ETHICAL RESPONSIBILITIES OF LANDMEN IN OIL & GAS

BY

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TABLE OF CONTENTS

ETHICAL RESPONSIBILITIES OF LANDMEN IN OIL & GAS

Some of you, if not all of you, may have begun to associate my name with ethics talks since I first began giving these talks in 1995. I must tell you the reason for my continuing to give these talks is not because I am a dynamic speaker. I know that for a fact since one of the attendees at the South Texas College of Law where I spoke recently said so on the evaluation form; of course, another comment was that it was not a very useful topic. I am hoping that it was the same person. Regardless, the real reason why I am here is because I said "yes" the first time in 1995 and that was by default. At that time, I was on the speakers' committee for the Houston Bar Association Oil and Gas section and suggested that it would be great if we had an ethics topic dealing with landmen and attorneys. After an unsuccessful attempt at finding a speaker, guess who was selected by the committee to prepare a paper. I think the lack of volunteers is not because landmen and attorneys are not interested, but because we really do not focus on the subject as an integral part of day to day business. We tend to focus primarily on negotiating techniques, a topic for which it is relatively easy to get a speaker and one which is always interesting to the landman trying to improve his skills. One of the purposes of my presentation is to remind us of basic ethical issues with which we deal on a daily basis while negotiating transactions even if we do not realize it.

ETHICS OF DISCLOSURE

The ethics of disclosure is something landmen and lawyers alike deal with on a daily basis, even if we do not think of it in this way. The reason is that ethics deals specifically with the standards for being honest and forthright in dealing with our clients or employer and with third parties. The basis for these rules comes from hundreds of years of legal precedent in deciding what constitutes misrepresentation or fraud in business transactions. To understand our ethical obligations, we first need to understand what our legal obligations are in conducting business transactions and how these legal issues vary depending on the relationship of the parties.

1.

LEGAL OBLIGATIONS RELATED TO ETHICS

Ethics can be defined as a set of moral values which govern the actions of a group of professionals. Even though the **Disciplinary Rules**[1] and **AAPL Code of Ethics**[2] are enforced independently from civil law, many of these rules have their inception in civil rules of law. In addition, since a complaint under the **AAPL Code of Ethics** is frequently investigated after legal proceedings are concluded, and since a judgment is often considered to be a violation, we should keep civil law and the **AAPL Code of Ethics** in mind while analyzing the relative duties of

[1] The **Texas Code of Professional Responsibility** (which set forth **Canons of Ethics and Disciplinary Rules** thereunder) up to January 1, 1990, and thereafter the **Texas Disciplinary Rules of Professional Conduct** (hereinafter referred to as **"Disciplinary Rules"**). See Supreme Court of Texas, State Bar Rules Art. X, § 9 (Texas Disciplinary Rules of Professional Conduct) (1995) [hereinafter Tex. Disciplinary Rules of Prof. Conduct] (located in the pocket part for Volume 3 of the Texas Government Code in Title 2 Subtitle G App., following § 83.006 of the Government Code).

[2] The **AAPL Code of Ethics and Standards of Practice, Bylaws Article XVI** (hereinafter referred to as "**AAPL Code of Ethics**").

landmen in regard to the fact situations we discuss. It would expand the purpose of this paper beyond its scope to consider these laws in detail, however, to assist us in recognizing their potential application while discussing our fact situations, the following is a brief summary of some of the areas of civil law that could be involved:

1. Agent and Principal. An agent can be defined as the legal relationship based on an express or implied contract or created by operation of law whereby the agent is authorized to act for the principal, i.e., a consensual relationship between two persons in which one is to act for and on behalf of the other[3]. This would, of course, include the relationship of employer and employee in cases where the employee, as agent, has some discretion that can bind his employer, as principal, to a third party[4].

2. Fiduciary Relationship. The relationship of agent and principal is a fiduciary relationship which strictly requires loyalty, good faith, and fair and honest dealing and the agent cannot benefit from the subject matter of the relationship without the permission of the principal[5].

3. Fraud. Fraud is not easily definable, but in general terms it consists of an act, omission, or concealment by a person that involves a breach of legal duty, trust or confidence relied upon by another person that is done in bad faith to cheat or deceive. Duress and undue influence are related to fraud, but may exist without an intent to cheat or deceive and are particularly applicable in a confidential relationship. To amount to fraud the representation must be false[6] and it must be material[7].

4. Trade Secrets. A trade secret consists of any formula, pattern, device or compilation of information which is used in one's business, and which gives one an opportunity to obtain an advantage over competitors who do not know or use it. Trade secrets must be secret, and not matters of general or public knowledge[8].

5. Tortuous Interference. Tortuous interference consists of (1st) a contract subject to interference, (2nd) an act of interference by a third party which was willful and intentional, (3rd) which was a proximate cause of the damage, and (4th) the occurrence of actual damages or loss[9].

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[3] Tex. Jur. 3d. *Agency* § 10 (1987).

[4] Ruiz v. Conoco, 868 S.W.2d 752 (Tex. 1993).

[5] 3 Tex. Jur. 3d *Agency* § 113 (1987).

[6] 41 Tex. Jur. 3d *Fraud and Deceit* §14 (1987).

[7] 41 Tex. Jur. 3d *Fraud and Deceit* §15 (1987).

[8] Stewart & Stevenson Services, Inc. v. Serv-Tech, Inc., 879 S.W.2d 89 (Tex. App.-Houston [14th Dist.], 1994).

[9] Holloway v. Skinner, 898 S.W. 2d 793 (Tex. 1994).

There are, of course, many other civil remedies that could be imagined and they will vary from state to state; however, these are the ones that most often come to mind while considering ethical responsibilities.

2.

ATTORNEY AND LANDMAN RULES DISTINGUISHED

As referenced herein, you can see we have used the Texas Rules to distinguish between landmen's and attorneys' rules of conduct. The Texas rules are based on the American Bar Association Model Rules of Professional Conduct. We did not check all states; however, we did compare the Texas rules to Louisiana, Oklahoma and New Mexico which are also based on the American Bar Association Rules. All of the rules were very similar and, therefore, we believe that our comments will be generally applicable in most states if they have based their rules on the American Bar Association Rules.

The **Disciplinary Rules** for attorneys have been continuously interpreted by the District Courts of the State of Texas and the District Grievance Committees pursuant to the Rules of Disciplinary Procedure established by the Supreme Court of Texas, both of which result in published opinions interpreting the rules which can be reviewed to compare particular fact situations. Private and public reprimands or disbarments are reported in the State Bar Journal and cases which are tried in the District Court and appealed to the Texas Courts of Civil Appeals or the Texas Supreme Court are also reported in the Southwest Reporter. Because of the length of time that the Rules of Professional Conduct governing attorneys have been in place, as well as the nature of these rules, there is considerably more published precedent to consider when confronted with a fact situation involving an attorney.

