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The Restatement (First) of the Oilfield Operator's Fiduciary Duty

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JOHN BURRITT McARTHUR*

The Restatement (First) of the Oilfield Operator's Fiduciary Duty**

ABSTRACT

The oilfield has seen hundreds of cases trying to classify the operator's relationship to its nonoperating investors and to determine whether the operator is a fiduciary. Courts have not treated the operator as a fiduciary per se, but have held it to fiduciary responsibilities in such core areas as acquiring acreage, handling investor funds, and marketing production. The Article surveys judicial approaches to this question by legal theory, by jurisdiction, and by the nature of the operator's activity. A duty in acreage acquisition, handling funds, and marketing production is entirely in accord with the common law's imposition of a fiduciary duty on trustees and agents. Yet instead of applying a single, clear theory, courts have used a hodgepodge of sometimes inconsistent approaches to define the operator's obligations. Among the unfortunate consequences has been an entirely unnecessary risk of nonoperator liability to vendors and other third parties. The Article restates the law by describing the unified operator fiduciary theory that is emerging from the cases, is based on the operator's control, and protects the nonoperator's dependence. It urges that the logic of this duty should lead the courts to extend fiduciary responsibilities to the operator's representations and omissions as well.

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** This Article culminates a series of articles by the author on the major legal relationships in the oil and gas industry. The first article, *A Twelve-Step Program for COPAS to Strengthen Oil and Gas Accounting Protections*, 49 SMU L. REV. 1447 (1996), discussed weaknesses in industry accounting standards. The second, *Coming of Age: Initiating the Oilfield into Performance Disclosure*, 50 SMU L. REV. 663 (1997), addressed the need for clear disclosure of the operator's economic performance and the financial structure of its program, as well as for updates as a program continues. *The Mutual Benefit Implied Covenant for Oil and Gas Royalty Owners*, 41 NAT. RESOURCES J. 795 (2001), concerned the basic nature of the royalty relationship. This Article addresses the fundamental nature of the operator/nonoperator relationship. The author has benefited from assistance and comments from Wilson Condon, Susan Conway, Gene Gallegos, Bill Large, Jim McCartt, Barry Pulliam, Washington Lem, and Mark Wawro. The author has represented producers, working interest owners, and royalty owners in a variety of oilfield lawsuits, and handled state royalty and severance tax claims as well. Most of his current oilfield litigation is on behalf of royalty owners, including the states of Louisiana and Alaska.

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I. INTRODUCTION

This Article is a guide for participants in the oil and gas industry, private lawyers, in-house counsel, employees, and courts, who have to grapple with the oilfield operator's duty to its investors under the ubiquitous Joint Operating Agreement (JOA). The Article addresses an issue where American courts are only now slowly articulating the governing principles in spite of decades of litigation: whether an oilfield operator,¹ which invests funds, markets production, and handles property for its investors, is a fiduciary to these "nonoperators."² Many courts have answered that question for many of the operator's activities in the affirmative. A number of these courts have grounded the fiduciary duty in the nonoperators' dependence upon the operator. Other courts only superficially explain their reasoning. Worse, the two major doctrines, the joint-venture and mining-partnership theories, rest on the diametrically opposed conception that nonoperators deserve special protection only when they are actively involved in running the project, *i.e.*, not when they are dependent, but when they are in control.

Most of this confusion results from courts resolving operator/nonoperator disputes with precedent developed in an entirely different setting involving liability to third parties. In these cases, vendors and other creditors claim that the operator and nonoperators are joint venturers or mining partners in a usually vain attempt to reach the nonoperators' personal assets. The principles governing the mutual

1. The oilfield operator is "a person, natural or artificial (*e.g.*, corporate) engaged in the business of drilling wells for oil and gas." HOWARD R. WILLIAMS & CHARLES J. MEYERS, *MANUAL OF OIL AND GAS TERMS: ANNOTATED MANUAL OF LEGAL ENGINEERING TAX WORDS AND PHRASES* 662 (7th. ed. 1987) [hereinafter WILLIAMS & MEYERS MANUAL]. The operator's duties are defined in an operating agreement, which is "[a]n agreement between or among interested parties for the testing and development of a tract of land. Typically, one of the parties is designated as the operator....The authority of the operator, and restrictions thereon, are spelled out in detail in the typical agreement." *Id.* at 659.

2. Nonoperators are equity partners who pool their resources, sometimes acreage but usually money, and share a proportionate interest in the outcome. The "nonoperating working interest" is an interest whose owner is "without operating rights by reason of an operating agreement." *See id.* at 619.

liability of an operator and its investors to third parties are logically distinct from the operator's internal liability to its investors, yet joint-venture and mining-partnership theories misappropriate standards that make sense in the first context to resolve the very different internal issue.

Courts are gradually rationalizing this mixed body of law in an emerging doctrine that protects the nonoperators' dependence by confirming that the operator is a fiduciary in several key aspects of this relationship. The fiduciary duty applies when the operator's interests diverge from the investors'—when the operator acquires property, handles the investor's funds, and markets the investor's production. At the same time, nonoperating investors do not have unintended third-party exposure under the emerging duty. The operator continues to enjoy a lesser nonfiduciary standard of care when handling physical operations.

The operator's responsibility for joint operations is important because this common relationship is the legal engine for the prolific American oil and gas industry, an industry in which American companies have retained their lead in the world market. Technological advancement has been heavily driven by incentives and ownership practices developed in the United States. Most American oil and gas ventures have been drilled under the standard JOA, issued by the American Association of Petroleum Landmen. Independent and major oil companies alike use the JOA.³ The JOA operating relationship is a

