



Texas Land & Mineral Owners Association

Official Newsletter

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82ND LEGISLATIVE SESSION WRAP UP

Well it's not over for the Legislators yet – they got called back in for a Special Session on budget, school finance, health care spending and congressional redistricting (to date) - but it looks like it's over for our issues.

The Texas Land and Mineral Owners Association had a great session! This newsletter will cover specifics on some of the measures we worked on. It was a great session not only because of the outcome, but it was great in terms of TLMA activity. This is the best we've seen in terms of grass roots efforts. We heard from many legislative offices during the session that they were getting calls and emails and understood clearly where we stood on the issues. So give yourself a big pat on the back TLMA, you made a difference!

CONGRATULATIONS MEMBERS OF THE TEXAS LAND AND MINERAL OWNERS ASSOCIATION!

Thanks to your efforts, H.B. 2087 failed to pass. This is the bill that would have required a non-participating royalty interest (NPRI) to accept a statutory allotment instead of having the ability to use their property right to improve their situation.

We believe the ability of an NPRI to ratify a pool or negotiate for improvements, in certain situations, is a property right! HB 2087 would have taken away that right and placed the royalty interest into a formula designated by statute.

The bill subjected landowners to one standard but exempted lands owned and maintained by the General Land Office. If it was bad enough to exempt lands owned by the State of Texas, why wasn't it bad enough to exempt lands owned by the rest of us? It was bad enough.

In addition, H.B. 2087 on its face looked like it attempted to give the NPRI some recourse by petitioning the Railroad Commission if they were not pleased with their allocation. However, the evidentiary standard the NPRI was held to was impossible to meet. How can you show something is 'clear and convincing' when it occurs thousands of feet under the ground? The language was a red herring and one that did not grant an NPRI an opportunity to correct what this legislation would have put into law.

Representative government actually worked! The Legislature heard you and did not move the bill through the process.

Now would be a great time to show appreciation to the Legislators who made a difference.

A quick call to say "Thank You for Listening" to members of the House Calendars Committee would be extremely rare and something they will likely remember. These guys usually only hear complaints - so a big hearty thank you is worth so much more. Contact the TLMA office for contact information of the members of the House Calendars Committee.

Once again, you did great TLMA!! Efforts like these are what make our Association effective!



Todd Hunter (R-Corpus Christi), Chair of the Calendars Committee

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TLMA's mission is to create a business and legal environment that is accommodating to the continued exploration for and production of oil and natural gas by ensuring that the rights of both the mineral and surface owners are protected, reduce litigation and to protect our precious groundwater resources.

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EMINENT DOMAIN LEGISLATION PASSES

As you are most likely aware, the omnibus eminent domain legislation finally passed the legislature and was signed by the Governor.

Texas Agriculture Commissioner Todd Staples probably summed it up best:

"In Texas, a family's home is their castle and we now have the means to defend it! SB 18 will strengthen our state laws by:

- Establishing stricter penalties for not negotiating in good faith
- Demanding adequate compensation for diminished access
- Providing a buy back provision that allows landowners to repurchase their land for the original sale price if the land isn't used for its intended purpose
- Clarifying that eminent domain must only be exercised for public use"



Agriculture Commissioner
Todd Staples

HB 3134: APPEAL PROCESS FOR "DEATH PENALTY"

As you recall, the Texas Land & Mineral Owners Association (TLMA) was intimately involved in the passage of HB 2259 last session. The bill provides a 'death penalty' to operators who do not comply with certain clean up and well plugging requirements. The 'death penalty' is that the Railroad Commission will not renew their P-5 operation permits. We feel that legislation is actually a good step towards getting the surface junk cleaned up and some wells plugged.

To that end, the members of TLMA were very nervous when H.B. 3134 was filed this session for two reasons: 1) it had potential to be amended to undo the good things put into statute last session and 2) the time extensions for an operator to be in compliance seemed exorbitant.

As a side note – we actually scored a small victory when the bill was filed. Some in the industry wanted legislation that would have significantly watered down what was accomplished the previous session. State Representative Myra Crownover (R-Denton) and State Senator Robert Duncan (R-Lubbock) shared our concerns and thus filed a bill limited to the appeal provisions.

