

*PROCEDURE*

## Expect the Unexpected: Nuances of Unclaimed Property Oil and Gas Reporting

*For holders of unclaimed property in the oil and gas industry, the challenge of complying with complex state laws is amplified.*

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Only three things are certain in life: death, taxes, and state unclaimed property enforcement. Over the last decade, state unclaimed property laws have become an easy method for states to increase revenue without raising taxes on their residents. Currently, states hold approximately \$42 billion in unclaimed assets.<sup>1</sup> This has been achieved either through increasingly aggressive penalty and interest assessments on past due remittances, or an exam conducted by multistate unclaimed property contract auditors. Both methods create a large, and potentially costly, headache for holders.

Unclaimed property laws are anything but uniform. From outreach requirements, dormancy periods, filing methods, and statutory deadlines, holders struggle to stay abreast of the numerous details and frequent changes to state laws. For holders in the oil and gas industry, this challenge is amplified, specifically due to the nuances around the reporting of "mineral proceeds."<sup>2</sup> This article provides an overview of the top ten unique items pertinent to the reporting of unclaimed mineral proceeds.

### Oklahoma—Two Agencies

Oklahoma is unique in that reporting of mineral proceeds may be required to two separate state agencies. First, mineral proceeds that emanate from forced pooled oil and gas interests located in Oklahoma, where

the owners of such proceeds cannot be located or are unknown, are required to be reported and remitted to the Oklahoma Corporation Commission.<sup>3</sup> Second, all other mineral proceeds that are required to be reported to Oklahoma are reported to the Oklahoma State Treasurer's Office.<sup>4</sup> We note that instructions to the relevant form state in pertinent part: "Form 497-UP-MIR must be completed when reporting royalty or mineral proceeds originating from mineral properties located within any state."<sup>5</sup>

## Current Pay Reporting

Companies in the oil and gas industry should be aware that a significant number of states have "current pay" or "current balance" rules that apply to the payment of mineral proceeds. Texas was one of the first states, if not the first, to require that mineral proceeds be paid on a current pay basis. Texas reporting instructions define "current pay" to mean "the first time you report a missing owner, you remit the total net amount you are holding for that owner, as of the date of your remittance, even though the three year abandonment period may not have run on the entire balance they are owed."<sup>6</sup>

The reporting of mineral proceeds on a "current pay" basis can be complex and requires a careful review of each state's reporting form and attendant reporting instructions. For example, the Texas State Comptroller's office has now indicated reporting code MI10 (a non-NAUPA reporting code) is to be used solely for the reporting of mineral proceeds on a current pay basis.<sup>7</sup> Wyoming, on the other hand, requires that a holder "[not] commingle newly-reported owners with those previously reported," but report them separately with one check issued for all current pay owners along with a detailed owner listing.<sup>8</sup>

To further complicate matters, Section 209 of the Revised Uniform Unclaimed Property Act (RUUPA) contains language suggesting that any state that adopts RUUPA becomes a current pay state for mineral proceeds.<sup>9</sup> Section 209 of RUUPA states: "At and after the time property is presumed abandoned under this act, any other property right or interest accrued or accruing from the property and not previously presumed abandoned is also presumed abandoned."<sup>10</sup> Significantly, the Comment to such Section states in pertinent part: "The section also encompasses such distributions or accruals on, for example, securities positions, mineral rights, etc. when the underlying property is presumed abandoned."<sup>11</sup>

## Escrow Accounts

Several states with significant oil and gas production have escrow account laws, which generally require a holder to set up an escrow account for certain types of outstanding mineral proceeds. For example,

pursuant to the Oklahoma Unclaimed Pooled Monies Act ("Act"), as discussed above, if a holder identifies mineral proceeds due and owing to an unknown owner or one who is unable to be located, which are required to be paid under a pooling order issued by the Oklahoma Corporation Commission (OCC), then the holder generally is required to establish an escrow account for the benefit of the rightful recipient of the monies and subsequently report and remit the funds to the OCC Mineral Owners Fund.<sup>12</sup>

By way of further example, Wyoming requires funds be placed into escrow "when the ownership is disputed or the account is in litigation."<sup>13</sup> In 2015, Arkansas enacted legislation that eliminated the requirement that holders of mineral proceeds escrow accounts file a special annual report for such accounts.<sup>14</sup> Due to the unique nature of each state escrow account provision, holders are encouraged to review each state's rules in this area carefully.

