Statement for the Record

Of

National Association of Royalty Owners (NARO)

Before the Pennsylvania Senate
Environmental Resources and Energy Committee
Senator Gene Yaw, Chairman

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David Sikes, President
david@jeroco.com
405-222-1179 or 405-274-6744
National Association of Royalty Owners (NARO)
15 West 6th Street Suite 2626 Tulsa, OK 74119
918-794-1660 or 800-558-0557
www.naro-us.org

Good Morning Chairman Yaw and Committee members. My name is David Sikes and I am the President of the National Association of Royalty Owners (NARO). It is my pleasure to be here today to represent a national perspective on today's topic. The National President's office in our organization is a volunteer position. As for my professional life, I am a royalty owner and vice-president of a non-operating oil company and mineral management firm located in Chickasha, OK.

<u>The Need for transparency and consistency in check stubs and legislation to establish limitations on royalty payment deductions</u>

1. Who does NARO represent?
2. History of Royalty Payments
3. Effects of royalty payment deductions
4. Check Stub Transparency and Consistency
5. Conclusions

1. <u>Who does NARO represent</u>?

We are the National Association of Royalty Owners (NARO) and represent the concerns of an estimated 8.5 million American private owners of oil and gas mineral and royalty interests. We live and vote in all 50 states, even though our producing minerals may be in Arkansas, New Mexico, North Dakota, Oklahoma, Pennsylvania, Texas, and Utah, Wyoming or any of the 33 producing states. NARO has been educating and advocating for mineral/royalty owners since our original incorporation 30 years ago in 1980.

The average NARO member is over 60 years old, widowed, and receives less than $500 in monthly royalties as a supplement to their social security retirement income.

The majority (something over 70%) of the minerals in the U.S. are owned by individuals and leased to companies for development. Thanks to the efforts of one of our members, we recently took a snap shot of one "marginal" oil well (producing less than 15 barrels of oil per day) in Grady County Oklahoma. This one little well has over 300 individuals in 46 states receiving royalty payments from its production.

Just to give you an idea of how many citizens are royalty owners, if you take our membership in each state as a percentage of a total and then multiply by the estimated 8.5 million royalty owners you get a rough idea of how many royalty owners live in each state. And here are those numbers:

AK 13,600	AL 33,150	AR 255,000	AZ 144,500	CA 510,000
CO 654,500	CT 17,000	DC 17,000	DE 2,550	FL 161,500
GA 85,000	HI 8,330	IA 33,150	ID 35,700	IL 76,500
IN 27,200	KS 147,900	KY 11,050	LA 125,800	MA 30,600
MD 35,700	ME 5,525	MI 44,200	MN 47,600	MO 110,500
MS 39,100	MT 47,600	NC 67,150	ND 24,650	NE 19,550
NH 13,600	NJ 47,600	NM 161,500	NV 44,200	NY 127,500
OH 30,600	OK 1,691,500	OR 51,000	PA 119,000	RI 5,525
SC 22,100	SD 5,525	TN 59,500	TX 2,975,000	UT 39,100
VA 85,000	VT 2,550	WA 39,100	WI 39,100	WV 19,550
WY 30,600			Total nationwide: 8,440,755.	

Remember, these are estimated numbers of *royalty* owners. The total number of *mineral* owners is much greater, as vast areas are unproductive or have not yet been explored and developed.

2. <u>A Brief look at the History of Royalty Payments</u>

The concept of paying a royalty for the use of land or anything owned by another party predates the discovery of this continent. It was always the case that the owner of the land or in this case the subsurface oil and gas minerals would create a contract for the use and/or extraction of those minerals. Obviously, this relationship has change over time. Technology now allows for the safe extraction of oil and gas from deep below the earth's surface. This process that started in Titusville in 1859 when the Drake No. 1 well was completed to a depth of 69.5 feet. Since that day, the exploration for oil and gas has become infinitely more complex.

Until about 10 years ago, one of the common definitions or the term "Royalty" was "Free of cost". This was the beginning of the differences in opinions between royalty owners and producers. Royalty Owners have always maintained that their royalty should be paid free of cost, after all; in most instances, the minerals belong to them.

3. **Effects of Royalty Payment Deductions**

The rapid increase in drilling technology has more than double the estimated reserves of oil and gas available to our country. This abundant, clean burning energy source is providing jobs and economic security for much of our nation. In a period of record high unemployment nationally, the states that are currently exploring for oil and gas are seeing well below average unemployment and strong economic growth.

When mineral owners lease the right to an oil company for exploration of the minerals they own, a legally binding contract is created. As stated previously, NARO is heavily involved in the education of royalty owners. It is imperative that mineral owners understand that the Oil and Gas Lease will dictate how they are paid when a producing well is completed. I have taken many calls from our membership and from my clients complaining about deductions on their royalty checks. My first question is what their lease says about deductions. Increasingly, I am finding that royalty owners have negotiated leases that specifically deny deductions of any kind and yet deductions are being taken. Most companies when this is brought to their attention will repay the deductions and pay the interest on that money.