The **AAPL Code of Ethics** applies to all landmen who are members of the AAPL, but the code does not have an extensive historical background for precedent and the decisions which are published do not normally provide sufficient detail of the fact situations involved to analyze prior decisions for precedent. The **AAPL Code of Ethics** are less specific and generic in describing ethical standards than the **Disciplinary Rules** for attorneys. We understand that this is by design so that the various facts and circumstances involving a landman can be evaluated on a case by case basis with an intended fair result. Also, the AAPL is concerned about the legal effect of its decisions possibly resulting in litigation. As a result, the **AAPL Code of Ethics** is frequently applied using civil or criminal remedies as a guideline. If there is a pending legal action, the AAPL will defer its action because its investigation could conflict with the pending legal proceedings. Once there is a judgment in a legal proceeding, enforcement of the rules will proceed and can result in a reprimand or dismissal from the AAPL. One interesting result of waiting for a judgment in a legal proceeding is that if the legal proceeding resulted in a sealed judgment, the facts needed to enforce the **AAPL Code of Ethics** might be unavailable and if known could have resulted in action by the ethics committee. This is understandable given that the authority of the AAPL is derived from the voluntary bylaws of the membership, and membership is on a voluntary basis, whereas the **Disciplinary Rules** for attorneys are promulgated by the Supreme Court of Texas[10],

[10] See Supreme Court of Texas Order dated June 11, 1979, at Tex. Rev. Civ. Stat. Ann. Art. 320a-1 (Vernon Supp.

giving them the effect of law, and governing the behavior of members of the State Bar of Texas in which membership is required to practice law.

The AAPL does publish a notice of its ethics decisions as required in the Bylaws in The Landman (the official publication of the AAPL). However, these are generic references to the complaint and action taken by the Ethics Committee and do not discuss in detail the facts giving rise to the Committee's decision. In fact, the By-Laws provide that only if the decision is suspension, resignation or expulsion is it to be published and then it must be so published. Another obvious difference between landmen and attorneys is that enforcement of AAPL rules can result in the loss of certification as a professional landman, but this does not prevent a person from continuing employment as a landman. As to Attorneys, violations of the rules of conduct can result in disbarment which means, of course, that you can no longer practice law.

It should be noted that local landmen's associations have their own codes of ethics and standards of procedure which we understand for the most part to be the same as the AAPL. Membership in the AAPL and local associations are controlled separately since it is possible and not unusual for a landman to be a member of one and not the other or, alternatively, a member of AAPL and several local associations.

It is easy to confuse the relationship of **Disciplinary Rules** for attorneys and **AAPL Code of Ethics** for landmen with civil law remedies. At times, ethics and civil law remedies seem to be almost indistinguishable. The difference then becomes the remedy that is available. We do have one case in Texas that defined this relationship as to attorneys.

In Atkins v. Tinning, a private investigator sued an attorney for breach of an oral contract to pay him a percentage of recovery after judgment or settlement of a case[11]. When the attorney failed to pay, the private investigator filed barratry charges against the attorney and had him arrested (Texas Penal Code Section 38.12, Barratry covers several offenses, including an offer to pay to obtain legal representation). These charges resulted in a trial and acquittal of the attorney as to the criminal charges and the attorney then sued the investigator for false imprisonment. Although interesting, the actual facts are not part of our analysis today, but the court's reasoning as to the relationship of civil law and **Disciplinary Rules** for attorneys is helpful. In this case, the court said that the matter being decided was whether a contract was illegal and not whether it was improper and unprofessional for an attorney to enter into the contract. The court further said that the **Disciplinary Rules** for attorneys do not govern the behavior of non-lawyers except tangentially in governing how lawyers may interact with them. In other words, even though the fee-splitting agreement might subject the attorney to **Disciplinary Rules**, the agreement itself is not invalid solely because it violates the attorney's professional duties. As a result, the rights of an attorney and third parties with whom he is dealing will be controlled not by the **Disciplinary Rules**, but by civil law and visa-versa. However, in Texas, an attorney can be disbarred for conduct committed

1995). Note that the Supreme Court recognized the legislature's passing of the State Bar in aid to the Supreme Court but that it is the Court which has the authority to regulate the practice of law.

[11] Atkins v. Tinning, 865 S.W.2d 533 (Tex. Civ. App, 1993, writ denied).

in his capacity as a private person. See, Minnick v. State Bar of Texas[12], where an attorney was disbarred for his actions while president of a mortgage company.

We think that this would also be true of landmen as to the rights of third parties with whom a landman is dealing. A complaint by a third party that a landman has violated the **AAPL Code of Ethics** should only result in disciplinary proceedings and not civil liability.

3.

TEXAS LEGAL DUTY TO DISCLOSE

In preparing this paper we reviewed an article entitled Legal and Ethical Aspects of Negotiations--Duties of Disclosure and The Right to Maintain Confidentiality in Natural Resources Transactions[13]. It contains a very thorough review of many of the same issues discussed in this paper, including the duty to disclose and associated ethical responsibilities. We refer you to such article and would suggest that you reflect further on these issues. Other than as noted below, our paper does not cite the article as authority; however, we do want to acknowledge that the article was very helpful in identifying many of the issues developed in our paper.

A. The common-law duty to disclose without regard to a contract.

The duty to disclose can arise out of common law, where misrepresentations made by a seller can amount to fraud. Common law fraud in Texas[14] can arise out of a material representation made by a party where such representation:

(1) is false;
(2) is made with the knowledge that it was false or made recklessly without any knowledge of the truth and as a positive assertion;
(3) is made with the intention that it be acted upon by the other party;
(4) was relied upon by the other party; and
(5) caused injury to the other party.

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[12] Minnick v. State Bar of Texas, 790 S.W.2d 87 (Tex. Civ. App. - 1990, denied).

[13] John E. Moye and Cynthia L. McNeill, Legal **and Ethical Aspects of Negotiations -- Duties of Disclosure and The Right to Maintain Confidentiality in Natural Resources and Transactions**, 42 Rocky Mtn. Min. L. Inst. 1 (1996). This article focuses on **Gold Fields Mining Co. v. Placer Dome U.S., Inc.**, United States District Court for the State of Nevada, Case No. CV-N-92-667 ECR filed in 1992 and settled in 1995 after summary judgment was granted to defendant on all issues except trade secret and intentional fraud. In this case, it was the buyer who misrepresented to the seller and the buyer's duty to disclose to the seller is recognized as being more difficult to establish than seller's duty to disclose to buyer although the same principles are applicable. The buyer had conducted test core drilling and knew that the seller's property was very valuable. In the negotiations, the buyer represented to seller that its test drilling had not developed significant mineral deposits and refused to disclose test core drilling information because it was confidential. **Schlumberger Technology Corporation and Schlumberger Limited v. John Swanson, et al**, 959 S.W.2d 171 (Tex. 1997), hereinafter discussed, was cited in the article at the Texas Court of Civil Appeals level as **Swanson v. Schlumberger**, 895 S.W.2d 719 (Tex. App - Texarkana 1994, writ granted). At the time this article was prepared, the Texas Court of Civil Appeals' decision at 895 S.W.2d 719 supported the duty to disclose discussed in the article. However, the Supreme Court decision thereafter reversed the Trial Court and the Court of Civil Appeals.

