

NARO Frequently Asked Questions.

This information is provided to assist mineral/royalty owners with common questions but is NOT intended to be considered legal or tax advice. The information provided here should not replace advice of professionals where necessary.

1. Q. Determining Mineral Interests. "Uncle Bill just died. The lawyer said I get all of the mineral rights. I didn't know Uncle Bill owned any mineral rights! I can't find the deeds for the properties. What can I do?"

A. This may require a bunch of work, but it's doable. Don't give up. Your investigatory efforts may become extensive but will pay off with tasty profits. Go to Uncle Bill's lawyer and get all the mineral files/information you can gather. Remember, the lawyer said "you get all the mineral rights" and therefore he must be aware of something. If he didn't write the Will, who did? Call the Personal Representative of the Estate, assuming there is one, and ask him/her if she/he has found anything pertaining to mineral interests relating to Uncle Bill. Look in Uncle Bill's home for files or information relating to minerals. Ask Bill's wife/partner if Uncle Bill had any mineral interests that she/he is aware of. If Bill lived in a smaller town, go his Banker and inquire. If you're in a state that assesses minerals, go to the county tax assessor where Bill lived and check to see if his name surfaces when entered in their data base. If the County is on-line, use the Internet. Check the ownership records in the area. Here's a biggie. Gather up Bill's last three (3) years tax returns, state and federal, and see if any mineral interest is reported as income, usually Schedule E. Gather up Bill's last two (2) years bank statements. Check his deposit slips. Maybe he had an interest in a working interest well and check expenditures. Go to "missing money", unclaimed property, on the Internet and check if his name pulls up any money due to Bill. Definitely go to the entity, Comptroller of Public Accounts, or State Treasurer, that holds lost money in the State where Bill resided, and see if anything shows up. Going in person and asking for assistance usually generates a little more fruition. Where did the money come from? Track it down. Check in the Estate of Uncle Bill's Dad/Mom. This is probably where Bill got his interest. Did Uncle Bill have any brothers or sisters? Check with them and see if they are receiving any production income. Bill probably has the same interest as Bubba or Sis has. Now this is a stretch, but, who are the largest Operator's in the County where Bill died. Give the revenue department a call and see if they might have Bill's name in their Payee/Owner/Unclaimed property list.

You may also want to contact a title company in the County where the property is located and ask them to conduct a mineral deed search listing Uncle Bill's name. You can also go the County Clerks Office in the designated County and look thru the deed books yourself. This part can be time consuming.

2. Q. Transfer of Mineral Interests from Decedent to Beneficiary. "What will the companies ask for? What will they need so that they will start sending checks to me and not to Uncle Bill's estate?"

A. Minimize your efforts. Don't re-invent the wheel. Each Operator/Payor/Oil Company usually has a different list of things for you to send them or hoops that you need to jump through. So, just call the Payor, ask for the Division Order Department, and explain the situation to the Division Order Analyst and exactly what they need to transfer the interest from Uncle Bill to you. Get the analyst's name, e-mail, address and telephone number. If there has been a probate proceeding, if the interest was left in Uncle Bill's Testamentary Living Trust, or if it was gifted/deeded to you, the procedure is usually pretty simple. You may be able to get by with just a simple filing of some documents and an Affidavit of Heirship. Just follow their requirements and you'll get it transferred.

3. Q. Mineral Property Valuation-Establishing a New Basis. "For estate valuation purposes and to establish a new basis for the recently inherited minerals, what kind of specialist can properly make and appraise mineral interests?"

A. You can get an expert in the oil and gas arena to give you a formal, written opinion. Look in the NARO ROAR monthly report and there are several appraisers listed or call NARO for a list of appraisers that advertise with NARO. But remember, to get a formal appraisal, including a reservoir analysis, is expensive. So you might want to first consider the following.

