

THE CROSSROADS OF AN INDUSTRY AND A PROFESSION

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I am humbled to have been invited to give The Deans of Oil & Gas Practice Lecture Series. I've chosen for the title of my topic, "The Crossroads of an Industry and a Profession," and with it, I want to pay tribute to this Institute. In preparation for the lecture, I went back and reviewed the collected proceedings of all of the Institutes on Oil and Gas Law and Taxation, and the names associated with this Institute are a galaxy of stars of the oil and gas industry and the legal profession. Any of these hundreds of people could have been selected to give this lecture, and most would have been a better choice.

As you look at the proceedings of the Institute, one can quickly read the history of the oil and gas industry over the past half century. Moreover, by looking at the presenters, you can identify the people who have made that history. This Institute has always been recognized as the best, and its reputation has attracted the best.

I am intensely proud of the oil and gas industry that has provided my livelihood and the legal profession that has been my career. The crossroads of oil and gas and the law has, since 1949, been the Southwestern Legal Foundation (now known as the Center for American and International Law). Long before mandatory continuing legal education became a requirement, lawyers were coming to this Institute to learn the latest legal and tax developments in the oil and gas industry. Most came year after year. The Eleventh Institute in 1960 was attended by 580 people from 23 different states.

The annual Institutes have been the site of the best scholarship from private practitioners, in-house counsel and the legal scholars of our body of law. I've had the privilege of doing lots of deals across the United States and throughout the world, and most of those deals are governed by Texas law. Texas has the largest and best-developed body of oil and gas law in the world, and so much of that law was explained, critiqued and clarified in the papers presented at this Institute.

The authors of the major treatises have all been presenters here, most on several occasions. W. L. Summers spoke at the first Institute, and he's been followed by Eugene Kuntz, Howard Williams, Charlie Meyers, Ernest Smith and Jackie Weaver. They've been joined by the great oil and gas professors, A. W. Walker, Jr., Richard Maxwell, John Lowe, Bruce Kramer, Gary Conine, Pat Martin, David Pierce and Laura Burney, not to mention Charles O. Galvin, Parker Fielder, and a host of other tax professors. At the Fiftieth Annual Institute in 1999, the first six speakers were Pat Martin, Owen Anderson, Ernest Smith, John Lowe, Bruce Kramer and David Pierce.

The oil and gas industry has pioneered so much and among them was the creation of the modern in-house legal department. At the very first Institute, the first three papers were presented by in-house counsel for Kerr McGee, Lone Star Gas Company and Phillips Petroleum, and that practice has carried through until today. I was co-chairman of the 43rd and 44th annual Institutes, and our presenters were equally divided between private practitioners and in-house counsel, not by design, but merely by looking for the best person to bring forth the highest level of expertise on a given subject.

The oil and gas industry is actually quite new, barely 100 years old. Spindletop blew in 1901. The first well in the Permian Basin was completed in 1920, and the Daisy O. Bradford #3 was the beginning of the East Texas Field in 1930. In many respects, the law that has grown up around our industry makes more sense because it was created in a modern environment to meet modern needs. Recall that the availability of kerosene for lamp oil did more to save the whale than Greenpeace, and the internal combustion engine was the answer to the biggest environmental problem at the beginning of the Twentieth Century, horse manure. In fact, our biggest failure as an industry has been a reluctance to defend what we do, and we stand by and let others impugn our integrity.

Throughout the history of this Institute, there have been papers about antitrust regulation. Regulators, as well as the public at large, simply will not believe that common gasoline prices on the street are the result of intense competition driving everybody's price down to the lowest posting, rather than some collusion to set artificially high prices.

As I said, the proceedings of this Institute have recorded the history of the industry for over half a century. Merely by reading the indices, you'll follow the industry's development, growth, change, regulation and majesty. You'll also follow the careers of so many of the stars that I mentioned. Al DeCrane made his first appearance at the Institute as in-house counsel in Texaco's Houston office. Next, he appeared as Texaco's Vice President of Production for the Eastern Hemisphere, and finally as the John Rogers Award recipient as immediate-past CEO of Texaco.

I had originally intended to list the stellar oil and gas practitioners who've given papers to this Institute, but the list quickly became too long to manage, and I would have surely overlooked some of the best and the brightest. Suffice it to say that the quality of this Institute is evidenced by one single panel in 1969 that included Morris Harrell, Vester Hughes and Harold Kleinman.

