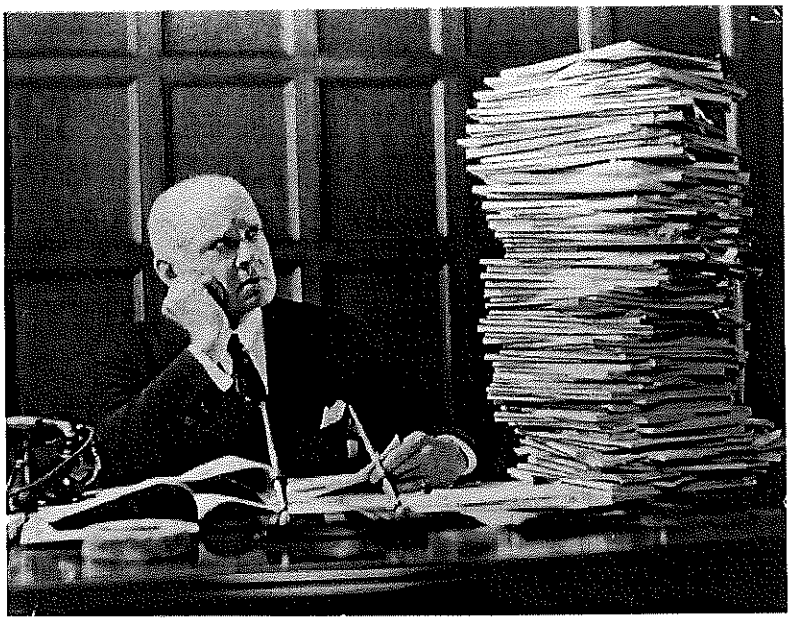
MINERAL / LEASEHOLD INHERITANCE

How to Determine What It Is And What To Do About It



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MINERAL / LEASEHOLD INHERITANCE

HOW TO DETERMINE WHAT IT IS AND WHAT TO DO ABOUT IT

Scenario: The client comes into your office. His grandfather has passed away. After you inquire regarding family property and what estate planning documents are in existence, the client says: "I think Grandpa owned some oil and gas interests."

Now, what do you do?

I. What Documents Do You Have?

In order to determine if any mineral or leasehold-derived interests are owned, first examine what the client has that has made him believe that oil and gas interests are involved.

These include:

- Tax Returns
- Check Stubs
- Division Orders
- DOI (Division of Interest) Sheets
- Oil and Gas Leases or Assignments
- Mineral Deeds

- Abstracts
- A letter received in the mail offering to lease or buy
- Title Opinions
- Family Stories

II. **Where are these "Interests" Located?**

Take whatever information you have and work backwards. If you only know that Grandpa said he owned some minerals in Oklahoma, without more, then you are out of luck. There is no "master book" per state. You have to narrow it down to at least the county.

Sources for County Records in Oklahoma:

- Grantor/Grantee Book at the County Clerk's Office
- Tract Index from the County Clerk if you actually have narrowed it down to a Section, Township and Range
- Abstractor's Office – every county has at least one
- County Records On-Line – try okcountyrecords.com first. If the particular county you are looking for is not available on that website, see if the county has document images available at its individual county website.
- Find a landman in the county or close by

III. What are Your "Interests" – Mineral or Leasehold?

[Here is where the alphabet soup comes in]

RI = Royalty Interest; this is a mineral interest that is leased so that it is currently being paid the royalty proceeds. CAVEAT: lay persons often call "mineral interests" the "royalty interest" and vice versa.

ORRI (or ORI) = Overriding Royalty Interest; derived from an oil and gas lease; it is non-cost-bearing (i.e., free money off the top of the production pile) but it goes away when the lease expires (usually).

WI (Working Interest) or NRI (Net Revenue Interest)

These refer to basically the same interest. The WI is a cost-bearing interest, a piece of the leasehold, the interest of the Lessee or his Assign. This interest pays its proportionate share of monthly costs for operating the well.

All the owners who own a working interest (WI) add to 100% and the net revenue interest (NRI) will always be less than 100% because the Royalty + ORRI + NRI = 100%.