3. The JOA is the controlling document for most American oil and gas investments. See, e.g., ANDREW B. DERMAN, *THE NEW AND IMPROVED 1989 JOINT OPERATING AGREEMENT: A WORKING MANUAL 1* (1991) (“[JOA procedures] have, generally, been effective in establishing procedures and obligations which have resulted in the drilling of tens of thousands of wells with minimal litigation.”); Howard L. Boigon, *The Joint Operating Agreement in a Hostile Environment*, 38 INST. ON OIL & GAS. L. & TAX’N 5-1, 5-2 (1987) (“[A JOA is] typically used to govern joint exploration and development of oil and gas properties.”) [hereinafter Boigon, *Hostile Environment*]; Howard L. Boigon, *Liabilities and Relationships of Co-Owners Under Agreements for Joint Development of Oil and Gas Properties*, 37 INST. ON OIL & GAS L. & TAX’N 8-1, 8-4 (1986) (“[JOA is] the instrument which both attorney and client ordinarily anticipate utilizing to conduct joint development operations.”) [hereinafter Boigon, *Liabilities and Relationships*]; William A. Keefe, *The Oil and Gas Joint Operating Agreement: Unraveling Some Knots*, 36 ROCKY MTN. MIN. L. INST. 18-1, 18-2 (1990) (“The model form is used in nearly every domestic, multiple party venture for the onshore drilling of oil and gas.”); Patricia A. Moore, *Joint Operating Agreements—Is There Really a Standard That Can Be Relied Upon?*, 5 E. MIN. L. INST. 15-1, 15-1 (1984) (“[I]t is amazing that for over a quarter of a century the industry (majors and independents alike) has relied upon a Model Form Operating Agreement to cover the drilling and subsequent operation of joint venture wells.”); J.O. Young, *Oil and Gas Operating Agreements: Producers 88 Operating Agreements, Selected Problems, and Suggested Solutions*, 20 ROCKY MTN. MIN. L. INST. 197, 199 (1975) (“It is presently believed that the Ross Martin, now A.A.P.L. Form 610, has gained such general acceptance, even by major companies, that it may be considered a Standard Operating Agreement.”).

successful, creative way of pooling funds, properties, and expertise.⁴ This investment form is so durable that a disproportionate amount of all exploration and development spending worldwide continues to occur in the United States, even though it has only a small fraction of the world's reserves.⁵ All this makes the legal standard governing the operator/nonoperator relationship a central question for the industry's health.

4. For landowners, of course, joint operations are not the investment vehicle of choice. Most landowners instead lease their property, receiving a bonus for issuing the lease, delay rentals to preserve it if the lessee does not find production within a certain time, and a percentage of production, the royalty, from any producing well, all without putting up any cash itself. An alternative format, but one less often used, is for the lessee to let the lessor keep a working interest, or some combination of royalty and working interests, in exchange for contributing acreage. Another is the "farmout" agreement in which the lessor "backs in" to a specific equity position after the lessee has recouped an agreed amount of its costs.

Joint operations overcome a variety of costs and risks of oilfield operations. They let parties who could not afford to drill their own wells participate anyway, thus creating projects where they otherwise might not exist. They facilitate fundraising by pairing those with no expertise with experienced companies in the search for oil or gas. They let even large companies spread risks across a wider area. And by letting even industry companies participate in more projects, joint operations help generate economies of scale. See generally JOHN E. JOLLY & JIM BUCK, JOINT INTEREST ACCOUNTING: PETROLEUM INDUSTRY PRACTICE 2-3 (1988) (discussing lower expenses and spreading of "risk capital" in joint operations); see also Lewis G. Mosburg, Jr., *An Introduction to the Model Form Operating Agreement*, in THE PETROLEUM EXPLORATIONIST'S GUIDE TO TITLES, LEASES & CONTRACTS 405 (Lewis G. Mosburg, Jr., ed., 1984) (observing in mid-1980s downturn that tough financial conditions were leading to increased joint operations). Lee Jones chronicled some of the benefits of joint operations in an even earlier article. Lee Jones, Jr., *Problems Presented by Joint Ownership of Oil, Gas and Other Minerals*, 32 TEX. L. REV. 697 (1954). He included the poorer operator's desire to "spread his bets," even major companies' choice to farmout "doubtful" properties, and the need to coordinate lease obligations when property in the same area is held under different leases. See *id.* at 715-16.

5. As an example, an *Oil and Gas Journal* survey projected that almost one-fourth of all oil and gas E&P expenditures for 2003 would occur in the United States. See Lehman: *Increases Slight for 2003 Global E&P Outlays*, 101 OIL & GAS J., Jan. 13, 2003, at 31.

The "success" of the standard JOA is shown by the fact that passive investors often will advance millions of dollars with little or no direct oversight because they believe they can trust the JOA operator. Such routine reliance upon the JOA's delegation of unsupervised activity to the operator reflects a mature legal instrument. Even the most hands-off economists concede the role of government in insuring a secure framework for private bargains. See, e.g., MILTON FRIEDMAN, CAPITALISM AND FREEDOM 13-15 (1962) ("[G]overnment is essential both as a forum for determining the 'rules of the game' and as an umpire to interpret and enforce the rules decided on."). Our market economy operates with great efficiency precisely because parties can enter such highly complex and difficult-to-monitor relationships knowing that they nonetheless can expect reliable performance of complex expert tasks. The ability to project oneself reliably into future relationships by the mechanism of contract law is an essential component of freedom as well as efficiency. See CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 13 (1981); K.N. Llewellyn, *The Effect of Legal Institutions upon Economics*, 15 AM. ECON. REV. 665, 674 (1925).

To assist businessmen, lawyers, and courts with their different needs, this Article discusses the operator fiduciary cases from several different perspectives. It begins in Part II with a short discussion of why the fiduciary duty arouses so much controversy, including the fiduciary's higher standard of care and disclosure and the punitive damages that can accompany this duty.

Part III turns to the different theories under which courts have determined whether operators should be treated as fiduciaries. This section is most likely to assist those seeking a deeper understanding of the fiduciary obligation, be it courts trying to find underlying principles or lawyers urging changes and synthesis in existing law. The Article illustrates inconsistencies in current approaches over whether the duty is a question of law or fact; over whether nonoperators should be protected because of their dependence or, in direct contrast, only if they can establish "cooperation" and "control" in the joint venture; and over whether cooperation or control should be tested by formal rights of control or should require the nonoperators to actually undertake meaningful acts of control.

Part IV groups the operator cases by jurisdiction for the major oilfield jurisdictions. The section provides a reference for lawyers and courts trying to apply the law in given jurisdictions, with cross-citations to the longer discussion of many of the cases in Part III. Oklahoma courts, parent to many of the leading cases and with their wide following in the Tenth Circuit and elsewhere, have come down most strongly for a fiduciary standard.⁶ Texas, in contrast, tends to limit liability to traditional contract terms.⁷ Yet even in Texas, courts from time to time have endorsed the major fiduciary theories. Jurisdictional differences therefore do not fully explain the variation in the law.⁸ Even in Texas, fiduciary responsibility can arise from partnership agreements; from informal, long-standing relationships of trust and confidence; from joint ventures or mining partnerships if nonoperators have some control over the project; and when the operator acquires acreage in the joint area, or markets production.⁹ To cover the largest producing states, Part IV also

6. See *infra* notes 202-209 and accompanying text.

7. See *infra* notes 210-216 and accompanying text. For other states, see *infra* notes 217-226 and accompanying text.

8. For some of the emerging common duties, see for example *infra* notes 64-73 and accompanying text (joint venture cases on acreage acquisition), 122-153 and accompanying text (duty in handling joint funds), 154-161 and accompanying text (marketing cases), and 370-387 and accompanying text (executive rights cases).