The first institute focused on oil field operations with special attention to unitization, a need that was only just developing at the time. Over the years, the Institute followed secondary and tertiary recovery and later to horizontal pooling. As the industry went offshore, so did the focus of the Institute. It's hard now to recall how difficult both the engineering and the new law covering early offshore activities were to create.

The Institute has followed the regulation of the industry, first with the Federal Power Commission and Interstate Commerce Commission, not to mention the IRS which has been a subject at almost every Institute. Later we moved to the Federal Energy Agency and the Department of Energy and FERC. Along the way we had the Interstate Oil Compact Commission and the numerous state agencies that regulate us.

Over the years, we've watched industry consolidation as Magnolia Petroleum and Humble Oil and Refining have become ExxonMobil. Great old names like Texas Eastern, Stanolind, Skelly, Sohio and Gulf have all been represented, among others, at this Institute.

Because of the importance of our industry, we had frequent visits by Senators, Governors and the many commissioners of one agency or another giving us their views and seeking ours. They often came as scholars and not merely as politicians. The first governor to address the Institute was John F. Simms of New Mexico whose topic was Recent Developments in the Law of Conservation and the Influence of the Interstate Oil Compact. While it involved a regulatory subject, Governor Simms' paper was evidence of the scholarship expected at this Institute, not merely a political speech.

The proceedings of the Institute are a clear barometer of the nature, type and volume of our regulation. At the height of energy price controls, the Twenty-ninth Annual Institute in 1978 only had two papers on non-regulatory oil and gas law, and they represented less than sixty pages out of a volume of more than 650. That was the first year that included a paper on the then newly created Department of Energy.

If you want an appreciation of the disaster of an over-regulated industry, try to make sense of the papers from that era. In the oil patch, we had old oil and new oil, then we had new new oil, new and release oil and stripper well oil. There was the 50,000 barrel per day East Coast window. MDL 378 was a consolidated class action that took years to resolve whether injection wells counted when determining if an oil field qualified for stripper status (they didn't).

Downstream we had the entitlements program. Refiners with access to more old oil that sold at an artificially controlled low price had to buy "entitlements" from refiners who could only get more expensive imported oil or other categories of domestic oil that sold at a range of different higher prices. Every month, the government would do a massive industry wide calculation, and enormous amounts of money would move between companies. It was a testament to the integrity of the industry as a whole that the program worked as well as it did, notwithstanding a few charlatans who sought to take advantage of the situation.

If you were charged with keeping up with DOE rule making, imagine the pleasure of reading regulations governing matching purchases and sales for the purpose of effectuating an exchange.

The system was so skewed, that rank speculators could buy a small refinery and be exempted from the entitlements program. If they could get access to old oil, they could refine it without having to buy an entitlement, and the purchase price of these refineries was often being paid off in less than a year.

The regulators created an entire new subindustry in crude oil trading. Over night, we went from a hand full of oil traders to more than 600 because of an artificial value built into the pricing regulations.

During this time, the Federal Energy Administration and later the DOE was making up rules out of whole cloth. The industry feared a retroactive reinterpretation that made a legal transaction suddenly illegal and subject to sanctions and penalties. Of course, most of the penalties were paid with a reduction in a company's unrecovered cost bank, another one of those convoluted calculations unique to overregulation.

Over on the natural gas side, we were grappling with interstate versus intrastate sales. The price disparities were enormous. The Texas Supreme Court had given us the *Vela* decision, and royalty owners demanded high royalties based on intrastate prices even though the producer was locked into a long term contract at what had become artificially low interstate prices. It took years before Exxon successfully established the proper standards for calculating market value for royalty purposes, and the *Middleton* decision was promptly featured in a paper at the Thirty-third Annual Institute in 1982.

As if all of this weren't bad enough, the IRS weighed in with Revenue Ruling 77-176, that substantially threatened the value of the intangible drilling cost deduction. Hot on the heels of that ruling, however, was a 1978 Institute paper on how to manage the problem with tax partnerships. I can only imagine the confusion of a young lawyer reading the tax partnership rider to a farmout and trying to make sense of why it's there.

One of my heroes has always been George Schultz. He was President Ford's Secretary of the Treasury and later Secretary of State under President Reagan. Schultz has always been one of the clearest thinkers on a macro level that I've ever known, and he persuaded President Ford to end wage and price controls begun during the Nixon administration before they became an embedded part of the American economy. Unfortunately, the oil industry was excepted. President Ford later said that his failure to deregulate the oil industry was the biggest mistake of his Presidency. It led to President Carter imposing a "windfall profits tax" and declaring the Moral Equivalent of War (MEOW) and to all of the chaos I've just described. Ultimately, the years it took to clear up the distortions created by over-regulation were longer than the regulations were actually in force.