Assuming this is for Estate Tax Returns, and taxing purposes, the attorney/accountant handling the estate will generally use a "rule of thumb" which is often: oil production, 4 X's last year's annual income: gas production, 7 X's last year's annual income. You can also use last year's 1099 times the 4 and 7 rules. For non-producing property: you may want to use the same basis as the person transferring the interest to you. Remember, probably not producing, probably not worth too much. Work with the attorney/accountant and keep it simple.

If this is for the State and/or Federal Estate Tax Return, you'll know if there is any objection to the "rule of thumb" and, if need be, you can then hire a professional appraiser. I would first find out what the taxing authority's objection is and what value they place on the mineral property. Don't go to war over peanuts. Save that effort for the bigger fish to fry.

4. Q. Leasing. "I just got a letter in the mail asking to lease my minerals. There was NO lease contract, just a letter asking to lease. Is that common?"

A. Yes, it is. The letter usually advises you of your net mineral acres (NMA), the bonus offer per acre, the royalty offered and the term (number of years) the landman/oil company wants to lease your land for, which is usually maximized at three years. These are the basic leasing terms. First, make sure you're showing/listing that mineral acreage in your inventory. Next, verify the NMA. Next, you'll need to see what are fair leasing terms in your area of interest-a little due diligence. Leave as little as possible on the table. Your lease agreement should contain: 1. Commenced Drilling definition, 2. Royalty clause to include no post-production expenses (use at least one showing you will pay for enhancement expenses after product reaches a marketable state), 3. Pugh Clause, horizontal and vertical, 4. Shut-in Royalty, not to exceed 3 years cumulative 5. Favored Nations clause, and 6. No warranty clause.

It is recommended that you get some help for the first few leases from an experienced individual who has dealt in negotiating oil and gas leases as in a Certified Minerals Manager. Whoever it is, Make sure she/he is familiar with the above terms. If he/she isn't, drink the rest of your coffee, finish the danish, stand up, thank the individual for chatting with you and run, don't walk to the door. Also, if they take a lease that includes language that you will be paid royalty at the "mouth of the well" or at the "wellhead" is acceptable, leave immediately, if not sooner.

Texas, ask her/him if familiar with the case of Heritage Resources, Inc V NationsBank, a 1996 case.

Oklahoma, ask if familiar with Mittelstaedt V Santa Fe Minerals case, a 1998 case. Or at least the consequences

If they answer in the negative, could be a red flag.

There are some (me) that before joining NARO didn't understand the terminology/jargon in leasing, got "taken to the cleaners" and fell prey to those who knew what leasing's' all about.

5. Q. If I don't agree to the lease terms and don't sign, but ALL of my neighbors surrounding me sign, what happens to my share of the royalties? Are they held in suspense? Or is that money "lost" forever? Can all of my minerals be "sucked out" from underneath me, leaving me nothing?

A. In Arkansas the typical "Unit" size is a 640 acres section. Your acreage would be a part of that "Unit" section. If the majority of the mineral owners in that section have signed a lease with a company and you have not, the gas company can submit a request to the State Gas and Oil Commission to have your acreage integrated into the "Unit". If you accept the integration order, your royalty and bonus payment would be based on the average rate paid to the other mineral owners were paid in that particular "Unit".

You can also decide to opt-out of the integration order. This means you are willing to pay your portioned share of cost to drill according to your percentage of acreage to the total acreage of that "Unit" and to receive the possible benefits from the production of that well. But there are no guarantees to the success of the well.

If the mineral owner decides to not accept any of the above offers a penalty will be assessed the mineral owner. The penalty and the portioned cost of production will be withheld from production payments until paid in full.

6. Q. If I insert a clause, such as a Pugh clause or Most-Favored Nation clause, and the leasing company doesn't like it, what can I expect then? How many drafts does it take before everyone is "happy?"