## Title Disputes

Holders should be aware that jurisdictions may have different rules with regard to whether mineral proceeds suspended as a result of title disputes are required to be reported and remitted as unclaimed property. For example, an Oklahoma appeals court, in the *Phillips Petroleum Co. v. Oklahoma Tax Commission* case, ruled in part that mineral proceeds suspended due to "title requirements" should be considered unclaimed property.<sup>15</sup> However, commentators discussing the ruling have taken a different position, stating as follows: "In some instances, such as a 'stale' title problem, this may make sense. However, in other situations, where an ongoing, bona fide title dispute exists, there may not be a 'fixed and certain' obligation to pay any identifiable person until the title dispute is resolved."<sup>16</sup>

Title disputes can cause considerable confusion in this area. Mineral interest payments that start out as "fixed and certain obligations" can become uncertain when the owner of the property is not clear. This can be due, for example, to surveying errors, boundary disputes, fraudulently conveyed deeds, adverse possession, tax-related issues, etc. Our experience has been that states do not wish to take possession of funds for which an owner is not easily determined, nor are they equipped to settle disputes with regard to possession.

The Commentary to Section 1 of the 1995 Uniform Unclaimed Property Act states in pertinent part: "The requirement that the right be fixed and certain excludes unliquidated claims from the coverage of the Act, such as disputed tort claims." Commentators analyzing this area further state: "Clearly disputed contract claims would be another type of unliquidated claim that should not be subject to a state's unclaimed

property law. In that case, escheatment would be premature and would improperly intrude on the orderly determination of the issue. As long as measures are being taken to resolve the title dispute/pending litigation, the monies associated with the dispute should not be considered unclaimed property."<sup>17</sup>

In support of that position, a review of the Utah State Treasurer's website reveals, under the heading "FAQs—Holder Information," a question that asks "Is Disputed Property Reportable?" It concludes that "[w]hen the holder is aware that the ownership interest of the apparent owner is in dispute or unsettled, the property is not reportable."<sup>18</sup> Similarly, Texas seems to support this position, stating in its reporting instructions: "do not report owners who are in suspense for legal or other reason if you have had contact with them during the preceding three years."<sup>19</sup>

The key here is that continued communication with the apparent owner must take place. Due in part to the complexity of the title dispute area, we recommend, in attempting to ascertain whether amounts suspended due to title disputes need be reported as unclaimed property, that a company's legal counsel be involved in the review process.

## Due Diligence Notifications to Owners

Some states have unique rules in the due diligence area. For example, New Mexico's law places a special, additional due diligence requirement on "the holder of unclaimed intangible property in the form of checks in payment of royalty interests, working interests, or other interests payable out of oil and gas production with a value of fifty dollars or more . . . ."<sup>20</sup> The law states that proof of due diligence is "(1) evidence of written notice mailed to the last known address of the apparent owner; and (2) proof of publication of notice to the apparent owner made between the end of the first year in which the property remained unclaimed and the end of the third year in which the property remained unclaimed."<sup>21</sup>

The notice generally must be published once a week, for two consecutive weeks, in a newspaper of general circulation within the county of the owner's last known address. Details of exact specifications of the notice are provided in the law.

## Non-Applicability of Aggregation Rules

Many states allow smaller amounts to be reported in the aggregate without reporting of details pertinent to each specific owner to whom the mineral proceeds are owed. However, several key states with significant

oil and gas production do not allow aggregation for reporting of mineral proceeds. Thus, Texas reporting instructions state in pertinent part as follows: "Section 74.101(d) allows holders to report individual owner records of less than \$25 in the aggregate. You may combine any amounts under \$25 by property type and provide a single total for each property type . . . . Mineral interests must never be aggregated."<sup>22</sup>

Similarly, Oklahoma State Treasurer Administrative Rules provide in pertinent part that "property which is one of a recurring number of continuous payments, including, but not limited to, royalties . . ." may not be reported in the aggregate, and "shall be reported in the same manner as property with a value of fifty dollars or more."<sup>23</sup> New Mexico, which appears to allow aggregation for other property types, does not allow aggregation for mineral proceeds.<sup>24</sup>

