Unclaimed Property Law: What Oil And Gas Cos. Should Know

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States have recently stepped up enforcement of unclaimed property laws to generate additional revenue and the oil and gas industry has become a particularly attractive target given fracking initiatives and the likelihood of lost mineral rights owners. Because unclaimed property compliance obligations for oil and gas firms can be particularly complex, it is critical that companies become proficient in unclaimed property law, the current landscape and impending changes, as well as the best ways to navigate the audit process.

Unclaimed property audits can take years to complete and, where audited companies are not in compliance with all applicable unclaimed property laws, can cost companies millions of dollars.

Unclaimed Property Law: A Brief Background

Every state has unclaimed property laws, also called escheat laws, which require companies holding unclaimed or abandoned property to turn that property over to the state.[1] State unclaimed property laws typically require the “holder” — the company in possession of unclaimed property — to undertake the following:

- Regularly identify property that is presumed abandoned because it has been unclaimed for the requisite dormancy period;

- Perform due diligence to attempt to locate and notify unclaimed property owners before the unclaimed property is reported to the state;

- Report the unclaimed property once the relevant dormancy period has expired, according to annual reporting obligations which may include filing null reports; and

- Deliver or transfer the unclaimed property to the state’s custody.

Additionally, many states require holders to maintain records of unclaimed property that was
or should have been reported. Once unclaimed property is reported, the state maintains custody of the property until the rightful owner appears and claims the property. Many states have adopted laws that permit the state to use unclaimed funds (to finance education and other programs) and only maintain a small amount of property to pay owners who appear.

In order to decide which state’s unclaimed property laws apply, a company must follow the priority rules articulated by the U.S. Supreme Court in Texas v. New Jersey in 1965.[2] Under the priority rules, the company (the holder) must first report the unclaimed property to the state of the last known address of the owner, based upon the company’s books and records. If that information is unknown, then the applicable unclaimed property escheats to the state in which the company or holder is resident or incorporated. Thus, companies generally must be knowledgeable about and consider multiple states’ unclaimed property laws.

Unclaimed Property Laws as Applied to the Oil and Gas Industry

Minerals and mineral rights involve payments and processes that differ significantly from other industries and state unclaimed property laws not surprisingly have unique provisions applicable to such property.[3]

Texas, in particular, has shaped the application of unclaimed property law concepts to mineral rights. Under Texas’s “stream of income” approach, adopted in 1985, companies must report payments owed to a mineral interest owner if all payments in a series of mineral proceeds payments were unclaimed during the dormancy period. Using this “stream of income” concept, Texas escheats the proceeds of an underlying mineral interest through the current payment date without taking on the responsibilities associated with ownership of the underlying real property containing the mineral interest. This concept further enables the state to automatically take custody of all subsequent payments once the dormancy period expires for the first payment. In other words, once the first payment owed to the mineral interest owner has reached the expiration of the dormancy period, all subsequent payments automatically escheat as soon as they become payable.

The “stream of income” model was subsequently incorporated into the 1995 Uniform Act. [4] The 1995 act broadly defines “mineral” and “mineral proceeds” to cover geothermal rights, as well as surface and sub-surface substances. The definition of “mineral” generally is
consistent with how the term is used in reservations by federal and state governments. Likewise, “mineral proceeds” applies to various types of payments made in connection with mineral rights, including payments such as delay rentals and shut-in royalties, which are not tied to production.[5]

Currently, most states have unclaimed property laws that explicitly include and define minerals proceeds, many of which are based on the 1995 act.[6] Like Texas, most states’ unclaimed property laws do not apply to the underlying real property or mineral interest itself, but just to the payments due in exploiting those rights. The majority of states have dormancy periods ranging from three to seven years and follow the “stream of income” model, triggering the dormancy period when the first payment is unclaimed.

Unclaimed property is a potentially significant issue for companies engaged in fracking because fracking unlocks the value of previously unprofitable land which, in many cases, was considered worthless. This increases the likelihood that mineral rights were effectively abandoned. Companies (and county assessors) may have seriously outdated owner information, particularly if the mineral rights were sold or passed to heirs who viewed them as essentially worthless.

**Enforcement Trends**

In recent years, there has been a staggering increase in the number of unclaimed property audits. More than half of Fortune 100 companies are currently subject to audit. Unclaimed property is the third greatest source of revenue for the state of Delaware, where the majority of Fortune 500 companies are incorporated, and where property owed to unknown owners is most often escheated, accounting for up to 16 percent of total state revenues in 2013.[7]

In 2010, Delaware added unclaimed property rules that shifted the burdens in audits, including an estimation provision that enables Delaware to estimate unclaimed property owed for years where records are unavailable based on results for more recent years. This estimation requirement, used in conjunction with Delaware’s lengthy look-back period (as early as 1981 in some cases), can have astronomical effects on companies’ potential escheat liability.

While Delaware’s unclaimed property law has historically been unfriendly to holders, many other states also have statutory regimes allowing for lengthy audits, the use of estimation
techniques and lengthy look-back periods. Moreover, most states rely upon third-party contingent fee audit firms such as Verus Financial, Kelmar Associates and Xerox Unclaimed Property Clearinghouse (UPCH) to perform unclaimed property audits. These auditors typically identify audit targets and then solicit states to join audits. Because they receive up to 10 percent of any property identified and only are compensated if they identify unclaimed funds, these auditors have every incentive to aggressively apply the unclaimed property laws and to employ lengthy look-back periods and aggressive estimation techniques.