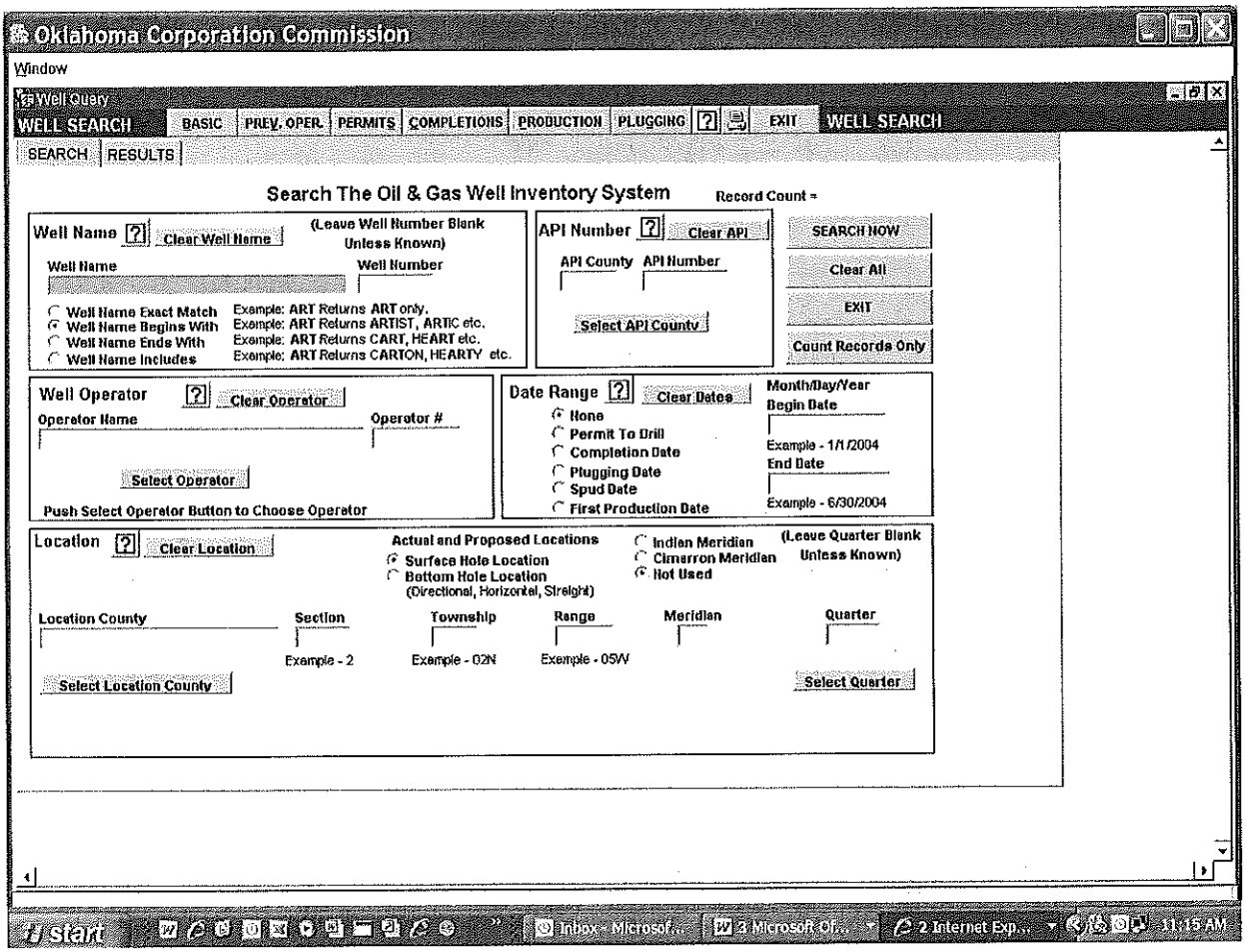
So, how do you know if your minerals are producing? Hopefully, the Decedent was receiving checks. But, if the Decedent did not live on the property and the county records did not have address information for him or

his predecessors, his interest could have been force pooled and his revenues may be held in suspense or even escheated to the State. To find out if there is a well on the property, you need to start with a legal description and go to the Oklahoma Corporation Commission website (www.occ.state.ok.us). There is a wealth of information available on the OCC website. You can obtain production information by clicking on "Divisions", then "Oil & Gas", then "Databases", and then choose either "Oil & Gas Database" (for well information prior to 6/2/10) or "New – Well Browse Database" (for well information after 6/2/10). At that point, you will see the screen on the next page of this handout, where you can enter in the location (example: Pittsburg County, Section 6, Township 3N, Range 12E) to see all wells that have been drilled in that legal location.