9. While the difference may appear semantic, there can be a world of difference in approach between, say, *Britton v. Green*, 325 F.2d 377 (10th Cir. 1963), in which the Tenth Circuit found a joint venture merely by reading the JOA and analyzing its structure, and

summarizes the law in Oklahoma, Louisiana, California, Alaska, New Mexico, and Kansas.

Part V discusses the fiduciary decisions by subject matter. Courts and practitioners faced with a dispute over a particular activity should be able to find the relevant law in each of nine areas: (1) acquiring property, (2) handling joint-account funds, (3) marketing production, (4) using affiliates, (5) conducting ordinary physical operations, (6) responding to third-party claims, (7) making geological and "success" predictions, (8) defending against plaintiffs who waited to see how drilling turned out before suing, and (9) running unitized operations. Part V shows that courts are likely to impose fiduciary duties on operators who acquire property in the JOA area or with JOA information, handle investor funds, or market their production, and it predicts that the duty may well extend to affiliate manipulations in these areas.

Part VI summarizes the disclaimer and no-partnership defenses in the JOA. These defenses are often a trap for the unwary – or a missed opportunity for the producer who overlooks them. The JOA-based defenses have become a particularly important focus of litigation in recent years. Responsibilities specifically disclaimed often will be excluded from fiduciary protection, but two specific areas carved out by the JOA, handling investor funds and marketing their production, are likely to be protected against the disclaimers. In addition, courts have been reluctant to let these clauses defeat claims for breach of contract.

Part VII looks at the disordered body of law on the duty of an oilfield operator as a whole. It begins by showing that courts ordinarily impose fiduciary duties to protect a party's unusual dependence, rather than requiring control or cooperation as in the oilfield joint-venture and mining-partnership cases. These latter two doctrines can create unintended liability and have spawned a telltale inconsistency in applications of their control-and-cooperation threshold. The ease with which some courts have enforced disclaimers is due in substantial part to their failure to more clearly explain the basis for the fiduciary duty. Each of these problems suggests that courts need to systematize the principles underlying their application of fiduciary duties to protect nonoperator dependence in areas where operators have a special interest distinct from their nonoperators.

cases that require factual proof that nonoperators actually exercise joint control. *But cf.* Oklahoma Co. v. O'Neil, 440 P.2d 978 (Okla. 1968) (joint venture under traditional three-part test treating minimal acts as enough to show cooperation). In addition to proving control, the three-part test requires proof of shared profits and losses and a joint interest. All of these issues are discussed in detail in Part III *infra*.

Part VIII briefly addresses the common objections to an operator fiduciary duty and concludes that the objections do not justify extinguishing all fiduciary responsibilities. It suggests that there is no persuasive reason to block a fiduciary duty in selected areas, particularly handling investor money and production, but also in acquiring property. One rationale for restructuring the duty is fear of runaway punitive damages, yet courts sharply limit such awards. Another concern is that the duty would prevent operators from collecting traditional fees for management services. Yet many fiduciaries collect separate fees for their services. Some feel that a fiduciary duty is too rigid; yet the emerging fiduciary standard already is a highly refined standard that varies according to the operator's activity. Finally, objections based on freedom of contract leave too little room for traditional tort duties, and claims that current tort duties are adequate to police operators ignore the weaknesses in those standards of law.

Part IX reviews five possible versions of the operator's fiduciary duty: (1) a fiduciary in all dealings; (2) a fiduciary in major areas of separate interest, but not for physical operations at the well; (3) a duty of good faith; (4) a case-by-case duty; or (5) no fiduciary duty at all. Although the second category best suits the evolving law and its underlying purpose, the protection of those dependent on the operator's highly discretionary activity, this section of the Article provides courts and other parties the tools to weigh the other standards as well.

Common-law reasoning is supposed to let courts experiment with new doctrines step by step, so that they can use deepening experience to refine the law. The operator cases have matured to a point where they are ready for a clear synthesis. This Article discloses the general understanding that the operator should be held to a fiduciary standard in certain core dealings with its nonoperators where its interests diverge from theirs.

II. WHY FIDUCIARY DUTIES MATTER

Before discussing the oilfield operator's fiduciary duty, it is worth considering why parties have found it worth litigating this issue so often. Why do companies fight so hard to avoid this duty, why are interest owners so eager to assert it, and why are some courts so reluctant to permit it? A fiduciary duty changes the position of the parties in at least four ways: first, the duty entitles a plaintiff to a broad jury instruction holding the operator to a high standard of conduct and disclosure, including a duty to speak and fairly disclose a wide range of information about which a nonfiduciary operator could stay silent; second, willful breach of the duty exposes the operator to punitive

damages; third, the measure of damages may be broader than under a contract theory; and fourth, tort liability may bring certain technical advantages, like tolling limitations or avoiding the Statute of Frauds.

The first advantage of a fiduciary duty is often underestimated. The most important effect of fiduciary relations is almost certainly *not* its potential enhancement of damages by adding punitive damages; it is that the plaintiff will get a very broad instruction holding the operator to a high duty of disclosure and of care. The duties fiduciaries bear are well summed up in the *Restatement (Second) of Agency*. Unlike arms-length businessmen, the agent, as a fiduciary, has to

account for profits arising out of the employment, [and has] the duty not to act as, or on account of, an adverse party without the principal's consent, the duty not to compete with the principal on his own account or for another in matters relating to the subject matter of the agency, and the duty to deal fairly with the principal in all transactions between them.¹⁰

Included within the duty to deal fairly is the requirement of keeping accounts and, critically, of making full disclosure: giving the principal all information that "may affect the desires of his principal as to his own conduct or the conduct of the principal or of another agent," including all information about any "adverse" interest of the agent.¹¹ The common

