and the trust instrument did not authorize the trustees to enter mineral leases. The life tenants and trustees executed a lease "for the purpose of operating and drilling for petroleum and gas," for the term of 15 years, and "so long thereafter as oil and gas can be produced in paying quantities." The lease invested the lessee "with the right to remove all the oil in place in consideration of his giving the lessors a certain percentum thereof." 34 A. at 565.

The *Blakley* Court held that any proceeds, including rent and royalties, constituted corpus, not income. 34 A. at 565. The Court opined that "oil in place is a mineral, and, being a mineral, it is part of the realty," such that any proceeds from the sale must go towards the corpus. *Id.* (citing *Appeal of Stoughton*, 88 Pa. 198, 201 (1878)). The life tenants were only "entitled to the enjoyment of the fund (i.e., interest thereon) during life, and at the death of the survivor the corpus of the fund should go to the remaindermen." *Id.*

As with royalties and rents, the open well doctrine has also played a role in how bonus money was treated. See *Bruner's Will*. In *Bruner's Will*, the Supreme Court applied the open well doctrine to bonus payments and royalties devised in an oil and gas lease. 70 A.2d at 224. It is one of the only cases

to characterize bonuses under oil and gas leases for trust purposes. There, the testator bequeathed his estate to the trustees, in trust, with the direction to pay the net income to the life beneficiaries with the final distribution to go to the remaindermen. *Id.* at 223. The trust authorized trustees "to sell and dispose of any and all of the property of my estate ... at any time they deem it advisable and in the best interests of my estate so to do." *Id.* However, there was no authorization

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for the trustees to lease. *Id.* The testator died possessed of a very large estate, which included two tracts in Illinois, upon which no wells had been drilled at the time of the testator's death. *Id.* The trustees, along with the life beneficiaries, entered into oil and gas leases for the Illinois tracts for consideration in the form of a bonus, one-sixteenth of all oil produced, and payment for the assignment of the lease. *Id.*

A dispute arose between life beneficiaries and the remaindermen over the funds derived from leases. *Id.* The issue was whether the funds exchanged constituted income payable to the life beneficiaries or part of the trust corpus for the remaindermen. *Id.*

The Supreme Court examined the open well doctrine and trust principles associated with such allocations and opined:

a life tenant is entitled to the royalties from an oil well drilled or a coal mine opened in the lifetime of testator, and, if no well be drilled or coal mine opened in testator's lifetime, but trustees are empowered by the trust instrument to lease the oil or coal, the same principle of law is applicable. *Wentz's Appeal*, 106 Pa. 301. On the other hand, if there were no wells drilled or mines opened and no power given to lease the oil or coal or authorization given to operate such business, the royalties received, or to be received, under the terms of the lease are princip[al] and not income. See *McFadden's Estate*

Id. at 224. The critical factor in the Court's analysis was whether the trustees were empowered by the trust instrument to lease the estate:

[W]here there is a power given to the trustee 'to sell or lease', the income from mines or wells opened in accordance with the power belongs to the life tenant as if the wells or mines had been opened during testator's lifetime. It was never our intention, however, that that principle should apply to a case such as the instant one, where testator has neither authorized trustees to lease or engage in the oil or mining business .

Id. at 225 (emphasis added). Thus, because the trustees did not have the power to lease, the Court determined that all revenue derived from the lease belonged to the corpus of

the estate, stating:

In reality, the lease contemplates removal of all the oil and is in effect a sale, with payment to be made as the mineral is removed. Obviously, it was a sale of part of the principal of the trust and properly the moneys received therefrom belonged to the corpus.

Id.

Relying on *Bruner's Will* and *Blakley*, the Foundation urges us to characterize both the rentals and bonus payments as part of the principal of the trust. However, the open well doctrine does not apply here for two reasons.

First, the Commonwealth, as the trustee of Pennsylvania's public natural resources, has the power to convert or lease State forest lands. Pa. Const. art. I, § 27; Section 302(a)(6) of the CNRA, 71 P.S. § 1340.302(a)(6) (authorizing DCNR to enter oil and gas leases on State forest lands and other Commonwealth-owned resources); see *PEDF II*, 161 A.3d at 947 (concurring and dissenting op. by Baer, J., recognizing that the drafters of Section 27 contemplated "the continued, but judicious, use of the resources rather than 'some form of environmental absolutism' "). The Court in *Bruner's Will* made it clear that "where there is a power given to the trustee 'to sell or lease', the income from mines or wells opened in accordance with the power belongs to the life tenant *as if* the

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wells or mines had been opened during testator's lifetime." 70 A.2d at 225.

Second, by the time Section 27 was ratified, Pennsylvania had abandoned the open well doctrine in favor of a uniform statutory law, discussed below. See 20 Pa. C.S. § 8151(c), *Uniform Law Comment*.

2. Statutory Law

In 1931, the National Conference of Commissioners on Uniform State Laws promulgated a model "Uniform Principal and Income Act" (UPIA).[15] The act concerned the ascertainment of principal and income and the apportionment of receipts and expenses among life tenants and remainder beneficiaries and was intended to promote uniformity of the law and remedy the inequities of common law. See *Guide to Uniform and Model Acts* (Uniform Law Commission 2018-19); [16] see also Walter L. Nossaman, *The Uniform Principal and Income Act*, 28 Cal. L.Rev. 34, 35 (1939). A primary purpose of UPIA was to abolish the common law's "open mine" or "open well" doctrine.[17] [18] See Comment to UPIA (2000).

