ethics in negotiations*

* and Title Curative

from the Landman's Perspective

By Gregory L. Jessup, CPL

Landmen are generally considered the face of the oil and gas industry. They perform many functions, but first and foremost they are the point person dealing with mineral owners in the acquisition of oil and gas leases, rights of way and other grants necessary for the exploration, production and transportation of oil and gas. They also deal with competitors and partners in the industry in asset acquisitions, divestitures and joint operating transactions. Negotiation in these contexts is the stock and trade of the landman. The stakes are high in these transactions and thus a bright light is shone (often after the fact) on the process and on the ethical standards that pertain to the process.

The establishment and maintenance of a Code of Ethics is a fundamental purpose of the national organization of professional landmen. A quick look at the AAPL website *(www.landman.org)* reveals the emphasis the association places on instilling the ethical ground rules in new landmen with its "Next Generation" programs as well as promoting a strong ethical foundation for the entire membership through continuing education programs.

THE AAPL CODE OF ETHICS (www.landman.org/about-aapl/bylaws):

Section 1. It shall be the duty of the Land Professional at all times to promote and, in a **fair and honest** manner, represent the industry to the public at large with the view of establishing and maintaining goodwill between the industry and the public and among industry parties. The Land Professional, in his dealings with landowners, industry parties, and others outside the industry, shall conduct himself in a manner consistent with **fairness and honesty**, such as to maintain the respect of the public. *[Emphasis added]*

Section 2. Competition among those engaged in the mineral and energy industries shall be kept at a high level with careful adherence to established rules of **honesty and courtesy**. A Land Professional shall not betray his partner's, employer's, or client's trust by directly turning confidential information to personal gain. The Land Professional shall exercise the utmost **good faith and loyalty to his employer (or client) and shall**

not act adversely or engage in any enterprise in conflict with the interest of his employer (or client). Further, he shall act in good faith in his dealings with the industry associates. The Land Professional shall represent others in his areas of expertise and shall not represent himself to be skilled in professional areas in which he is not professionally qualified. *[Emphasis added.]*

Additionally, AAPL developed certain guidelines as part of its mission to bind members to ethical, respectable and appropriate behavior when dealing with landowners. That includes certain expectations from a landmen, including that they "protect the members of the public with whom he deals against fraud, misrepresentation and unethical practices" and "place all pertinent facts before the proper authority of the American Association of Professional Landmen if charged with unethical practice or is asked to present evidence in any disciplinary proceeding or investigation, or has direct knowledge of apparent unethical misconduct of another member" *(www.americaslandman.com/best-practices)*.

While honesty and good faith are well-understood terms, these aspirational guidelines do not translate into a specific script for every vignette that the landman encounters. This article attempts to at least identify the tension the ethical landman faces with regard to his or her relationship and duty to the employer or client and the duties owed to the counterparties, the "opposition," and perhaps give some practical perspective to how the landman should respond to issues that may arise in specific transactions and negotiation contexts.

The Landman's Responsibilities to His Client and the "Other Guy"

A couple of years ago I testified as an expert witness in a trial that brought forth the question of when does a person or company actually become a landman's client and how should he or she be treated before and after that point. From that deposition I penned an article titled "When Does a Client Become a Client?" for the September-October 2012 *Landman*. I also spoke to other business relationships outside of the landman-client. The following are portions of that article as they relate to this article:

> It's important to note that the AAPL groups "partner," "employer" and "client" together in the Standards of Practice and Code of Ethics. There is commonality between these relationships. They are also each formalized by some form of documentation, whether it's a partnership agreement, a Contractor-Client service contract or a simple W-2 form delineating compensation requirements with the accompanying state employment codes. This formalization is a significant and expected practice in our business. Section 2 of the Code of Ethics puts forth two different and distinctive groups or classifications: 1) Partner, Employer and Client; and 2) Those engaged in the mineral and energy industries or basically, everyone else that isn't in the first group. There are different standards for each classification, each with certain expectations, both explicit and implied; and while they may have similarities, they are not the same.
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> We know that it is expected of landmen, as outlined, to treat others in a fair, honest and courteous manner. However, if there is not a land service agreement in place that covers confidentiality, there is only the codified obligation to be fair, honest and courteous, as well as the expectation to keep competition at a high level. Once you have established a contractor/client relationship, we described above as entering into a land service agreement with confidentiality language, the landman shall exercise good faith and loyalty and not act in conflict with the interest of his client.

Note that the obligations and expectations are now much higher once the agreement is entered into and a client relationship has become established. The expectation of loyalty and nonbetrayal has elevated the responsibility of the landman that may not be as obviously noticeable in just a "prospective client" relationship. He now has the obligation of confidentiality and nondisclosure upon him as defined in the (land service agreement). Remember, in the Code of Ethics, "client" is put on the same level as "partner" and "employer." The landman is to treat both "client" and "prospective client" with fairness, honesty and courtesy but his higher obligation is to the client with whom he has a confidential relationship and duty as prescribed in the agreement.