The bill ultimately passed and was sent to the Governor. The good news is that it avoided any amendments that would have harmed the good work previously done and, as it passed through the Senate, the timelines for appeal were shortened.

All in all it is probably a good piece of legislation and one that should help avoid any unintended consequences of HB 2259.

FORCED UNITIZATION BILL DIES IN COMMITTEE

The House Committee on Energy Resources heard the Unitization bill; HB 3586 by Van Taylor (R - Plano), in late April and never brought it to a vote.

This bill was substantially the same as all other forced unitization bills that have been heard by the Legislature over the years. Representative Van Taylor added a little language near the end that mentioned the storage of CO2 in reservoirs that either are or have been subject to enhanced recovery operations (i.e. CO2 floods).

The bill used environmental concerns saying that it will allow CO2 to be pumped into the ground instead of being released into the air. It also argued it was needed to make Texas a leader in carbon sequestration. Actually it would have allowed carbon to be forced under your land without you, the landowner, having a say. It also failed to adequately explain why current laws that work very well for oil and gas will not work for CO2 floods other than it would be cheaper for the companies if they can force unitize and force pool.

Many states have forced-pooling statutes which in effect allow an operator to force an unleased mineral owner to lease his/her mineral interest and "force" the interest into a pooled unit. Texas has a limited form of forced pooling, under the Mineral Interest Pooling Act. That act was passed to allow small tract owners to force an operator to include their interests in pooled units, rather than to force owners to lease their tracts and join units - - although recently operators in the Barnett Shale have made use of the act to force small tracts into units.

The concept of underground injection of CO2, sometimes referred to as carbon sequestration, has recently been discussed as a response to Congressional proposals for "cap and trade" legislation, in which limits would be placed on industries' ability to emit carbon dioxide into the atmosphere. One alternative to emissions of CO2 is to dispose of the CO2 underground, by injection.

Industry advocates are proposing large commercial CO2 injection operations, which would require obtaining permission from landowners under whose land the CO2 would be injected and stored. Forced unitization would give CO2 injection operators the ability to mandate landowners to accept CO2 injection under their lands by "forcing" their interests into units covering underground storage reservoirs.

Four groups testified against the bill: the Texas Land & Mineral Owners Association, the Committee for Texas Independence, the Bass Family, and NARO.

Denbury Resources and the Carbon Capture Storage Association testified in support of the bill. Peabody Coal also testified in support of the bill and encouraged the committee to take up the issue as part of any Interim Study being considered. The University of Texas also spoke in favor.

The bill was left pending and it languished there until the session ended May 31.

That's good news! But we know this issue is not going away and we will be on the lookout for future efforts that will try to open the door to forced unitization.

RAILROAD COMMISSION SUNSET REVIEW

Unfortunately, the bill that made improvements to Railroad Commission operations based on the recommendations of the Sunset Commission failed to pass.

TLMA liked the legislation because it would have required the Commission to adopt uniform guidelines for enforcement and penalty provisions for bad actors.

What the Legislature ultimately cared about, however, was whether the Commission should be run by three elected commissioners or one. The Senate passed a version of the bill that changed the agency to the Texas Oil and Gas Commission, reduced the number of Commissioners to one and moved many of the judicial functions of the agency over to the State Office of Administrative Hearings (SOAH).

The House on the other hand kept the name change but returned it to three commissioners and removed the SOAH provisions. House and Senate authors never came to a compromise position so the bill ultimately failed. The Commission is now scheduled to go through the same process it did last interim where the Sunset Commission reviews their operations and makes recommendations to the Legislature.

By Eric Foulz

There are many challenges in the successful transfer of family wealth from one generation to the next. This is especially true when the family's wealth is comprised of illiquid assets such as ranch land, mineral interests, privately held companies or other "legacy" assets.

We all think of estate and financial planning as being paramount to passing on family wealth; however, research has shown that a lack of appropriate trust and communication among family members is the primary factor responsible for the 70% failure rate in wealth transfer to the receiving generation.

