A Closer Look

Mineral and Energy Resource Management Leaves No Stone Unturned

BESSEMER TRUST

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In Brief

- **A typical oil and gas mineral rights portfolio may consist of numerous holdings in various counties across multiple states, making it challenging for mineral rights owners to ensure that all revenues from production are being captured.**
- **We use our expertise on behalf of clients to identify and recover past and present revenue to which they are entitled from their mineral rights holdings.**
- **In this *A Closer Look,* we discuss how our mineral and energy resource management team determines whether clients' mineral rights have been tapped and the necessary steps we take to bring our clients into the payment stream.**

Our Mandate: Maximize Returns to Clients

While it's always important for mineral rights owners to capture all of the revenues they're entitled to from their mineral rights holdings, it's even more critical during crude oil market downturns — as we saw in 2014 and most recently (and drastically) in 2020. The focus of Bessemer Trust's mineral and energy resource management (MERM) team is to maximize returns to clients. We use our expertise on behalf of our clients to identify and recover past revenue to which they are entitled from their mineral rights holdings. When new oil and gas leasing opportunities arise, we seek to attain the highest cash consideration and largest royalty share reasonably obtainable.

Identify Oil and Gas Holdings

To understand what oil and gas holdings are, it may be best to start with what they are not. Oil and gas holdings are not ownership interests or equity dividend interests in oil or natural gas companies. Rather, oil and gas holdings represent ownership interests in underground minerals. Identifying and accounting for all revenue-producing mineral interests takes time and expertise, and is particularly important during times of price volatility.

As oil and gas companies almost never own the mineral rights under the land where they believe oil and gas deposits may be located; typically, they contract with the mineral rights owners to gain access to, drill, and extract resources. These mineral rights are often owned wholly or in part by our clients. This contract takes the form of an oil and gas lease, which is not a lease in the conventional sense as legal title to the leased minerals, in most states, passes to the company (lessee) for the life of the lease subject to the mineral owner's (lessor's) retained royalty interest in any extracted minerals.

Underground oil and gas extraction can be difficult to track as it is often not visible above ground. MERM works to ensure that our clients receive their interests' revenue entitlements. We do so by leaving no stone unturned.

How Oil and Gas Leasing Works

As we have noted, an oil and gas lease is not a conventional lease. Additionally, while the language of oil and gas leases across states may be similar, each will have unique terms. Typically, however, an oil and gas company (lessee) will enter into a mineral extraction lease with the owner (lessor) of mineral rights under a tract of land.

When an oil and gas company expresses an interest in leasing mineral rights from our clients, our team helps to negotiate a lease that maximizes the cash consideration being paid for the lease as well as the size of the royalty share from future production as stipulated in the lease. If the lessee's extraction efforts are successful, the lessor will be entitled to cash proceeds based on a percentage of the production stream. For example, if the owner of the mineral rights under a tract of land grants a lease providing for a standard 25% royalty, and drilling efforts for oil are successful, the mineral rights owner is entitled to the cash proceeds from 25% of the production stream. The lessee is entitled to proceeds from the remaining 75% of the production stream. The companies' shares, the working interests, may also be sub-divided and held as fractional interests in our clients' accounts (Exhibit 1).

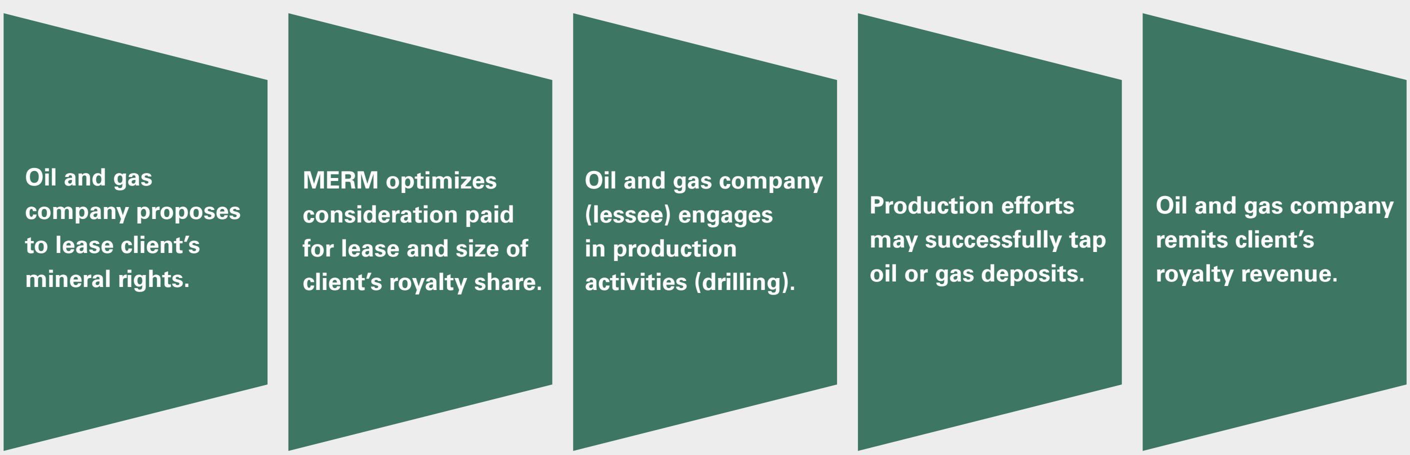
Mineral rights constitute real estate in most states and, once producing, will be taxed as such. As with other real estate, these rights may be transferred by deed, in whole or in part, with the resulting ownership fractionalization determining how the proceeds from a production stream will be allocated. In fact, it's not uncommon for a client's account to consist of many fractional interests, some underlying hundreds, if not thousands, of acres of land.