The land service agreement should outline the terms, conditions, responsibilities, obligations, consideration, etc., e.g., *AAPL Master Land Services Contract*. It was concluded that while the formal relationship dictated that a mutually executed agreement be in place, it's also understood that there may be a contractor/client relationship established by a less formal agreement, e.g., oral contract, course of conduct contract or even email communications between the parties presenting terms and conditions of a land service agreement.

A landman/client relationship is created under the promulgated AAPL MLSC, which references the *AAPL Code of Ethics*, Section 2: "A Land Professional shall not betray his partner's, employer's, or client's trust by directly turning confidential information to personal gain. The Land Professional shall exercise the utmost good faith and loyalty to his employer (or client) and shall not act adversely or engage in any enterprise in conflict with the interest of his employer (or client).

ARTICLE IV OF THE MLSC, CONFIDENTIALITY, NONDISCLOSURE AND CONFLICT OF INTEREST:

A. Unless otherwise designated by Company, all work-related information, title information, areas of interest, maps, letters, memoranda, and other information provided by Company, and all other materials, plans, and negotiations with third parties concerning the services requested of Contractor are proprietary to Company and shall be held strictly confidential by Contractor, its employees and permitted subcontractors and for twelve (12) months after the termination of the Contract. Contractor shall take all reasonable steps to identify all such confidential information to its employees and permitted subcontractors, and to ensure that those parties observe the provisions of this paragraph. All maps, reports and other work product produced by Contractor in the performance of this Contract shall be the exclusive property of Company, and shall be delivered to Company at its request within a reasonable time upon completion of services.

B. During the term of this Contract and for twelve months (12) thereafter, Contractor shall not negotiate for, nor purchase, oil, gas or mineral leases, royalties, fee or mineral interests, options for any of the foregoing, or seismic permits, nor perform for third parties any services which are the subject matter of this Contract, without Company's written consent. Excluded from this provision are properties that the Contractor was negotiating for purchase or lease prior to the date of the Contract.

C. Contractor and Company agree that no employee of Company has a direct or indirect financial interest in Contractor's business. Company, its employees, directors or officers, may not request and shall not receive from Contractor any commissions, gifts or compensation of any type or value above that normally encountered in usual and customary business practices and exceeding either (i) those permitted under Company policy or (ii) what is permitted by applicable law.

D. Company agrees not to circumvent by opportunity, collusion, or hiring of any subcontractors and delegatees of Contractor, and agrees that in doing so, such action shall be considered to be a breach of contract with Contractor, and may be considered a breach of Contractor's right of first art of services, established business goodwill and right to work in the State of Texas. A copy of any employee's and delegatee's executed Non-circumvent and Confidentiality Agreement will be issued to Company prior to commencing work.

This MSLC language explains the ethical and practical obligations of the landman to his client. But sometimes it's not that obvious. What about the times that the landman is working the same area or county for different clients at the same time? Though this can be somewhat problematic, it actually is not that unusual, especially when you have an active play.

As an example, I was taking leases for a client, Company A, in the Permian Basin, and the project was

almost completed when I received a phone call to take leases for Company B in the same basic area that also might include some overlapping of acreage. Company B had a much larger area and would keep our crew busy for quite a while. I hated to lose work, but full disclosure seems to have served me well over the years, so I told Company B that I would get back with him and immediately called Company A. I told him of the situation and that my first obligation was to him who was my client and with whom I had an MLSC in place. Note that I didn't get into specifics with him as to Company B's area of interest but did tell him that there could be a conflict and some possible overlapping of acreage. In this case it was determined that he had all the leases he wanted, and I assured him that any information I had from our project was confidential as put forth in our agreement. Therefore, he gave me the greenlight to go forward with Company B. Company B gave me the new project and understood our obligations to each party and the code of ethics under which I worked.

Now this was a good story, but I've had similar situations where I didn't even try to go this route. I knew upfront that the parties were fierce competitors and I would only make them mad at me by even proposing the dual role, which I knew wouldn't be accepted anyway. This oil and gas land service world is a small fraternity, and once you "stub your toe," you may be "persona non grata" in the industry from then on.

On a separate note, as an officer for a publicly traded company, when confronted with a similar scenario, I chose to obtain the services of another land service group. I didn't want to take any chances that anyone might feel that was tempting fate and not upholding my obligation for protecting undisclosed company information.

