



## Dealing With Suspense Accounts For Mineral Interest Production



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A “suspense account” is a tool often used in double entry accounting to park funds temporarily during a period of uncertainty about the identity of the owner or difficulty in delivering the funds.<sup>1</sup> It is widely used by businesses to cope with currently held unclaimed monies and intangible rights as varied as uncashed dividend checks, unused gift or loyalty reward cards, and pre-paid burial services. State officials, such as the Texas Comptroller, regularly employ suspense accounts for taxes paid under protest<sup>2</sup> and similar funds. Suspense accounts are not a recent innovation. Texas courts have reviewed the use of suspense funds involving Texas citizens since at least 1900.<sup>3</sup>

### Operators’ Use of Suspense Accounts

Operators<sup>4</sup> use suspense accounts for problems concerning mineral proceeds for the full range of mineral interests: royalties, overriding royalties, production payments, bonuses, delay rentals, shut-in royalties, minimum royalties, net revenue interests, and working interests. The issues that might create the need for a suspense account include a cloud on title,<sup>5</sup> a bad address, a failure of an owner to provide a tax identification number, and pending litigation over the interest.

The Texas Natural Resources Code specifies the required conduct of operators as to production revenues, including holding funds in suspense. The operator must keep books showing the amount of oil and gas produced and the sales price.<sup>6</sup> That information may be inspected by any royalty owner.<sup>7</sup>

The operator must begin paying royalty owners by 120 days after the end of the month of first production.<sup>8</sup> Thereafter, payment is due by 60 days after the end of each month oil is sold or 90 days after the end of each month gas is sold, unless the contract between the operator and royalty owner states otherwise.<sup>9</sup> The operator may also wait until the end of the month in which at least \$100 in due payments have accumulated, but no later than 12 months.<sup>10</sup>

Payments may be withheld in suspense without interest beyond those time limits only in any of three circumstances. The first is where there is a dispute concerning title that would affect distribution of payments.<sup>11</sup> The second is when there is reasonable doubt that a payee may have sold its share of

production or may not have clear title to the interest in the proceeds.<sup>12</sup> The third justification for withholding payment is a requirement in a title opinion that places in issue the title, identity, or whereabouts of the payee which was not satisfied by the payee after a reasonable request by the payor for curative information.<sup>13</sup>

In addition, a signed division order from the payee is a prerequisite to the duty to disburse proceeds.<sup>14</sup> The Natural Resources Code specifies the permissible contents of the division order which include the name, address, and taxpayer identification number of the payee, the fractional interest, the description of the property, and the effective date of the division order as well as a provision authorizing suspension of payment in the event of a title dispute or adverse claim on the production claimed by the payee.<sup>15</sup> The operator also has the duty to provide specific detailed information on payment stubs to royalty owners.<sup>16</sup>

Texas courts have declined to impose a fiduciary duty on operators holding production proceeds.<sup>17</sup> Operators have often commingled those funds and used them for internal business operations.<sup>18</sup>

The wise operator will establish and enforce standard procedures based upon the statutory requirements to be followed by trained employees who are collecting signed division orders and information from royalty interest owners. Such compliance offers a safe harbor for the operator in the event of litigation by a royalty owner.

A second portion of Texas statutory law that bears upon disbursement of mineral proceeds is the Texas escheat statute set forth in the Texas Property Code. That Code creates a presumption of abandonment for proceeds held for three years while unclaimed by the owner.<sup>19</sup> An operator must determine abandoned property in its possession as of June 30 each year and deliver that property to the Texas Comptroller no later than November 1 of that year.<sup>20</sup>

Besides complying with the Natural Resources Code and Property Code, an operator will want to minimize overhead costs

and risks of paying proceeds twice. It also should want to maintain its reputation for good business practices and not become known for “slow pay.” Striking the right balance among all of those sometimes competing goals can be challenging.

### Royalty Owner Remedies

On occasion a royalty owner may accept an operator’s use of a suspense account. Suspense may seem fully justified if the royalty owner has failed to do a necessary act such as furnish a social security number. Also, if the hang-up results from bitter litigation over title, the owner may take some comfort that at least the owner’s adversary is not getting the suspense funds. More often, however, the royalty owner will feel frustration with the lack of payment the owner has been anticipating for months since learning of the initial production.

When that disappointment is severe enough to cause the royalty owner to seek relief and no legitimate excuse for the delay is apparent, there are various avenues available. Since the Texas Natural Resources Code prescribes the appropriate use of suspense accounts by operators, a lawsuit for failure to pay should be based upon a violation of Chapter 91 of that Act. Claims for conversion, breach of contract, and unjust enrichment are typically added. If the operator is contesting title, then a count in the petition to quiet title is needed. A request for a declaratory judgment<sup>21</sup> is the standard vehicle to establish the royalty owner’s right to the mineral proceeds.