This article speaks to the generational differences among today's families. It is critical for families to understand these differences in order to effectively communicate on a multi-generational basis. Without effective communication, the likelihood of unsuccessful wealth transfer is greatly increased.

As history has shown us, the controlling generation is reluctant to transfer wealth while the next generation is anxious to assume it. Although each family's situation is unique, successful wealth transfer is often dependent upon the entire family understanding and appreciating the long-term vision for its wealth.

The need to understand generational differences is more critical today than ever. This is the first time in history that there are four distinct generations active in the workforce. These generations are: Traditionalists, Boomers, Gen Xers and Millennials.

TRADITIONALISTS

Traditionalists are "Seniors" ages 66 and older and born before 1945. They have lived through Two World Wars, the Great Depression, the New Deal and Social Security. They participated in Victory Gardens, were all about self-sacrifice and influenced by the military's top down approach. Women entered the workplace during this generation. Traditionalists experienced hard times while growing up which were followed by times of prosperity.

How have these experiences shaped Traditionalist values, mottos and attitudes? They have been described as loyal, respectful of hierarchy and honoring family and community. A belief in duty before pleasure and trust in government are central characteristics. Traditionalists dress formally and desire formal organizational structures. Their Depression experience resulted in a "pack rat" mentality -- you never know when you might need it. Traditionalists believe that your word is your bond.

Their motto is "save it for a rainy day," attitude about money is "to save it" and keyword is "loyal." Traditionalist use of technology: dictate documents, e-mail only in the office, use of library instead of web, more likely to use phone.

BOOMERS

Next are the Boomers, Ages 65 - 47 and born between 1946 & 1964. They did not go through economically hard times as their parents did -- they had the "good life." Shaping Boomers lives have been consumerism, Ozzie and Harriet (idealism to a fault), sexual revolution, civil, women and gay rights, divorce and corporate downsizing. Boomers came of age in a society that changed at an unparalleled rate of speed that included Cold War / Soviet Union, Vietnam, space travel, assassinations and where even "retirement" was being reshaped. More than anything, work defines a Boomers self-worth and the evaluation of others. This is a significant tension point between them and younger generations as they expect the same work ethic and work hours.

The values we find in Boomers are success, freedom, idealism, seeing one's work as one's identity, focus on time (efficiency) and a focus from others to self. For Boomers who are afraid of new technology or simply do not understand it, the impact is that newer generations do not seem fully committed. There is still the perception in a workplace that if the employees are not "seen," they cannot be working.

Their motto is "I am what I Do and I am what I own," attitude about money is "spend it, buy it" and keyword is "optimist." Boomer use of technology: documents prepared by associates, e-mail primarily used in the office, web use limited to "Google."

GEN X

Gen Xers are persons ages 46 - 31 and born between 1965 & 1980. Their life experiences include inflation, dual career families, fall of Berlin Wall, downsizing in full bloom, aids, drugs, a sense of hopelessness and an inability to identify or find a career. In addition, they are the first generation to be raised on "to do lists" and grow-up with a high rate of blended families. Gen Xers were shaped by having to take care of themselves during childhood (latchkey kids) while watching their politicians lie and their parents get laid off. This is the first generation to NOT do as well financially as their parents.

Gen X is characterized as skeptical, cynical, independent and seeking immediate but not always deserved reward. Gen Xers don't want to follow Boomers into burn out while they think Millennials need too much hand holding. They work to live, not live to work. Work loyalty to Gen Xers means two-weeks' notice.

Their motto is "I trust only myself," attitude about money is "I want it" and keyword is "skepticism." Gen X use of technology: creates own documents, uses mobile and laptop, uses web to research, e-mail / mobile 24/7.