In 1945, the Pennsylvania General Assembly adopted the

UPIA, by enacting the Act of May 3, 1945, P.L. 416 (1945 Act).[19] In 1947, the General Assembly enacted its successor, the "Principal and Income Act of 1947" (1947 Act).[20] The 1947 Act repealed and replaced the 1945 Act as well as Section 22 of the "Fiduciaries Act." [21] See former Section 14 of the 1947 Act, formerly 20 P.S. § 3470.14. The 1947 Act substantially reenacted the 1945 Act, with some changes.[22]

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The 1947 Act provided for the ascertainment of income and principal and apportionment of receipts and expenses between tenants and remaindermen. Former Section 2 of the 1947 Act, formerly 20 P.S. § 3470.2. Its purpose was to insure equitable treatment of various interests in trust corpus. *In re Anthony's Estate*, 423 Pa. 401, 223 A.2d 857, 861 (1966). Indeed, "the Legislature acted to provide for a fairer, more orderly and more uniform apportionment between income and principal." *In re Norvell's Estate*, 415 Pa. 427, 203 A.2d 538, 542 (1964) (footnote omitted).

At the time Section 27 was ratified, the 1947 Act, *as amended*, was the trust law in effect. Section 1 of the 1947 Act defined the term "principal" as used therein to mean "any realty or personalty which has been so set aside or limited by the owner thereof, or a person thereto legally empowered, that it and *any substitutions for it are to remain in trust perpetually*, or are eventually to be conveyed, delivered or paid to a person, while the return therefrom, or use thereof, or any part of such return or use, is in the meantime, to be taken or received by or held for accumulation for the same or another person." Former Section 1 of the 1947 Act, formerly 20 P.S. § 3470.1 (emphasis added). It defined the term "income" as "the return derived from principal." *Id.* As used within the 1947 Act, the term "tenant" referred to "the person to whom income is presently or currently payable, or for whom it is accumulated, or who is entitled to the beneficial use of the principal presently and for a time prior to its distribution." *Id.* The term "trustee" included "the original trustee of any trust to which the principal may be subject and also any succeeding or added trustee." *Id.* "Remainderman" meant "the person ultimately entitled to the principal, whether named or designated by the terms of the transaction by which the principal was established, or determined by operation of law." *Id.* "The particular definitions that the Legislature adopted by the 1947 Act represent what that body determined to be a pragmatic necessity for a current, definite, more understandable and more workable rule of fair apportionment." *Norvell's Estate*, 203 A.2d at 542.

The 1947 Act governed:

the ascertainment of income and principal and the apportionment of receipts and the expenses between tenants

and remaindermen in all cases where a principal has been established with, or, unless otherwise stated hereinafter, without the interposition of a trust: *Provided, That the person establishing the principal may himself direct the manner of ascertainment of income and principal and the apportionment of income and principal and the apportionment of receipts and expenses or grant discretion to the trustee, or other person, to do so and such provision and direction, where not otherwise contrary to the law, shall control, notwithstanding this act .*

Former Section 2 of the 1947 Act, formerly 20 P.S. § 3470.2 (emphasis added).

Section 9 of the 1947 Act governed the disposition of natural resources or wasting assets, providing:

Where any part of the principal consists of property in lands from which may be taken timber, minerals, coal, stone, oil, gas or other natural resources

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and the trustee or tenant is authorized by the terms of the transaction by which the principal was established or by order of court to sell, lease or otherwise develop such natural resources or where such natural resources have been leased or developed prior to the transaction by which the principal was established, and no provision is made for the disposition of the net proceeds thereof after the payment of expenses and carrying charges on such property, one-third of the net proceeds, if received as rent or payment on a lease, or as royalties, shall be deemed income, and the remaining two-thirds thereof shall be deemed principal to be invested to produce income Such proceeds if received as consideration for the permanent severance of such natural resources from the land, payable otherwise than as rents, or royalties, shall be deemed principal to be invested to produce income .

Nothing in this section shall be construed to abrogate or extend any right, which may otherwise have accrued by law, to a tenant to develop or work such natural resources for his own use.

Former Section 9 of the 1947 Act, formerly 20 P.S. § 3470.9 (emphasis added).[23]

Our research has only revealed one case specifically addressing application of Section 9 of the 1947 Act.[24] In *In re McLean's Estate*, 85 Pa. D. & C. 129, 132 (C.P. Washington 1953), the will authorized trustees to sell at their discretion any of the assets of the trust but made no special disposition of net proceeds of any sale. Pursuant to Section 9 of the 1947 Act, the court determined that one third of the returned purchase price received from the sale of coal was income to be awarded to the income

beneficiaries and the balance was principal to be invested. 85 Pa. D. & C. at 132.

Though the statutory law in this regard has since changed,[25] our directive on remand

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was to apply underlying principles of Pennsylvania trust law in effect at the time of the Environmental Rights Amendment's ratification. As the 1947 Act, as well as common law make clear, it is the testator's intent as reflected in the governing instrument that controls. Section 9 of the 1947 Act governs trusts where the trustee is authorized to sell, lease or otherwise develop such natural resources *and* no provision is made for the disposition of the net proceeds. Former 20 P.S. § 3470.9. Therefore, we reexamine the intent embodied in Section 27 to determine whether Section 9 of the 1947 Act applies.

D. Testator's Intent

As the 1947 Act and common law both make clear, the paramount principle that guides interpretation of the trust provisions is the expressed intention of the testator as reflected in the governing instrument. Section 27 is the governing instrument of the public natural resources trust. Section 27 contemplates the Commonwealth's "continued, but judicious, use of the resources." *PEDF II*, 161 A.3d at 947 (Baer, J., concurring and dissenting). As Justice Baer noted in *PEDF II*, during the drafting process of Section 27, the framers substituted the word "conserve" for "preserve" and removed the phrase "in their natural state." *PEDF II*, 161 A.3d at 947. Consequently, the drafters "did not intend to freeze the current status of the natural resources nor to prevent the Commonwealth's ability to utilize the resources." *Id.* As a result, the Commonwealth is authorized to lease the lands and develop its natural resources provided it is in the Commonwealth's best interests. *Id.*; see also Section 302(a)(13) of the CNRA, 71 P.S. § 1340.302(a)(13) (authorizing DCNR to enter oil and gas leases when it serves the Commonwealth's best interests).

