



Despite Slowdowns, Unclaimed Property Still Looms Large for Oil and Gas Firms

**By: William King, Sr. Manager, KPMG LLP,
State and Local Tax practice**

Over the last few years, oil and gas companies have grappled with increased scrutiny by state unclaimed property departments and auditors as royalty suspense account balances grew exponentially and land professionals worked feverishly to find and pay owners. While recent price declines have caused pullbacks by many companies, unclaimed property compliance issues and enforcement trends continue to create significant headaches and burdens for oil and gas firms. Statutory changes, ongoing litigation, and related audits are requiring businesses to dedicate attention and already scarce resources to stay ahead of substantial—and often hidden—risks.

Unclaimed Property Requirements

All fifty states and several U.S. territories have unclaimed property laws which require corporations (referred to as “holders”) to report outstanding and unclaimed obligations owed to owners after a statutorily-defined period of time has elapsed (known as a “dormancy period”) without the owner making a claim on their property. These obligations can take many forms, but often include checks, stock shares, customer credit balances and—as is the case with oil and gas companies—royalty suspense account balances. If the dormancy period (usually between one and five years, depending on the property type and state law) passes without any owner-generated activity or contact, the holder is required to report and remit the property to various states. A 1965 U.S. Supreme Court decision (*Texas v. New Jersey*, 379 US 674), lays out a set of jurisdictional “priority rules” which dictate to which states holders have reporting obligations. Under this body of case law, holders must report unclaimed property to the state of last known address of the owner or if that is unknown, to the holder’s state of incorporation. This often creates situations where holders must meet the eligibility, due diligence, and filing obligations of jurisdictions where they may not have operations, employees, or any other nexus.



Each jurisdiction’s unclaimed property law (UPL) is slightly different, meaning there is no “cookie-cutter” or wholly uniform compliance option for companies with an obligation to report. For example, nearly all state laws require some level of “due diligence” to be completed on property prior to reporting. This normally takes the form of a letter mailed to the owner’s last known address. However some states, such as California, require the letter contain prescribed language (and even dictate a particular font size). Further variances in the timing (at various intervals prior to the report deadline) and methods of delivery (some states require certified mailings or the inclusion of postage-paid return envelopes) make complying with this single aspect of the UPL burdensome for holders with filing obligations in multiple jurisdictions. When combined with state specific rules for dormancy periods, eligibility criteria, and record retention, unclaimed property compliance can quickly become a resource intensive operation for a holder. For oil and gas companies, additional nuances make compliance with these laws particularly challenging and the costs of noncompliance especially high.



Recent Regulatory and Legislative Changes

A slew of legislative changes last year have added to the report requirements for oil and gas holders. With the passage of Senate Bill 1589 in Texas and House Bill 1782 in Arkansas, holders completing reports for mineral interest property in those states must now provide certain additional property-specific information with their reports. Under the Texas law, holders of mineral interest proceeds must now report (a) the name; (b) any identification number; and (c) the county in which the lease, property, or well is located that generated the proceeds.ⁱ The Texas Comptroller of Public Accounts has updated the National Association of Unclaimed Property Administrators (NAUPA) report format to assist holders in reporting this information.ⁱⁱ

Compliance with these rules can be complicated. For example, special considerations will need to be accounted for when owners have interests in multiple wells or leases and when owners have both in and out of state leases, wells, or properties to report.

Under the new Arkansas law, holders must now provide not only the name and last known address of the owner but also the (a) well, uncontrolled lease, or unitized area name as recognized by the state's Oil and Gas Commission; (b) either the (i) county, section, township, and range of the well or from where the minerals were severed or produced; and (c) any other information as may be required from the Auditor of State.ⁱⁱⁱ A special form is available on the Arkansas' Auditor's website that allows holder's to comply with these requirements though additional guidance for reporting in the NAUPA format may be forthcoming.^{iv} Note that Oklahoma has also required similar reporting obligations for some time.^v

Texas has also recently updated its unclaimed property reporting instructions for holder's this year reminding them that continuing payments due to the state must be included on the annual report and indicated as such with a special MI10 property type code.^{vi} Under Texas law related to the reporting of mineral interest property, once an owner's property has been remitted, additional amounts that accrue in subsequent years must also be reported.^{vii} Monthly or minimum suspense checks are to be held until July 1 and then included on the annual report.^{viii} Last year, Texas began requesting holders create supplemental reports for any ongoing payments that were sent to the Comptroller

ⁱ Tex. Prop. Code § 74.101.