MILLENNIALS (GEN Y)

Millennials are 30 and younger and were born since 1981. The life experiences of this newest generation are the internet, multitasking on multiple portable and hand held devices, superficial research, immediate gratification with little effort, school shootings, Clinton / Lewinsky, a global economy, virtual friends and experiences, helicopter parents and over scheduled lives in sports, social and academic involvements. This generation grew-up with a negative, and at times ambivalent, perception of US wars and foreign policy (Iraq/Afghanistan). In this generation, everyone is given a trophy; there is equality of sexes and races. For Gen Yers, it takes a village to raise them and each has his or her own team consisting of parents, therapists and tutors. This is the first generation of children with schedules and has never known a world without high-speed internet, speed dial and ATMs. 75% of Millennials have a working mom and 25% are from single Moms; this contributes to a breakdown in familial closeness and dependence.

Values of Millennials include being self-sufficient, individualistic, optimistic and tolerant while also displaying an unrealistic heroic spirit and a lack of skills for dealing with difficult people. They feel extremely entitled, have great self-esteem, and a short attention span. Gen Yers are more aware of environmental issues, civic minded, charitable and interested in social responsibility, but they also want the corner office day one. This shows a shift from “self” to “global” while not necessarily committed to community or family. Through technology, they believe that superficial ‘participation in a cause’ can be the same as true involvement in something philanthropic or charitable.

Their motto is “I am a brand” such as Apple, attitude towards money is “borrow it now, online” and keyword is “realistic.” Millennial use of technology: creates own documents, creates databases, uses web to research and network, use of e-mail / text / IM 24/7.

Now that we have an understanding of today’s generational differences, how do Traditionalists and Boomers communicate better with Gen Xers and Millennials? This is a critical question if “trust and communication” issues are at the heart of wealth transfer failure. A few guidelines to consider include: learn to coach and not boss, incentivize based on what the generation values, be socially responsible, don’t just say it, do it, create jobs that are truly meaningful, learn to use the same technology to communicate and agree to flexible hours and workplace.

Some may say this generational stuff is just socially acceptable stereotyping...politically correct rationale offered for immature behavior. However, as research has shown, 2/3 of family wealth is consistently lost from one generation to the next and 60% of this failure rate is due to a breakdown of trust and communication within the family. In order to reduce this failure rate, there is a need for improved communication within the family’s generations. Each of the four current generations has distinct values based on life experiences. Recognizing these differences and being willing to embrace them will likely result in the development of stronger multi-generational relationships and enhance the success rate of family wealth transfer.

Eric Foulz is a Senior Managing Director at LBJ Family Wealth Advisors, Ltd., a multi-family office based in Austin, Texas. www.lbjadvisors.com. The firm has a 70 year history starting when Lady Bird Johnson made successful investments in AM radio with KLBJ. As the Johnson family is now in its 4th generation, LBJ Advisors is intimately familiar with the issues and strategies surrounding the successful transfer of family wealth.

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CRITICAL GROUNDWATER LEGISLATION PASSES!

SB 332 by Sen. Troy Fraser/Rep. Allan Ritter: Strengthens landowners' ownership of groundwater below their land.

SB 332 does the following:

- Reaffirms that landowners own the groundwater below their land as real property.
- Entitles landowners to drill for and produce the groundwater below their land.
- Preserves the rule of capture.
- Recognizes that groundwater may continue to be conserved while ensuring fair and impartial regulation of landowners' groundwater ownership rights.

DIVISION ORDERS: WHAT YOU NEED TO KNOW

Other than the oil and gas lease itself, the division order is undoubtedly the most common legal instrument mineral owners are asked to sign. Mineral owners should know the purpose of a division order, what rights and obligations it imposes on them, and the division order's relation to the oil and gas lease.

First, I should say that the law and practice regarding division orders varies from state to state. I practice in Texas, so what follows relates only to the use of division orders in Texas.

Historically, there has been much controversy and litigation in Texas about division orders and their effect. As a result, in 1991 the Legislature passed a statute governing the use of division orders. The statute was amended in 1995, 1997 and 1999. It is now Chapter 91, subchapter J of the Texas Natural Resources Code, commonly called the Division Order Statute. So the law applicable to division orders in Texas is the court-made law plus the division order statute.

The main purpose of a division order is to protect the payor of the proceeds of production from double liability. The company issuing the division order is requiring the royalty owner to (1) verify that the royalty owner's decimal interest set out on the division order is correct and (2) agree that the company can make payments based on that decimal interest until notified by the royalty owner that the ownership has been changed. By the division order, the royalty owner indemnifies the payor against liability to third parties.