Oil and gas companies are enticing targets because of the challenges that producers face in tracking down the owners of mineral proceeds. In recent years, a number of contingent fee audit firms have approached the states seeking authorization to audit oil and gas companies and numerous companies are now under audit.

Legal and Legislative Developments

In what appears to be a reaction to aggressive state regulatory enforcement and the concerns of business leaders, many states recently have adopted more holder-friendly legislation.

Delaware implemented a new voluntary disclosure program under the auspices of the secretary of state in 2012 in response to the imminent risk of corporate flight. This program shortens the look-back period and the overall turnaround time of the program is much shorter than the typical audit. Additionally, the program includes incentives such as interest and penalty waivers if the holder reasonably adheres to the disclosure work plan. Other states have either recently enacted or are currently in the process of enacting more holder-friendly legislation, which may include changes such as the following:

- Procedures for more streamlined audits;
- Shorter look-back periods;
- Business-to-business exemptions (eliminating business-to-business transactions from the definition of unclaimed property); and
• Limiting the practice of contingent-fee auditors.[10]

Many of these changes have occurred in the past year or two and more changes in more states are likely on the horizon with the release of the final draft of the Revised Uniform Unclaimed Property Act this year.[11]

Currently developing case law may also have an impact on aggressive state enforcement behavior. The Federal District Court in Delaware recently held that Delaware’s attempted retroactive application of its estimation laws violated the substantive due process rights of holders under the United States Constitution. See Temple-Inland Inc. v. Cook, No. 14-cv-00654-GMS, 2016, at *16 (D. Del. June 28, 2016) (holding that the state escheator’s decision to wait for decades to audit the company without notifying them of the need to maintain records and exploiting loopholes in the statutes of limitations was a “game of ‘gotcha’ that shocks the conscience”). This rationale may be used to curtail other states’ use of estimation techniques and attempts to impose escheat liability for periods where a holder lacks records and had no obligation to maintain records under applicable law.[12]

Implications for Oil and Gas Companies

In light of the dynamic and evolving legal environment, companies must expend significant resources to monitor changes in unclaimed property laws and regulations as well as how these laws and regulations are applied in enforcement audits.

Oil and gas firms face particularly difficult industry-specific regulatory challenges and states have shown a tendency to target such companies. The rise of fracking initiatives over the past few years has only added to the administrative and compliance burdens faced by companies.

Compliance with unclaimed property obligations also may have significant implications in the merger and acquisition context. Although merger and acquisition activity recently has been stagnant in the oil and gas industry,[13] deal-making opportunities have begun to percolate.[14] Target companies’ compliance may materially affect the liability that an acquiring entity would assume in a transaction. States’ unclaimed property laws do not restart dormancy periods upon acquisition. Accordingly, thorough due diligence regarding a potential target’s compliance with unclaimed property liabilities is crucial.
It is also vital for oil and gas firms to implement comprehensive compliance programs. Companies seeking to successfully navigate unclaimed property laws and audits should enlist experienced counsel to assist in navigating the sometimes convoluted and occasionally inconsistent state laws.

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reflects a broad array of payments arising out of obligations to pay resulting from the production and sale of minerals, including net revenue interests, royalties, overriding royalties, production payments, and payments to participants (nonoperators) in a joint operating agreement. Other types of payments relate to obligations for the acquisition and retention of mineral leases, including bonuses, delay rentals, shut-in royalties, and minimum royalties.

[4] See generally id. § 9A.04. A notable state exception in not following the “stream of income” model is Oklahoma. Oklahoma’s statutory scheme does not exclude dormant mineral proceeds from the scope of its unclaimed property law, and Oklahoma state courts have determined that under the specific wording of the relevant Oklahoma statute, mineral proceeds are to be held for the entire seven-year dormancy period without owner contact in order to be presumed abandoned. Id. (citing Phillips Petroleum Co. v. Oklahoma Tax Comm’n, 876 P.2d 719 (Okla. Ct. App. 1994)).


[6] See, e.g., Tex. Prop. Code tit. 6, § 75.001(a)(2) (defining “mineral proceeds” as “all obligations to pay resulting from the production and sale of minerals, including net revenue interest, royalties, overriding royalties, production payments and joint operating agreements; and all obligations for the acquisition and retention of a mineral lease, including bonuses, delay rentals, shut-in royalties and minimum royalties”). Kentucky is the notable exception, with its unclaimed property law specifically excluding mineral proceeds. See Ky. Rev. Stat. § 393.010(2).


[8] On July 22, 2015, Delaware’s governor signed legislation that permanently extended the voluntary disclosure program.


[10] See, e.g., Arizona HB 2343 (requiring the Arizona Department of Revenue to establish procedures to monitor the performance of its contractors), eff. Aug. 8, 2016. Similar
legislation is also pending in Massachusetts. In addition to holder-friendly legislation, some of the new laws being passed focus on assisting owners in reclaiming their property from the state – thus, helping shift unclaimed property laws back to their original purpose. Texas recently passed such a law, with new legislation now requiring holders to include well information when reporting unclaimed mineral proceeds. See Texas SB 1589, eff. Jan. 1, 2016. This legislation came as a result of recommendations made by the Unclaimed Mineral Proceeds Commission (UMPC), which recommended that the legislature consider increasing reporting requirements for unclaimed mineral proceeds to include property-specific information. See Texas SB 1589 (Author’s/Sponsor’s Statement of Intent). While this new law appears likely to increase owner recovery of unclaimed mineral proceeds, it may be in tension with well-established priority laws governing reporting obligations.