[14] See **Trenholm v. Ratcliff**, 646 S.W.2d 927, 930 (Tex. 1983).

B. Statutory Fraud.

Texas has a specific statute dealing with fraud in a real estate transaction which is applicable to sales of producing oil and gas properties (the "Texas Fraud Statute").[15] The Texas Fraud Statute provides:

"(a) . . . that fraud in a real estate transaction:

(1) . . .consists of a false representation of a past or existing material fact, when the false representation is:

(A) made to a person for the purpose of inducing that person to enter into a contract; and
(B) relied upon by that person in entering into that contract . . ..

(b) A person who makes a false representation. . .commits the fraud described in Subsection (a) of this section and is liable to the person defrauded for actual damages.

(c) A person who makes a false representation. . .with actual awareness of the falsity thereof commits the fraud described in Subsection (a) of this section and is liable to the person defrauded for exemplary damages. Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness. . ..

(d) A person who (1) has actual awareness of the falsity of a representation or promise made by another person and (2) fails to disclose the falsity of the representation or promise to the person defrauded, and (3) benefits from the false representation or promise, commits the fraud described in Subsection (a) of this section and is liable to the person defrauded for exemplary damages. Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness.

(e) Any person who violates the provision of this section shall be liable to the person defrauded for reasonable and necessary attorney's fees, expert witness fees, costs for copies of depositions, and costs of court."

[15] **Texas Business and Commerce Code**, Section 27.01 et seq.

C. Discussion of cases applying common and Texas statutory law fraud to fact situations.

(1) Concealment or failure to disclose. Due to recent events in the bankruptcy court, one case that summarizes the law in this area is of special interest. The case is Transamerican Natural Gas Corporation, et al v. Coastal Oil & Gas Corporation (the "Transamerican Case")[16]. This is an unpublished case, and, therefore, it may not be cited as authority in court; however, the case contains a good discussion of the law concerning common law fraud and Texas statutory fraud in a real estate transaction. Further, the court's opinion in the Transamerican Case cites several reported cases in support of its position. I find the case to be of interest since, in my early years of practice, I found myself involved in the first bankruptcy of a Jack Stanley-controlled oil and gas company (being the Goodhope Refineries, Inc. bankruptcy in 1974). The Transamerican Case arises out of the Transamerican bankruptcy filed in 1987. As I am sure many of you are now aware, a third bankruptcy was filed by a third company with which Jack Stanley was involved, TransTexas Gas Corporation, in which a plan of reorganization was confirmed by the bankruptcy court.

In the Transamerican Case, Coastal had sued Transamerican for breach of a gas purchase and transportation contract. The price of the gas to be paid to Transamerican was based on a price to be established by Valero Industrial Gas Company, which was to buy the gas. Transamerican countered by suing Coastal for misrepresentation amounting to common law and Texas statutory fraud, since Coastal did not disclose that it intended to resell the gas to a subsidiary of Valero (presumably at a higher price). The gas contract, as well as several companion contracts discussed in the case, arose out of the plan of reorganization that was approved in the 1987 bankruptcy. The Court, in holding that Transamerican failed to prove that Coastal had made any misrepresentations amounting to fraud, set forth a very succinct statement of how misrepresentations can constitute fraud. The Court stated that:

> (i) Deceit may be negative as well as affirmative (citation omitted). In an arms-length transaction, a party has a duty to disclose the falsity of a prior statement (citation omitted).
>
> (ii) If a party makes a representation which was true when made but later acquires information that makes the prior statement untrue, the person has a duty to disclose the subsequently acquired information to the other party (citation omitted).
>
> (iii) Specifically, a party to a business transaction is under a duty to disclose subsequently acquired information that he knows will make untrue or misleading a

[16] **Transamerican Natural Gas Corporation and TransTexas Gas Corporation v. The Coastal Corporation, Coastal Gas Marketing Company and Coastal Oil & Gas Corporation**, Appeal No. 04-94-00412-CV, Texas Court of Appeals, Fourth District, San Antonio. Pursuant to the Texas Rules of Appellate Procedure, unpublished opinions cannot be cited as authority.

previous representation that when made was true or believed to be so (citation omitted).

(iv) Silence under these circumstances is equivalent to a false representation (citation omitted).

It is not necessary that the seller say anything to give rise to common law or Texas statutory fraud. Silence can be fraud if there is a duty to disclose. This duty can arise where the seller knows that an undisclosed fact would be regarded by the buyer as material.[17] The duty to disclose also can arise when representations are made by a seller, who later determines such representations are not true and allows the buyer, nonetheless, to rely upon the early representations to his detriment.[18]

(2) Caveat Emptor (i.e., let the buyer beware). Caveat Emptor is the standard for all business transactions unless otherwise modified by some duty. In such an instance, the buyer must have relied upon the misrepresentation to his detriment, and he must not have failed to exercise reasonable care to protect himself. In other words, the buyer must not have shut his eyes and ears to matters equally open and available to him upon reasonable inquiry and investigation.[19]

(3) Opinions as a misrepresentation. In order to constitute actionable fraud, a misrepresentation must concern a material fact, as distinguished from a mere matter of opinion, judgment, probability or expectation.[20]

(4) Measure of damages. The measure of damages for fraud is the difference between the purchase price for the properties and the value of the properties as delivered under the contract. The amount of exemplary damages under the Texas Statute was previously limited to twice the actual damages. However, that portion of the statute was repealed and the cases interpreting the statute suggest that, depending upon the facts, exemplary damages could be more than twice the actual damages, but less than ten times such damages.

(5) Texas statutory law versus other law. The Texas Statute is in addition to any other laws or rights that a party may have, such as common law fraud or breach of contract rights,

[17] See **Warren H. Smith v. National Resort Communities, Inc**., 585 S.W. 2d 655 (Tex. 1979).

[18] See **Susanoil, Inc. v. Continental Oil Co.**, 519 S.W.2d 230 (Tex. Civ. App. - San Antonio 1975, writ ref'd n.r.e.).

[19] See **Moore & Moore Drilling Co. v. E. F. White, Jr.**, 345 S.W. 2d 550 (Tex. Civ. App. - Dallas 1961, writ ref'd n.r.e.).

[20] See **C. M. Berquist a/k/a C. B. Riley v. Totis Onisiforou**, 731 S. W. 2d 577 (Tex. App. - [14th Dist.], Houston 1987, no writ).

or under other statutes such as the Deceptive Trade Practices - Consumer Protection Act.[21] Further, other disclosure issues may be raised under state and federal laws[22] if a seller is insolvent. These remedies, of course, are well beyond the purpose of this paper and are mentioned only to inform you that legal issues in addition to those discussed here may arise out of a seller's duty to disclose.