What then are the landman's obligations to those outside of the MLSC, including the other guy, the one the landman is trying to get to execute that NPRI ratification? That is partially explained in the *AAPL Code of Ethics*, Section 2: "Competition among those engaged in the mineral and energy industries shall be kept at a high level with careful adherence to established rules of honesty and courtesy."

The mission is to fulfill the landman's duty to the client while dealing with the opposition honestly and courteously.

Now the balancing act begins.

As my client's landman, I have an explicit obligation to perform my duties under the MLSC, e.g., get that ratification signed and to the "best of my abilities, with all work and services provided by me, the Contractor pursuant to this Contract shall be performed in a good and workman-like manner, with diligence and in accordance with good industry practices and procedures."

On the other side of the scale, I have a responsibility to adhere to the established rules of honesty and courtesy with the competition. I want to emphasize that honesty doesn't require giving away confidential information. And, while a landman may feel compelled to explain the effect of a contract or a provision in a contract as part of the negotiation and persuasion process, the landman cannot have a duty to provide interpretive analysis and advice to the opposing party.

I make many visits to Mel's Diner, M-E-L, in these situations.

First, is my approach moral? I recommend always deferring to honesty and courtesy; the Golden Rule comes to mind *(Matthew 7:12)*.

Second, is it ethical? What are my obligations under the Code of Ethics I signed off on when I joined the AAPL and became a landman?

And last, but certainly not least, is it legal? The only courthouse visits I want are when I run title for title attorneys. Always remember: The landman shall avoid business activity that may conflict with the interest of his employer or client or result in the unauthorized

disclosure or misuse of confidential information.

Next, I focus on some specific transaction hypotheticals and personal experiences to examine how the landman's duties and responsibilities unfold in these contexts.

Oil and Gas Leasing — "Get the Lease!"

Acquiring oil and gas leases for exploration and production companies is perhaps the quintessential landman task: "Go lease the survey on our form at $200 per acre and 3/16 royalty. Don't accept any markups on the form. Get them all recorded by the end of next week. Fail not."

Landmen meet all kinds of mineral owners — hustlers, fighters and hard traders, others who are desperate for some cash and in no mood for a fight or a delay, people who have a lawyer in the family (but that lawyer is not familiar with oil and gas) and mineral owners who think they know everything. You name it. Some of these owners are rich and/or sophisticated; and others are not. They may engage an attorney and/or have their own form of oil and gas lease. The ones who are not rich or sophisticated may not know where to start, but inevitably negotiations break out. Clearly, the landman has information these potential lessors do not have. The mineral owners likely have information the landman does not have. As already noted, honesty does not require transparent disclosure of confidential information (or nonconfidential commercial information for that matter) or subordinating your (or your client's) interest to the other guy's (lessor's) interest. While the negotiations may include discussion regarding the effect of various provisions, the submission of alternative or supplemental provisions (e.g., the ubiquitous bolt-on addendum) and the difference in text and effect among the various provisions, neither of the parties has a duty to protect the interest of the other. Even if there are no meaningful negotiations, the landman does not have a duty to represent or protect the interest of the other guy.

From time to time, there are consumer protection sentiments and even legislative efforts that would attempt to impose that kind of duty on the landman and the industry in the oil and gas leasing context. Ohio House Bill 493, the Truth in Leasing Act, introduced in March 2012 did not pass, but even its introduction and serious pursuit reflects an attitude on the part of some that the oil and gas leasing process needs governmental oversight. This legislation would have required a landman to give to a prospective oil and gas lessor a series of thorough explanations and also would have required the lessor to sign an acknowledgment that all of the following explanations were received:

- A thorough explanation of how oil and gas drilling works, including a description of the equipment used in oil and gas drilling and how hydraulic fracturing is used to remove oil and gas from the ground.
- A thorough explanation of how a company obtains the right to drill an oil or gas well under Ohio laws, which means an oil or gas drilling permit.
- A thorough explanation of the lease for oil or gas rights, including an explanation of how long the lease may last and the minimum royalty required under Ohio law.
- A thorough explanation of all the parts of the lease covering the oil or gas mineral rights that may make the lease last longer, including an explanation of the longest time that the oil and gas lease would last.
- A thorough explanation that the lessor has a right to request a separate land-use contract to use the property to drill a well.
- A thorough explanation that the lessor has a right to request a no surface use lease, which means a lease that would not allow a well to be drilled on the property.
- A thorough explanation that the lessor has a right to include a requirement in the lease to stop the lessee from free use of oil, gas and water from the property.
- A thorough explanation that the lessor has a right to put in the lease a requirement that he must be paid for the lessee's use of oil, gas or water from the property.
- A thorough explanation that the lessor has a right to put in the lease a requirement that the lessee must give him a list of all the chemicals and other substances that will be used in any hydraulic fracturing of the well for which the property will be a part of the drilling unit.
- A thorough explanation that the lessor has the right to speak to or meet with an attorney before signing a lease for the oil or gas mineral rights from the property.
- A thorough explanation that the lessor may have an attorney read the lease before its execution and provide advice to him about the lease for the oil or gas mineral rights owned.