Although Section 27 expressed the intent to conserve and maintain the corpus - public natural resources - for the benefit of all the people, it made no provision for the disposition of the net proceeds obtained from the use thereof. In other words, it did not specify the method for allocating receipts. Though Section 27's intent was clear, the directions for administration of the trust were not expressly delineated. Consequently, Section 9 of the 1947 Act governs the ascertainment of income and principal and the apportionment of proceeds between income and principal. See former 20 P.S. § 3470.2, 3470.9.

The Supreme Court in *PEDF II* apportioned royalties to the

corpus because

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they were received as consideration for the permanent severance of natural resources from the land. *PEDF II*, 161 A.3d at 933-34 (citing *McKeown's Estate*, 106 A. at 190).[26] However, the Supreme Court did not answer the question regarding how to apportion the proceeds from rents and bonuses. Thus, we must determine whether those payments were "received as rent or payment on a lease" and therefore income, or "received as consideration for the permanent severance of such natural resources from the land" and therefore principal. We turn now to the leases themselves and the evidence presented by the parties to determine "the purpose of the up-front bonus bid payments" and rental payments. *PEDF II*, 161 A.3d at 935.

E. State Forest Oil and Gas Leases

Section 302(a)(6) of the CNRA empowers DCNR "to make and execute contracts or leases in the name of the Commonwealth for the mining or removal of any valuable minerals that may be found in State forests ... whenever it shall appear to the satisfaction of [DCNR] that it would be for the best interests of this Commonwealth to make such disposition of those minerals." 71 P.S. § 1340.302(a)(6). Section 302(a)(6) further provides:

Any proposed contracts or leases of valuable minerals exceeding \$1,000 in value shall have been advertised once a week for three weeks, in at least two newspapers published nearest the locality indicated, in advance of awarding such contract or lease. The contracts or leases *may then be awarded to the highest and best bidder*, who shall give bond for the proper performance of the contract as [DCNR] shall designate. However, where the Commonwealth owns a fractional interest in the oil, natural gas and other minerals under State forest lands, the requirement of competitive bidding may be waived, and [DCNR] may enter into a contract to lease that fractional interest, with the approval of the Governor, and upon such terms and conditions as [DCNR] deems to be in the best interest of this Commonwealth.

Id. (emphasis added).

1. Leases

Pursuant to this authority, in 2008, DCNR approved a lease sale of 74,000 acres of State forests. *PEDF II*, 161 A.3d at 920; see Petitioner's Amended Application for Relief, Exhibit A (Information identifying 18 tracts comprising 74,023 acres offered for sale in September 2008); Respondents' Joint Brief in Support of Summary Relief, Exhibit B (Deposition of Daniel Devlin, 2/15/18) at 27 (Devlin Deposition). DCNR conducted a competitive,

sealed bid process and received bids ranging from \$2,104,028 for 1,828 acres to \$28,451,200 for 8,891 acres. Petitioner's Amended Application for Relief, Exhibit A (Affidavit of John H. Quigley, 6/29/17) at 1 (Quigley Affidavit); Respondents' Application for Summary Relief, Exhibit A (Declaration of John Norbeck, 5/2/18) (Norbeck Declaration) ¶14. In January 2009, DCNR executed oil and gas leases for these tracts with companies that offered the highest bids (referred to as "first year's land rental" or bonus payments) on the State forest tracts offered for oil and gas extraction and sale (January 2009 Leases). Petitioner's

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Amended Application for Relief, Exhibit A (bid details).

Thereafter, DCNR held additional State forest lease sales and entered leases for those tracts in January 2010 for 32,000 acres (January 2010 Leases) and May 2010 for 33,000 acres (May 2010 Leases) with the highest bidders. See Quigley Affidavit at 1-2; Petitioner's Amended Application for Relief, Exhibits B (1/8/09 Lease for State Forest Tract No. 728), C (1/20/10 Lease for State Forest Tract No. 001), and D (5/10/10 Lease for State Forest Tract No. 728). In February 2013, DCNR held a lease sale for publicly owned streambeds (2013 Streambed Leases). See Petitioner's Amended Application for Relief, Exhibit E (2/15/13 Lease for Streambed Tract No. 2004).[27]

In general, the leases established a lease term of 10 years. The primary term of the lease is five years during which time the lessee must "commence a well" or the lease will automatically terminate. The lease "shall continue from year-to-year thereafter so long as oil or gas is produced in paying quantities from the leased premises, ... or as long as Lessee demonstrates to [DCNR's] satisfaction bona fide attempts to secure or restore the production of oil and gas by conducting drilling or reworking operations on the leased premises. See Petitioner's Amended Application for Relief, Exhibits B, C and D, § 1. When the primary lease term ends without commencement of production by the lessee, the lease contract expires. *Id.* § 20.

The leases also generated funds in the form of: (1) bonus bid, (2) rental, (3) royalty, and (4) interest on late payments. Petitioner's Amended Application for Relief, Exhibits B, C and D, § § 3-6; Norbeck Declaration ¶4; see *PEDF II*, 161 A.3d at 920-21. Of relevance to our discussion are the bonus and rental payments, which are both incorporated under the "RENTAL" section of DCNR's standard lease agreements. Pursuant to the "RENTAL" provision, lessees are required to pay to DCNR a bonus bid, which is referred to as a "bonus rental payment" for the first year, and "rental payments" for years 2 through 10. Petitioner's Amended Application for Relief, Exhibits B, C and D, § 3. The leases classify oil and gas royalties and penalty interest separately.