Search for Previously Unknown Production

Part of the complexity of managing a client's mineral interests stems from the fact that a client's account might comprise numerous holdings in multiple counties and states. Even if it were reasonably possible to inspect, physically, each of the sites, the simple fact that no oil or gas wells are visible on the surface doesn't necessarily exclude the possibility that production is occurring — and that our clients might be owed payments on production streams that are not obvious or visible.

Exhibit 1: The Basics of Oil and Gas Leasing

Key Takeaway: Negotiating oil and gas leases, and identifying and recovering production revenue takes time and expertise.



Source: Bessemer Trust

Many states allow oil and gas companies to tap an underground deposit by various means, including horizontal drilling. Horizontal drilling is like sticking a straw in sideways to extract minerals.

The challenge then becomes determining whether clients' mineral rights have been tapped, and if so, taking the necessary steps to bring our clients into the payment stream.

We use digital data resource maps to locate our clients' holdings in relation to existing and proposed well locations in an area. We examine the maps' drilling permits and committed acreage for wells and locations of vertical and horizontal wellbores. If we discover that wells might be on, or encroach on, a client's interests, we contact the producing oil or gas company to initiate the process of having current and in-arrears revenue placed in pay status.

Tax Rolls as a Valuable Resource

County tax rolls are another handy resource in the due diligence process. As noted previously, in most states (with Oklahoma and Louisiana as notable exceptions), once an oil and gas holding turns producing, it becomes taxable much like conventional real estate. The MERM team examines tax rolls on a county-by-county basis to identify and recover any owed funds on behalf of our clients or accounts. The team's ability to work quickly and efficiently is critical as interests with tax delinquencies may be seized, like other real estate, and sold for unpaid taxes. The delinquent tax rolls additionally serve to identify the responsible oil and gas company and facilitate the team's subsequent efforts to bring the rights holder into the revenue stream.

Whenever MERM's research discovers previously unknown interests in production, the team acts to determine if any past production revenues have been escheated to a state by examination of that state's online Unclaimed Money Fund database. If we determine that a state is holding proceeds from a client's interests, we take steps to claim the escheated funds on behalf of our client or account.

Identify and Recover Improper Revenue Withholdings

Bessemer's MERM team provides services to verify that a mineral property's production status is well documented, all historic production revenue is accounted for, payments on current production are being received timely, and that revenue payments are reconciled with each lease's terms and provisions.

Most modern oil and gas leases stipulate that royalties will be paid to the lessor free of deductions for any charges and expenses such as transportation, processing, compressing, and marketing costs, excepting only the lessor's share of production taxes. Oil and gas companies, however, are notorious for taking improper deductions, particularly those companies with rosters of royalty owners that may run in the hundreds of thousands, each governed by their own, often unique, lease terms.

Particularly in active areas (such as shale plays) where wells are often drilled in rapid sequence and companies are charged with paying all royalty owners timely, the sheer number and complexity of underlying leases can result in payments being made improperly, perhaps

Previously Unclaimed Mineral Revenue

Occasionally, new clients may have reason to suspect that their previous asset managers have not fully accounted for all mineral revenue. These clients engage our team for due diligence and discovery services. The client provides recent account statements, which typically include legal descriptions of the client's known mineral properties, for MERM's review.

We research tax rolls in the counties where the holdings are located to find any delinquent tax statements. Delinquent tax statements, in turn, will typically identify an oil company holding past-due mineral revenue to which our client is entitled. In certain cases, our team may identify substantial past-due revenue from production that may continue to generate future royalties.

with the buffering justification that any unauthorized or improper deductions can always be refunded at a later time. Our team's task is to compare any deductions against the terms of the governing leases and follow up with the producers as may be warranted. Depending on the amount of funds improperly held, our recovery efforts may also include demands for interest on funds due at the contractual or statutory rate (Exhibit 2).

Conclusion

The primary drivers of mineral revenue — production levels and product prices — are beyond anyone's control. In times of depressed oil and gas prices, MERM's ability to identify and account for producing mineral accruals may impact an owning client's bottom line.

Exhibit 2: Mineral and Energy Resource Management's Service to Clients

How Bessemer Trust's Mineral and Energy Resource Management Team Serves Clients			
Monitor Oil and Gas Company Production	**Inspect Tax Rolls**	**Search States' Unclaimed Money Funds**	**Enforce Economic Terms of Leases**
Monitors visible and not-so-visible production.	Identify producing interests and place clients in the revenue stream.	Identify and recover clients' mineral interest revenue.	Ensure that oil and gas companies do not take improper deductions against payment revenue.

Source: Bessemer Trust

About Bessemer Trust

Privately owned and independent, Bessemer Trust is a multifamily office that has served individuals and families of substantial wealth for more than 110 years. Through comprehensive investment management, wealth planning, and family office services, we help clients achieve peace of mind for generations.