Even though the bill did not pass — for the time being — the premise that mineral owners do not stand on equal footing with the landman in the leasing transaction continues to result in extra scrutiny being placed on the landman's conduct in that arena.

Another item worth discussing is the sight draft. This can be a beneficial tool to give the landman some extra time to confirm title, including the addition of a payment subject to title confirmation clause on the draft itself.

I've had clients who want me to add what some may deem to be an extraordinary number of days to the draft, e.g., 120 days, in order to perhaps shop the acreage. The Ohio folks, if they think of it, may want to add this thorough explanation item to their extensive laundry list.

So a question to consider asking: Is the sight draft with excessive days or any other lease-related items a provision that should be brought to the attention of the prospective lessor? In doing so, could such a provision create a problem for a client by the landman just being honest and courteous to the prospective lessor?

These are not rhetorical questions, but these may each be unique, and the landman needs to contemplate and answer each question for each lease negotiation. For example, I presently represent a mineral owner who is often a prospective lessor. The owner prefers not to allow any surface use at all by the lessee. However, we have developed a very restrictive surface use agreement that some may call onerous, which makes it worth our while if the lessee has no choice but to use our surface to develop his leasehold.

Sometimes it's "Go Get That Lease Amendment!"

A landman truism: It's always more difficult to go back and get something changed, especially when it's not deemed to be better than the status quo.

One of my first projects as a newly hired land manager back in 1997 was to travel out to the Texas Panhandle and convince about 30 lessors to give up their free gas provisions from their 1950s era leases. I was not well received by the majority, as they loved that free gas for lighting their pilot light and irrigating their land. Of course when these leases were taken by our predecessor (several times removed), the lessee did not object to agreeing to allow the lessor to lay a pipe to the well and take gas for use at a home on the lease, especially if there was no market for the gas in view of the remote location of the well or if the lessee did not need to use that gas for its operations on the lease.

But we now live in a different time where this type of liability by an operator/lessee can be disastrous to a company. My orders were to get a modification to the lease (amendment) to remove that right. I was authorized to negotiate a reasonable buyout or, if that hit a dead end, to see if we could get an amendment expanding on the original free gas provision. The gist of the amendment would allow the lessor to take gas not otherwise authorized under the free gas provision, but the use by the lessor might be made expressly subject to disconnection by the lessee if he deems that the supplying of such gas is not safe or proper in view of the risk to the lessor and his family as well as public health and safety due to the explosive and poisonous nature of the gas being taken.

I cited some real-life disasters attributable to this situation, which caused almost all of the lessors to take either a yearly payment in lieu of free gas or a total buyout of that obligation. True stories of exploding houses apparently did the trick. The few lessors who didn't give up the free gas allowed us to come onto their property and unhook their water hose (yes, water hose) and lay a proper flow line. We also paid them for executing an amendment to disavow the free gas rights to be transferred to the next owner. I wish I could say that it was my fantastic and insightful negotiating abilities that got this done, but in fact, as usual, it was all about the dollars.

I don't use ploys when negotiating a lease, an amendment or any agreement for that matter, but I attempt to be prudent and thoughtful with the information disseminated. I don't volunteer all, but when asked specific questions, I respond thoughtfully and truthfully but with nothing additional. Perhaps this answer is akin to giving a deposition,

i.e., only answering the question asked, with no explanation or embellishment.

Dealing with NPRIs — "Get That Ratification and Cure That Title!"

When the owner of executive rights executes an oil and gas lease, it binds nonparticipating mineral or royalty owners (for this discussion collectively, NPRIs) to all terms of the lease except for any pooling authority contained in the lease. Acquiring the right to pool NPRIs is a critical and challenging task for landmen, especially in Texas where forced pooling is an inadequate tool for dealing with these issues. In the absence of binding pooling, the NPRI owner who owns under the drillsite tract for a well will receive production allocable to full interest in the drillsite undiluted by pooling. This NPRI owner, if he knows where the drillsite will be, will likely not grant pooling authority without special considerations, such as a monetary payment or the realization or strong belief that the well cannot be drilled without his joinder in pooling. On the other hand, the owner of an NPRI under a nondrillsite tract, when he realizes where the drillsite will be, will stampede to authorize or ratify the pooling of the lease. Otherwise, he does not share in production even though his tract is likely being drained. This latter ratification is the one with which every landman wants to be

Note: In an opinion delivered March 6, 2015, *KCM Fin. LLC v. Bradshaw*, No. 13-0199, 2015 WL 1029652 (Tex. Mar. 6, 2015), the court discussed that the duty is owed, but a determination as to whether that duty has been violated is fact specific, and the executive does not automatically have to obtain the same benefit for the nonexecutives. The executive owes the nonexecutive a duty of utmost good faith and fair dealing. Furthermore, that duty has been defined as an obligation to "acquire every benefit" for the nonexecutive that the executive "would acquire for himself." In re Bass, 113 S.W.3d 735, 745 (Tex. 2003).