Id. § 4-6, 7.03.

Aside from the first year's bonus payment, the rents are comprised of annual rental fees, ranging from \$20-25 per acre, in addition to an initial "bonus payment." *Id.* § 3. For example, the January 2009 Leases provide:

3. RENTAL

3.01 Lessee shall pay to [DCNR] a rental for the leased premises at the following rate: *the first year's rental shall consist of the bonus payment which was made by Lessee and shall be payable upon delivery of this lease to Lessee.* The second, third and fourth year's rentals shall be TWENTY DOLLARS (\$20.00) per acre each year, payable upon the anniversary date of this lease. For the fifth and all subsequent years thereafter, the rental shall be THIRTY-FIVE DOLLARS (\$35.00) per acre each year, payable on the anniversary date of this lease.

Petitioner's Amended Application for Relief, Exhibit B, § 3.01 (emphasis added). The preliminary provision of this lease set forth:

NOW THEREFORE, in consideration of the sum of TWELVE MILLION

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TWO HUNDRED EIGHTY-SEVEN THOUSAND TWO HUNDRED THIRTY-NINE DOLLARS (\$12,287,239.00) paid by Lessee to [DCNR], receipt of which is hereby acknowledged, and other mutual covenants and agreements hereinafter set forth, [DCNR] does hereby grant, demise, lease, and let, exclusively unto Lessee for the purposes only of exploring, drilling, operating, producing, and removing of oil, gas and liquid hydrocarbons; and at locations subject to the approval of District Forester, acting for [DCNR], the laying of pipelines and the building of roads, tanks, towers, stations, and structures thereon to produce, save, take care of, and transport said products, all that certain tract of land, TRACT NO. 728 containing 4,621 acres

Id. While the rental prices are consistent from lease to lease, the subject tracts and bonus prices vary. *See* Petitioner's Amended Application for Relief, Exhibits B, C and D, § 3.

Significantly, the rental payments are reduced by the number of wells producing in paying quantities, i.e., royalties. Petitioner's Amended Application for Relief, Exhibits B, C and D, § § 3, 4, 5, 20. In effect, if the lessee drills enough productive wells, per the spacing terms set forth in the lease, lessee may not owe any rentals during the lease term. *See id.* If, however, a well that is capable of producing natural gas is "shut in, suspended, or otherwise not produced and the natural gas is not used or marketed," lessee must pay rent. *See, e.g.,* Petitioner's Amended

Application for Relief, Exhibit B, § 3.03.

The wording and placement regarding the bonus payment changed slightly in the January 2010 Lease, which provides:

3. RENTAL

3.01 Lessee shall pay to [DCNR] *a bonus rental payment of THREE THOUSAND ONE HUNDRED TWENTY FIVE DOLLARS (\$3,125.00) per acre for the leased premises for the first year*, which equates to a total payment of TWENTY THREE MILLION, TWO HUNDRED FIFTY THREE THOUSAND, ONE HUNDRED TWENTY FIVE DOLLARS DOLLARS [sic] (\$23,253,125.00), no later than 5:00 p.m. EST, Friday, March 12, 2010.

Petitioner's Amended Application for Relief, Exhibit C, § 3.01 (emphasis added). The preliminary provision of this lease set forth:

NOW THEREFORE, in consideration of the foregoing and the mutual promises contained herein, and intending to be legally bound, the parties agree as follows:

1. LEASE TERM

1.01 [DCNR] hereby leases to Lessee all that certain tract of land known as TRACT NO. 001 containing approximately 7441 acres ... for the sole purposes of (1) exploring, drilling, operating, producing, and removing of oil, gas and liquid hydrocarbons; and (2) at locations approved by [DCNR], laying pipelines and constructing roads, tanks, towers, stations, and structures thereon to produce, save, take care of, and transport extracted products.

Id. The May 2010 Leases and 2013 Streambed Leases were similarly structured to the January 2010 Leases. *Compare* Petitioner's Amended Application for Relief, Exhibit C with Exhibits D and E.

2. Other Evidence

The parties also presented other evidence regarding the nature and purpose of these payments. John Norbeck, Deputy Secretary for DCNR's Parks and Forestry, attested that DCNR utilizes a formal

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bidding process for most of its oil and gas leases. Norbeck Declaration ¶6. The successful lessee is often determined by its high bid, i.e., bonus payment. *Id.* The bonus payment is money paid to DCNR after successfully obtaining a lease. *Id.* ¶5. Norbeck stated: "Not all leases result in the

extraction of oil or gas, but every lessee pays a bonus payment. *Id.* Rental payments are required to be paid to DCNR on an annual basis prior to, and notwithstanding, the extraction of oil or gas. *Id.* DCNR's oil and gas leases provide that DCNR retains any bonus payments and rentals received even when no oil or gas is produced. *Id.* ¶11. Similarly, interest charged on late payments is due when no oil or gas is produced. *Id.* Royalty payments, on the other hand, are directly related to the extraction of oil and gas and only become due and owing if oil or gas is extracted from the public natural resource. *Id.* ¶10.

Norbeck further attested that between 2003 and 2015, DCNR terminated 16 oil and gas leases with various operators because no oil or gas was extracted from the tracts under the lease; there was no sale of public natural resources in those scenarios. *Id.* ¶13. Norbeck provided specific examples of oil and gas leases that were terminated for lack of production. *Id.* ¶14(a)-(p). Based on these 16 terminated leases, DCNR received and retained a total of \$120,479,684 in bonus payments and \$3,528,630 in rental payments, without any gas or oil removed. *Id.* ¶¶14-15.