10. RESTATEMENT (SECOND) OF AGENCY § 13 cmt. a (1958). See also Lynn P. Hendrix & Staunton L.T. Golding, *The Standard of Care in the Operation of Oil and Gas Properties: Does the Operator Owe a Fiduciary Duty to the Nonoperators?*, 44 INST. ON OIL & GAS L. & TAX'N 10-1, 10-6 (1993) (explaining no uniform rule, but duty requires utmost good faith and fair dealing, with "variations" including "loyalty, restraint from self-dealing, accounting for money received, and full disclosure of information relevant to the beneficiary's interests"; in general, a fiduciary must "not place his own interests over those of the beneficiary, or in other words, a fiduciary may not profit at the expense of the party to whom he owes the duty"); Howard R. Williams, *The Fiduciary Principle in the Law of Oil and Gas*, 13 INST. ON OIL & GAS L. & TAX'N 201, 203 (1962) [hereinafter Williams, *The Fiduciary Principle*] (A fiduciary is a person "who undertakes to act in the interests of another person," immaterial of whether contract creates duty or not (citation omitted)); *id.* at 261 (The "most important characteristic" of fiduciary duty is that it gives parties the "right to demand and expect from his associates full, fair, open and honest disclosure" and prevents excluding associates from properties within the subject area.); 2 HOWARD R. WILLIAMS & CHARLES J. MEYERS, WILLIAMS & MEYERS OIL AND GAS LAW § 437.1, at 520-21 (Patrick H. Martin & Bruce M. Kramer eds., 2004) [hereinafter WILLIAMS & MEYERS TREATISE] (maintaining operator's fiduciary duty requires "full, fair, open, and honest disclosure of everything affecting the relationship").

11. See RESTATEMENT (SECOND) OF AGENCY § 381 (1958); *id.* cmt. a, d. This duty may include pre-contract matters; "[a] significant body of authority holds that a fiduciary duty comes into play with the commencement of preliminary negotiations leading to a contract." Christopher Lane & Catherine J. Boggs, *Duties of Operator or Manager to Its Joint Venturers*,

venture brings a fiduciary's duty of trust and confidence, with courts often returning to Justice Cardozo's formulation that the "rule of undivided loyalty is *relentless and supreme*."¹²

Fiduciary standards impose a duty of deep honesty on the operator. They encompass many factors not covered in writing or expressly discussed. Omissions, and not just affirmative misrepresentations, are likely to be actionable under this standard. While arm's-length partners generally do not have a duty to speak,¹³ a fiduciary has to provide the information needed to understand an investment, even if the operator preferred to stay silent. For instance, unlike two businessmen who happen to trade products in the marketplace, an agent or trustee has to disclose profits, to act for the other party, and cannot take advantage of the principal.¹⁴ The fiduciary has to provide full disclosure.¹⁵ These standards make it easier for investors to recover when the operator affirmatively conceals information or simply fails to disclose bad facts.¹⁶

29 ROCKY MTN. MIN. L. INST. 199, 212 (1983). Those sheltered by fiduciary standards do not have the duty to investigate, which is a necessary corollary of their right to rely on the fiduciary's duty to speak (to say that nonoperators have to investigate would be the same as excusing the operator for not speaking). See *id.* at 226-27. For an example of how much difference this can make, see the discussion of *Oklahoma Co. v. O'Neil*, 440 P.2d 978 (Okla. 1968), in note 15 *infra*.

12. *Meinhard v. Salmon*, 164 N.E. 545, 548 (N.Y. Ct. App. 1928) (emphasis added); see WILLIAMS & MEYERS TREATISE, *supra* note 10. On *Meinhard v. Salmon*'s continuing direct influence in oilfield law, see *infra* note 457.

13. RESTATEMENT (SECOND) OF TORTS § 551 (1977).

14. See RESTATEMENT (SECOND) OF AGENCY § 381 cmt. a, d (1958) (Duty to Give Information); *id.* § 382 (Duty to Keep and Render Accounts); *id.* § 387 (General Principle of Loyalty).

15. The Oklahoma Supreme Court defined this duty, which is the most important aspect of the fiduciary obligation, as follows: the fiduciary operator must give "the fullest and fairest explanation and communication of every particular resting in the breast of the one who seeks to establish a contract with the person so trusting him." *Blackstock Oil Co. v. Caston*, 87 P.2d 1087, 1089 (1939). An unusually graphic example of the importance of a fiduciary duty is *Oklahoma Co. v. O'Neil*, 440 P.2d 978 (Okla. 1968). Though the Oklahoma Company overstated lease and other costs, misstated facts about production, and carved out secret royalties, the Oklahoma Supreme Court initially found no liability in the absence of a fiduciary duty. See *Oklahoma Co. v. O'Neil*, 333 P.2d 445 (Okla. 1958). The court dismissed the fraud claims because all oral representations were merged into the contract. Nine years later, with the initial opinion voided because the company allegedly had bribed a Justice, see *Oklahoma Co. v. O'Neil*, 431 P.2d 445 (1967), the court imposed a fiduciary duty and found the operator liable. See *Oklahoma Co. v. O'Neil*, 440 P.2d 978, 984-86 (Okla. 1968).

16. To put the duty in the context of the kind of issues that can come up in joint investments, a fiduciary operator presumably would have to notify investors if, for instance, it was buying equipment from a certain high priced vendor because it was making separate profits when it sold back used equipment to the same vendor. *But see*

One way to see the importance of the duty to disclose is to compare a claim for breach of fiduciary duty to one for fraud. In the typical fraud case, the plaintiff has to prove that a misrepresentation or omission was "material," that the defendant intended the plaintiff to rely upon it, and that its reliance was reasonable.¹⁷ Fiduciary cases have no such limits.

The second effect of fiduciary standards is the change that colors most critics' views: punitive damages. A fiduciary is exposed to punitive damages if it violates its duty intentionally or with gross recklessness.¹⁸ Because a fiduciary is often very hard to monitor, the law increases its risk in hopes of deterring, and punishing, wrongdoing. Punitive damages probably explain why the industry has so strongly resisted proposals to treat operators as fiduciaries.¹⁹ Companies generally oppose any measure that they believe creates an added cost of doing business. Punitive damages do just that.

Dime Box Petroleum Corp. v. La. Land & Exploration Co., 717 F. Supp. 717 (D. Colo. 1989), *aff'd*, 938 F.2d 1144, 1147-48 (10th Cir. 1991) (allowing operator to keep proceeds of buyback arrangement by applying JOA disclaimer to limit fiduciary duty). If a fiduciary operator had hidden discounts, there also would be a duty to notify investors. *Cf. Gilbert v. Nixon*, 429 F.2d 348, 357-63 (10th Cir. 1970) (finding failure to pass on discounts breach of partnership arrangement, but not a fraud that could void that investment; refusing to void entire package of leases for securities fraud or any individual lease without a direct connection between alleged false report and lease purchase; and remanding for consideration of specific representations on individual wells). Had they been fiduciaries, these operators could not have stayed silent about material risks and later claimed that the investors had to uncover the problem before they could rely.