Now that we've set the table as to the landman's responsibilities with the involved players, let's test it out in the context of "go get ratifications from the NPRIs." Our first hypothetical will be the challenge to obtain that hard-to-get ratification from the NPRI owner who's just smart enough to be trouble, and to make matters worse, his interest is in the drillsite tract.

Note: If the NPRI was a nondrillsite tract, he is entitled to no share of production until the date he either (1) ratifies the lease as to pooling or (2) ratifies the pooling transaction.

In this example, we have a client who is about to drill a well in the Permian Basin, Wolfcamp formation. He has two 320-acre tracts he is pooling together to form a 640-acre unit. Each tract has just one owner, now lessors, with the leases giving authority to pool. However, as already acknowledged, any nonparticipating royalty interest must ratify the lease and/or unit, otherwise he is in an undiluted position, and the lessee's interest would be burdened and directly affect the net revenue interest of the operator, which is why the operator really wants the NPRI to ratify the unit/lease if the NPRI is on the drillsite tract. If it is nondrillsite, the operator/lessee doesn't really care, since he is enriched as to the NPRI not being pooled. Same thing with an unleased, nondrillsite mineral interest.

So now our landman has contacted the NPRI owner and made an appointment to get the ratification executed. The owner greets him politely at the front door. They sit down in the living room with two glasses of already prepared sweet iced tea, and the owner asks: "Why should I sign this ratification?" After placing his index finger to his chin in a thoughtful manner, taking a few contemplative seconds and one sip of his tea, the landman answers in a way that I have used numerous times, and the one that works the majority of the time: Simply inform the owner that "by doing so you may give yourself the opportunity to be in not just the well on your own tract, but if the next well is drilled on your neighbor's land, then you're in that one too; in fact, you'll be in all the wells drilled in the unit." Please observe that the use of the words "may" and "if" are important to include. Phrases not to use would be similar to "the next well on your neighbor's property may be a barnburner" or perhaps, "all of your hydrocarbons will be drained from your land if you don't ratify." Though the owner may not remember your use or nonuse of certain words, you will and you can testify to that if ever need be. This, so far, has helped me almost always seal the deal except maybe with one exception in over 30 years. However, if that approach doesn't get it done, you then really have to earn your money as a landman.

Some have suggested that when the NPRI owner isn't amenable to ratifying the unit, it may be advisable to employ the assistance of the executive rights owner. After all, he is the one who takes the hit if the NPRI doesn't ratify. The operator pays the executive mineral owner, and the person holding executive rights must acquire for the holder of the nonexecutive rights every benefit that he gets for himself. (Refer to *KCM Fin. LLC v. Bradshaw* case, being subject to change.) If the holder of the executive rights receives royalties pursuant to the rights held by the NPRI holder, he is chargeable in equity as constructive trustee with a duty to

hold the royalties attributable to the NPRI holder. In addition, the executive rights holder, while not a fiduciary, may have some amount of obligation to see that the NPRI owner is dealt with fairly, whether before or after the unit well is drilled. (A case implying that the executive owner has a fiduciary duty to NPRI is *Friddle v. Fisher,* 378 S.W.3d 475 (Tex.App. — Texarkana 2012) — Duty of Owner of Executive Rights to Royalty Owners; see new case, *KCM Fin. LLC v. Bradshaw.*)

If the NPRI and executive rights owners have a good relationship, it may indeed be helpful to draft the executive's assistance. But if not, there is sometimes the natural suspicion that one party is taking advantage of the other, and that may end up causing more of a problem. I generally keep them apart and appeal to the NPRI's greedy nature. In the spirit of disclosure, I confirm that yes, he can be undiluted if he doesn't execute, and I again relate that if he does ratify, he will have the opportunity to be in all of the wells drilled in the unit, not just the ones on his tract. I continue to impress upon him that it cuts both ways. What if a good well is on the neighbor's tract, but since he didn't ratify, he may be out of luck and the well? Frequently he wants to know if he can ratify later. Yes, he can, but he cannot recoup past production from the well outside of his tract. He would only start being credited with production and associated royalty payments at the time he ratifies. A possible solution would be to have language in the lease that requires the lessee or his assigns to notify the NPRI owner of his rights. (Refer to *Friddle v. Fisher* case; see new case, *KCM Fin. LLC v. Bradshaw.*)