4.

CONTRACTUAL WAIVER OF MISREPRESENTATION AND FRAUD

The question is: "Can a seller absolve himself of liability for consciously misrepresenting material facts to the buyer?" The answer is "maybe". It appears that, at least in Texas, it depends on the facts and circumstances surrounding the release. In Schlumberger Technology Corporation v. John Swanson[23], Schlumberger was the successor to SEDCO, Inc. that had expertise in offshore drilling and had previously used its technology to mine manganese from the ocean floor. The factual circumstances are lengthy but necessary to understand the decision. The Swansons had entered into an agreement with SEDCO to study the feasibility of mining diamonds from the ocean floor. Schlumberger was the successor to SEDCO by merger and formed a South African subsidiary with the Swansons to continue the project, Sedswan Diamonds Limited. The SEDCO lease was originally issued to SEDCO and the Swansons jointly, but was thereafter reissued to Sedswan Diamonds Limited ("Sedswan") individually. South Africa had leased adjacent tracts to DeBeers Mining Consolidated Limited ("DeBeers") and African Selection Trust Exploration Limited ("Seltrust"), which entered into a joint venture agreement with Sedswan to jointly develop the leases. The Swansons were concerned about Schlumberger continuing the project and their receiving little information. Apparently, Schlumberger represented to the Swansons that the project was neither technologically feasible nor commercially viable, but refused to give the Swansons progress reports or information. The concerns over lack of information and disclosure to the Swansons by Schlumberger occurred over a lengthy period of time. Finally, Schlumberger gave notice to the joint venture that Sedswan was withdrawing from the venture. DeBeers and Seltrust were offered the Sedswan interest but refused to buy it as long as the Swansons owned part of Sedswan. Schlumberger then negotiated with the Swansons for 13 months to buy out their interest for $814,000. As a part of this buy-out, the Swansons signed a release which stated:

> "Each of us expressly warrants and represents. . .that no promise or agreement or agreement which is not herein expressed has been made. . .in executing this release, and that none of us is relying upon any statement or representation of any agent of the parties being released…."

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[21] **Texas Business and Commerce Code**, Section 17.41 et seq.

[22] See **Texas Business and Commerce Code**, Section 24.01 et seq. and **United States Code, Title 11, Bankruptcy**, Section 548, regarding fraudulent transfers.

[23] **Schlumberger Technology Corp. v. Swanson**, 959 S.W.2d 171 (Tex. 1997).

Thereafter, Schlumberger sold the Swansons interest for $4,100,000, which, after Schlumberger recouped its investment in the project, netted a profit of $319,000 or so. At the trial an employee of Schlumberger admitted that Schlumberger had misrepresented the value to the Swansons and had not disclosed that valuable deposits had been located. The jury in the trial court awarded the Swansons $15 million in actual damages and $35 million in exemplary damages under Section 27.01 of the Texas Business and Commerce Code and $10 million for common law fraud. The Supreme Court of Texas overturned the jury's award and held that the release and disclaimer were binding as a matter of law and precluded a claim by the Swansons that they were fraudulently induced to sell their interest. In so holding, the Supreme Court said that, under the facts of this case, the release and disclaimer were binding, but left open what facts might constitute misrepresentation and fraud in other fact situations.

This case is difficult to understand on its face. Perhaps if the entire transcript was reviewed, one would get a better feeling for the result. From what we see in the published opinion, it appears that fraud may be acceptable in settling a disputed fact situation if you can get the other side to sign a disclaimer and release. I am certain this could not be the court's intent. It would be better to have said that as a matter of public policy, you cannot contract away fraud, but that under the facts the statements by Schlumberger were not fraud. Instead, the court said that as a matter of law the language released Schlumberger from common law and statutory fraud (Section 27.01). The only explanation appears to be that the disclaimer concerned the very disputed matter that was settled, i.e., the value of the asset. Even though it was not arising out of actual litigation, it was a disputed matter that was negotiated over a substantial amount of time by parties who were knowledgeable and experienced in the business of mining diamonds.

The Schlumberger case is also very different from the purchase and sale of producing oil and gas properties. First, the buyer and seller are usually unrelated and not parties to a joint venture. Second, in the purchase of producing properties, the buyer is utilizing information furnished by the seller to establish what price the buyer will offer the seller. The price can be and usually is negotiated by offer and counteroffer, but there is not a settlement of a disputed fact situation concerning the price. For this reason, I do not believe the language quoted above is meant as a matter of law to allow a seller of producing properties to misrepresent facts to the buyer upon which the buyer relies to his detriment to establish the purchase price. However, the obvious solution for the buyer is to not run the risk and to refuse to accept this language in a purchase and sale agreement. If the language is not negotiable and the buyer wants to sign the agreement anyway, then several other parts of the agreement should be reconsidered.

Typically, the data upon which the purchase price is based has a cut-off date earlier than the effective date; thus, the buyer should get updated production data and conduct a field inspection of the more valuable properties just before signing the purchase and sale agreement. If possible, some form of a material change in condition provision (from the condition represented by the data furnished by seller) should be included in the agreement. Also, the closing date should be relatively close to the effective date to avoid the possibility of material change in condition of the property while seller is operator prior to closing.

5.

LOUISIANA LAW REGARDING DUTY TO DISCLOSE AND FRAUD[24]

(1) Louisiana Civil Code. As you know, Louisiana is a civilian, not a common law, jurisdiction. Thus, the law applicable to a seller's duty to disclose arises out of the Louisiana Civil Code (the "Code"), which includes the following articles that are relevant to this discussion:

> Art. 1953. Fraud is a misrepresentation or a suppression of the truth made with the intention either to obtain an unjust advantage for one party or to cause a loss or inconvenience to the other. Fraud may also result from silence or inaction.
>
> Art. 1983. Contracts have the effect of law for the parties and..must be performed in good faith.

Thus, it appears that misrepresentations created by intentional misstatements or the furnishing of misleading information or by omissions to reveal information, which result in the other party's detrimental reliance, would amount to fraud in Louisiana just as it would under Texas common and statutory law. This analysis is supported by the thorough and thoughtful discussion found in a Louisiana Law Review article titled "Vices of Consent, Error, Fraud, Duress and an Epilogue on Lesion", which provides an interesting contrast between the styles and reasoning used historically in French jurisprudence versus the English common law.[25] Furthermore, Art. 1983 of the Code embellishes the obligations of parties to contracts by imposing the duty of good faith upon them, which supports the duty of both the seller and buyer to make appropriate disclosures to each other in the course of contractual performance.