There are some companies; however, that appear to not care what the lease says and continue to make unauthorized deductions and refuse to substantiate why those deduction are being made. In this instance a clear breach of contract has occurred. The problem is that most royalty owners cannot afford to file a lawsuit on an oil company that has lawyers on their staff. I would not want my testimony to be misconstrued that I believe this is the way all companies deal with royalty owners. On the contrary, most companies do not; it is the few companies that are taking these deductions that are causing the problems. I have personally seen some royalty owner's checks that have had as much as 22% taken out as deductions. This is not including taxes. I have been told by other mineral management companies that they have seen post production expense deductions approach 50% of the royalty owners check total.

Effectively having your royalty payments cut by these kind of percentages severely affects royalty owners, most of whom as stated previously, are on fixed incomes. For a moment, let's look at some other affected entities. The taxes paid on the revenue from oil and gas production helps support state and local government. When excessive deductions are taken, tax revenues are also affected. This decline in taxable revenue has brought this problem to the attention of county commissioners in your state that depend on these funds to build and support infrastructure in their counties.

Royalty owners are teachers, farmers, ranchers, homemakers, accountants, firemen, plumbers, retirees, bankers, dentists, small business owners, factory workers, engineers, pet groomers, widows, roofers, lawyers, policemen, florists, architects, carpenters, secretaries, bricklayers, and members of Congress; we are ordinary citizens, not multi-national corporations. We consider our mineral estates as assets to be managed and protected with responsible stewardship. For the majority of us, our minerals are part of a family legacy acquired through the hard work and sacrifices of our for-bearers. Royalty income pays to educate our children, care for aging parents, and supplement salaried and Social Security income. We spend our money in our communities, give to our local charities and save for the future. Our financial benefits come solely from the mineral interests we own – deep under American soil. When those resources have been exhausted, the royalty income ends.

We want the Committee to understand on a personal level the effects on royalty owners when exceedingly large deductions are taken from royalty payments. Below is a letter to NARO members as posted on the NARO-Arkansas message board in September 2006. This is a very typical royalty owner story.

> "I would have liked to have been at the Convention and Lord willing, I will be at the next one. My absence related to the health of my mother, a 20 year quadruple survivor of cancer. 2 years ago she was once again diagnosed with the disease and elected not to use aggressive treatments. She was given some 3 months to live. I was blessed with 2 years of her continued presence and she was able to live by herself until about one month ago. My niece, my girlfriend, my brother, and I were able to stay with her around the clock until Sept. 6th when we moved her to a nursing home. On Sept. 10th she passed away being lucid until just hours before dying.
>
> It is not unusual to die, my grandfather was fond of saying that it was the most natural thing about living. But I bring up the subject for another reason. The last check my mother received Sept 1 from our Family General Partnership was about $700, that and spousal SS benefits were all she had to live on. Without her royalty income, she could not have remained in her own home which she had lived in since 1944. Quite recently she remarked that without that check she could never have afforded the several hundred dollars per month in medicine that she took in her battle with cancer. In my mother's case, that royalty interest, reserved in 1938 by the foresight of my grandfather in a county which had no oil or gas production, was the difference between living an independent life and living as a ward of the state. . ." *signed by Terrel Shields, NARO-Arkansas Member.*

When a royalty owner has successfully negotiated an Oil and Gas Lease that states that there royalty shall be free from all cost. This contract should be honored, and the courts of that state should and have upheld that the royalty owner was damaged. Oklahoma, Colorado and Texas all have case law where it was upheld that the Oil and Gas Lease is a legally binding contract and must be adhered to by both parties.

4. Check Stub Transparency and Consistency

As I stated before, most royalty owners cannot afford to file lawsuits. Another issue is often times they are not even aware of the fact that deductions are being taken. This brings up the issue of check stub transparency and consistency. Texas and Oklahoma both have statutes that require certain information be included on check stubs. This information is vital so that royalty owner can verify their royalty payments. Most of these statutes only require basic information, but can also include verbiage to require standards for how and when interest is to be paid, and at what rate.

5. Conclusions

Royalty owners need the protection that state statutes can provide in regard to the information that oil and gas companies must make available to royalty owners as well as they need a well-defined statute defining production revenue standards. The technology of drilling has advanced rapidly in recent years creating a situation where oil and gas statutes have been rendered ineffective in some instances.

It is the position of the National Association of Royalty Owners to support legislation that will lead to greater transparency and better relations between royalty owner and our industry partners (producers).

The revenue lost by royalty owners and by state and county governments due to a breach of contract should not be tolerated.

RESPECTIVELY SUBMITTED:

David Sikes, CMM
President, National Association of Royalty Owners