

SUPREME COURT OF PENNSYLVANIA

PENNSYLVANIA ENVIRONMENTAL DEFENSE FOUNDATION,
Appellant

v.

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

No. 64 MAP 2019

**PENNSYLVANIA ENVIRONMENTAL DEFENSE FOUNDATION
APPELLANT BRIEF**

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TABLE OF CONTENTS

| | <u>Page</u> |
|---|-------------|
| I. STATEMENT OF JURISDICTION | 1 |
| II. ORDER IN QUESTION | 1 |
| III. SCOPE AND STANDARD OF REVIEW | 1 |
| IV. STATEMENT OF QUESTIONS INVOLVED | 3 |
| V. STATEMENT OF THE CASE | 5 |
| VI. SUMMARY OF THE ARGUMENT | 7 |
| VII. ARGUMENT | 12 |
| 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 | 12 |
| 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 | 23 |
| C. The Commonwealth Court Erred in Authorizing the Transfer of One Third of Bonus and Rental Payment To the General Fund | 30 |
| 1. The Commonwealth Court Erred in Concluding that Bonus and Rental Payments Are Solely for Oil and Gas Exploration | 33 |
| 2. The Commonwealth Court Erred in Characterizing the Payments as Rent Because They are Not Refundable .. | 34 |

TABLE OF CONTENTS

| | <u>Page</u> |
|---|--------------------|
| 3. The Commonwealth Court Erred in Characterizing Section 27 Beneficiaries as Life Tenants Entitled to Income and Remaindermen | 36 |
| 4. The Commonwealth Court Erred in Relying upon DCNR’s Authority to Lease under CNRA in Interpreting Section 27 | 38 |
| 5. The Commonwealth Court Erred in Applying Section 9 of the Principal and Income Act of 1947 to Lease Payments | 41 |
| 6. The Commonwealth Court Erred in Asserting that Lease Income Can Be Transferred to the General Fund | 42 |
| 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 | 46 |
| D. SECTIONS 1604-E AND 1605-E OF THE FISCAL CODE AND SECTION 1912 OF THE SUPPLEMENTAL GENERAL APPROPRIATIONS ACT OF 2009 ARE UNCONSTITUTIONAL | 49 |
| VIII. CONCLUSION | 53 |

TABLE OF CITATIONS

| | <u>Page</u> |
|---|----------------|
| Pennsylvania Caselaw | |
| <i>Bolton v. Stillwagon</i> , 190 A.2d 105 (Pa. 1963) | 18, 19, 28, 29 |
| <i>Commonwealth ex rel. Paulinski v. Isaac</i> , 397 A.2d 760 (Pa. 1979) | 38 |
| <i>East Crossroads Center Inc. v. Mellon Stuart Co.</i> , 205 A.2d 865 (Pa. 1965) | 13 |
| <i>Felte v. White</i> , 302 A.2d 347 (Pa. 1973) | 16 |
| <i>Hutchinson v. Sunbeam Coal Co.</i> , 519 A.2d 385 (Pa. 1986) | 12 |
| <i>Ieropoli v. AC & S Corp.</i> 842 A.2d 919 (Pa. 2004) | 37 |
| <i>In re Bruner’s Will</i> , 70 A.2d 222 (Pa. 1950) | 18 |
| <i>In re Hartje’s Estate</i> , 28 A.2d 908 (Pa. 1942) | 32, 39 |
| <i>In re Sparks’ Estate</i> , 196 A.48, 57 (Pa. 1938) | 39 |
| <i>In re Trust Estate of Pew</i> , 191 A.2d 399 (Pa. 1963) | 40 |
| <i>Jubelirer v. Rendell</i> , 953 A.2d 514 (Pa. 2008) | 2, 37 |
| <i>Hillcrest Foundation, Inc. v. McFeaters</i> , 2 A.775 (Pa. 1938) | 17 |
| <i>The Hospital & Healthsystem Ass’n of Pa. v. Commonwealth</i> , 77 A.3d 587 (Pa. 2013) | 3 |
| <i>McKeown’s Estate</i> , 106 A. 189 (Pa. 1919) | 17 |
| <i>Metzger v. Lehigh Valley Trust & Safe Deposit Co.</i> , 69 A. 1037 (Pa. 1908) | 32, 39 |

TABLE OF CITATIONS

| | <u>Page</u> |
|--|----------------------|
| Pennsylvania Caselaw (cont.) | |
| <i>Murphy v. Duquesne University of The Holy Ghost</i> , 777 A.2d 418 (Pa. 2001) | 12 |
| <i>Page v. Allen</i> , 58 Pa. 338 (1868) | 45 |
| <i>PEDF v. Commonwealth</i> , 108 A.3d 140 (Pa. Cmwlth. 2015) (<i>PEDF I</i>) | 5 |
| <i>PEDF v. Commonwealth</i> , 161 A.3d 911 (Pa. 2017) (<i>PEDF II</i>) | <i>passim</i> |
| <i>PEDF v. Commonwealth</i> , 214 A.3d 748 (Pa. Cmwlth. 2019) (<i>PEDF III</i>) | <i>passim</i> |
| <i>Robinson Twp. v. Commonwealth</i> , 83 A.3d 901 (Pa. 2013) | 3, 27, 32, 37, 39 |
| <i>Stelmach v. Glen Alden Coal Company</i> , 14 A.2d 127 (Pa. 1940) | 17 |
| <i>Steuart v. McChesney</i> , 444 A.2d 659 (Pa. 1982) | 12 |
| <i>Struthers Coal & Coke Co. v. Union Trust</i> , 75 A. 986 (Pa. 1910) | 39 |
| <i>T.W. Phillips Gas & Oil Co. v. Jedlicka</i> , 42 A.3d 261(Pa. 2012) | 12 |
| Pennsylvania Constitution | |
| Article I, Section 25 | 45 |
| Article I, Section 27 | <i>passim</i> |

TABLE OF CITATIONS

| | <u>Page</u> |
|--|---------------|
| Pennsylvania Statutes | |
| Act of October 9, 2000, P.L. 779, No. 10A, § 1912 | 2 |
| Act of October 30, 2017, P.L. 725, No. 44, § 20 | 15 |
| Conservation and Natural Resources Act, 71 P.S. § 1340.302(a)(6) | 4, 38 |
| Declaratory Judgments Act, 42 Pa.C.S. §§ 7531 – 7541 | 1 |
| Fiscal Code, | |
| Section 1602-E, former 72 P.S. § 1602-E | 7 |
| Section 1603-E, former 72 P.S. § 1603-E | 7 |
| Section 1604-E, 72 P.S. § 1604-E | <i>passim</i> |
| Section 1605-E, 72 P.S. § 1605-E | <i>passim</i> |
| Oil and Gas Lease Fund Act, Act of December 15, 1955, P.L. 865, No. 256 (formerly 71 P.S. §§ 1331-1333) | 15, 20 |
| Principal and Income Act of 1947, Act of July 5, 1947, P.L. 1283 (formerly 20 P.S. §§ 3470.1 – 3740.15) | <i>passim</i> |
| Other | |
| Restatement (Second) of Trusts § 186 | 45 |
| <i>Williston on Contracts</i> (revised edition) Vol. 1, sec. 103C | 17 |

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 IP*”).

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]hough 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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