## Forms Unique to Mineral Proceeds

Several states with significant oil and gas production delineate in their reporting instructions that a separate reporting form should be used for mineral proceeds. As mentioned above, mineral proceeds emanating from mineral interests to be reported to Oklahoma (non-forced pooled) are to be reported on State Treasurer Form 497-UP-MIR.<sup>25</sup> Arkansas states that Form AOS/UP3 is to be used only to report unclaimed mineral proceeds.<sup>26</sup> Montana, by way of further example, requires that unlocatable mineral property be filed on Form UCM-1. The reporting instructions describing such form state: "Please note that you may not report other property that is not unlocatable mineral property with this report."<sup>27</sup>

Another recent trend is that more states are requiring holders to report online or electronically. Oklahoma, for example, requires that holders reporting 15 or more items of property must file the report electronically using the State Treasurer's online reporting system.<sup>28</sup>

## Suspense Accounts

In the oil and gas industry, suspense accounts, due to the complexities of the oil and gas business, are widely used for mineral proceeds.<sup>29</sup> Oil and gas companies hold mineral proceeds in suspense accounts for a variety of reasons, including, but not limited to, title disputes, transfer pending, estate pending, unsigned division orders, etc. As stated by the Texas State Comptroller's Office in its instructions to its audit personnel: "Royalty suspense ledgers are a necessary part of the accounting system and here, as elsewhere, unclaimed property appears as an exception to the normal flow of business."<sup>30</sup>

Before any mineral proceeds funds held in suspense should be reported as unclaimed property, we recommend that a company involve its legal counsel in analyzing which suspense account codes or categories should be categorized as reportable and which categories should not be viewed as reportable. A key part of this analysis will likely involve whether legal counsel believes a "fixed and certain obligation" has arisen.<sup>31</sup> Our experience with state contract auditors is that suspense accounts generally are a high-visibility item with the auditors.

## Federal Priority Rules

A mistaken assumption in some circles is that mineral proceeds need only be reported to the state where the underlying mineral interest is located. That is not the case. Several cases which expressly considered this issue in the context of mineral proceeds have ruled that such proceeds should not be reported to the state where the mineral interest is located.

Significantly, in *Texas v. New Jersey*, Texas argued for that result, but its argument was expressly rejected by the U.S. Supreme Court.<sup>32</sup> In addition, in a leading federal court case in this area, it was ruled that an Oklahoma law which purported to require mineral proceeds emanating from production in Oklahoma to be reported solely to Oklahoma violated the federal priority rules of *Texas v. New Jersey*, and thus was preempted by the Supremacy Clause of the U.S. Constitution.<sup>33</sup>

## Connection with Real Property

Unlike most other types of intangible personal property, mineral proceeds have a close connection with the underlying mineral interest, or real property, where the mineral interest is located. There has been an increased interest by states in recent years, when holders turn over payments on mineral interest properties as part of the periodic reporting process, to include the land description so as to more clearly identify the property and assist in causing it to be returned to the owner. A key difficulty, however, in conforming to this requirement lies in the design of standard reporting forms. There is typically less space in the NAUPA approved format (approximately 50 characters) than is necessary for the full land description required by some states.

For example, Oklahoma requires, for mineral proceeds originating from mineral properties located within Oklahoma, that certain details of the associated mineral property be provided. Thus, the state requires that one "enter the legal description of the property as it appears on the deed (Quarter, Section, Township and

Range), owner's percentage of interest as shown on the Division or Transfer Order, and owner's SSN or FEIN . . . ."<sup>34</sup> And, while Texas does not require the property's full legal description, it does require, as of January 1, 2016, an additional entry on the NAUPA file to include the county name or county code if the well is located in Texas, in addition to the already required well name and identification number on mineral interest properties.<sup>35</sup> Wyoming requires the owner number and "the same information . . . normally provided owners on their check stubs or the 'Remittance Advice' which accompanies the checks, and while the lease names (or numbers) are helpful, they are not required."<sup>36</sup>

By way of further example, Arkansas enacted legislation in 2015 requiring a holder of abandoned mineral proceeds to provide the following reporting information, in addition to the name and last known address of the property owner: (1) applicable well name, uncontrolled lease name, or unitized area as recognized by the state's Oil and Gas Commission; (2) either (i) the county, section, township and range of the well, or (ii) the county, section, township and range from which the abandoned minerals were severed or produced; and (3) any other information required by the Auditor of State.<sup>37</sup>