John H. Quigley, who formerly served in several executive positions with DCNR between 2005 and 2011, was involved in all of the activities and decisions related to the lease sales conducted by DCNR between 2008 and 2010. He attested that "[t]he bonus bid was designed to reflect the partial or potential value of the natural gas that would be extracted." Quigley Affidavit at 2. According to Quigley, the competitive bonus bid component of the process was the basis upon which DCNR awarded the leases and granted access to State forest land. *Id.* Under the leases, DCNR received bonus bids, annual rentals and royalties, which were all deposited into the Lease Fund. *Id.*

Daniel Devlin, the current Director of the Bureau of Forestry, testified by deposition as DCNR's designated representative to answer questions regarding the origin, history, and purpose of bonus payments. Devlin Deposition, at 4, 11-12, & Exhibit A (Application for Determination of Bonus Payments Notice of Deposition). Devlin testified regarding the process leading to the execution of a lease. Oil and gas companies "nominate land" and ask DCNR to put it up for bid. Devlin Deposition, at 9. DCNR conducts an environmental review to determine if the tract is suitable for leasing. *Id.* at 9-10. Once a tract is chosen, DCNR advertises the tract in multiple outlets with bidding instructions. *Id.* DCNR usually conducts a sealed bid, which includes a bonus bid component. *Id.* at 10-11.

Devlin described the bonus component of the bids as "an up front payment that's to differentiate who is the high bid[der]." *Id.* at 13. It is "a method to differentiate the different bidders, in other words to get the highest bid." *Id.* at 11. DCNR places a minimum bid on the tract, "but the

bonus bid is really what the companies are willing to pay for that particular tract of land. From our perspective, it's our fiduciary responsibility to get the best value for the tract of land possible." *Id.* at 11. Normally, the company with the highest bid is awarded the oil and gas lease. *Id.* at 11. The bid determined "who got the right to explore and potentially extract gas." *Id.* at 31-32.

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Devlin differentiated royalties and rentals from bonuses. Rentals, he explained, are a "set fee" established in the bid proposal and lease itself. *Id.* at 13. Rentals are due every year under the terms of the lease regardless of whether the company develops the tract. *Id.* "A royalty is when they actually do the extraction, and royalty is determined again by the lease, and it is usually a percentage of the income generated by the company." *Id.* at 32. The lease "specifies the amount of royalty." *Id.*

Devlin testified that the Commonwealth has leased public land since the 1950s and the royalties, rents, and bonus bid payments have gone into the Lease Fund. *Id.* at 17, 13-14, 30. Devlin did not know whether the transfers from the Lease Fund to the General Fund per the fiscal amendments derived from royalties, rents, bonus bid payments, or from some combination of the three sources. *Id.* at 32-33, 35.

Stacie Amsler, DCNR's Director of Administrative Services, testified by deposition as the designated representative to answer questions regarding the history of the use of bonus payments. Respondents' Joint Brief in Support of the Application for Summary Relief, Exhibit C (Deposition of Stacie Amsler, 2/15/18) at 4. Amsler testified that bonus payments, rents, royalties and interest go into the Lease Fund and have since the Lease Fund Act was established in 1955. *Id.* at 5. The payments are coded separately in the general ledger accounts. *Id.* at 5.

F. Analysis

Based upon the evidence presented and our review of Pennsylvania's trust law in effect in 1971, we conclude that bonus and rental payments are not for the severance of natural resources. Rather, these payments are consideration for the exploration for oil and gas on public land. More particularly, the rentals secure the lessee's right to enter the property for exploratory and development purposes and the rents accrue based on mere passage of time, not the production of oil or gas. The purpose of the bonuses is to determine the highest bidder for the award of the lease. The bonuses are consideration for the execution of the lease, and not consideration for severance of the mineral.

Though bonuses and rental payments are made in anticipation of extraction, these payments relate directly to

the lessee's ability to secure the lease and the right to explore for oil and gas on the property. As demonstrated by the evidence presented, the Commonwealth is entitled to keep this money regardless of production, even when the lease is terminated. Thus, we conclude that these payments were received as rent or payment on a lease and were not "received as consideration for the permanent severance" of natural resources from the land.[28] *See former* 20 P.S. § 3470.9.

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Pursuant to *former* Section 9 of the 1947 Act, "one-third of the net proceeds, if received as rent or payment on a lease, ... shall be deemed income, and the remaining two-thirds thereof shall be deemed principal to be invested to produce income." Therefore, we conclude that one third of the rental and bonus payments going into the Lease Fund constitute income; the other two thirds of rental and bonus payments constitute part of the corpus. *See former* 20 P.S. § 3470.9.

Because proceeds designated as "income" are not required to remain in the corpus of the Section 27 trust and used solely for the conservation and maintenance of our public resources, this money may be appropriated for General Fund purposes. *See PEDF II*, 161 A.3d at 936. Therefore, Sections 1604-E and 1605-E of The Fiscal Code and Section 1912 of the Supplemental General Appropriations Act of 2009, which directed the transfer of money from the Lease Fund to the General Fund, are not facially unconstitutional under Article I, Section 27 of the Pennsylvania Constitution. However, an accounting is necessary to ensure that only one-third of the proceeds allocable to income are removed from the Lease Fund for non-conservation purposes and that the funds designated as principal are ultimately used in accordance with the trustee's obligation to conserve and maintain our natural resources. *See PEDF II*, 161 A.3d at 939.

