

SEVERED AND ABANDONED MINERALS - BACKGROUND MEMORANDUM

House Concurrent Resolution No. 3045 ([Appendix A](#)) directs the Legislative Management to study severed and abandoned mineral rights and methods to reduce the discount for oil produced in North Dakota. The resolution suggests addressing concerns with:

1. The high number of mineral rights owners for certain parcels of property.
2. The burden on the surface owner who may not own any mineral rights.
3. Determining the mineral rights owners.
4. The operation of North Dakota Century Code (NDCC) Chapter 38-18.1, termination of mineral interests.
5. The discount for North Dakota oil and incentives to reduce the discount.

The legislative history reveals the impetus for the study was a desire to have abandoned minerals return to the surface owner. A return to the surface owner would make location of the mineral owner easier. The means to return the minerals to the surface owner which were discussed included taxing mineral interests and NDCC Chapter 38-18.1. Taxation would place an expense on ownership of minerals. Presently, a person may retain mineral interest without any or very little cost and have the opportunity to have a large income if the minerals are developed. The impetus for the study of the oil discount came from an uncertainty as to which factors, in what proportion, affect the discount. Transportation was discussed as a major factor.

MINERAL LAW

The common law states that whoever owns the soil, owns to the sky and down to the depths. Property rights have been characterized as a bundle of sticks. A person may own a bundle of all the sticks with fee simple absolute ownership. However, a person may take that bundle and sever some sticks by conveying them to another person. A mineral interest is an interest in real property. The severance of mineral interests is done through a grant, a mineral deed, or through a reservation in a deed. The prime characteristic of a mineral interest is the right to enter the land to explore, drill, produce, and otherwise carry on mineral development activities. The mineral estate is dominant and inherent in the right are surface rights to find and develop the minerals. Without the dominant rights, the mineral rights would be meaningless. Under NDCC Chapter 38-18.1, the mineral owner must cooperate with and pay compensation to the surface owner. The practice of severing mineral interests from surface interests creates two sets of potentially conflicting rights. Even if not exercised, the greatest value of a mineral

interest may be its impairment of the surface estate, which may have a ransom value to a person that wants an unencumbered fee interest.

Attempts to Unify Ownership With the Surface Estate

Proponents of legislative efforts to eliminate fractionalized severed mineral interests assert that such ownership is an impediment to development of mineral resources. The primary problems they point out are that as mineral interest ownership is divided there is an increased likelihood of disagreement among joint owners about whether and under what terms development should occur, increased likelihood that interests will be owned by minors or other persons lacking legal capacity to contract, and increased likelihood that owners will be unlocatable.

Legislative approaches to elimination of fractionalized severed mineral interests generally follow one of two approaches. One approach is to avoid the necessity for all of the owners of a divided mineral interest to agree on a development plan. Examples of this approach include compulsory pooling of mineral interest ownership within a development unit and establishment of a trust to hold proceeds of mineral development for unlocatable property owners. The second approach is a more direct attempt to eliminate fractionalized severed mineral interest ownership by providing for statutory termination of dormant severed mineral interests after a certain number of years or imposition of property taxes on the mineral interest and termination of the mineral interest if taxes have not been paid. Under the second approach, the surface owner is often given the opportunity to acquire the mineral interest.

Compulsory Pooling

Proponents of compulsory pooling say that it promotes efficient development of resources by preventing proliferation of unnecessary wells, protecting mineral owners from having mineral resources drained without compensation, and allowing development of mineral resources when it is not possible to obtain consent from all coowners of a mineral interest.

North Dakota Century Code Section 38-08-08 provides for compulsory pooling of mineral interests within a spacing unit. If voluntary pooling cannot be achieved, any interested person may apply to the Industrial Commission for compulsory pooling. A pooling order must be made after notice and hearing and must be just and reasonable and afford to the owner of any interest in the spacing unit the opportunity to obtain a just and equitable share of production.

Trusts for Unlocatable Mineral Owners

North Dakota established statutory provisions in 1967 to provide that when an owner of mineral interests cannot be located, the district court may declare a trust for the benefit of that person for deposit of any bonuses, rental payments, royalties, or other interest due to that person. The law was rewritten in 2007 by passage of House Bill No. 1048, which is codified as NDCC Chapter 38-13.1. Under the 2007 changes, the county treasurer of the county in which the mineral interest is located is to serve as the trustee. The proceeds of each trust are subject to the laws governing unclaimed property under Chapter 47-30.1.