A demand letter must be sent at least 30 days before institution of the lawsuit.<sup>22</sup> The royalty owner should also review the lease and division order to ensure that there are no alternate dispute resolution steps required, either a mediation before filing or arbitration in lieu of litigation. Venue for the suit is in the county where the well is located.<sup>23</sup>

In addition to the suspended monies, the successful plaintiff can recover attorneys’ fees<sup>24</sup> and pre-judgment interest.<sup>25</sup> The four-year statute of limitations applies.<sup>26</sup>

If a third party has caused the creation of the suspense account through claiming title, then that party should be the primary defendant in a declaratory judgment suit with tort claims against that party as may appear appropriate. Usually, the operator, as stakeholder with the suspense funds, is also joined in such a lawsuit. Absent wrongful conduct by the operator, the award of attorneys’ fees would be only available against the miscreant third party based on the Declaratory Judgment Act,<sup>27</sup> not the Natural Resources Code. The operator could itself initiate an interpleader naming the parties claiming the royalties as defendants and placing the proceeds in the registry of the court.<sup>28</sup>

If an inability of the operator to identify the royalty owner or successfully deliver funds is the reason for the suspense account and more than three years elapses, the operator will pay the monies into the state Comptroller’s office in accordance with the Property Code. Thereafter, the royalty owner must pursue its remedies through the Comptroller’s office dealing with unclaimed funds. ■

3. See *New York Life Ins. Co. v. Scott*, 57 S.W. 677 (Ft. Worth 1900, writ *ref’d*).

4. Sometimes an operator may delegate to another entity, such as the purchaser of production, the responsibility for disbursing payments from production revenues. If one well produces oil and gas, then two different production purchasing companies may be the source of royalty payments. Such delegation does not release an operator from its duties to the mineral interest owners unless a contract with the royalty owner expressly does so. *Williams v. Baker*, 767 S.W.2d 193, 196 (Tex. App.—Waco 1989, writ denied) The royalty owner has a security interest in the mineral proceeds which is very helpful in an operator or purchaser bankruptcy. Tex. Bus. & Com. Code § 9.343.

5. E.g., a *lis pendens*. *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984).

6. Tex. Nat. Res. Code Ann. § 91.141(a).

7. Tex. Nat. Res. Code Ann. § 91.141(b).

8. Tex. Nat. Res. Code Ann. § 91.402(a).

9. *Id.*

10. Tex. Nat. Res. Code Ann. § 91.402(c)(1).

11. Tex. Nat. Res. Code Ann. § 91.402(b)(1).

12. Tex. Nat. Res. Code Ann. § 91.402(b)(2).

13. Tex. Nat. Res. Code Ann. § 91.402(b)(3).

14. Tex. Nat. Res. Code Ann. § 91.402(c)(1).

15. *Id.* The division order may also include an indemnity and hold harmless provision from the owner protecting the payor. § 91.402(d).

16. Tex. Nat. Res. Code Ann. §§ 91.501-502.

17. *HECI Exploration Co. v. Neil*, 982 S.W.2d 881, 888 (Tex. 1998). Strangely, it has been imposed in a criminal context. *Coleman v. State*, 131 S.W.3d 303, 308 (Tex. App.—Corpus Christi—Edinburg 2004, *pet. ref’d*).

18. See *Mitchell Energy Corp.*, 80 F.3d 976, 981 (5th Cir. 1996); *Phillips Petroleum v. Adams*, 513 F.2d 355, 360 (5th Cir. 1975).

19. Tex. Prop. Code Ann. § 75.101.

20. Tex. Prop. Code Ann. § 74.301. The operator is subject to audit by the State to ensure compliance with both the Texas Natural Resources Code and the Property Code. If another state enters the fray to battle Texas over escheated mineral proceeds, the state of the last known address of the royalty owner has priority. *Texas v. New Jersey*, 379 U.S. 674, final decree 380 U.S. 518 (1965).

21. Tex. Civ. Prac. & Rem. Code § 37.001 *et seq.*

22. Tex. Nat. Res. Code Ann. § 91.404(a). The written demand is not deficient if the operator (or oil buyer) with the suspense account had all the information necessary to be apprised of the demand. *Koch Oil Co. v. Wilber*, 895 S.W.2d 854, 865 (Tex. App.—Beaumont 1995, writ *denied*).

23. Tex. Nat. Res. Code Ann. § 91.404(c). Oddly, a suit by a lessee-operator for a declaratory judgment on the computation of royalties does not have to be brought in the county of the well. *Yzaguirre v. KCS Resources, Inc.*, S.W.3d 532, *aff’d on rehearing* 53 S.W.3d 368 (Tex. 2001).

24. Tex. Nat. Res. Code Ann. § 91.406.

25. The interest is calculated at two percentage points above the New York Reserve rate charged depository institutions, unless a different rate of interest is specified in a written agreement between the payor and the payee. Tex. Nat. Res. Code Ann. § 91.403. It is not available if there was a legitimate title dispute. *Concord Oil Co. v. Pennzoil Exploration and Production Co.*, 966 S.W.2d 451, 461 (Tex. 1998); *Headington Oil Co. L.P. v. White*, 287 S.W.3d 204, 210 (Tex. App.—Houston [14th Dist.] 2009, no *pet.*).

26. *Koch Oil Co. v. Wilber*, 895 S.W.2d 854, 864 (Tex. App.—Beaumont 1995, writ *denied*).

27. Tex. Civ. Prac. & Rem. Code § 37.001, *et. seq.*

28. Tex Rule Civ. Proc. 43.

1. Suspense accounts may also be used for costs, accounts receivable or other subjects which are doubtful or uncertain.

2. *Sunoco Terminals v. Bullock*, 756 S.W.2d 418 (Tex. App.—Austin 1988, no writ). Tex. Gov. Code § 403.035.