This disposition fulfills Section 27's purpose and intent to "conserve and maintain" Pennsylvania's public natural resources for the benefit of all the people while also allowing today's generation of Pennsylvanians to benefit in other ways from the revenue produced. The 1947 Act's allocation of proceeds to principal and income reflects an equitable balance between the needs of present and future generations of Pennsylvanians. This equitable balance was strived for in the UPLA and the 1947 Act, and is similarly reflected in today's law.[29] This result is not only a reasonable construction of Section 27's intent, but is in strict accordance with the Supreme Court's mandate on remand to apply Pennsylvania trust law in effect when Section 27 was ratified.

IV. CONCLUSION

Accordingly, we grant the Commonwealth's application for summary relief upon concluding that Sections 1604-E and 1605-E of The Fiscal Code (72 P.S. § § 1604-E and 1605-E), and Section 1912 of the Supplemental General Appropriations Act of 2009 are not facially unconstitutional. We deny the Foundation's application for summary relief.

Judge Fizzano Cannon did not participate in the decision of this case.

ORDER

AND NOW, this 29th day of July, 2019, Respondents' application for summary relief is hereby GRANTED, and Petitioner's application for summary relief is DENIED in accordance with the foregoing opinion.

Notes:

[1] This Court has original jurisdiction pursuant to Section 761(a) of the Judicial Code, 42 Pa. C.S. § 761(a).

[2] The Foundation is an environmental advocacy entity.

[3] 42 Pa. C.S. § § 7531-7541.

[4] As this Court has explained:

"[I]t has long been the law in Pennsylvania that following remand, a lower court is permitted to proceed only in accordance with the remand order." *Commonwealth v. Sepulveda*, 636 Pa. 466, 144 A.3d 1270, 1280 n.19 (2016). In *Levy v. Senate of Pennsylvania*, 94 A.3d 436 (Pa.Cmwlth.), *appeal denied*, 630 Pa. 738, 106 A.3d 727 (Pa. 2014), which the Supreme Court cited with approval in *Sepulveda*, this Court explained: "Where a case is remanded for a specific and limited purpose, 'issues not encompassed within the remand order' may not be decided on remand. A remand does not permit a litigant a 'proverbial second bite at the apple.'" *Levy*, 94 A.3d at 442 (quoting *In re Indep. Sch. Dist. Consisting of the Borough of Wheatland*, 912 A.2d 903, 908 (Pa.Cmwlth. 2006)).

Marshall v. Commonwealth, 197 A.3d 294, 306 (Pa.Cmwlth. 2018).

[5] Act of April 9, 1929, P.L. 343, *as amended*, 72 P.S. § § 1-1805.

[6] Act of December 15, 1955, P.L. 865, *formerly* 71 P.S. § § 1331-1333, repealed by the Act of October 30, 2017, P.L. 725. The Lease Fund Act was replaced by Section 1601.2-E of The Fiscal Code, added by the Act of October 30, 2017, P.L. 725, 72 P.S. § 1601.2-E. Section 1601.2-E continues to

provide that "[r]ents and royalties from oil and gas leases of land owned by the Commonwealth, except rents and royalties received from game and fish lands" shall be deposited into a special fund." 72 P.S. § 1601.2-E. The fund also includes: payments provided for in Section 5 of the Act of October 8, 2012, P.L. 1194, 71 P.S. § 1357.5, known as the "Indigenous Mineral Resources Development Act," and "[a]ny other money appropriated or transferred to the fund." *Id.* Rents and royalties continue to remain undefined. See Section 1601-E of The Fiscal Code, added by the Act of October 9, 2009, P.L. 537, 72 P.S. § 1601-E (definitions).

As for the permitted "use" of money within the Lease Fund, Section 1601.2-E of The Fiscal Code now provides: "Money in the fund may only be used as provided under subsection (e) or as annually appropriated by the General Assembly. In making an appropriation from the fund, the General Assembly shall consider the Commonwealth's trustee duties under section 27 of Article I of the Constitution of Pennsylvania." 72 P.S. § 1601.2-E. Subsection (e) permitted the following annual transfers:

(1) For the 2017-2018 fiscal year and each fiscal year thereafter, \$20,000,000 shall be transferred from the fund to the Marcellus Legacy Fund for distribution to the Environmental Stewardship Fund.

(2) For the 2017-2018 fiscal year and each fiscal year thereafter, \$15,000,000 shall be transferred from the fund to the Marcellus Legacy Fund for distribution to the Hazardous Sites Cleanup Fund.

72 P.S. § 1601.2-E(e).

[7] The Lease Fund Act was repealed after the Supreme Court's opinion in *PEDF II*, which was decided on June 20, 2017.

[8] Act of June 28, 1995, P.L. 89, as amended, 71 P.S. § § 1340.101 - 1340-1103.

[9] Specifically, the Supreme Court declared that Sections 1602-E and 1603-E of The Fiscal Code, added by the Act of October 9, 2009, P.L. 537, 72 P.S. § § 1602-E, 1603-E, are facially unconstitutional. Section 1602-E provided:

Notwithstanding any other provision of law and except as provided in section 1603-E, no money in the fund *from royalties* may be expended unless appropriated or transferred to the General Fund by the General Assembly from the fund. In making appropriations, the General Assembly shall consider the adoption of an allocation to municipalities impacted by a Marcellus well.

72 P.S. § 1602-E (emphasis added). Section 1603-E provided:

Subject to the availability of money in the [Lease Fund] following transfers, up to \$50,000,000 from the [Lease Fund] *from royalties* shall be appropriated annually to [DCNR] to carry out the purposes set forth in the [Lease Fund Act]. [DCNR] shall give preference to the operation and maintenance of State parks and forests.

72 P.S. § 1603-E (emphasis added).

[10] Section 1604-E was added by the Act of October 9, 2009, P.L. 537, 72 P.S. § 1604-E, and provides: "Notwithstanding section 1603-E or any other provision of law, in fiscal year 2009-2010 the amount of \$60,000,000 shall be transferred from the [Lease Fund] to the General Fund." 72 P.S. § 1604-E.