Termination of Mineral Interests

North Dakota Century Code Chapter 38-18.1 deals with termination of mineral interests. This chapter was revised substantially by House Bill No. 1370 (2009) ([Appendix B](#)). Section 38-18.1-01 defines the term "mineral interest" for purposes of the chapter to include oil, gas, coal, clay, gravel, uranium, and all other minerals. Section 38-18.1-02 provides that a mineral interest is, if unused for a period of 20 years immediately preceding the first publication of the notice required by Section 38-18.1-06, deemed to be abandoned unless a statement of claim is recorded. Title to the abandoned mineral interest vests in the surface owner in the land in or under which the mineral interest is located on the date of abandonment. In addition, the surface owner may record a statement of succession in interest on the date of abandonment.

North Dakota Century Code Section 38-18.1-03 provides that a mineral interest is deemed to be used if:

1. There are any minerals produced under that interest;
2. Operations are being conducted for injection, withdrawal, storage, or disposal of water, gas, or other fluid substances;
3. In the case of solid minerals, there is production from a common vein or seam by the owners of the mineral interest;
4. The mineral interest on any tract is subject to a lease, mortgage, assignment, or conveyance of the mineral interest recorded in the office of the recorder in the county in which the mineral interest is located;
5. The mineral interest on any tract is subject to any order or an agreement to pool or unitize, recorded in the office of the recorder in the county in which the mineral interest is located;
6. Taxes are paid on the mineral interest by the owner or the owner's agent; or
7. A proper statement of claim is recorded.

One of the main changes in 2009 was the removal of an eighth deemed use--when the owner or lessee utilized the mineral interest under or authorized by the instrument creating the mineral interest. This use was

determined by the term "utilized" which is circular and ambiguous. As a result, in practice a judicial determination of termination through a quiet title action was needed for good title.

North Dakota Century Code Section 38-18.1-04 governs what a statement of claim must contain and when it must be recorded. The statement of claim provided for in Section 38-18.1-02 must be recorded by the owner of the mineral interest or the owner's representative before the end of the 20-year period. A joint tenant, but not a tenant in common, may record a claim on behalf of oneself and other joint tenants. The statement of claim must contain the name and address of the owner of the mineral interest and a legal description of the land on, or under which, the mineral interest is located as well as the type of mineral interest involved. Finally, the statement of claim must be recorded in the office of the recorder in the county in which the mineral interest is located. The mineral interest is deemed to be in use at the date of recording if the recording is made within the specified time period. A statement of claim filed after July 31, 2009, filed by a person other than the record owner is not effective unless the record owner is referenced.

North Dakota Century Code Section 38-18.1-05 governs the failure to record the statement of claim. This section provides that failure to record the statement of claim within the time period provided in Section 38-18.1-04 will not cause a mineral interest to be extinguished if the record owner does one of the following within 60 days of the first publication of notice:

1. Files a statement of claim; or
2. Files a document showing the mineral interest is deemed used under Section 38-18.1-03 during the last 20 years.

North Dakota Century Code Section 38-18.1-06 governs the method by which surface estate owners intending to succeed to the ownership of a mineral interest upon its lapse must give notice of lapse of the mineral interest. This section provides that a person intending to succeed to the ownership of a mineral interest upon its lapse must give notice of the lapse of the mineral interest by publication. The publication must be made once each week for three weeks in the official county newspaper of the county in which the mineral interest is located; however, if the address of the mineral interest owner is shown of record or can be determined upon reasonable inquiry, notice must also be made by mailing a copy of the notice to the owner of the mineral interest within 10 days after the last publication is made. The notice must state the name of the record owner of mineral interest, contain a description of the land in which the mineral interest is located, and contain the name of the surface estate owners giving the notice. A copy of the notice and affidavit of service of the notice must be recorded in the office of the recorder in the county in which the mineral interest is located and constitutes prima facie

evidence in any legal proceedings that the notice has been given. The surface owner that succeeds to mineral interests is entitled to record a statement of succession in interest. Section 38-18.1-08 provides that the termination of mineral interest chapter does not apply to a mineral interest owned by a governmental body or agency. One of the main changes in the law in 2009 was the definition of the reasonable inquiry needed to find the mineral interest owner, and not find the owner, to be excused from mailing notice. Under Section 38-18.1-06, reasonable inquiry requires the surface owner to search:

1. The county recorder's records for any documents showing the mineral interest is deemed used under Section 38-18.1-03;
2. The clerk of court's records for any judgment, lien, or probate records for the mineral interest owner's identity;
3. The Social Security death index for the last-known address of a deceased mineral interest owner; and
4. Other public Internet databases to locate or identify the mineral interest owner. However, the surface estate owner is not required to use a database for which a fee is charged.