To understand division orders, it is helpful to understand how exploration companies handle royalty payments. When a company decides it wants to drill a well in a particular area, it first hires landmen who investigate the mineral title to the tracts in the area where the well will be drilled and identify the mineral owners of those tracts. The company or its landmen then contact those mineral owners and negotiate oil and gas leases covering their interests. Depending on the complexity of the mineral title, there may be dozens or even hundreds of mineral owners from whom oil and gas leases must be obtained. The company may want to acquire leases in a large area around its proposed drillsite, in order to lock up the minerals in that general area so that additional wells can be drilled if the exploratory well is successful.

After the company has acquired the oil and gas leases in the area it wants to exploit, it picks its initial drillsite and then engages an oil and gas attorney to examine the title to the drillsite tract. The attorney reviews all of the documents gathered by the landmen involving the mineral title to the drillsite tract and then gives an opinion, called a *drilling title opinion*, to the company. The purpose of the drilling title opinion is to assure the company that it owns oil and gas leases covering 100% of the mineral estate in the drillsite tract. If the drillsite consists of a pooled unit encompassing two or more smaller tracts, the drilling title opinion may cover all of the tracts in the proposed pooled unit. Where the well to be drilled is a horizontal well, the drilling title opinion should cover at least all of the tracts that will be penetrated by

the well bore. If the attorney discovers an unleased interest or finds defects in the mineral title that raise questions about the mineral ownership, the company will engage landman to "cure" these title defects prior to the drilling of the well.

Once the drilling title opinion is complete and shows that the company has the drillsite 100% leased, the company drills its well. If it is successful and placed into production, then the company engages an attorney (who may or may not be the same attorney as the one who did the drilling title opinion) to prepare a *division order title opinion*. The purpose of this second opinion is to tell the company how to pay the royalty owners, based on the record title ownership of the minerals and the oil and gas leases covering the well or pooled unit. The division order title opinion will list each owner of an interest in production and that owner's decimal interest in production, all of which must add up to 100%. Again, if there are issues regarding the correct ownership of any person, the opinion will discuss those issues and what needs to be done to "cure" the problem. Those issues are listed as "requirements" in the opinion. Where there are requirements, those owners affected by the requirements will not be paid until the requirements are cured. Remember that a title opinion is just that -- an opinion. It is prepared by attorneys skilled in examining titles, but it may be wrong. First, it is based only on the documents provided to the attorney for review. The attorney may not have seen documents that affect the title, or the attorney may have missed provisions in the documents that affect the title.

Based on the division order title opinion, the company then prepares a division order for each owner entitled to payment on production from the well and sends it to the owner. The company personnel who deal with division orders are called *division order analysts*. When you call a company asking about your royalty payments, you are usually speaking to a division order analyst. Often, the royalty owner's receipt of a division order is the first indication to the royalty owner that a well has been completed and is producing. Depending on the complexity of the title, there may be a significant time between the completion of the well and the issuance of division orders - sometimes several months.

Problems arose concerning the use of division orders because companies began using them for something other than their original purpose. Many division orders contained provisions specifying how the oil or gas would be valued for purposes of paying royalties and what deductions could be made from royalty owners' payments. These division-order provisions often conflicted with the terms of the oil and gas leases under which the royalties were being paid. So litigation inevitably resulted. Courts were confronted with how to characterize and enforce signed division orders that conflicted with the terms of the leases

In Texas, courts have held that division orders are executed without consideration, but that they are an enforceable agreement *until they are revoked*. A division order can be

revoked at any time by either party, after which it has no further effect. So, if a division order provides that royalties shall be paid based on the net proceeds from sale of the production, less all post-production costs incurred by the lessee prior to sale, then the lessee is entitled to pay on that basis as long as the division order is in effect, even if the lease required the lessee to value the production in another way.