(2) Waivers and Releases. We know of no Louisiana cases interpreting the Code that would support the decision in the Schlumberger case. To the contrary, Louisiana courts have rejected waivers of the redhibitory warranty[26] where the seller knew or should have known of the defect in the object sold, but failed to declare such to the buyer.[27] More specifically, one Louisiana court declared:

> A seller with knowledge of a redhibitory defect who, rather than informing the buyer . . . opts to obtain a waiver. . .commits fraud, which vitiates the waiver because it is not made in good faith.[28]

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[24] We want to thank Patricia H. Chicoine, a former partner with Morris & Campbell, P.C. who is licensed to practice in Louisiana, and who helped prepare this section of the paper.

[25] Saul Litvinoff, **Vices of Consent, Error, Fraud, Duress and an Epilogue on Lesion**, 50 La. L. Rev. 1 (1989).

[26] Such warranty is defined at **La. C.C., art. 2520**.

[27] **Boos and Maynard v. Benson Jeep-Eagle Co.**, 717 So. 2d 661 (La. App. 4th Cir. 1998); *see also*, **Cook v. Charan Industries, Inc.**, 1999 U.S. Dist. LEXIS 9832 (U.S.D.C., E. Dist. La. 1999).

[28] **Boos and Maynard** at 664.

Be aware, however, of the following Code provision:

> Art. 1954. Fraud does not vitiate consent when the party against whom the fraud was directed could have ascertained the truth without difficulty, inconvenience, or special skill.
>
> This exception does not apply when . . . confidence has reasonably induced a party to rely on the other's assertions or representations.

This Code article seems most appropriate for the residential home purchase situation where a simple mechanical inspection might reveal, for example, electrical wiring problems[29]; however, such article should reinforce a buyer's desire to conduct reasonable due diligence in the oil and gas purchase instance.

6.

ETHICAL RESPONSIBILITIES

Landmen:

> **AAPL Code of Ethics** are comprised of two separate parts, (i) Article XVI of the Bylaws which is entitled "Code of Ethics", and (ii) immediately following the Code of Ethics in the Bylaws is an addendum entitled "Standards of Practice". The Standards of Practice is also divided into two parts being (i) a summary of the Bylaws which restates what is set forth in the Code of Ethics, Art. XVI of the Bylaws and (ii) the Preamble which sets forth the Standards of Practice which in turn refers back to the summary of the Bylaws by reference to lettered paragraphs. I know this can be somewhat confusing, so I am going to refer to the both the Bylaws and the Standards of Practice as the **AAPL Code of Ethics**. For your reference, we have attached the complete **AAPL Code of Ethics** as Exhibit "A".

That part of the **AAPL Code of Ethics** we believe applicable to the fact situations discussed in this paper are as follows:

A. Applicable **AAPL Code of Ethics** (by reference to lettered paragraphs summarizing the By-Laws in the Standards of Practice).

   A. Fair and honest dealing with landowners, industry associates and the general public so as to preserve the integrity of the profession.

   C. Avoiding business activity which may conflict with the interest of his employer or client or result in the unauthorized disclosure or misuse of confidential information.

[29] E.g., **Cook v. Charan Industries, Inc.**, supra .

B. Standards of Practice (by reference to numbered paragraphs in the Preamble to the Standards of Practice).

3. To promote and protect the interests of his employer or client. The obligation of absolute fidelity to the employer's or client's interest is primary but it does not relieve the land professional of his obligation to treat fairly all parties to any transaction, or act in an ethical manner. (Bylaws Summary A and B).

12. The land professional shall avoid business activity which may conflict with the interest of his employer or client or result in the unauthorized disclosure or misuse of confidential information. (Bylaws Summary C).

Notice as we review the fact situations that the **AAPL Code of Ethics** are general in nature and directed toward the relationship of the landman and his employer or client. Extending these rules to a multiple client and party transaction does not always seem to cover all possibilities as we will see in our discussion of the fact situations.

Attorneys:

In previous papers, we have touched upon the involvement of ethics in the purchase and sale of producing properties.[30] There are a number of Disciplinary Rules of Professional Conduct ("Disciplinary Rules")[31] for attorneys that are involved in complying with the duty to disclose. For a good discussion of these issues as they relate to the American Bar Association Model Rules of Professional Conduct ("ABA Model Rules") we would refer you to the Rocky Mountain Mineral Law Institute article.[32] These rules can create a disclosure dilemma, particularly to a licensed attorney employed as either a corporate counsel or in private practice. The duty to disclose is also distinguished by the fact that it may not rise to the level of a legal obligation, but it could very well raise ethical issues. As we will see, ethical issues do not appear to create legal liability even though they may raise legal issues. In other words, they act independently of each other.

A. Texas Disciplinary Rules.

The applicable portions of the Texas Disciplinary Rules (which vary only slightly from the ABA Model Rules) considered in this paper are as follows:

[30] Donald G. Sinex, **"Ethical Responsibilities of Attorneys and Landmen in Oil and Gas Transactions"**, The Landman, January/February, 1997, South Texas College of Law Oil & Gas Institute, August 7, 1997, Dallas Bar Association Energy Law Section, Review of Oil and Gas Law XII, August 21, 1997, **"Sellers Duty to Disclose to Buyer"**, The Landman, July/Aug. 1999, 47th Louisiana State University Mineral Law Institute, March 31, 2000.

[31] **Supreme Court of Texas, State Bar Rules, Govt. Code T. 2, Subt. G. App A. Art. 10, Sec. 9, Texas Disciplinary Rules of Professional Conduct** (located in the pocket part for Volume 3 of the Texas Government Code in title 2 subtitle G app., following § 83.006 of the Government Code).

[32] **Legal and Ethical Aspects of Negotiations -- Duties of Disclosure and the Right to Maintain Confidentiality in Natural Resources and Transactions**, supra.

(a) The Preamble to the Disciplinary Rules sets forth a statement of the general responsibilities of attorneys in practicing law and does not for the most part deal directly with ethical issues which are specifically defined in specific Disciplinary Rules. However, the following portions of the preamble to lawyers' responsibilities are appropriate to consider for our purposes:

"1. Section 1 requires that attorneys have an obligation to maintain the highest standards of ethical conduct.

7. Section 7 of the Preamble recognizes that conflicting responsibilities are encountered in the practice of law. It recognizes that nearly all ethical responsibilities arise from apparent conflict between a lawyer's responsibilities to clients, the legal system, and the attorney's own interests. This section also recognizes that the Disciplinary Rules constitute a body of principles upon which the attorney can rely for guidance."

The Preamble discusses at length the general principles that should guide an attorney in his relationships with clients and others and in the practice of law. However, it is the Disciplinary Rules themselves that deal specifically with the ethical issues involved in our discussion.

(b) Summary of that portion of the Disciplinary Rules governing client-attorney relationships applicable to our fact situations:

R.1.02 Scope and Objectives of Representation

"(c) A lawyer shall not assist or counsel a client to engage in conduct that the lawyer knows is criminal or fraudulent. . ..

(d) When a lawyer has information clearly establishing that a client is likely to commit a criminal or fraudulent act that is likely to result in substantial injury to the financial interests or property of another, the lawyer shall promptly make reasonable efforts under the circumstances to dissuade the client from committing the crime or fraud."