## Conclusion

In summary, preparation of unclaimed property reports for mineral proceeds presents several unique challenges not commonly found in other industries. As such, it requires a close attention to detail, to the specific reporting instructions of each state, and a familiarity with the oil and gas industry in general. Unclaimed property is becoming increasingly important for the states, for holders, and for missing owners. By being aware of the issues discussed in this article, holders in the oil and gas industry may be able to improve relations with owners, reduce regulatory risk, and avoid the ever-growing number of pitfalls relating to unclaimed property reporting.

<sup>1</sup> <http://www.cnbc.com/2016/03/29/hungry-for-revenue-states-hanker-for-unclaimed-assets.html>.

<sup>2</sup> As used here, the term "mineral proceeds" is used broadly to refer collectively to the property types represented by National Association of Unclaimed Property Administrators (NAUPA) codes currently in use by most states for categorizing mineral proceeds for purposes of unclaimed property reporting (i.e., MI01-net revenue interests, MI02-royalties, MI03-overriding royalties, MI04-production payments, MI05-working interests, MI06-bonuses, MI07-delay rentals, MI08-shut-in royalties, and MI09-minimum royalties). We note that the term "mineral proceeds" also is defined in §102(16) of the 2016 Revised Uniform Unclaimed Property Act.

<sup>3</sup> See Oklahoma Unclaimed Pooled Monies Act, Okla. Stat. tit. 52, § 551 *et seq.*

<sup>4</sup> See Oklahoma State Treasurer Form 497-UP-MIR (rev. 10/4/2016).

<sup>5</sup> *Id.*

<sup>6</sup> See Texas State Comptroller's Unclaimed Property Reporting Instructions 2017, p. 18, <https://comptroller.texas.gov/programs/claim-it/docs/96-478.pdf>. See also Tex. Prop. Code Ann. § 75.101.

<sup>7</sup> See Texas State Comptroller's Unclaimed Property Reporting Instructions 2017, pp. 33-34.

<sup>8</sup> See Wyoming State Treasurer's Unclaimed Property Reporting Guidelines, Chapter 2—Property Specific Mineral Proceeds, p. 2.

<sup>9</sup> See, e.g., Section 1135 of the Delaware Escheats Law, as adopted by S.B. 13 (2017), which now states: "At the time an interest is presumed abandoned under this chapter, any other property right accrued or accruing to the owner as a result of the interest, and not previously presumed abandoned, is also presumed abandoned."

<sup>10</sup> See Revised Uniform Unclaimed Property Act § 209. We note that RUUPA was adopted at the July 2016 Annual Conference of the National Conference of Commissioners on Uniform State Laws. Note: A uniform act is normative in nature and is not the law in any particular state unless and until adopted by a particular state.

<sup>11</sup> See Revised Uniform Unclaimed Property Act § 209 cmt.

<sup>12</sup> See Okla. Stat. tit. 52, § 551 *et seq.* See also Ark. Code Ann. §§ 18-28-402 and 18-28-403; Wyo. Stat. Ann. § 34-24-117; and Mont. Code Ann. § 82-1-302, all of which discuss an escrow account or trust requirement for certain unclaimed mineral proceeds.

<sup>13</sup> See Wyoming State Treasurer's Unclaimed Property Reporting Guidelines, Chapter 2—Property Specific Mineral Proceeds, p. 1.

<sup>14</sup> See Arkansas H.B. 1782, enacted on April 4, 2015, effective July 22, 2015, amending Ark. Code Ann. § 18-28-402.

<sup>15</sup> See *Phillips Petroleum Co. et al. v. Oklahoma Tax Commission et al.*, 876 P.2d 719 (Okla. Civ. App. 1994).

<sup>16</sup> See F.D. Spiegelberg, Esq., S. Schaunaman, and A. Andreoli, *What Oil & Gas Companies Need to Know About Unclaimed Property: A Primer for the Industry*, *The American Oil & Gas Reporter*, vol. 47, no. 5, 6 and 7 (June-July 2004), p. 7.

<sup>17</sup> *Id.* at p. 7.

<sup>18</sup> See Utah State Treasurer's website, "FAQs—Holder Information."