Note: The lessor's interest that is subject to the NPRI has the burden of carrying the nonparticipating interest as to the extent of the royalty provided on the lease, after which the burden then shifts to the operator. The following is my version of a clause that has been suggested to me to use that may help the mineral interest owner get around that problem and get his full share:

"If there are any royalty interests (participating or nonparticipating) in oil, gas and minerals in the leased premises owned by other parties (other than Lessor), Lessor makes no warranty, representation or stipulation that this Lease grants Lessee the power or authority to pool such royalty interests, but in the event of pooling hereunder, Lessor's royalty on production from the pooled unit and/or unitized area shall be calculated and paid as if Lessee had the power, and had exercised the power, to pool such royalty interests in the Leased Premises, whether or not Lessee actually has in fact such authority. Further, if Lessor's executive rights and mineral interests hereunder are subject to a nonparticipating royalty interest, it shall be the burden, duty and obligation of Lessee to advise such nonparticipating royalty interest owner of his rights, benefits, duties and obligations under this lease."

Production Sharing Agreement — "Get that PSA!"

A production sharing agreement is a contractual agreement between the lessors and lessees that details the manner in which production from an allocation well will be allocated. An allocation well is a horizontal well that is drilled across the boundary line of two leases or units without pooling the two leases or units under the pooling authority contained in the leases. If all owners entitled to production or royalty do not agree to the allocation formula, there may be issues regarding whether the well violates underlying oil and gas leases, but even if that is not an issue, there will be allocation issues.

Currently, the Railroad Commission (Form PSA-12) requires, as a condition to drilling permit, at least 65 percent of all mineral and working interest owners in each lease, tract or unit to join in the PSA. The purpose of an allocation well is to bypass the need for express pooling authority, instead contracting as to the method by which

interest owners will share in production. Proponents of allocation wells recognize that drilling wells across lease and unit lines will encourage further development, prevent waste, prevent the drilling of unnecessary wells, increase ultimate recovery of hydrocarbons and protect correlative rights. Another benefit of an allocation well is that it potentially allows for development on tracts that are already pooled and would otherwise not allow for a horizontal well. However, since an allocation well is not pooled, production only holds the drillsite tracts, royalties are calculated on a well-by-well basis and the lessee remains vulnerable to suits brought by lessors who did not execute the PSA.

PSAs provide that the royalty owners in the two (or more) existing units agree that production from a horizontal well will be shared between the two units based on the percentage of lateral length (or proportionate length of open drainhole, etc.) on each unit, and production allocated to each unit will be treated for lease and royalty payment purposes as if produced from the unit. ***Note:*** There have been cases where the operators asked the Railroad Commission to grant permits for allocation wells even if they don't have PSAs from 65 percent of the royalty owners (even if they have no agreements from royalty owners). The RRC has granted over 40 of these permits without requiring the operators to have PSAs with any of the royalty owners. Cases have been filed and prosecuted recently that contest whether the RRC has the authority to issue allocation well permits for PSAs on an individual basis instead of under a general rule, which has not yet been promulgated. To date, all such suits have been settled before final resolution, so the question of RRC authority to issue such permits remains an open one.

When pursuing the signature of the nonparticipating interest for a PSA, it is much easier for the landman in that he can tell the owner: "I'd like you to sign, but, hey if you don't, no problem, as I don't HAVE to have your signature, and by the way if you don't sign, you're out."

Another Real-Life Example

It just so happens that as I prepared this article, I was engaged by a client to assist him with analyzing a letter from a midsize operator requesting his execution of an attached PSA for his minerals in Grimes County, Texas. The letter for the most part is well written, as it explains the purpose of the PSA as follows:

> The planned wells will cross multiple pooled units including (the unit that your lease is in). As you may know, horizontal wells must be drilled in a certain direction and with sufficient horizontal length to be economically productive and to maximize the ultimate recoveries of oil and/or gas. In many cases and because of the configuration of already existing pooled units, a single horizontal well has to be drilled across more than one of these units to achieve sufficient horizontal length at the desired location. Because these wells will cross the boundary between multiple existing units, production must be reasonably allocated to the different units traversed by each well.
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> In order to allocate production in a fair and reasonable method, the industry has been using what is known as the Production Sharing Agreement ("PSA") which provides a fair and reasonable solution for all owners. The PSA has been one of the most successful methods used for drilling horizontal wells across multiple pooled units in Texas. The method for resolving these issues is relatively simple. The agreement allocates the production from a horizontal well drilled across more than one pooled unit, called a "Sharing Well." Allocation is calculated on the basis of the proportionate amount of the length of open drainhole under each pooled unit as compared to the well's total open drainhole length.
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> The resulting percentage of production allocated to each unit is treated as if it were produced from the unit.
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> The enclosed PSA will not affect your share of production from the existing wells in (your unit) or future wells drilled and completed solely within the boundary of (your unit). This agreement applies only to *Sharing Wells* which are those wells drilled across more than one pooled unit.
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> By executing the enclosed PSA, we believe your production revenue will increase and we will be able to drill wells to recover oil and/or gas underlying your unit which may otherwise go unrecovered.