R.1.05. Confidentiality of Information:

"(a) Confidential information includes both privileged information and unprivileged information. Privileged information refers to information protected by the attorney-client privilege.[33] Unprivileged information is information furnished by the client and acquired during the course of representation of a client.

[33] **Tex. R. Civ. Evid. 503**.

(b) Except as authorized by client or R.1.05, a lawyer cannot reveal privileged or unprivileged information."[34]

R. 1.15 Decline or Terminating Representation

"(b) . . .a lawyer shall not withdraw from representing a client unless:

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes may be criminal or fraudulent. . .."

R 4.01 Truthfulness in Statements to Others

"In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; or

(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid making the lawyer a party to a criminal act or knowingly assisting a fraudulent act perpetrated by a client."

R 8.04 Misconduct

"(a) A lawyer shall not:

(3) engage in conduct involving dishonesty, fraud, deceit or misrepresentation; . . . ."

[34] Exceptions whereby an attorney can reveal privileged information are found at R. 1.05 (c) and include, among others, disclosure to clients' representatives, employees of the lawyer, and disputes between the lawyer and client. Unprivileged information may be disclosed under R. 1.05 (d) in certain instances of dispute between lawyer and client as well as when the lawyer deems it necessary to effectively represent the client.

B. Louisiana Disciplinary Rules.

The Louisiana disciplinary rules are found in the Rules of Professional Conduct promulgated by the Louisiana Supreme Court, and like Texas are based on the ABA Disciplinary Rules. Therefore, there is very little difference. The Louisiana Disciplinary Rules corresponding to the above cited Texas Disciplinary Rules are as follows:

R 1.02 Scope of Representation (Corresponds to Texas R 1.02 (c) and (d))

"(c) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent. . ..

(d) When a lawyer knows that a client expects assistance prohibited by the rules of professional conduct or other law, the lawyer shall consult with the client regarding the relevant limitations on the lawyer's conduct."

R 1.06 Confidentiality of Information (Corresponds to Texas R 1.05 (a) and (b)

"(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation. . .."

(Note: The concept of privileged and unprivileged confidential information is unique to the Texas Disciplinary Rules.)

R 1.16 Declining or Terminating Representation (Corresponds to Texas R 1.15)

"(b) . . .a lawyer may withdraw from representing a client if withdrawal can be accomplished without material adverse effect on the interests of the client, or if:

(1) The client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(2) The client has used the lawyer's services to perpetrate a crime or fraud;"

R 4.01 Truthfulness in Statements to Others (Corresponds to Texas R 4.01)

In the course of representing a client, a lawyer shall not knowingly:

"(a) Make a false statement of material fact or law to a third person; or

(b) Fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6."

R 8.4 Misconduct (Corresponds to Texas R 8.04)

It is professional misconduct for a lawyer to:

"(c) Engage in conduct involving dishonesty, fraud, deceit or misrepresentation;"

C. Discussion of Disciplinary Rules Effects.

As you can see, except for minor differences, Texas and Louisiana have very similar Disciplinary Rules based on the ABA Disciplinary Rules. Under these rules, a lawyer involved in representing either the buyer or seller in the sale of producing properties has a potentially difficult problem if his client either by his silence or statements is misrepresenting material facts to the other party. Consider for example a corporate lawyer representing the seller in Schlumberger who knows that one of Schlumberger's employees had materially misrepresented the facts by his statements as well as by not saying what he knew to be correct. The fact that the lawyer is an employee of the company does not change his responsibilities under the Disciplinary Rules. What should he do? First, and most obvious is, he should consult with his client and advise that the misrepresentation could amount to fraud and, if so, the client should correct the misstatements and disclose all undisclosed data that was not confidential and if confidential to so advise the other party. Second, if he is asked a direct question that he cannot answer without perpetuating the misrepresentation, he should respond by saying that he cannot answer the question without consulting with his client. What does the lawyer do if his client refuses to correct the misrepresentation? I feel that he should advise his client that, in his opinion, to not truthfully answer the question would cause him to violate the Disciplinary Rules and that, pursuant to the Disciplinary Rules, he would be required to withdraw from representing the client on this matter. What if the lawyer did not withdraw and assisted his client in negotiation and drafting of the release and disclaimer language? I think it is entirely possible that the lawyer could be disciplined under the Disciplinary Rules, possibly to the extent of disbarment, at the same time that his client under the Schlumberger case could be released from fraud.

It is really hard to imagine being in the position of either a corporate employee lawyer or a lawyer in private practice, sitting at the negotiating table putting the finishing touches on the purchase and sale agreement, when the buyer asks, "Before we sign this, since you are not willing to put a material change of condition provision in the agreement, are there any material changes in the properties that you know of?" The lawyer knows that the casing has collapsed in one of the wells between the data room cut-off date and signing. What does he do, say, "Please excuse me while I consult with my client"? His client then says, "No I am not telling them anything; they signed the letter of intent before the casing collapsed." Does the lawyer then walk back in and say, "I cannot answer that question and I am also withdrawing from representing my client on this matter." At what point does the lawyer reasonably believe that the client is perpetrating a fraud?

How does the civil remedy for fraud relate to the disciplinary procedure for lawyers? At times ethics and civil law remedies seem to be almost indistinguishable. The difference then becomes the remedy that is available.

7.

DISCUSSION OF DUTY TO DISCLOSE

The question now is: What does all this mean? Applying the combined legal and contractual duties is a subjective analysis, which does not lend itself to a list of objective rules that can be mechanically applied in every conceivable fact situation. Thus, we must analyze the legal and contractual duties each time we are faced with a fact situation and must make a decision as to what is necessary to disclose. Obviously, the more that is disclosed, the less chance that a breach of the legal or contractual obligation will occur. In light of the ethical and legal duties discussed above, let us ask ourselves questions relative to several different fact situations.

A. Lease Negotiation

(i) Are you an Employee or Agent/Independent Contractor and does it matter?

(ii) Are you dealing with a sophisticated or unsophisticated Lessor and does it matter?

(iii) What information do you have to disclose, i.e., what is proprietary and what is not?

The answer to the first question for lease negotiations is that the in-house landman and contract field landman will almost always be considered as one and the same for legal and ethical duties. The definition of Agent set forth above means that for purposes of negotiating a lease the independent contract landman will be treated the same as the in-house employee landman.

Unleased Mineral Interest. Let us assume that the oil company landman knew that his company had drilled on a tract that had an undivided unleased interest. The company landman does not tell the contract landman of this fact and asks that the contract landman obtain a lease on the unleased interest. Let us further assume that the unleased owner is not in the oil business and lives out of state, and that the unleased interest owner in his conversation with the contract landman asks if there have been any wells drilled in the area and the contract landman says to his knowledge that there were none in the area. Let us also assume that the unleased mineral owner knows that the contract landman is representing the oil company and the lease is taken in the name of the oil company. In this circumstance, the landman would have a duty to disclose the existence of the well if asked. What would happen if he was not asked. The same duty still exists since the contract landman is acting as agent for the oil company. The risk then is a possible cause of action for misrepresentation amounting to fraud. If we look at the duty to disclose as outlined in the Transamerican Case, the failure to disclose when there is a duty can result in liability under common law and statutory law including exemplary damages. The jurisdiction for these types of cases would be in the county where the land is located. It does not take much to imagine who a local land owner jury would favor.