17. Consider *Naftalis v. Rankin*, 542 S.W.2d 893, 898 (Tex. Civ. App. 1976) (court of appeals enforcing fiduciary duty in spite of jury's finding lack of justifiable reliance because such findings could not negate a fiduciary duty, in case where jury also found operator lied to plaintiffs about his intention to secure a lease for them as well as himself), *rev'd on grounds that claimed violation fell outside scope of fiduciary duty*, 557 S.W.2d 940 (Tex. 1977). The court of appeals held that whether the plaintiffs were justified in believing the operator's promises, or whether the operator's conduct was an "abuse of the relationship," was immaterial because of the operator's fiduciary duty. *Id.* at 899. The plaintiffs in *Rankin* did not plead fraud, which is something of a surprise on such facts, but the jury's finding of no justifiable reliance suggests that a better pleading would not have fared any better in the end. See *Rankin v. Naftalis* 557 S.W.2d 940, 943 (Tex. 1977). See also *Oklahoma Co. v. O'Neil*, 440 P.2d 978 (Okla. 1968); *Mitchell Energy Corp. v. Samson Res. Co.*, 80 F.3d 976, 981, 985 (5th Cir. 1996) (reversing a judgment that included \$50 million in punitive damages with the observation that, "[a]bsent a fiduciary or confidential relationship, the failure to disclose information is not actionable as fraud"). The fiduciary duty can be of even greater importance if the parties have no written agreement. Given the wide acceptance of the various JOAs in today's industry, however, it is the rare joint investment that lacks a written agreement.

18. For a discussion of punitive damages, see *infra* Part VIII.A.

19. The resistance extends to the disclaimer inserted in the standard industry agreement in 1989. See *infra* Part VI.

Third, the tort standard applying to fiduciaries may yield a wider net of damages cognizably "caused" by a breach. Contract law provides no penalty for breaches of contract other than payment of the expected profit, the "benefit of the bargain." These damages have been limited in common-law jurisdictions to "reasonably foreseeable" damages.²⁰ Torts, in contrast, allow recovery of all damages "proximately caused" by the wrongdoing.²¹

Finally, the fiduciary duty may bring certain procedural benefits. The plaintiff may be able to claim wrongfully acquired property without satisfying the Statute of Frauds.²² The fiduciary duty may lead courts to

20. See *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854). *Hadley* is one of the more famous wrongly explained cases in the history of the common law. As virtually every first-year law student knows, a shipper was late in delivering a broken crankshaft to a mill in the high years of the Industrial Revolution. The mill had no backup equipment and had to shut down until the replacement arrived; it sued for the lost profits resulting from its unexpected closure. The court refused to hold the shipper liable, arguing that the damages were not foreseeable.

While this opinion cries out for more detail, the damages may well have been foreseeable. There was no indication that the shipped part was hidden or disguised, so the shipper presumably knew that it was a machinery part for the mill. The shipper may not have expected late delivery to shut down the mill (he may not have known that the existing part was broken, what role it filled, and that there were no backups), yet it surely was foreseeable that the part (1) probably was needed when requested; and (2) if needed, might well be necessary for mill operations; and (3) if the mill could not operate, that severe damages would result. Interestingly, though *Hadley* has become a restrictive rule for confining contract damages, the possibility that the carrier might have been liable had it been put on notice was a revolutionary, expansive suggestion in nineteenth century law. See GRANT GILMORE, *THE DEATH OF CONTRACT* 51-53 (1974).

The better basis for limiting damages is one later used in tort cases. The mill was in a far better position to limit its damages than the shipper. The mill would know what parts wore out and how often and could plan to stock replacement parts ahead of time. The necessary information was within its special expertise. It could plan for late deliveries with very little added cost. The shipper, on the other hand, has no reason to know anything in detail about the customer's business, and the overall cost of shipping would rise astronomically if it had to insure business risks for every customer whose shipment was late. Making shippers cover such generally foreseeable risks that are largely within its customers' control would turn the shipper into an insurer. There are insurers who will protect businesses against risks like late shipment, but these are highly specialized companies with charges pegged to the likelihood of the risk and the extent of damages if late shipment occurs. It would be socially costly to make every shipper bear these risks instead, and far more efficient to let customers use their skill to either plan for late shipment or insure against the risk of late delivery.

21. See generally W. PAGE KEETON ET AL., *PROSSER AND KEETON ON THE LAW OF TORTS* § 42 (W. Page Keeton ed., 5th ed. 1984).

22. Where an operator acquires property using joint-account information but refuses to share it with nonoperators, for instance, the latter can seek a constructive trust without having to prove a written agreement. As stated in one of the lead joint-venture cases, the Texas Supreme Court opinion in *Rankin v. Naftalis*, 557 S.W.2d 940, 943-44 (Tex. 1977), a fiduciary relationship sustains a constructive trust that can skirt the Statute of Frauds'

toll limitations — or at a minimum, the high duty of disclosure may lower the standard of care under which courts will toll limitations.²³

The primary benefits of a fiduciary duty, however, lie in the first two factors. A fiduciary labors under a very high duty of care, and ignoring that duty can expose it to punitive damages. The courts have found a variety of reasons for imposing such standards on operators.

III. THE FIDUCIARY DUTY BY THEORY: MULTIPLE COMMON LAW THEORIES HAVE MADE OPERATORS FIDUCIARIES

Courts have taken at least nine approaches to operator fiduciary responsibility. Two theories, the joint-venture and mining-partnership theories, can fit any operator relationship. The other fiduciary theories cover only certain kinds of operators or of activities. A number of courts have treated unit and grubstake operators as fiduciaries. The activities of acquiring acreage interests within the common venture area, handling joint-account payments and revenues, and marketing production are fiduciary in nature. Any operator who signs up investors using a partnership form is a fiduciary, as are operators whom a jury finds have a long-standing relationship of "trust and confidence" with their investors.

These doctrines encompass most externally funded oil and gas investments. Unfortunately, the piecemeal, case-specific development of these rules has never been combined into an overall theory of the operator's duty. Courts rarely address the underlying reason for imposing these heightened responsibilities. They have preferred instead to focus on whether the operator fits into a particular fiduciary category or not. No court has addressed the full body of operator fiduciary law and the inconsistency between the various theories, nor has any court

ordinary requirement of a writing. Mining partnerships can elude the Statute, too. See Terry Noble Fiske, *Mining Partnership*, 26 INST. ON OIL & GAS L. & TAX 'N 187, 233 (1975).