From there, you can choose from the tabs at the top of the screen ("Production" or "Plugging") and highlight the particular well for which you want to see information, then choose "Search Now" and you will see the production information by month.

Although there is a lot of information available on the OCC website, it is not always intuitive as to where to find what you're looking for and you may need assistance. Also, the first time you want to access the databases, you will need to download some software that is available on the website. If you have any trouble, the help desk staff is very helpful –

just give them a call at (405) 521-3636 and they can guide you though screen by screen.



Also, if you can tell them the legal location of the interests or the well name, they may be able to pull the production and plugging information and send it to you (if you ask *very* nicely).

IV. **How To Determine What the Interest is Worth.**

A. If it is good enough for Uncle Sam . . .

The Oklahoma Tax Commission provided a formula that was used for valuing producing mineral interests for estate tax filings (when we had Oklahoma estate taxes).

For Oil: The value of total production paid (to the Decedent) for the last four (4) years.

For Gas: The value of total production paid (to the Decedent) for the last eight (8) years.

Use this if you have minerals that have been leased and thus, have become a royalty interest.

CAVEAT: Look at the annual sums to see if production is in a steep decline, which often happens. Compare actual production and/or compare actual dollars paid. If production is declining – especially if you have several years of production records – you may want to use the average of a lesser number of years as your baseline value and then plead your case.

B. Mineral Interests that are not producing (not currently under lease)

If you have no revenue checks coming in, then how do you determine the value of non-producing minerals? There are **numerous** companies that are more than willing to make you an offer for your minerals. Let your

fingers do the walking by Googling or Yahooing "sell my minerals"; "what are my minerals worth"; "oil and gas interest for sale" – or any variation of these phrases. They are almost as numerous as the free insurance quote sites.

Similarly, you will find numerous listings in the various oil and gas publications and journals. The key here is to obtain several quotes or bids to get an idea of what the minerals would sell for in an arms length transaction. The problem with this process is that you need to know the exact ownership interest and legal location of the interest, because if you are going to try to get offers you want to compare apples to apples.

C. Call a Landman.

Landmen can be your best friends if you have a client that has bad records and really needs to know what they own. They are also often familiar with the going rate for minerals in a specific area or can find someone who is. Be prepared to (currently) pay between $350 - $500 per day for a competent landman.

D. Petroleum Geologist and Reservoir Engineers.

These professionals are usually only for the big dogs. If you have a major interest or your client is an energy company owner of a closely held oil and gas company who failed to think of estate planning while he or she

was out amassing their fortunes, then maybe you need one of these, but rarely is that the case.

V. Dealing With The Oil Companies

A. I've just received a lease proposal in the mail – now what?

Often, the arrival in the mail of an oil and gas lease proposal is the first time people become aware of inherited mineral rights. Frequently, the lease is to the deceased' family member, since no evidence of death is found in the record and it has been forwarded. While usually a welcome parcel, it often prompts the following questions:

- Is this a good deal?
- Did other family members receive one or do they know about this?
- What is the going rate for royalty percentages and bonus monies?

Landman – A landman familiar with the area can help you determine this information.

County Records – If a company is leasing, it probably has taken other leases in your section and surrounding sections. Review the most current leases in the county records to compare.

Do Nothing – If the company is serious about drilling in the section, they will force pool this interest if they cannot get a lease. They must offer the going

rate in the force pooling, so while you possibly could have negotiated a *slightly* better deal, it will still be very fair in the force pooling. Your client should notify the company.

Note: If your client decides to accept the lease offer, strike the warranty clause, unless you are sure of the title ownership and interest amount.

B. "Grandpa had leases with several companies on several tracts of land. I have written them and told them that Grandpa died, and now every company wants something different from me?!!"