House Bill No. 1370 also created a new section, which was codified in NDCC Section 38-18.1-06.1. This section provides for the perfection of the title in the surface owner. The surface owner may maintain an action in district court to obtain a judgment in quiet title. If a surface owner follows the procedures in the statute, the district court is required to issue findings of fact, conclusions of law, and enter a judgment perfecting title in the surface owner. The judgment is deemed conclusive except for fraud, misrepresentation, or other misconduct. A mineral lessee may rely on the judgment and any lease remains effective if the judgment is vacated. In addition, the lessee is not liable to any third party for proceeds paid to the surface owner under a judgment. Absent fraud or misrepresentation, the surface owner keeps proceeds gained under a judgment before a judgment is vacated.

Although the term mineral interest, as used in NDCC Chapter 38-18.1, includes clay and gravel, these substances are often reserved by the surface owner and are not included in a conveyance of oil, gas, or coal. The reason is that oil and gas resources can be developed with minimal use of the surface estate while clay and gravel extraction usually results in destruction of the surface estate. To determine whether clay and gravel have actually been severed from the surface estate, one would have to review the relevant instruments. A number of different substances have been classified under North Dakota law as "minerals" within the meaning of instruments conveying or reserving an interest in "minerals." The question whether certain substances constitute "minerals" for that purpose depends upon the type of instrument, applicable statutes, and the date of the

instrument. Due to various statutory changes and a series of decisions of the North Dakota Supreme Court over a number of years, the question of what constitutes a "mineral" or "minerals" in an instrument dealing with severed mineral interests depends upon the date of the instrument and whether the instrument is a conveyance by mineral deed or other instrument, a reservation or exception of minerals in a conveyance of the surface, or a mineral lease.

A review of NDCC Sections 47-10-24 and 47-10-25 and changes to those sections results in the following complicated application of what minerals are conveyed with the term "minerals." Before July 1, 1955, a deed or reservation of minerals conveyed oil, gas and related hydrocarbons, coal, sulfur, iron, uranium, and any other mineral but did not convey gravel, clay, or scoria. As of July 1, 1955, and until July 1, 1983, a deed or other instrument conveying severed minerals (excluding leases and reservations of minerals) conveyed oil, gas and related hydrocarbons, sulfur, iron, and any other mineral but did not include scoria and did not include coal, uranium, gravel, or clay unless the intent to convey coal, uranium, gravel, or clay was separately set forth in the instrument. As of July 1, 1955, and before July 1, 1975, a reservation of minerals covered oil, gas and related hydrocarbons, coal, sulfur, iron, uranium, and any other mineral but did not include gravel, clay, or scoria. As of July 1, 1975, and before July 1, 1983, a reservation of "minerals" covered only those minerals specifically named in the instrument creating the reservation and their compounds and byproducts. As of July 1, 1983, a deed or other instrument conveying or reserving minerals (excluding leases) conveys to the grantee, or reserves to the grantor, all minerals of any nature whatsoever except those specifically excluded by name in the instrument, together with their compounds and byproducts, but does not grant or reserve gravel, clay, or scoria unless they are specifically mentioned.

In short, to succeed to a mineral interest, one must follow the procedure outlined in NDCC Chapter 38-18.1. However, because gravel is involved, one would want to review the instruments severing the minerals from the surface estate and the relevant mineral title standards to determine whether the gravel has actually been severed from the surface estate.

Dormant mineral Acts, such as NDCC Chapter 38-18.1, have been enacted in several states and subjected to several legal challenges. The North Dakota Supreme Court has not addressed the constitutionality of Chapter 38-18.1. Dormant mineral Acts have been found unconstitutional in Wisconsin, Nebraska, and Illinois but have been found not to violate either federal or state constitutional guarantees in Indiana and Michigan. In *Texaco, Inc. v. Short*, 454 U.S. 516 (1982), the United States Supreme Court reviewed the Indiana Dormant Mineral Act and upheld it. The Court found that because it was the

owner's failure to make any use of the property, rather than action by the state, that caused the loss of the property interest ownership, there was not a taking of property that required compensation under the 14th Amendment of the United States Constitution.