23. See Goodall v. Trigg Drilling Co., 944 P.2d 292, 294 (Okla. 1997); *id.* at 295 (Summers, J., concurring) (discussing fiduciary duty in a royalty case as the "something else" that can toll limitations); Ludey v. Pure Oil Co., 11 P.2d 102, 104 (Okla. 1931). For instance, a fiduciary obligation to disclose might have protected unit lessors who claimed that they were duped by misrepresentations about increased production when they let Exxon put their property into one of its units. See Rutherford v. Exxon, 855 F.2d 1141, 1145 (5th Cir. 1988) ("As the legal duties of one party become more strict, the resulting trust and confidence in the other party alter the content of the phrase 'reasonable diligence' within the particular relationship."); Gary W. Catron, *The Operator's 'Fiduciary' Duty to Royalty and Working Interest Owners*, 64 OKLA. B. J. 2763, 2767 (1993) (duty may mean no limitations). *But cf.*, Fiske, *supra* note 22, at 233 (mining partnership may have different limitations, but courts still may apply estoppel or laches).

systematically considered the unintended liabilities created by some of the theories.

Though not often stated, two facts connect most oilfield fiduciary cases: first, the operator assumes a special responsibility for its investors; and second, nonoperators have to depend upon the operator in areas that are hard to monitor or control. Courts have imposed fiduciary obligations in areas where the operator's interests are most likely to diverge from those of its investors. Oilfield jurisprudence obscures the central goal of protecting nonoperating investors because the primary doctrines under which it has addressed the operator's duty, the joint-venture and mining-partnership theories, purportedly require an act of "cooperation" or "control" by nonoperators. In other words, *more* active nonoperators, who presumably are better able to protect themselves, nonetheless get *more* protection under these two theories. To satisfy the control requirement, courts at times have had to stretch the facts beyond all recognition and find cooperation in behavior that cannot plausibly denote real control. Like most legal fictions, this one has hurt the rational development of the law. It has at times created unintended liability to third parties because slight acts of control sometimes expose investors to financial responsibility for all of the venture's debts.

Cases in many of the other categories of the oilfield operator fiduciary duty, though properly resting a fiduciary finding on the nonoperator's dependence and need for protection, are problematic because they too rarely explain *why* they define the operator as a fiduciary. A concern with operator power can be extracted from these cases, but most courts follow precedent without bothering to explain their thinking. In short, the courts have not integrated their partial insights into larger fiduciary principles like those governing agents and trustees. The rest of this Part discusses the various theories courts have used in labeling the basic operator relationship.

A. Joint Ventures and Mining Partnerships Create Fiduciary Duties

The biggest cluster of cases treating operators as fiduciaries are the joint-venture and mining-partnership cases. Joint ventures, which are indistinguishable from mining partnerships as a practical matter,²⁴ have

24. Boigon, *Liabilities and Relationships*, *supra* note 3, at 8-14 (differences in these two doctrines are "largely insignificant" for "relationship and liability purposes"); Clarence A. Brimmer, *Mining Partnerships*, 15 ROCKY MTN. MIN. L. INST. 85, 94 (1969) ("[I]t is suggested that the distinction between a mining partnership and a joint venture is doubtful.") (citations omitted); Fiske, *supra* note 22, at 189 n.3 (doctrines "essentially indistinguishable"); *id* at 227-28 (doctrines do not "vary in any material element, characteristic, or consequence"); *id* at 229 (not even in standards of intent, agreement, duty,

been called "informal" partnerships. They carry all the requisites of partnerships but, unlike partnerships, are usually limited to a specific project or development.²⁵ As far back as 1962, in the first detailed review of the fiduciary cases, Howard Williams concluded that "[f]iduciary principles are usually applicable to most forms of joint endeavor, whether described as a partnership or in less formal terms."²⁶ Some other major commentators have been nearly as bullish.²⁷ Yet the law of joint

or scope of agency); Hendrix & Golding, *supra* note 10, at 10-9 (the two concepts "can be considered" the same "for practical purposes"); Ernest E. Smith, *Duties and Obligations Owed by an Operator to Nonoperators, Investors, and Other Interest Owners*, 32 ROCKY MTN. MIN. L. INST. 12-1, 12-6 (1986) [hereinafter Smith, *Duties and Obligations*] ("Although there are some differences in their elements and in their effect, the two concepts can be treated as essentially identical insofar as the rights and obligations of the participants are concerned."). Eugene Kuntz has claimed that joint ventures cannot be equated exactly with mining partnerships in oil and gas law because the doctrine of "delectus personae" (the power to select partners) applies to joint ventures but not to mining partnerships. See 2 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 19A.8 (1989). He finds "no real reason to distinguish" the doctrines where that difference is not significant. See *id.* Williams and Meyers note that mining partnerships are joint ventures, but that joint ventures can take a wider variety of forms. See WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437, at 517; cf. Williams, *The Fiduciary Principle*, *supra* note 10, at 261 (a mining partnership is a joint venture, but not all joint ventures are mining partnerships).

25. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437, at 516.1 (citations omitted).

26. Williams, *The Fiduciary Principle*, *supra* note 10, at 274.

27. Writing nearly a generation after Howard Williams in a second major analysis of the operator's duty, Ernest Smith suggested that courts have come to accept that operators in general do fit the fiduciary mold under joint-venture theory:

One can, I think, safely start with the assumption that *in the absence of other factors modifying the relationship*, the operator owes a fiduciary duty to the nonoperators with respect to the ventures contemplated by their agreement. This general assumption is justified both by the broad proposition that anyone who undertakes to act on behalf of another is, in a general sense, a fiduciary for that person and by the joint venture analysis.

Smith, *Duties and Obligations*, *supra* note 24, at 12-14 (emphasis added); see also *id.* at 12-5. Smith's actual position is somewhat clouded, because he seems to have felt strongly that parties should be able to contract for a lesser duty, see *id.* at 12-30 (suggesting that JOA article V.A could relieve operator of liability for breach of specific provisions of agreement); cf. *id.* at 12-7 (question whether JOA modifies operator's duty "not susceptible of an easy answer"), but one can understand why at least one commentator has put Smith's article into the strong fiduciary camp. See Patrick H. Martin, *The Joint Operating Agreement – An Unsettled Relationship?*, 1997 PROC. INT'L OIL & GAS EDUC. CENTER S.W. LEGAL FOUND. SPECIAL INST. 98, 115 n.39. Smith's belief that oilfield parties should be able to disclaim fiduciary duties, indeed that such a duty may not fit oilfield realities, comes through even more clearly in his 1985 article on executive rights. See Ernest Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371 (1985) [hereinafter Smith, *Fiduciary Implications of Executive Rights*].