Yes, that is true. Depending on the policies of each company, the value and size of decedent's interest in the well, and the revenues current producing from that well, each company may very well want something different, ranging from a new division order that they want the heir to sign, all the way up to an ancillary probate (and proceeds will be put into suspense until they get it.) If they are insisting on an ancillary probate and you really do not want to do one, call the division order analyst in charge of that property at the company and talk it through with him or her. (Do not call the general counsel – this is a division order analyst matter – start there.)

VI. Probates and Other Things

A. Minerals are considered real property for probate purposes, so a probate (or ancillary) is proper in any county where the minerals or leasehold interest is located. "Royalties" – payments received and are cash and cash is personal property. But you only get royalties because someone has leased a mineral interest – and a mineral interest is real property for these purposes. Out-of-State attorneys frequently will argue with you that the minerals are not real property in Oklahoma and do not need to be probated. They are "real property" for probate purposes.

B. "Other Things" [like Affidavits of Death and Heirship]

Oklahoma has authorized the use of affidavits to supplement or clarify information in land records. An Oklahoma statute,[1] passed in 1985, authorized affidavits relating to family history, heirship, identity and similar matters. Such affidavits could be filed in the office of the clerk of a county where real property was located. The statute provided that an affidavit "may not take the place of a judicial proceeding, judgment, decree or Title Standard."[2] In 1994, the language of the statute was changed when Oklahoma adopted the Rebuttable Presumption statute.[3] The amendment

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1 16 O.S. 2001, § 83

2 16 O.S. 2001, § 82

3 16 O.S. 2001, § 53

to the statute now provided that "[t]here shall be a rebuttable presumption that facts stated in a recorded affidavit are true as they relate to real estate, or use, or its ownership." A rebuttable presumption is a presumption that may be challenged by other evidence. While statements in a recorded affidavit were allowed to be relied upon, to do so was at one's own risk, since these statements could be rebutted. There was no immediate protection afforded by the reliance on the Rebuttable Presumption statute. Significantly, the Oklahoma Title Examination Standards reiterated that the "[r]ecorded affidavits and recitals should cover the matters set out in 16 O.S. 2001, § 83; they cannot substitute for a conveyance or probate of a Will."[4]

Prior to 1999, Oklahoma required judicial determinations of the ownership of severed mineral interests. However, oil and gas companies had the wherewithal to absorb some business risks in order to deliver their production to market so many companies waived the requirement of a formal probate or judicial determination of death and heirship and accepted affidavits of death and heirship as sufficient proof of ownership for small mineral interests. In adopting this practice, the oil and gas companies recognized that it was not economically reasonable for the owners of small

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[4] Oklahoma Title Examination Standard 3.2.A.

mineral interests to pay for probate proceedings solely for a small mineral interest. As a result of this informal practice, landmen have been obtaining affidavits of death and heirship from Oklahoma residents for many years. For some, it became a frequent practice to file these affidavits of death and heirship of record in order to establish ownership. This practice is now being rewarded.

In 1999, and then again in 2010, Oklahoma amended its Simplification of Land Titles Act[5] (the "Act") to allow the purchasers of severed mineral interests who bought from a person who claimed their title through a recorded affidavit or recital of death and heirship to have the protection afforded by the Act. This statute states as follows:

Section 67 - Acquiring a Severed Mineral Interest from Decedent - Establishing Marketable Title

> A. After the date of death of a person who was an owner of a severed mineral interest in real estate, a person who claims such interest, immediately or remotely, through an affidavit of death and heirship recorded pursuant to Sections 82 and 83 of this title, shall acquire a valid and marketable title to such interest as against any person claiming adversely to such recorded affidavit on the conditions set forth in subsection C of this section.
>
> B. Any purchaser for value acquiring a severed mineral interest in real estate from a person who claims such interest, immediately or remotely, through a recorded affidavit of death and heirship or a recital of death and heirship in a recorded title transaction, as that term is defined in Section 78 of Title 16 of the Oklahoma Statutes, shall acquire a valid and marketable title to such interest as against any person claiming adversely to such recorded affidavit or recital on the conditions set forth in subsection C of this section.
>
> C. In order to establish marketable title pursuant to this section:
>
> 1. The affidavit or recital must state that the decedent died without a will, or if the decedent had a will, that the will was never probated in Oklahoma and a copy of the will is attached to the affidavit or recital, or if the will was probated that the severed mineral interest was omitted from the final