A. One of the cornerstone phrases of our founder, Jim Stafford, is that everything in a lease is negotiable. When you negotiate clauses in your lease, you need to decide what you must have and what clauses you are willing to be flexible. This is a business for the royalty owner as well as the oil company. Both parties will be trying to get the best deal they can for their respective side. Initially, you will often find heavy resistance to a Favored Nations Clause. Most companies are willing to give you a Pugh Clause. The main battle will be how tough the Pugh Clause. I have heard of some that only grant the producing formation. Others only grant from the surface of the earth to the base of the deepest producing formation. Another is from the surface of the earth to the deepest depth drilled. It may take one or several drafts of the lease before everyone is "happy".

A crucial thing to consider is what happens if you can not reach an agreement with the oil company. In Texas, it could be crucial on the location of the well. If the well is going to be drilled on your minerals, you have more bargaining power. A common term for that is a "drill site lease". If your minerals are in a unit, but the well is going to be drilled on land adjacent to yours, you could be carved out of the unit. That would mean you would not receive your proportionate share of the production revenue from the well. In States like Oklahoma that have Force Pooling Laws, you might have your minerals leased by an action with the Oklahoma Corporation Commission called a "Pooling". A Pooling does allow you to select some form of a royalty rate and bonus consideration or to participate in the drilling of the well. You would also receive your share of the production if they drill and complete a producing well. The down side of a pooling is that there are almost no provisions in the order to protect the rights of the mineral owner. A pooling order will contain no provisions to receive a shut-in royalty, no Pugh clause, and basically no provision for the order to expire...just to name a few of the negatives associated with a pooling.

Lastly, there is nothing that says you must lease your lands to the company that wants to lease your lands. It can be to your advantage to get more than one company interested in leasing your lands. Keep a list of companies that have contacted you in the past. Try and find out if there are other companies leasing or drilling wells in your area. Some companies are so large that they are interested in drilling wells in many areas around the country.

7. Q. I don't have the original lease and I don't know what the spacing unit size is. How can I "verify" that the decimal interest is correct?

A. Having a copy of the original lease is crucial to determining if you are being paid correctly. You can call the company that is operating the well to see if they will provide you with a copy of the recorded lease. If they are unwilling or unable to give you a copy of the actual lease, they might have the recording information and you could order a copy of the lease from the county clerk. Payment records are usually based upon the review of the abstract by an attorney. This is often called a Title Opinion or a Division Order Title Opinion. Companies will sometimes provide you with a selection portion of this title opinion that would reflect information about the lease to which your interest is subject. Another alternative is to go to the county clerk's office (or hire someone) to locate a copy of the lease. This can be somewhat costly and/or time consuming.

If you have a Division Order that you signed, it will "sometimes" reflect the spacing for the well. You can also call the company that is operating the well and ask them for the spacing. Sometimes you can get the information from a State Agency like the Texas Railroad Commission or the Oklahoma Corporation Commission.

8. Q. How can I verify that I am being properly paid for all the drilling activity on my property? Might there be wells for which I am not being paid?

A. Research will be required to identify drilling permits and determination the unit size (acres). Once unit size is known this becomes the denominator and your owned acreage, within the unit, is the numerator. Multiple his factor times your lease royalty to determine of your revenue interest decimal. Your revenue check should show the same revenue decimal in each of the unit well and if for some reason you are not being paid, or are not paid on all the wells, write the known disbursing company or if that entity is unknown write the well/wells operators.

9. Q. How can I verify if the production numbers are truly what are being reported to the state? If they are incorrect, who should I notify?

A. Every state requires monthly reporting of each type of well production by the operator. These reports are forwarded to the Texas Railroad Commission (RRC), the Oklahoma Corporate Commission, other states oil, gas and mining commissions or this agency may be part of that States Department of Natural Resources. Additionally, the taxes deducted from your check require reporting and payment to the states tax commission or state treasure. When you compare the monthly state reported production to the production shown on your check, the numbers should be the same. If there is a difference, the first party you contact is the company mailing your checks. Ask if they are disbursing 100% of all well production and if they aren't, please provide the name, address and phone of the other responsible parties.