What if the non-resident unleased mineral owner did not ask any questions and the contract landman did not know about the well. This might qualify for an arm's length caveat emptor transaction with no duty to disclose, however it would still be better if the unleased mineral owner had some independent means by which he should have determined the status, such as a relative

living on the land. The point here is that it does not improve your situation to lease through a contract landman if he is acting as your agent.

Dealing with a more sophisticated and knowledgeable Lessor results in less of a duty to disclose for the Lessee. In other words, the potential more sophisticated Lessor has a greater duty to investigate and determine facts than would an elderly non-resident Lessor who does not have the same level of business expertise. Each situation is therefore a sliding scale from white to gray to black and must be individually evaluated on this basis.

B. Sale of Producing Property

(i) Are you an Employee or Agent/Independent Contractor and does it matter?

(ii) Are you dealing with a sophisticated or unsophisticated Seller or Buyer and does it matter?

(iii) What information do you have to disclose, i.e., what is proprietary and what is not?

To understand how this duty works, we need to remind ourselves of the relationship between the buyer and seller in the sale of oil and gas properties. Unless the buyer already owns an undivided interest in the property which would give the buyer an independent source of information, most transactions involve the following sequence of events:

1. The seller furnishes the buyer technical information, usually from a data room, regarding production and operation history (e.g., number of workovers and mechanical history), logs of wells, operating expense information, production sales contract information including prices received by seller and possibly a reserve report.

2. The buyer then analyzes this information to evaluate the properties and makes an offer to purchase (usually in the form of a letter of intent signed by both buyer and seller), subject to execution of a definitive purchase and sale agreement.

The information used to make the offer could include title and contractual documentation, but at the offer stage it likely does not. At the offer stage, normally there has been no review of title or contracts, such as operating agreements and production sales contracts; likewise, typically there has been no inspection of the properties for environmental or mechanical condition. Therefore, the buyer relies upon the seller's information to establish the purchase price for the properties prior to knowing how title, contracts, environmental problems and mechanical condition of the wells may affect the value of the properties. Subsequent review of title, contracts, environmental and mechanical condition of the properties thus becomes a part of the negotiation of the purchase and sale agreement and the conducting of the due diligence process pursuant to the purchase and sale agreement.

It is at this stage that the parties negotiate the purchase and sale agreement. I am sure that all of you recognize the competing interests of the seller and buyer and that the process of negotiation revolves around price adjustments for: (a) title defects including preferential rights and

consents to assign; (b) environmental remediation and indemnity; and (c) mechanical and physical condition of the properties. I have represented both buyers and sellers and find that a common misconception of sellers is that, once the offer price has been agreed to in the letter of intent, the buyer should take the properties as is and where is without adjustment to the purchase price. In a legal sense, this seems patently incorrect since the seller has furnished the information upon which buyer has established a price without regard to many matters that could substantially affect the value. Of course, from the seller's point of view, negotiating price adjustments opens the lid to Pandora's box and (in the seller's mind) allows the buyer to make unreasonable defect claims to obtain a downward adjustment of the purchase price, not to mention that (in the seller's opinion) the properties are worth the price notwithstanding the undisclosed defects. Philosophically, I believe that both buyer and seller should accept this situation as being the nature of the beast and deal with the issues as they arise rather than trying to completely eliminate them in the purchase and sale agreement. As you probably realize, my philosophical opinions seldom become reality in either the process of negotiating the purchase and sale agreement or in conducting the due diligence process. What really happens is that, depending upon the relative bargaining power of the parties, the purchase and sale agreement will eliminate all but the most egregious defects, and adjustments to the purchase price will be primarily affected by preferential rights, consents to assign, and environmental problems, if any.

Before we go further in this analysis, remember that when we refer to seller's and buyer's duty to disclose, we are referring to the company and not an individual employee. It is possible, if not probable, that the individual employee being asked the question, and who is responsible for disclosing on behalf of the selling company, will not know the company history or have actual knowledge in respect to the property being sold. That is not an excuse for non-disclosure. The reason, of course, is because it is the company itself that has the duty to disclose, whether or not the individual employee has actual knowledge.

Documents Reviewed. The first decision addresses what is made available for the buyer to review. At a minimum, the purchase and sale agreement will require that the buyer be furnished with copies of all title opinions, division orders, operating agreements, leases and any other contracts affecting the properties, including production sales contracts. As a practical matter, sellers normally do not selectively pull from their files just these limited number of documents. Normally, the seller will make available its complete original files, including correspondence such as lease files, division order files, well files, and contract files. In a very short period of time, the buyer will find copies of applicable documents or evidence of other documents and agreements that have affected the properties over the years, and which will give rise to numerous questions long before solved or waived by the seller. By allowing the buyer to have access to the complete file, many of these historical issues will be resolved by the buyer through the buyer's due diligence review and, thereby, eliminate a possible defect notice to the seller.

An example of what can happen when less than all documents are produced recently impacted one of my clients. The seller indicated that it had elected to copy all of the original files and furnish these for review. This was all right for purposes of a data room, but created numerous problems for a due diligence review. In fact, many of the files were not completely reproduced, a fact that could not be determined until the files were reviewed by the buyer. Other files were selectively not reproduced at all. As the due diligence team pored over the documents, missing

documents were identified due to references in correspondence and other documents, which necessitated numerous requests for information. The seller was short-handed, and the land representatives did not always have either historical or current knowledge regarding the property. As is often the case, the original files were spread among several different departments in seller's company, and less than all were cooperative in locating the files, principally because the seller believed that all of the data had been made available. To make it worse, after the closing, a large number of boxes containing important information was found by seller and delivered to the buyer. The effect of this situation was to increase the time spent by the buyer's and seller's staffs, as well as by outside consultants and attorneys, and to increase the potential for missed defects. Most of this could have been avoided by providing the buyer with all of the original records in the beginning.

In the foregoing example, did the seller breach its duty to disclose by not furnishing all of the information? The short answer, in my opinion, is "yes." The seller had a duty to disclose all of the applicable documents, many of which were not of record. The individual employees of seller did not know that the duty had been breached, but that does not relieve the seller company from being responsible. The seller represented under its purchase and sale agreement that, to the best of its knowledge, the files furnished contained all material agreements and contracts affecting the property. The seller as an entity certainly had this knowledge, even though the individual employees did not. As a result of this situation, at least one defect issue has arisen subsequent to closing. One way to avoid this result is to give the buyer access to all applicable original files and let the purchase and sale agreement deal with any defect issues that may arise. When a question is asked, the seller then is comfortable that all of seller's information has been disclosed. In this regard, if the historical answer is not known by seller, then it can state that the only information available to it is disclosed in the files provided. Thus, the seller will have complied with its duty.