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5 16 O.S. 2010, § 67

decree of the decedent and a copy of the will and final decree is attached to the affidavit or recital;

2. The affidavit or recital must list the names of the decedent's heirs and their relationship to the decedent;

3. The affidavit or recital must state that the maker is related to the decedent or otherwise has personal knowledge of the facts stated therein;

4. The affidavit or the title transaction that contains the recital must have been recorded for at least ten (10) years in the office of the county clerk in the county in which the real property is located; and

5. During the ten-year period following the recording of the affidavit or the title transaction that contains the recital, no instrument inconsistent with the heirship alleged in the affidavit or recital was filed in the office of the county clerk in the county in which the real property is located.

This section shall apply to affidavits recorded before November 1, 1999, as well as to those recorded thereafter, except that, with respect to those recorded before such date, the ten-year period specified above shall not expire until one (1) year after November 1, 1999. This section shall not apply as against any person in possession of the land, by occupancy or by occupancy of a tenant, at the time such purchaser acquires an interest in such land.

Added by Laws 1999, c. 84 § 2, eff. Nov. 1, 1999; Laws 2010, c. 223 § 1, emerg. eff. May 10, 2010.

The probate statutes were also amended in 2010 to authorize payment or delivery of property to successors through the use of such affidavits.[6]

Subsection D of 58 O. S. § 393 was added and reads as follows:

D. At any time after the date of death of a person who was an owner of a severed mineral interest in real estate, any person who claims an interest, immediately or remotely, through the decedent may file with the county clerk of the county where the mineral interest is located an affidavit of death and heirship in compliance with subsection C of Section 67 of Title 16 of the Oklahoma Statutes. Pursuant to Sections 82 and 83 of Title 16 of the Oklahoma Statutes, there shall be a rebuttable presumption that the facts stated in the recorded affidavit are true as they relate to the severed mineral interest, the death of the decedent, and the relationships, family history and heirship stated therein.

[6] 58 O.S. 2010, § 393

The $20,000 limit for payment of property by Affidavit is found in sub-section A.1. of § 393 and does not apply severed minerals and the use of Affidavits of Death and Heirship found in sub-section D.

The statute's application was initially quite narrow and the 2010 amendment broadened it slightly more. *First,* the statute only applies to severed mineral interests so it cannot be used if any surface interest is owned. *Second,* the statutory protection may only be used by a "purchaser for value." For example, Grandma Moses dies and John Smith is her only heir. John Smith files an affidavit of death and heirship of record in the county where the land is located. The affidavit states these background facts and recites the legal description, along with a statement that Grandma Moses owned an undivided 1/4 mineral interest in Section 22, *etc.* John Smith later deeds this inherited mineral interest to his daughter, Sally Smith, as a family gift. Sally is not afforded any protection under the Simplification of Land Titles Act because Sally is not a purchaser for value.

Third, in the 1999 version, the decedent must have died without a will and the affidavit must state that the person died intestate.

In the 2010 amendment, the statute allows the use of the Affidavit of Death and Heirship for decedents who also died <u>with</u> a Will, if:

a) the Will has never probated in Oklahoma and a copy of the Will is attached to the Affidavit, or

b) if the Will was probated in Oklahoma, the severed mineral interest was omitted from the Final Decree and a copy of the Will and the Final Decree is attached to the Affidavit.

This is a monumental change when it comes to ancillary probate requirements if the heirs are not planning to sell the minerals so that marketable record title is not required immediately. However, if the interest is leased and the well is a good one, the oil company may still require an ancillary probate if they insist on marketable record title prior to paying proceeds. If the Will leaves the minerals to anyone other than the legal heirs of the decedent, the oil company will still only pay proceeds to the heirs.

Fourth, the affidavit must identify the name of the decedent, the heirs of the decedent and everyone's relationship to the decedent, including the relationship of the person making the affidavit to the decedent. The person making the affidavit must also explain how he or she knew these facts. Failure to include this information may call the validity of the affidavit into question for purposes of protection afforded by the Act.