I initially decided to present this letter with the intention of highlighting all the misspeaks and misrepresentations, but actually I ended up liking it. The writer doesn't overly embellish the upside and presents it in a succinct and understandable way. If I want to be picky, I may point out that the last paragraph stating that they "believe your production revenue will increase" could be left out. I understand that it's subjective and shouldn't be a problem,

but I also have seen owners latch onto these statements like they were guarantees, and though there may or may not be legal ramifications, it can still cause uncomfortable issues down the line if the revenue does not increase.

Do's and Don'ts for the Landman in Negotiations

My No. 1 do: disclosure. This is defined by Merriam-Webster as "something (such as information) that is made known or revealed; something that is disclosed." Disclosure may keep you and/or your client out of the courthouse. I'm not necessarily endorsing full or partial disclosure but practical disclosure — information that honors the contractual commitment to the landman's client and still deals honestly with the other side. (***Note:*** I have been advised there may be times when full disclosure is required by law, but for this discussion, I'm referring to the negotiation discourse between parties when full disclosure is not required.) I refer to a recent case, *PanAmerican Operating Inc. Appellant v. Maud Smith Estate, a Texas General Partnership, Appellee* [No. 08-12-00036-CV; 07/24/2013], that helps prove the point.

Facts of this case:

1. PanAmerican entered into an agreement with a landman to take leases on its behalf.
2. PanAmerican provided the landman with an office, telephone and company email address.
3. Exchange of emails occurred between the appellant's landman and the appellee's attorney, including a lease offer and terms.
4. The appellee's attorney accepted said terms of the lease offer and mailed the executed lease to the landman at PanAmerican's offices.
5. Prior to paying the lease bonus (consideration), the price of crude oil dropped.
6. PanAmerican refused to pay the bonus claiming that the landman did not have general power of agency.

The trial court ruled for Maude Smith with the Court of Appeals affirming the trial court ruling. It reasoned that since PanAmerican provided the landman with an office, telephone and company email address in addition to making him the "point man" in negotiations and never informed the landowner of landman's lack of authority, that the landman had "apparent authority" to act on behalf of principal and bind the principal. The principal either knowingly permitted its agent (landman) to hold himself out as having authority to negotiate agreement or demonstrated a lack of ordinary care "as to clothe its agent with indicia of authority" to act on its behalf.

In my opinion, there are two quick ways to avoid this train wreck: 1) Make sure you're entered into the promulgated AAPL Master Land Service Agreement that includes Article II. Relationship of Company and Contractor: "In the event that services provided by Contractor include the acquisition of oil, gas or mineral leases, minerals, royalties, rights-of-way, seismic permits, options to acquire any of the foregoing, or interests in other real or personal property for the account of Company, Contractor shall act as agent on behalf of Company, but **shall have no authority to bind Company in any other manner or for any other purpose, or to enter into any contract or agreement on behalf of Company**" *(emphasis added)*. 2) Disclose to the landowner that while you have the authority to negotiate on behalf of your client, you do not have the authority to bind him to a lease. Basically, just read the owner the pertinent language in Article II, or perhaps hand him a copy of that language. It lets the landowner know that while he can negotiate with you as a representative of the company, he will need the company's signature to bind the deal.

My No. 2 do: honesty. More specifically, do not incorporate deception into

your presentations. Suppressing, covering up, distorting and twisting facts to serve your own purposes — or supposedly those of your client — almost always leads us down roads best not taken. This reminds me of the annual competition called the World's Biggest Liar held in Cumbria, England, where competitors from around the world have five minutes to tell the biggest and most convincing lie they can. A true fact about this contest: Politicians and lawyers are not allowed to enter. Why? Because they are judged to be too skilled at telling porkies (lies). I have no doubt if there were landmen in the U.K., we would be on the "no lie" list too.