The Institute has recorded how we financed and accounted for our industry. Early Institutes focused on bank financing; later we got into the details of securities regulation with drilling funds, Reg D offerings, and penny stock companies. The SEC toyed with a concept

called "reserve recognition accounting" which was debunked in papers presented at this Institute, while other papers clarified the distinctions between successful efforts accounting and full cost accounting.

From the beginning the Institute recognized that the oil and gas industry is international. The first Institute featured Alberta's Minister of Mines and Public Lands, and international topics have been a recurring theme at almost every Institute since. This year, an entire block is devoted to international topics. In the past, I've had occasion to do some oil and gas work in Bolivia, and I would have been much better served if I had the presence of mind to check that hydrocarbon concessions in Bolivia was a topic at the Ninth Institute back in 1958. More recently, we've watched the Soviet Union disintegrate in the papers of the annual Institute.

I don't know how you could not love the oil business. To hear rugged wildcatters talk about the "romance" of exploration; geologists who've drilled fifteen dry holes in a row but can't wait to have a bit turning to the left because the next prospect is the best they've ever had. The engineers who are constantly challenged to get more production out of a reservoir and the landmen who know more jokes than Jay Leno (and can tell them better).

As lawyers, we've written dry hole agreements, checker board farmouts, and last minute non-consent elections so that one partner could drill just a little deeper with a rig on stand-by. We've come behind to document a deal that was sealed with a handshake, and we've rhapsodized about the dominance of the dominant estate.

What other industries have such colorful phrases as "heaving shale," "take-or-pay," "casinghead gas," "Producer's 88," "behind the pipe," and "frac job," and where essential equipment includes vacuum trucks, tank batteries, Christmas trees, Kelly slides, sucker rods, and drilling mud. Doodlebug crews shoot seismic; scouts search for new drilling or leasing activity; lawyers do stand-up title opinions; and every animal ever injured was a child's 4-H project on the way to the county fair.

What other industry calls its primary document a lease, when it is anything but a lease. What other industry has roughneck as one of its most important positions and its most important piece of equipment is studded with diamonds.

I've been exceptionally fortunate to have been an oil and gas lawyer, not that I didn't think it was my birthright. After all, I grew up in Texas. My father drove a truck, but I was well into adulthood before I found out that living on a gravel road with an open ditch in front of the house was evidence of poverty. The ditch is where I played with my boats after a rain. Of course, using sticks for toys was another of those indicia of poverty. Who knew, or more importantly, who cared? None of that meant that I couldn't go to college and law school or that I couldn't get hired into the industry.

My first industry job was with Hunt Oil Company when H. L. Hunt was still alive. It was a great place for a young lawyer, because they didn't worry about experience or expertise. If a deal needed to get done, they sent one of the lawyers, it didn't matter which one. The Hunts took great risks, most with great rewards. Mr. Hunt rarely got a drill site title opinion. His view was that the man on the ground knows whether or not he owns it, and if he doesn't, he knows who does and he'll tell you. If he's wrong, nine times out of ten you'll get a dry hole and it won't matter, and in the other ten percent of the time, you'll at least have some revenue to fight a lawsuit with.

Tesoro Petroleum let me pretend that I was in international lawyer, and between Tesoro and Fina, I've done deals on five continents.

I've had the privilege of knowing some of the great general counsel who built the modern legal department, Jesse Luton at Gulf, Ken Roberts at Exxon, Joe Morris at Shell and Bill Paul at Phillips to name just a few. I've also had the privilege to be part of the best trade association of any industry, the American Petroleum Institute. By the way, Frank Ikard, who left the Congress to become the long-time president of the API, spoke to the Fifteenth Annual Institute in 1964.

Please let me then take my hat off to the Southwestern Legal Foundation, to Robert Story, and Andrew Cecil, David Ellwanger, and my friend, France McCoy, David Winn and all of the others who've made the organization what it's been and what it's become. It has succeeded in so many ways, but for me, the measure of its success is and always has been the International Oil and Gas Education Center, or The Institute for Energy Law as it's now known, and this annual Institute on Oil and Gas Law and Taxation.

Thank you very much.