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At-The-Well or First-Marketable Product? Pennsylvania's High Court will Hear Dressler, LP v. PennEnergy Resources, LLC

On February 15, 2023, the Supreme Court of Pennsylvania granted allocatur to *Dressler Family, LP v. PennEnergy Resources, LLC*; a case squarely addressing the question of whether Pennsylvania is an “at-the-well” jurisdiction, or a “first-marketable product” jurisdiction.^[1]

At issue in *Dressler Family, LP* is the following royalty provision:

Lessee covenants and agrees to pay Lessor as a royalty for the native gas from each and every well drilled on said premises producing native gas, an amount equal to one-eighth (1/8) of **the gross proceeds** received from the sale of same at the prevailing price for **gas sold at the well**, for all native gas saved and marketed for the said premises, payable monthly.^[2]

Gas, of course, is not sold at the well head.^[3] The question, then, is whether the lessee, PennEnergy Resources, LLC, is permitted to deduct costs incurred between the well head and the point of sale. The Court of Common Pleas of Butler County, Pennsylvania, said yes.^[4] The Pennsylvania Superior Court disagreed, holding the provision ambiguous, and thereby opening the door to parole evidence.^[5]

As summarized in the Pennsylvania Superior Court decision, a minority of Pennsylvania's sister states, including North Dakota and Colorado, have adopted the first-marketable product rule, which provides, in summary, that because a lessee has an implied duty to market the oil and gas, it is responsible for the costs to get them to market, and therefore cannot deduct the lessor's pro-rata costs for this.^[6] Under this regime, even if a royalty provision calls for an at-the-well royalty calculation, deduction of post-production costs to get the gas to the point of sale is prohibited. However, at-the-well jurisdictions hold the opposite: that an at-the-well royalty

calculation inherently implies the lessee's right to deduct costs related to getting the gas to the point of sale.^[7]

Specifically, the Supreme Court will address these four questions:

- Whether the Superior Court's decision failed to apply how this Court defined the key Lease terms in *Kilmer v. Elexco Land Services, Inc.*, 605 Pa. 413, 990 A.2d 1147 (2010), and violated the longstanding principle that custom and usage in an industry or trade is always admissible to show that a contract is unambiguous;
- Whether the Lease unambiguously allows for the deduction of post[-]production costs is a key question to Pennsylvania's oil and gas industry, which needs the guidance this Court's review will provide;
- Whether the Superior Court's decision breaks from other courts that have interpreted materially identical lease language, and leaves Pennsylvania as an outlier in not recognizing the significance of common oil and gas lease terms; and
- Whether the Superior Court's decision violated the longstanding principles set by this Court that, to be found ambiguous, a contract must be interpreted to give effect to all of its terms and be subject to a second reasonable interpretation.^[8]

Exactly how Pennsylvania's high Court will answer these questions is not known. But, Pennsylvania is the nation's second-largest producer of natural gas, and its jurisprudence should reflect that status. Therefore, it's imperative for the Court to provide guidance to the Commonwealth's thousands of lessors and lessees. Stay tuned.

For more information, contact any attorney with Frost Brown Todd's [Energy](#) industry team.

^[1] See *Dressler Family, LP v. PennEnergy Res., LLC*, 208 WAL 2022, 2023 WL 2008310 (Pa. Feb. 15, 2023).

^[2] *Dressler Family, LP v. PennEnergy Res., LLC*, 2022 PA Super 77,

276 A.3d 729, 731 (Pa. Super. Ct. 2022), *reargument denied* (July 6, 2022), *appeal granted*, 208 WAL 2022, 2023 WL 2008310 (Pa. Feb. 15, 2023) (bold typeface in original). [A copy of this opinion can be found here.](#)

[3] “The parties agree that gas is not, in fact, sold ‘at the well.’” *Id.*

[4] *Id.*, 276 A.3d 729, 733.

[5] *Id.* at 742.

[6] *Id.* (citing *Newfield Exploration Co. v. State ex re. N.D. Bd. Of Univ. & Sch. Lands*, 931 N.W.2d 478 (N.D. 2019) and *Rogers v. Westerman Farm Co.*, 29 P.3d 887 (Co. 2001)); *see also*, § 33:3. “Marketable product” rule for calculating oil and gas royalties, 3A Summers Oil and Gas § 33:3 (3d ed.) (“The ‘marketable product’ rule holds that ‘production’ is not complete until the lessee has both captured and held the product and made it marketable.”)

[7] *See, e.g.*, § 33:2. “Capture and hold” rule for calculating oil and gas royalties, 3A Summers Oil and Gas § 33:2 (3d ed.) (The ‘capture and hold’ rule states that “production” occurs, for royalty calculation purposes, when the oil or gas is captured and held, either at the wellhead or elsewhere on the lease premises, so that the post-production costs of transporting, compressing, and processing, as well as certain severance and gross production taxes, are charged proportionately against the royalty interest.”)

[8] *Id.* at *1.

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