

MEMORANDUM OF LAW

FROM: Lisa C. Coppolo, Esq.

DATE: September 25, 2009

RE: Unknown and Unlocatable Heirs of Oil and Gas Interest Owners in
Pennsylvania

ISSUE PRESENTED

In Pennsylvania, what must an owner of a partial interest in oil or gas rights do in order to proceed with developing the oil or gas if the other co-owners cannot be located or identified?

DISCUSSION

A. Pennsylvania Dormant Oil and Gas Act

On July 11, 2006, the Pennsylvania legislature enacted the Dormant Oil and Gas Act, 58 P.S. § 701.1 et seq. The purpose of the Act is to permit the development of oil and gas reserves when all owners of oil or gas interests cannot be located or identified. The Act provides for the creation of a trust for the benefit of certain owners of interests in oil and gas, authorizes a trustee to enter into leases of interests in oil and gas under terms and conditions authorized by the court of common pleas, provides for the administration of the trust and for payment of moneys to the trustee, and imposes penalties for nonpayment. As stated in § 701.2, the purpose of the Act is "to facilitate the development of subsurface properties by reducing the problems caused by fragmented and unknown or unlocatable ownership of oil and gas interests and to protect the interests of unknown or unlocatable

owners of oil and gas. It is not the purpose of this act to vest the surface owner with title to oil and gas interests that have been severed from the surface estate.”

Although § 701.4 of the Act creates a trust mechanism to allow for royalties to be paid to a trustee, the Act limits standing to those who already have an interest in fee, by lease, as royalty, or by ownership of correlative rights in the oil and gas underlying the property. The definition of standing is not clear under the Act. Particularly, the phrase “correlative rights” causes concern because of the lack of definition in the Act.

While Pennsylvania courts have yet to address standing under the Act, it is unlikely that any judge would interpret the Act to allow a “grab” of oil or gas rights by a party who has no ownership rights in the estate sought. This is particularly so as the legislature expressly disavowed any intent to vest rights in the surface owner, and reason would dictate that the legislature would not have intended to prevent a surface owner from obtaining rights but to allow an owner of a corresponding mineral rights to do so. Instead, a court would likely hold that only a co-owner of the same mineral interest would have standing to pursue the action. Owners of rights in the corresponding hydrocarbon (e.g., oil v. gas) would be relegated to an action pursuant to the Inalienable Property chapter of the PEF Code, which would appear to be appropriate to allow for the sale of the interest, the receipt of the Commonwealth of the proceeds of escheated property (see *Links Estate*, 319 Pa. 513; 180 A. 1 (1935)), and the subsequent exploitation of the mineral estate.

In essence, it appears, e.g., that partial gas interest owners have standing to file a petition regarding missing gas rights, but gas owners do not have standing to file a petition regarding oil rights. If current, locatable co-owners of the same estate are available to be named as petitioners in a Petition under the Act, standing will not be an issue. If no current owners are available to file suit, no one has standing to pursue an action under the Act. For more information on standing, see the Memorandum of Law on the same provided in tandem with this Memorandum.

B. Filing under the Dormant Oil and Gas Act

With regard to the mechanics of an action under the Act, the Act provides as follows:

(a) GENERAL RULE.-- Any person who owns an interest in oil and gas underlying a tract of land may petition the appropriate division of the court of common pleas of the county in which the tract or any portion of the tract is located to declare a trust in favor of all unknown owners of an interest in the oil and gas underlying the tract whose identity, present residence or present address is unknown and cannot be determined by diligent efforts. The petitioner's interest may be in fee, by lease, a royalty or by ownership of correlative rights in an oil and gas reservoir.