Section 1605-E was added by the Act of July 6, 2010, P.L. 279, 72 P.S. § 1605-E, and provides:

(a) Fiscal year 2010-2011.--Notwithstanding section 1603-E or any other provision of law, in fiscal year 2010-2011, the amount of \$180,000,000 shall be transferred from the [Lease Fund] to the General Fund.

(b) Fiscal year 2014-2015.--Notwithstanding section 1603-E or any other provision of law, in fiscal year 2014-2015, the amount of \$95,000,000 shall be transferred from the [Lease Fund] to the General Fund.

72 P.S. § 1605-E.

[11] Act of October 9, 2009, P.L. 779. Section 1912 of the Supplemental General Appropriations Act of 2009 directed the transfer of \$143 million from the Lease Fund to the General Fund.

[12] Rule 1532(b) of the Pennsylvania Rules of Appellate Procedure, governing summary relief, provides that "[a]t any time after the filing of a petition for review in an original jurisdiction matter the court may on application enter judgment if the right of the applicant thereto is clear." Pa. R.A.P. 1532(b). We may grant summary relief "only if no material questions of fact exist and the right to relief is clear." *PEDF II*, 161 A.3d at 929. In addition:

[A]s challenges to the constitutionality of statutes present pure questions of law, our standard of review is *de novo*, and our scope of review is plenary. As with any constitutional challenge to legislation, the challenger bears the heavy burden of demonstrating that the statute "clearly, plainly, and palpably violates the Constitution," as we presume that our sister branches act in conformity with the Constitution. In interpreting constitutional language, the fundamental rule of construction which guides [this Court] is that the Constitution's language controls and must be interpreted in its popular sense, as understood by the people when they voted on its adoption. As with our interpretation

of statutes, if the language of a constitutional provision is unclear, we may be informed by "the occasion and necessity for the provision; the circumstances under which the amendment was ratified; the mischief to be remedied; the object to be attained; and the contemporaneous legislative history.

Id. (internal citations and quotations omitted).

[13] We note that the issue is not necessarily restricted to money in the Lease Fund or DCNR's ability to use that money. As our Supreme Court noted:

DCNR is not the only agency committed to conserving and maintaining our public natural resources, and the General Assembly would not run afoul of the constitution by appropriating trust funds to some other initiative or agency dedicated to effectuating Section 27. *By the same token, the Lease Fund is not a constitutional trust fund and need not be the exclusive repository for proceeds from oil and gas development.*

PEDF II, 161 A.3d at 939 (emphasis added).

[14] *See Rights of tenant for life or for years and remaindermen inter se in royalties or rents under oil, gas, coal, or other mineral lease*, 18 A.L.R.2d 98, § 2 (1951). In the absence of a special trust provision or statute, the allocation among beneficiaries of proceeds from oil and gas leases follows the division of proceeds between the owner of a legal life estate and the owner of the complementary future interest depending upon application of the "open mine" or "open well" doctrine, discussed supra. 18 A.L.R.2d 98, § 2; Kuntz § 8.7. There is a split of authority as to whether a bonus paid for an oil and gas lease is income or principal to be conserved for the remainder beneficiary. 18 A.L.R.2d 98, § 2; Kuntz § 8.7; *see Bogert* § 827 (a bonus is a sum paid for the execution of the lease, representing its market value, or to be paid later out of the lessee's share of the production of a well); Sullivan at 108 (the principal questions are whether the cash bonus is merely additional consideration for the execution of the lease or additional or advance royalties). According to one view, the bonus is not payment for depletion of oil and gas, but rather income from the premises and the life tenant may retain the entire sum. Kuntz § 8.7; Sullivan at 75. The other view is that the bonus is paid for the right to deplete the corpus and represents a part of the consideration for the sale of the mineral estate. Kuntz § 8.7; Walter L. Summers, *A Treatise on the Law of Oil and Gas* § 586 (1958). Under the latter view, a life tenant is only entitled to the interest thereon. Sullivan at 74. However, "a problem arises as to whom they are payable inasmuch as these provisions are covenants that run with the land and with the lease." Sullivan at 108. Rentals have also been variously apportioned as income or principal depending upon the

application of the doctrine.

[15] The UPIA was revised in 1962, 1997, 2000 and, most recently, in 2008.

[16] Available at www.uniformlaws.org (last visited on July 8, 2019).

[17] The doctrine was considered an inequitable distribution between present day and future interest owners because it was an either/or proposition. *See* 18 Hastings L.J. at 398; *see also* Scott § 239.3; Kuntz § 8.2. If a mine or well was open, the doctrine favored the life tenant or life beneficiary at the expense of the remainder in interest, and if the mine or well was not open, the inverse. *See* Scott § 239.3; Kuntz § 8.2; 18 Hastings L.J. at 398. If open, it allowed the complete exhaustion of the natural resources by a life tenant to the exclusion of remaindermen. *See* Eley's Appeal.

[18] It also abrogated the so-called "Pennsylvania Rule" of apportionment applicable to corporate stocks and dividends. *In re Cunningham's Estate*, 395 Pa. 1, 149 A.2d 72, 77 (1959). Under the Pennsylvania Rule, a life tenant had a right to receive, as income, an apportionment of the stock dividends and the gains from the sale of stocks, which were accumulated since his ownership. *Id.* (citing *Earp's Appeal*, 28 Pa. 368, 374 (1857)); *see also* *McKeown's Estate* (applying Pennsylvania Rule in apportioning corporate dividends between income and principal).

[19] Formerly 20 P.S. § § 3471-3485.

[20] Act of July 5, 1947, P.L. 1283, *as amended*, formerly 20 P.S. § § 3470.1-3740.15.