Fifth, the affidavit must be filed in the office of the county clerk where the land is located for a period of at least ten (10) years. The ten (10) year period is significant. The affidavit of death and heirship will not be effective if it is inconsistent with any other instrument filed of record prior to or during

the ten (10) year period. Recall the example of Grandma Moses. Suppose that Grandma died in 1985. In 1986, there appears of record a mortgage from "Grandpa Moses, the widower of Grandma Moses", mortgaging an interest in the land. In 1987, John Smith file his affidavit of death and heirship and recites therein that Grandma Moses owned certain property (and gave the legal description) and further recited that he, John Smith, was the only heir of Grandma Moses. Under the 1999 statute, the John Smith affidavit would not afford a purchaser for value the protection of acquiring marketable title after a ten (10) year period: The mortgage – an instrument of record – is inconsistent with the facts of heirship alleged in the affidavit. Under the intestacy statutes, the husband of Grandma Moses would be an heir. The result would be the same if the mortgage had been filed after the filing of the affidavit.

The statute only affords protection to "purchasers for value acquiring a severed mineral interest." From an oil and gas industry perspective, does a lessee of an oil and gas lease qualify as a purchaser for value? The logical conclusion is that a lessee should be afforded the protection under the Act.

Under the "Definitions" section[7] of the Simplification of Land Titles Act, an "interest in real estate" includes "interests of purchasers under . . . leases, easements, oil and gas lease, and mineral and royalty interests." The legislative intent of the Simplification of Land Titles is afforded its own section in the Act.[8] ". . . the Act shall be liberally construed to effect the legislative purpose of simplifying real estate transactions by permitting purchasers to rely upon the status of title as reflected by the county records. . . ." As a general matter, a "purchaser for value" is one who is paying value for an interest in severed minerals. One of the attributes of owning a severed mineral interest is that the owner can "sell" (*i.e.,* lease) the right to remove and own some or all of the minerals by selling to another an oil and gas lease. That lease grants ownership of the minerals removed from the ground which are then owned by the lessee. The definitions section recognizes that an interest to which this Act applies is oil and gas leases. Consequently, since oil and gas lessees are within the class of persons afforded protection by the Act and because the legislative purpose is that the Act is to be liberally construed, lessees should have been specifically excluded from Section 67 if they were not intended to be purchasers for value.

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7 16 O.S. 2001, § 61

8 16 O.S. 2001, § 66

The statute is retroactive and covers those affidavits that were recorded prior to the effective date of the statute (November 11, 1999).

CAVEAT: See 58 O. S. 1998 § 394:

Discharge and Release of Person Paying, Delivering, Transferring, or Issuing Personal Property to Successor

The person paying, delivering, transferring, or issuing personal property or the evidence thereof to the successor or successors named in the affidavit is discharged and released to the same extent as if the person dealt with a personal representative of the decedent. Such person is not required to inquire into the truth of any statement in the affidavit. If any person to whom an affidavit is delivered refuses to pay, deliver, transfer, or issue any personal property or evidence thereof, it may be recovered or its payment, delivery, transfer, or issuance compelled upon proof of their right in a proceeding brought for the purpose by or on behalf of the persons entitled there to. Any person to whom payment, delivery, transfer, or issuance is made is answerable and accountable therefor to any personal representative of the estate or to any other person having a superior right.

This statute directs a "payor" to pay over to the person in the Affidavit of Death and Heirship any property they are holding and treat them as if they were dealing with a personal representative of the Decedent. This could create a real problem in that it is the oil company's prerogative to make a determination – short of someone having marketable record title – as to whether to pay them or not. Section 394 directs the person to pay them. Just because a rebuttable presumption is created, there is no safety net for the person who relies on the rebuttable presumption until the ten years have passed, no contrary intervening information is filed of record, and then a purchaser for value has good and marketable title to the severed minerals under the Affidavit of Death and Heirship. An heir is not a

purchaser for value and only a purchaser from that heir could acquire marketable record title to that interest.

VII. **Deeds Into And Out Of Trusts**

Example: Deeds into "John Doe, Trustee of The Doe Family Trust dated January 1, 2012." If deeded to the Trustee (as opposed to directly into the Trust) you do not need to file a Memorandum of Trust.

Deeds out of the Trust should show the grantor in exactly the same name as the deed into the Trust. If the Trustee is now the successor Trustee, say so: "Janet Doe, successor Trustee to John Doe, Trustee of the Doe Family Trust dated January 1, 2012."