The miss-use of division orders led to the Texas Legislature's passage of the division order statute. Like most legislation, the statute is a compromise. It provides that division orders cannot be used to modify leases, and it gives the companies the right to require execution of a division order, as long as it does not seek to modify the lease. The statute provides that "Any provision of a division order ... which is in contradiction with any provision of an oil and gas lease is invalid to the extent of the contradiction." But it also provides that "A division order may be used to clarify royalty entitlement terms in the oil and gas lease."

The statute then has an odd provision: "With respect to oil and/or gas sold in the field where produced or at a gathering point in the immediate vicinity, the terms 'market value,' 'market price,' 'prevailing price in the field,' or other such language, when used as a basis of valuation in the oil and gas lease, shall be defined as the amount realized at the mouth of the well by the seller of such production in an arm's-length transaction." Texas Natural Resources Code Section 91.403 (h) and (i). When the statute was passed, there had been a lot of litigation about the meaning of the term "market value" when used in the royalty clause of a lease, and lobbyists for the producing companies got this provision added to the statute to try to reduce their exposure to liability for royalty payments under leases requiring them to pay based on "market value." It is hard for me to understand how the Legislature could dictate what the parties intended in a private contract, but that is apparently what they tried to do. I am not aware of any case dealing with this provision of the statute.

The division order statute says that, if a company uses a division order that meets the requirements of the statute, it can refuse to pay the royalty owner until the royalty owner has signed the division order. The statute also adopted an "approved form" of division order - but only for oil royalties. If the payor uses the statutory division order form, it can be sure that it has no liability for failing to pay royalties if the royalty owner refuses to sign it.

The statute also:

- Makes clear that a payor of royalties has no obligation to pay if there is a title question about ownership of the royalty.
- Provides that royalties must be paid within a certain number of days after production occurs, and sets a

statutory rate for interest that must be paid on late royalty payments - 2% above the "Fed Funds" rate. Such a low rate does not give companies much of an incentive to pay royalties on a timely basis.

Producers and purchasers who pay royalties today generally use division order forms that attempt to comply with the division order statute. The National Association of Division Order Analysts has adopted a form of division order that some companies use. But some companies still try to use division orders to alter the terms of the lease.

So, what should a royalty owner do when he/she receives a division order? *First*, the owner should determine whether the royalty decimal shown on the division order. Sometimes this is a simple matter, but often it is not, especially where pooled units are involved. When companies send out division orders, they make no attempt to explain how the decimal for payment was arrived at, so the royalty owner may have to call the company to find out how the decimal was calculated. Royalty owners should not be bashful about making such calls. Don't sign a division order until you know and agree with how the decimal was calculated and are satisfied that the lease is still in effect. It is sometimes hard to get to the right person with the company who can explain it. Usually, the division order or the accompanying letter has a number to call, or the company may have a royalty owner hotline that can be found on its website.

Second, read and understand the language in the division order. If you don't understand or don't agree with something, don't be bashful about asking questions or making changes. Most companies will take a division order with changes that don't alter its basic purposes.

Third, I recommend that royalty owners always add language to a division order as follows:

THIS INSTRUMENT DOES NOT MODIFY OR AMEND THE TERMS OF ANY OIL AND GAS LEASE. ALL ROYALTIES DUE AND PAYABLE UNDER ANY OIL AND GAS LEASE SHALL BE CALCULATED AND PAID AS PROVIDED IN THE LEASE. THIS DIVISION ORDER IS EXECUTED WITHOUT CONSIDERATION AND MAY BE REVOKED AT ANY TIME.

This article was provided by John B. McFarland an attorney with Graves, Dougherty Hearon & Moody, P.C. in Austin, TX. It was previously published on his blog www.oilandgaslawyerblog.com on February 22, 2011. In the last twenty years, Mr. McFarland has negotiated oil and gas leases and lease options covering more than 235,000 acres of land in Texas. His practice also includes negotiation of seismic survey permits, data use licenses, purchase and sales agreements, pipeline easements, and financing agreements covering leasehold, mineral and royalty interests. He obtained Board Certification as a Specialist in Oil, Gas and Mineral Law in December 1986. Mr. McFarland is the author of the Texas Land & Mineral Owners Association oil and gas lease form.



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