ⁱⁱ See <http://comptroller.texas.gov/up/report/mineral.php>.

ⁱⁱⁱ Ark. Code § 18-28-403(a)(3).

^{iv} See http://auditor.ar.gov/images/uploads/list_unclaimed_mineral_fill-in.pdf.

^v See <https://www.ok.gov/treasurer/documents/497-UP-MIR-Instructions-12302015.pdf>.

^{vi} See <http://comptroller.texas.gov/up/report/pdf/96-478.pdf> at p. 18-19.

^{vii} Id. and Tex. Prop. Code § 75.101(b).

^{viii} See <http://comptroller.texas.gov/up/report/pdf/96-478.pdf> at p. 18-19.

that did not accompany the annual report; Texas had made clear for 2016 that separate current production reports will no longer be accepted.^{ix}

Audit and Risk Environment

Adding to this complex compliance landscape, states have increased their focus on unclaimed property audits of oil and gas companies. Nearly all states authorize unclaimed property audits to be conducted on a contingency fee basis, meaning private, third-party auditors are compensated based on a portion of the unclaimed property collected from the holders they audit. This can create a natural incentive for those auditors to push for higher assessments or apply aggressive interpretations of state unclaimed property laws. Furthermore, the auditors in many states do not specialize in the oil and gas industry and educating them on the specific requirements of oil and gas reporting – such as JIB accounting or suspense codes – can delay exams. Lastly, long look back periods (back to 1981 in the case of some ongoing exams), and the risk of statistical sampling and estimation methodologies in cases where records are no longer available, can lead to large liabilities that become very difficult to mitigate.

In January of this year, North Dakota released an internal audit report related to the performance of the state's unclaimed property department (UPD).^x Among the findings – which included harsh criticisms of the functionality of the department's website where owners can conduct searches for property held by the state – was a determination that a lack of audits resulted in "limited, to no, assurance property presumed abandoned was turned over...."^{xi} In 2013, the UPD successfully requested legislative changes which removed statutory language that prohibited third party auditing for some categories of holders, primarily those known to be "in state," but as of the date of the report issuance, no audits of North Dakota companies had been conducted.^{xii} A separate report issued by the North Dakota Department of Trust Lands at the end of 2015 noted a 55 percent increase in unclaimed property receipts in 2015 over the amounts collected in 2013, and a near tripling of the amounts collected as unclaimed property royalties in the same time frame.^{xiii} Much of this increase in receipts relates to an increase in oil and gas royalties that have gone unclaimed.^{xiv} It is anticipated that audit activity by the state of North

^{ix} Id.

^x Unclaimed property in North Dakota is administered by the Unclaimed Property Division of the Department of Trust Lands (the "Division"). For ease of reading, we have referred to the Division in this article as the UPD. The full report from the North Dakota State Auditor is available at https://www.nd.gov/auditor/reports/3036b_16.pdf.

^{xi} Id. at p. 4.

^{xii} Id.

^{xiii} See <https://land.nd.gov/docs/biennialreports/report.pdf> at p. 24.

^{xiv} Id.



Dakota will increase in the coming months as a result of these findings and a particular focus may be on oil and gas firms.

In one positive development for holders, in mid-May Arizona Governor Doug Ducey signed House Bill 2343, which attempts to curtail third-party audit practices there. Although it stops short of prohibiting contingency fee contracts altogether, the new law does require: (a) the unclaimed property department establish procedures to monitor the performance of contingent fee contract auditors; (b) a notification of rights to holders under exam; and (c) the issuance of a request for information by January 1, 2017 to explore the feasibility for contracting unclaimed property audits on a non-contingency basis.

Conclusion

For oil and gas firms, unclaimed property compliance requirements and enforcement trends continue to present specialized issues. Holders in this industry must actively monitor their compliance programs to ensure accuracy and minimize associated risks. Further, the increased reliance by many states on private, contingency fee auditors means holders will need to be vigilant in their review of unclaimed property assessments. Staying educated and being proactive remains critical for staying ahead of unclaimed property risks.

About the Author

Will King is a senior manager at KPMG LLP, where he provides oil and gas companies with compliance solutions, audit defense guidance, voluntary disclosure support, policies review, and other unclaimed property risk mitigation strategies. He has authored several articles related to unclaimed property and is a frequent speaker on unclaimed property topics at local and regional conferences, including for the National Association of Division Order Analysts and the Unclaimed Property Professionals Organization (UPPO). He can be reached via e-mail at williamking@kpmg.com or phone at 214-840-6107.

kpmg.com/socialmedia



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