[21] Act of June 7, 1917, P.L. 447. Section 22 of the Fiduciaries Act addressed apportionment of income, providing:

All annuities, and all payments of rents, income, interest, or dividends of any real or personal property, directed by any will to be made during the lifetime of the beneficiary, or for the life or lives of another person or persons, or for a term of years, shall, like interest on money lent, be considered as accruing from day to day, and shall be apportioned to the date of the death of such beneficiary or of such *cestui que vie*, or to the end of such term of years.

Id.

[22] The 1947 Act was subsequently amended by the Act of August 1, 1963, P.L. 442 (relating to corporate dividends), and was later codified by the Act of November 25, 1970, P.L. 707, as Title 20 "Decedents' and Trust Estates." The 1947 Act was repealed and replaced by the Act of June 30, 1972, P.L. 508, which itself, was repealed,

replaced and amended, and now stands, in its current version as the "Pennsylvania Uniform Principal and Income Act," 20 Pa. C.S. § 8101-8191, which was enacted in 2002 (2002 Act). Although the parties discuss the applicability of the 2002 Act in their briefs, they did not address the 1947 Act, which was the law in effect at the time of the Environmental Rights Amendment was ratified.

[23] This was a deviation from Section 9 of the 1945 Act, as well as Section 9 of UPIA, which provided that the proceeds received by the trustee as rent on a lease shall be deemed income, but if received as consideration, whether as royalties or otherwise, for the permanent severance of such natural resources from the lands, shall be deemed principal. There was no allocation of proceeds received as rent or payment on a lease between income and principal in UPIA and the 1945 Act; it all constituted income. Unfortunately, a review of the legislative journals offers no insight as to why the General Assembly changed the law.

[24] Cases decided after the enactment of the 1945 Act and the 1947 Act still focused on common law principles because, until *In re Catherwood's Trust*, 405 Pa. 61, 173 A.2d 86 (1961), the Supreme Court held that the uniform principal and income acts could only be applied to trusts and tenancies created *after* their enactment; a retroactive application to trusts created prior to their enactment would be unconstitutional. *In re Tyler's Estate*, 447 Pa. 40, 289 A.2d 441, 448 (1972); *see In re Pew's Estate*, 362 Pa. 468, 67 A.2d 129, 130 (1949), *overruled in part by Catherwood's Trust*; *In re Crawford's Estate*, 362 Pa. 458, 67 A.2d 124, 129 (1949), *overruled in part by Catherwood's Trust*; *see, e.g., Bruner's Will* (the will involved was dated, and decedent died, prior to the effective date of the 1945 Act and the 1947 Act; therefore, the statutory provisions did not govern; rather, common law applied). In *Catherwood's Trust*, the Supreme Court held it was not unconstitutional to give retroactive effect to the 1945 and 1947 Acts in the context of corporate stocks, but noted that "[t]he constitutionality of a retroactive operation ... will depend on the existence or nonexistence of any vested property right in the life tenants or remainderman subject to interference by the legislative enactment." 173 A.2d at 91.

[25] *See* Section 8151 of the 2002 Act, 20 Pa. C.S. § 8151. Section 8151 provides:

(a) Allocation for receipts from minerals and other natural resources.--To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources under this section, the trustee shall allocate them as follows:

(1) If received as nominal delay rental or nominal annual rent on a lease, a receipt shall be allocated to income.

(2) If received from a production payment, a receipt shall

be allocated to income if and to the extent that the agreement creating the production payment provides a factor for interest or its equivalent. The balance shall be allocated to principal.

(3) If an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus or delay rental is more than nominal:

(i) sixty-six and two-thirds percent shall be allocated to principal; and

(ii) the balance shall be allocated to income.

(4) If an amount is received from a working interest or any other interest not provided for in paragraph (1), (2) or (3):

(i) sixty-six and two-thirds percent of the net amount received shall be allocated to principal; and

(ii) the balance shall be allocated to income.

* * * (c) Application.--This chapter applies whether or not a decedent or donor was extracting minerals, water or other natural resources before the interest became subject to the trust.

Id.

[26] We note that *McKeown's Estate* involved a trust containing corporate stock and bonds, not realty or mineral leases and the application of the "Pennsylvania Rule." The apportionment of corporate dividends and share rights have their own unique nuances at common law and statutory law. *See Cunningham's Estate*, 149 A.2d at 77; *Earp's Appeal*, 28 Pa. at 374; *see also* Section 5 of the 1947 Act (governing corporate dividends and share rights).

[27] The Foundation attached full copies of the leases to its Amended Application for Relief. According to the parties, the leases identified as exhibits are representative of the Commonwealth leases involved in the respective lease sales.

[28] We note the Supreme Court's admonition that "the Commonwealth, as trustee, has a constitutional obligation to negotiate and structure leases in a manner consistent with its Article 1, Section 27 duties." *PEDF II*, 161 A.3d at 936. Consequently, "[o]il and gas leases may not be drafted in ways that remove assets from the corpus of the trust or otherwise deprive the trust beneficiaries (the people, including future generations) of the funds necessary to conserve and maintain the public natural resources." *Id.* After a careful review of the leases at issue and industry norms, DCNR has utilized standard industry leases, which have included rents, bonuses and royalties as forms of payments since oil and gas development began. DCNR did

not structure or draft the leases in an attempt to remove rents and bonuses from the corpus of the trust. Rather, by securing the highest bid through a competitive bid process, DCNR has acted in the best interests of the Commonwealth. The Commonwealth has not neglected its fiduciary obligations as trustee.

[29] *See* Section 8151 of the 2002 Act, 20 Pa. C.S. § 8151 (apportioning one-third of rentals and bonus payments to income and two-thirds to principal).