There are certain questions I just don't want to hear, but almost always do:

1. My client has told me to take leases in my name and that it's imperative that no one knows he is out there buying. So, of course, the very first question the prospective lessor asks me is, "Whom are you leasing for?" I simply reply that for competitive purposes, my client prefers anonymity at this time. I try and explain that this could also be helpful to his overall development program of the area, which in the long run could be beneficial to the lessor. This usually does the trick. There are exceptions, even to the point that it's a deal killer. For example, they may not want the operator to be XYZ Oil Co., which by the way cheated them and/or their neighbors during the last round of leasing. I would have to obtain permission from my client so that I can let the owner know who they are not — just not who they are. Now if my client does happen to be XYZ Oil, I'm screwed.
2. The first question is usually followed up with, "How soon is the operator going to drill?" If allowed by the client, I will give a very broad time frame with the proper caveats that could delay drilling, i.e., commodity prices. If not allowed, then I'll let him know that the answer to that question is not to be made public, again for competitive purposes.
3. And I get this a lot: "I want the highest royalty interest and bonus that you are paying in this area — what are they?" I am very upfront on this because I know that neighbors talk. That's just the way it is. And to add to the intrigue, you finally get a lease from this guy and the very next week his curmudgeon of a neighbor leases for $50 an acre more because he's the drillsite tract and he knows you've got to have him. If the client allows, I will include a most favored nations clause in the oil, gas and mineral lease. I understand it has the possibility of getting pricey, but it sure can make it easier to get that first guy's signature.

Also, be prepared for the "dilemma" question: "Is this the best thing for me to do?" An answer to consider may be: "That is of course something you need to decide for yourself, but I can see where it could be beneficial to you." I hate those gray areas.

My No. 1 don't: misrepresentations. Basically this is staying away from certain phrases that some landmen may use to embellish the results a signee may enjoy if certain documents are executed. My favorite examples:

- "All of your neighbors have already signed up. You'll be left out."
- "If you don't sign, then all of your oil will be captured by your next door neighbor's well."
- "Once you sign, we can drill that well and you'll be receiving some very nice royalty checks."

Now, any one or all of these phrases may be correct in certain situations, but tread lightly even then before uttering any of them. They may still be construed as coercive and come back to haunt the landman and his client.

My No. 2 don't: creative editing. Actually this is tied with my No. 1 don't because engaging in this exercise may be considered criminal activity. As a landman I have been tempted more than once in 35 years to "cure" a defect by using "creative edits." Several years ago my company at the time, acting as an operator, had a rig scheduled to move in, rig up and spud in one week. All was fine until one of my in-house landmen saw that a pertinent ratification was signed by the signatory party only as an individual when he was also a trustee for another party — the family trust. My choices were to 1) ignore it, 2) correct the document and go back to get the party to execute it correctly or 3) just "add" the required words to the title and notarization. The latter was very tempting in that the original document had plenty of space left to add the wording and still look good, and additionally it had not yet been recorded. What could go wrong? I refer to John C. Heywood's presentation, "Top 10 Things Landmen Do to Irritate Their Lawyers." That paper discussed an eerily similar situation that involved forgery, criminal activity, misrepresentation, etc. — all of which I want nothing to do with. Even when it took several attempts to make an appointment with the party who wasn't all that amenable to signing in the first place, I had to make the good effort. My employer would have to make the business decision to go forward with

the operation, but I would make sure he had all the facts at hand when he did. A side comment to this is that now I always prefer to have a drillsite title opinion. If we had it in this case, my employer may have caught the requirement early on and given us plenty of time to cure the matter.

Take Away

Be fair, honest and courteous when dealing with everyone in the industry.

Be faithful and loyal to your client. You have a fiduciary responsibility.

Don't use "ploys" when negotiating an agreement; be prudent and thoughtful with the information disseminated. Don't volunteer all but when asked specific questions, answer truthfully but with nothing additional added in. Use "practical disclosure."

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Gregory L. Jessup, CPL, is CEO of Jessup, Harper, Dean LLC *(www.JHDpetro.com)*, a petroleum land service company that was specifically created in 2008 to target niche demands that encompass the interconnected areas of land, exploration and development, legal, financial and mineral owner aspects of the oil and gas industry. He is also the founder and president of Larson Energy LLC, starting the company in 2005 as a purchaser of oil and gas minerals in Oklahoma and eventually expanding the search area to 14 additional states. In petroleum land management for over 35 years, Jessup has been actively involved in all phases of land operations, including negotiations, acquisitions, divestitures, marketing, maintenance, management, administration, expert consulting and offshore exploration. He is a licensed real estate broker and a member of numerous professional organizations. Jessup served as secretary of the AAPL Executive Committee (2002-2003), president of the Texas Energy Council and officer on the Outer Continental Shelf Advisory Board. He was an officer and director of the Dallas Association of Petroleum Landmen, which honored him as 2001 Landman of the Year. Jessup graduated in 1975 from Texas Tech University with a Bachelor of Administration degree in management and attended Tulsa University and Texas A&M University-Commerce.