Thus, the Act requires the filing of a petition in the name of the co-owner of the rights. In practice, this means that the operator will not file the petition, unless the operator has actually purchased the rights at some point. Instead, the general practice is for an operator who has already leased the rights to pay the legal costs for prosecuting the action but to name the co-owner of the rights as the petitioner. Where the co-owner is already under lease prior to the discovery that a partial interest is owned by another, practice varies as to whether the operator wishes to absorb the legal costs as a cost of doing business or to deduct the legal costs from amounts paid to the lessor based on lease provisions that reduce amounts due to the lessor if it is determined that the lessor owns less than the entire estate.

The Orphans' Court has jurisdiction of DOGA actions pursuant to 20 Pa.C.S. § 711(11). Upon request in the DOGA petition, the court may order service by publication pursuant to Pa. R.C.P. 430(a):

If service cannot be made under the applicable rule the plaintiff may move the court for a special order directing the method of service. The motion shall be accompanied by an affidavit stating the nature and extent of the investigation which has been made to determine the whereabouts of the defendant and the reasons why service cannot be made.

Accordingly, to commence an action under the Act, a petition should be filed in the Orphans' Court Division of the Court of Common Pleas, along with a request for service by publication setting forth all of the efforts to determine the whereabouts of the unknown or unlocatable owners/heirs.

C. Prosecution of a DOGA Petition

Once the court receives the Petition, the court will schedule a hearing, at which time the co-owner will testify that it is his desire to develop the oil/gas and to have the unlocatable heirs' royalties placed into trust. An abstractor will be required to testify with regard to the efforts made to locate the heirs through searching courthouse records. An attorney may also advise the courts of additional efforts made to locate the heirs. The efforts must be exhaustive and mirror the requirements of Pa. R.C.P. 430(a).

A trustee will need to be identified to administer the trust. The trustee need not testify. Identifying a trustee who is willing to serve prior to hearing expedites the process. Pursuant to § 701.4, the trustee must be a financial institution authorized to do business in this Commonwealth, and upon appointment, the trustee may execute and deliver one or more oil or gas leases or other instruments on terms and conditions approved by the court.

Once the court hears the testimony, it will make a decision as to whether the interest should be placed in trust. The court may make its decision from the bench and will usually do so if the evidence is unequivocal. Once the trust is approved and the trustee is appointed, the lessee must submit the proposed lease or other instruments to the court after obtaining approval of the terms from the trustee. Once approval is obtained, the trustee may execute the lease, and the lessee may proceed.

Pursuant to § 701.5, the lessor must pay all bonuses, rental payments, royalties and other income due to the unknown owner or owners to the trustee until the trust is terminated and notice of its termination given to all interested parties. If the unknown or

unlocatable owners are not found, the trust proceeds escheat to the Commonwealth. From a practical standpoint, courts may be more inclined to approve a trust because 1) the lessee is not attempting to take the oil or gas interest itself but is acting in the interest of the owners by paying the monies into trust; and 2) the Commonwealth will likely gain possession of the funds as unclaimed property as the real owners will not be found.

Proceeding under DOGA provides benefits to developers in that § 701.6 restricts liability: Any lessee or other person who pays bonuses, rental payments, royalties and other income due to the unknown owners to the trustee shall not be liable for further claims by the unknown owners for any other income produced from the oil and gas interests subject to the trust. On the other hand, § 701.6 provides a penalty for noncompliance: Any person who fails to pay any bonuses, rental payments, royalties or other income due owners of interests in oil and gas who are unknown or cannot be found to the trustee within six months of the date of which those funds become due shall be liable for all attorney fees and court costs of collection, with interest to the date of payment. Accordingly, filing a DOGA petition is advisable any time co-owners of oil and gas interests cannot be found and development is desired.

CONCLUSION

The Dormant Oil and Gas Act establishes a method to insure that owners of oil and gas interests are not deprived of the opportunity to exploit their rights by the unfortunate inability to locate other owners of the same estate. The Act is also intended to protect the rights of unascertainable or unlocatable heirs and owners of partial interests. Any operator that determines that some of the co-owners of an oil or gas interest cannot be located should proceed under the Act to create a trust for the interests of those owners in order to protect itself from liability.