<sup>19</sup> See Texas State Comptroller's Unclaimed Property Reporting Instructions 2017, p. 18.

<sup>20</sup> See N.M. Stat. Ann. § 7-8A-10.1(A).

<sup>21</sup> See N.M. Stat. Ann. § 7-8A-10.1(B).

<sup>22</sup> See Texas State Comptroller's Unclaimed Property Reporting Instructions 2017, p. 3.

<sup>23</sup> See Okla. Admin. Code § 735:80-3-4 (Aggregate Reporting; Reporting Requirements). See also Okla. Stat. tit. 60, § 661(B)(1).

<sup>24</sup> See document found on State Treasurer's website captioned "Unclaimed Property Report Holder's Filing Kit," which states at p. 7 under the heading "Aggregate Reporting of Mineral Proceeds": "Please do not aggregate amounts less than \$50 on your report."

<sup>25</sup> See Instructions to Form 497-UP-MIR (rev. 10/4/2016), which state in pertinent part that the form is to be "completed when reporting royalty or mineral proceeds originating from mineral properties located within any state."

<sup>26</sup> See Form AOS/UP3 found on Office of Auditor of State's website. Note: As is the case with all state unclaimed property websites referenced in this article, they can be accessed via [www.unclaimed.org](http://www.unclaimed.org), the website for the National Association of Unclaimed Property Administrators.

<sup>27</sup> See document found on Montana Dept. of Revenue website captioned "Responsibilities and Reporting Frequently Asked Questions." Note: The mention of the three states above as requiring separate reports for mineral proceeds is not meant to suggest that other states may not have such a requirement; the discussion of any other states with respect to forms is beyond the scope of this article.

<sup>28</sup> See Okla. Admin. Code § 735:80-3-8, promulgated by the State Treasurer.

<sup>29</sup> As used here, the term "suspense accounts" refers to those mineral proceeds that have been placed in a holder's internal suspense account pursuant to procedures of a particular company or holder.

<sup>30</sup> See Texas Comptroller's website at [http://www.window.state.tx.us/taxinfo/audit/unclaimed/04\\_Mineral\\_Interest\\_to\\_Unidentified\\_Deposits.htm](http://www.window.state.tx.us/taxinfo/audit/unclaimed/04_Mineral_Interest_to_Unidentified_Deposits.htm).

<sup>31</sup> As stated in the Commentary to Section 1 of the Uniform Unclaimed Property Act (1995), there is a "fixed and certain" requirement before property is thought to be escheatable. Thus, such Commentary states: "The requirement that the right be 'fixed and certain' excludes unliquidated claims from the coverage of the Act, such as disputed tort claims." In other words, just as disputed tort claims are thought to be excluded, so too are disputed contract claims.

<sup>32</sup> See *Texas v. New Jersey*, 379 U.S. 674 (1965). In footnote 9 of the opinion, the Court stated as follows: "Texas argues in particular that at least the part of the intangible obligations here which are royalties, rents, and mineral proceeds derived from land located in Texas should be escheatable only by that state. We do not believe that the fact that an intangible is income from real property with a fixed situs is significant enough to justify treating it as an exception to a general rule concerning escheat of intangibles."

<sup>33</sup> See *American Petrofina Co. v. Nance*, 697 F. Supp. 1183 (W.D. Okla. 1986), *aff'd*, 859 F.2d 840 (10th Cir. 1988).

<sup>34</sup> See document found on State Treasurer's website captioned "Instructions for Completing Report of Unclaimed Property (Form 497-UP-MIR Rev. 10/4/16)," [http://www.ok.gov/treasurer/documents/Instructions-497-UP-MIR1004 16.pdf](http://www.ok.gov/treasurer/documents/Instructions-497-UP-MIR1004%2016.pdf).

<sup>35</sup> See document found on Texas State website titled "Reporting Mineral Proceeds," <http://comptroller.texas.gov/programs/claim-it/report/mineral.php>.

<sup>36</sup> See Wyoming State Treasurer's Unclaimed Property Reporting Guidelines, Chapter 2—Property Specific Mineral Proceeds, p. 2.

<sup>37</sup> See Arkansas H.B. 1782, enacted on April 4, 2015, effective July 22, 2015, amending Ark. Code Ann. § 18-28-403(a).