Knowledge of unrecorded document affecting title. There are two possible scenarios that may arise in the instance of an unrecorded document: (1) the document is not in the files or referenced in the files that are furnished to buyer, but seller knows it exists and intentionally withholds the information, and 2) the existence of the document is referenced in the files, but it is not found in the seller's files by buyer. Under the first scenario, it is obvious that, if it was not disclosed, seller's silence would be an omission of a material fact that could qualify as a breach of the duty to disclose under applicable law. The second scenario is less obvious since seller may not have a copy of the document and may not be able to locate a copy when seller's employee is informed of its existence. Since the seller normally is an entity (as opposed to a natural person), it would technically know of the document and be bound by it (if it was a party) or, if it knew of the document through any of its prior or present employees or representatives, the duty to disclose would exist and its contents and the effect on buyer would be a title defect. However, under these circumstances, the seller's inability to locate the document would not give rise to a duty to disclose since it had no intent to deceive the buyer. Therefore, the inability to perform the duty under the second scenario should not rise to the level of a duty of disclosure that would be actionable under applicable law.

Condition of the properties. Let us assume that January 1 is the effective date of the sale of the properties, the closing is July 1, and the offer letter was signed April 1. Let us also assume that the production data in the data room was current through November of the prior year. In

addition, assume that two wells ceased producing, one on December 1 of the prior year and the other on June 1. Buyer inspects the properties on May 1. In this situation, the seller's data room did not have current data and the offer assumed that the wells were producing historically as they were in November. The buyer discovered upon inspection that the first well had not been reworked between November and May. The buyer also discovered that the second well had ceased to produce after the offer letter was signed. The purchase and sale agreement was signed before the inspections, and it allowed an adjustment only for conditions changing between the effective date and closing.

What happens? As to the first well, which ceased to produce before the effective date, but which was assumed to be producing based on seller's data room information, seller had a duty to disclose the change in condition before the buyer made its offer. The purchase and sale agreement does not protect the seller in this instance because the well ceased producing prior to the effective date. However, since the seller failed to disclose, the buyer should be able to prove misrepresentation by the silence of the seller. The second well, which ceased to produce between the effective date and closing, should be governed by the purchase and sale agreement. The buyer would have a duty to discover the condition of the well, which it did. However, if buyer did not discover the well condition, and, for example, the well ceased to produce after buyer's inspection and, further, seller was aware that the well was down, then the seller's duty arises again. In my opinion, seller must disclose prior to closing or, by its silence, it will again be exposed to possible misrepresentation of the condition of the property to buyer. You might think that, since properties are generally sold without warranty and on an "as is and where is" basis, that the seller's duty will end subsequent to closing if buyer does not find out that the well has ceased to produce. If the buyer was considered to have reasonably conducted its due diligence, and since the seller had the knowledge and did not disclose it to buyer, the laws relative to disclosure should override the disclaimers and lack of warranty after closing. In other words, buyer may have a cause of action to either rescind the transaction or recover damages based on the failure to disclose being a misrepresentation amounting to fraud.

Failure to disclose based on opinion that document or information was not applicable. What if the seller had previously purchased the properties it was now selling and had decided, in its own due diligence, that a letter agreement that granted a preferential right had terminated? As a result, seller removes the preferential right letter from its files and does not tell buyer. After closing, buyer discovers the preferential right agreement when approached by the third party who claims the preferential right, wondering why it was not offered the property. Normally, when the seller offers his opinion, which as a general rule he should not do, it would be an exception to the duty to disclose. Thus, in this instance, the seller could have left the letter in its files and allowed the buyer to discover it. At that time, seller could offer its opinion that the letter agreement was not applicable, and, thus, place buyer in the position of having to waive or assert it as a defect under the purchase and sale agreement. However, if as suggested, the seller removes the letter and buyer has no chance of locating it, the seller has misrepresented the burdens on the properties to buyer, and, if buyer is damaged, buyer may have a cause of action for fraud.

Written or oral questions during due diligence. As most of you have experienced, there are two schools of thought with respect to whether or not a buyer's inquiries to seller during due diligence should be in writing. The thought on making inquiries in writing is a legal defensive

measure by seller to be able to prove what was requested by buyer and what seller's response was. As an attorney, I can understand this and probably approve of it, particularly in transactions with multiple properties and employees involved on both sides. However, remember that the written request is a double-edged sword.

The interests of buyer and seller are frequently opposed in certain situations. For example, if seller has not acquired ratifications from a drillsite non-participating royalty owner and the well has produced a number of years, seller may not want to raise this issue with the non-participating royalty owner, while buyer may very well want to have the non-participating royalty owner ratify the lease. In this instance, should the pros and cons of the issue be debated in an exchange of written communication between buyer and seller? Probably not, because the written communications would be available to the non-participating royalty owner if litigation arose between the parties. Therefore, on some issues, the buyer and seller may want to discuss the issues rather than placing them in writing. Of course, the issue may come up in writing anyway as a defect notice, although the defect notice could be worded in a manner to avoid this problem.

SUMMARY AND CONCLUSION

The Schlumberger case presents some thought provoking issues. The possibility of being able to intentionally commit fraud and avoid liability through a disclaimer and release seems patently unfair to me. It would have been easier to understand if the parties knew of the nature and extent of the misrepresentations amounting to fraud and with that knowledge disclaimed reliance on the misrepresentations and released the party from any liability. However, we recognize the facts developed in the trial and included in the transcript reviewed by the court were not recorded in the published opinion, and that such facts led the Texas Supreme Court to decide that under the specific facts the disclaimer and release precluded liability for the misrepresentation. The controlling issue seems to be that the misrepresentation was the very matter being settled, i.e., the value of the property.

Since most transactions will not involve a disclaimer and release such as that discussed in the Schlumberger case, we do not want to overshadow the importance of understanding the duty to disclose discussed in this paper. From a legal point of view, seller will be viewed as having superior knowledge that, if disclosed, would have affected the value of the properties. In acquiring leases from unleased mineral owners, the duty to disclose information may be less but it still exists, particularly when the potential Lessor asks a direct question. Do not misunderstand, however; there is no duty to disclose confidential or proprietary information. Further, proprietary information does not have to be disclosed (e.g., seller/lessee's geological interpretations or reserve analysis). My recommendation is that a seller/lessee disclose no information involving its interpretation or opinion of value, proprietary or otherwise, but that the seller/lessee should disclose all other material information related to the properties.

Even in its simplest form, it is easy to see that both the ethical and legal duty to disclose can be expanded or contracted by the relative bargaining power of the parties. In each fact situation duty to disclose material information should be considered at each point in the negotiation of a lease or sale of property.