Taxation of Severed Mineral Interests

For more than 100 years, periodic attempts have been made in North Dakota to tax severed mineral interests. In 1907 the Legislative Assembly enacted a law that required assessors to list and assess severed mineral interests for property tax purposes. The law was in existence until 2009; however, the law was not followed because it was impossible as a practical matter to locate the owners and to assess the value of minerals in place in the earth.

In 1923 the Legislative Assembly enacted an annual state tax of three cents per acre for severed mineral interests. The revenue from the tax was to be paid into the state general fund. If the tax was delinquent for three years, proceedings were instituted to declare the title to the mineral interest forfeited to the state. The North Dakota Supreme Court in *Northwestern Improvement Co. v. State*, 220 N.W. 436 (N.D. 1928) ruled that the tax on severed minerals was unconstitutional. The court concluded that the law provided an unreasonable and arbitrary classification for property tax purposes based on severance of ownership of minerals. The court concluded that the statute violated the uniformity of taxation within a class of property requirement of Article X, Section 5, of the Constitution of North Dakota.

In 1947 the Legislative Assembly again attempted to tax severed mineral interests. The 1947 law attempted to avoid the Supreme Court objections from 1928 by not imposing a "property" tax. The 1947 law provided for an "excise tax" of three cents per acre on severed mineral interests. The tax did not apply when mineral rights are developed or for mineral leases held for development purposes. The North Dakota Supreme Court in *Northwestern Improvement Co. v. County of Morton*, 47 N.W.2d 543 (N.D. 1951) ruled the 1947 legislation unconstitutional. The court ruled that the standard of uniformity under Article X, Section 5, of the state constitution is substantially the same as the standard of equality under the 14th Amendment to the United States Constitution. The court concluded that the limitation on the power of the Legislative Assembly to classify property is equivalent to the limits of the 14th Amendment to the United States Constitution which, by requiring equal protection of the laws, precludes purely arbitrary classification. The court stated "[i]t is obvious to this court that the manner or method by which mineral rights are severed from the surface of the land cannot be made the full basis of the classification of such mineral rights for taxation purposes."

In 1953 another attempt was made to impose a tax to eliminate severed mineral interests. This time, the

attempt was made to avoid the Supreme Court's conclusion that tax cannot be levied against only severed mineral interests. The Legislative Assembly passed a bill that would have taxed all mineral interests and conveyed severed mineral interests to the owners of the surface estate in the event of tax foreclosure. The bill was vetoed by the Governor, who pointed out that the opportunity for the surface owner to regain mineral interests would be at the expense of property owners who had retained their mineral rights and who would have been taxed on those interests.

A mineral tax of 25 cents per acre for severed mineral interests would have been imposed by Senate Bill No. 2421 (1981). The bill failed to pass the Senate.

A mineral tax of 25 cents per acre, which could be increased to 35 cents per acre by the board of county commissioners, would have been imposed by Senate Bill No. 2410 (1983). The bill failed to pass the Senate.

A tax of 25 cents per acre on severed mineral interests would have been imposed by House Bill No. 1361 (1989). The bill was withdrawn before its first committee hearing.

House Bill No. 1281 (2009), which failed to pass the House, would have imposed a tax of \$2 per acre of mineral interests to be paid as property tax. Presently producing minerals were exempt from the tax. The surface owner would have had the right of first refusal to acquire ownership by payment of taxes delinquent after 12 months.

In addition to the constitutional impediments to imposing a tax on severed minerals, numerous practical problems exist. According to an attorney engaged in oil and gas title work, there are more than 70,000 square miles of property in the state for which title work would be required if severed mineral interests were taxed, and there are approximately 2.5 million severed mineral interest owners who would need to be identified and taxed by county officials. The potential existence of severed mineral interests under city lots, rights of way, lakes and streams, and platted lands would further complicate the title work and administrative problems. In addition to administrative problems for county officials, title attorneys working for the oil and gas industry would face an increased workload because it would be necessary to check the status of paid or unpaid taxes on severed mineral interests. This increase in title work and the resulting increase in costs probably would cause counties and the oil and gas industry to oppose legislation to impose taxes on severed mineral interests.

SUGGESTED STUDY APPROACH

The committee may desire to receive testimony by persons impacted by severed mineral rights. These persons would include surface owners, attorneys, landmen, oil and gas companies, mineral owners,

county recorders, and clerks of court. These persons may provide insight as to the scope of any perceived problem. In addition, these persons would provide information as to how present procedures are conducted and possible changes that might streamline the process.

ATTACH:2