The third major commentator on the operator's duty, Howard Boigon, agreed that the standard joint operating agreement satisfies the requirements of a joint venture and its fiduciary trappings. See generally Boigon, *Liabilities and Relationships*, *supra* note 3, at 8-20

ventures and mining partnerships, the two doctrines under which courts most frequently address the operator's duty, has not developed with such clarity. An uneasy tension underlies these doctrines because they arise in two very different contexts.

A minority of these cases concern the operator's internal duty to nonoperating investors. Because joint ventures and mining partnerships technically require cooperation among the partners, courts often strain to protect vulnerable and innocent nonoperators by treating very slight acts of participation as enough to create a fiduciary duty. Even though liability requires control, they actually are trying to protect dependence (the absence of control).

Most of the cases, however, arise from claims brought by vendors, service companies, and drillers. These third parties claim that the program is a joint venture or mining partnership in hopes that the status will give them standing to collect unpaid bills from nonoperators as well as the operator. In these cases, courts often deprecate the nonoperators' cooperation because they know that the typical industry partner has no real role in management and no one expects it to be liable (beyond its own investment commitment) for the operator's well-site decisions.

A second inconsistency in the joint-venture and mining-partnership cases concerns whether the operator's status can be defined as a matter of law, or instead poses a factual question for the jury. If the question is the operator's contractual assumption of responsibility for others and the partners' structural dependence, it should be a question of law. In contrast, if the relevant question is whether nonoperators actually exercised control in the joint project, this factual duty could vary with actual involvement. Because courts have not been clear on the true purpose of operator liability (whether it turns upon the structured

("[I]n states other than Texas the conduct of operations under a typical joint operating agreement or other comparable arrangement will likely lead to findings of fiduciary responsibilities between the co-owners and joint and several liability of the co-owners for claims of third parties."); cf. Boigon, *Hostile Environment*, *supra* note 3, at 5-5 ("The JOA, even in its unaltered form, has been construed by the courts in most states—with the notable exception of the Texas courts—to create something more than a passive cotenancy or a mere service contractor relationship."); Lane & Boggs, *supra* note 11, at 238-39 ("Parties entering into agreements for joint development of mineral properties must be aware that they may well be stepping into a new and different world—the world of the fiduciary—where traditional mining concepts of competition, hard bargaining, and jealous guarding of information are replaced with probate court principles of loyalty, acting for another's benefit, and full disclosure."). For others seemingly perceiving a fiduciary duty, see Derman, *supra* note 3, at 41, 71-73 (operator may be mining partner if mutual control exists). Some recent commentators have been much more negative on the fiduciary duty. See *infra* notes 298-99, 302.

control of the operator and nonoperators' powerlessness or, instead (and paradoxically), upon whether they share actual "control" or "cooperation"), they have been inconsistent on whether fiduciary status is a question of law or of fact.

1. *The Joint-Venture Theory of the Fiduciary Operator*

The joint-venture doctrine is a powerful tool in equity. The court, "in order to do justice, declares that a joint venture existed and a fiduciary duty was owed by one of the participants to the other."²⁸ Courts use this legal relationship as an "adjectival," not a substantive, concept.²⁹ It is a legal tool that justifies the decision already made.

Technically, a joint venture tends to require three elements: a "community" of interest,³⁰ an agreement to share profits and losses,³¹

28. 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437.1, at 524. "The most important characteristic of a joint venture is that a fiduciary relationship of trust and confidence arises therefrom." *Id.* at 519 (citations omitted). Each party is owed "full, fair, open, and honest disclosure of everything affecting the relationship." *Id.* at 521.

29. Williams, *The Fiduciary Principle*, *supra* note 10, at 262; *see also* 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437.1, at 524 ("In a sense, 'joint venture,' like 'constructive trust,' is an adjective rather than a substantive concept; its main employment by the courts is to provide a basis on which to find a fiduciary relationship on which to found a constructive trust....[T]he court, in order to do justice, declares that a joint venture existed and a fiduciary duty was owed by one of the participants to the other.").

30. *See* 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437, at 519. The courts have uniformly agreed that the ordinary JOA arrangement, in which each party owns a proportionate share of some common property, satisfies the joint or concurrent ownership test. *But see* Martin, *supra* note 27, at 105-06 (Martin, who does not believe that the typical JOA relationship satisfies *any* of the joint-venture elements, seemingly argues that the JOA does not satisfy the ownership prong of test because the parties do not create a cotenancy through cross-conveyances).

A "farmout" is a related arrangement in which a landowner assigns a lease, keeping a royalty interest, and in the most basic case has an option to convert its interest to a working interest when the farmee has recovered its costs. *See* 2 KUNTZ, *supra* note 24, § 19A.3, at 74-75. The farmor wants its property drilled without risking its cash; the farmee wants to acquire acreage by drilling without paying cash for the lease. *See id.* at 76. Kuntz notes that the farmout "standing alone" does not create a joint venture or mining partnership because there is no mutual control. *Id.* at 81.

Another reason that some distinguish farmouts from joint ventures would be an overly technical reading of the "joint interest" requirement. Gary Conine believes that a farmout may establish the mandated "community of interest" for a joint venture, but questions whether a farmout has the necessary sharing of profits and losses or mutual control. *See* Gary B. Conine, *Joint Ventures in Oil and Gas Contracts: Myths and Reality*, 47 INST. ON OIL & GAS L. & TAX'N 8-1, 8-20, 8-22 (1996). In contrast, he argues that farmout agreements generally fail the mining-partnership test because they do not arrange a "joint interest," which he treats as different from the joint venture's shared-interest requirement. Conine believes that farmouts lack such a joint interest because the farmor does not transfer title until the farmee finishes its drilling obligation. *See id.* at 8-20. Yet while it may be fair not to make the farmor a full partner with liability, for instance, for what the farmee does

and the most disputed element, some amount of "cooperation" or "control."³² This last element means, generally, "some mutual right of control or management of the enterprise."³³ The burden is on the plaintiff to prove the joint venture, with virtually all states applying a preponderance of the evidence standard to the issue.³⁴ Some courts

on the surface of the property, it hardly seems fair to deny that the farmee is a partner in its performance of its drilling responsibilities to the nonoperators. Obviously both sides expect to share in the property. It is their ardent hope that the farmee's contingent interest will harden into a property interest of real value. And it seems to elevate form over substance to pretend that the farmee becomes magically transformed into a fiduciary the moment production is found in payable quantities, but not if, say, some financial subterfuge damages the property before then.

31. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437, at 519. The existence of a joint interest and joint profits and losses is rarely disputed. Martin does argue that JOA parties do not share profits and losses "in the manner generally associated with a mining partnership or a joint venture." Martin, *supra* note 27, at 107. His examples are that the parties' revenues may be different if some take-in-kind, and their costs can be different if they pay out different burdens on the well or have differences in underlying financing. See *id.* Taken literally, this would require an identity in every case of the exact financial position of each party—and if financing is relevant, an identity of tax effects will not be far behind. It is almost never true that JOA parties have exactly the same financial incentive to invest, so this approach seems a recipe designed to defeat joint-venture status. Suffice it to say that by shared profits and losses, the oil and gas cases generally have meant getting shares out of the common production in a largely similar way. Thus, an operator who owned no interest in the acreage and received a fee for drilling would not share profits and losses with the nonoperators, but one who gets a share of the revenue does share in the profits and losses, even though he also receives a variety of direct payments from the nonoperators.

On profits and losses, many courts require only some form of sharing profits, not losses. See generally Boigon, *Liabilities and Relationships*, *supra* note 3, at 8-3 (most courts do not require shared losses or else imply this element). Shared losses may be implied from an agreement to share profits or ignored. See Conine, *supra* note 30, at 8-17; see, e.g., Crosby-Mississippi Res., Ltd. v. Saga Petroleum U.S., Inc., 767 F.2d 143, 147 (5th Cir. 1985) (finding as second ground for decision that parties did not have joint venture where no intent existed to share profits from refining petroleum products).

32. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437, at 519. Joint cooperation or control generally is the "most important" or "pivotal" element and is "usually" the "focus of the courts' analysis." See Conine, *supra* note 30, at 8-16, 8-19, 8-28. It is easily met by "direct involvement" in operations, but, Conine argues, not as often by what he calls "prudent investment activity," such as receiving reports. See *id.* at 8-28 to 8-32. As the text later argues, the actual test is less consistent than this. When courts face facts that they believe should create liability, they tend to find joint control.

33. 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437, at 519.

34. The California Supreme Court reviewed the various state standards in a 1991 opinion and found that, of 25 states (including California) that had addressed the standard of proving a joint venture, 19 seemed to use preponderance of the evidence. *Weiner v. Fleischman*, 816 P.2d 892, 898 n.3 (Cal. 1991). Of the five that used clear and convincing evidence, the only major producing state was Alaska. See *id.*

require proof that the parties "intended" to form a joint venture,³⁵ but intent is not ordinarily listed among the three key elements and the relevant intent may just be to undertake conduct that displays these elements.

The joint-venture doctrine has been so important in the oilpatch because the standard oil and gas investment has shared interests and an agreement to share profits or losses. Thus, the duty can be a convenient peg upon which a court can hang a fiduciary duty, with the only real hurdle to fitting the relationship into the joint-venture category being proof of nonoperator cooperation or control.³⁶ Though one can find statements that a joint operating agreement "will not constitute a joint venture because there is no mutual right of control or management,"³⁷ the typical JOA risks being declared a joint venture when the nonoperators exercise even slight control.

Parties can form a joint venture expressly, but the sharply disputed cases arise when the parties did not address their legal status or disavowed a joint venture. In such cases, courts traditionally have found that parties entering a relationship that satisfies the elements of a joint venture have fiduciary duties to each other. Some courts have suggested that this "objective" standard is appropriate when third parties sue to establish common liability among joint-operations parties, but that subjective intent should control in disputes between the parties.³⁸ It is fair to say, however, that the great majority of operator joint-venture cases do not treat the requirement of an express agreement as a separate element for proving a joint venture.

The standard three-factor test is the most common test for seeing whether the parties have created a joint venture, whatever they say they intended when brought to court.³⁹ Because joint ventures and mining

35. See *Hendrix & Golding*, *supra* note 10, at 10-8 (listing "intention of parties" as a first element of a joint venture); see generally *Misco-United Supply, Inc. v. Petroleum Corp.*, 462 F.2d 75, 79 (5th Cir. 1972) (joint venture "usually a question of fact"); *West v. Kerr-McGee Corp.*, 586 F. Supp. 493, 495-96 (E.D. La. 1984) (including intent as element of joint venture), *rev'd on other grounds*, 765 F.2d 526 (5th Cir. 1985).

36. See *infra* Part VII.C (on the confusion that the control-or-cooperation hurdle has injected into the law).

37. 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437, at 519.

38. See, e.g., *Bolivar v. R & H Oil and Gas Co.*, 789 F. Supp. 1374, 1379 (S.D. Miss. 1991).

39. As Howard Boigon has written on the related mining-partnership doctrine, this relationship often is "imposed by law" and "independent of—often antagonistic to—the contract. Boigon, *Liabilities and Relationships*, *supra* note 3, at 8-4; see also Williams, *The Fiduciary Principle*, *supra* note 10, at 262 (Joint venture can arise from negotiated agreement; "[t]ypically, however, we find the term 'joint venture' employed where the parties to a dispute had not reached any clearly defined formal agreement...."). The prevalence of the JOA means that most joint operations do occur under a formal agreement, one that

partnerships are needed to fill gaps in the law, both tend to arise by implication, often when the parties have not specifically defined their relationship.⁴⁰ Courts apply these standards to reflect the substance of an investment, whatever its technical form. As a result, these fiduciary duties traditionally have not been open to disclaimer: "The fact that a written agreement specifically provides that a partnership is not created will not prevent the finding of a mining partnership if all the elements thereof are present."⁴¹ Thus, operators who sell interests in a common program, with shared profits and losses and some amount of cooperative effort, risk being held to fiduciary standards regardless of the formal structure of the investment.

A close reading of some of the early joint-venture cases shows two underlying bases for the duty: first, the operator's structural assumption of a higher duty or responsibility; and, second, dependence on the part of the investors. This basic understanding has gone astray as courts have retreated to a more formalistic test without considering exactly why they are imposing fiduciary responsibilities.

a. The Operator-Nonoperator Joint-Venture Cases

Oklahoma courts have been most aggressive in their use of joint-venture theories, in both state and federal court. The Oklahoma Supreme Court articulated the basic approach over 65 years ago in *Blackstock Oil Co. v. Caston*.⁴² Blackstock, the operator, concealed good results because it

disclaims any fiduciary duty, with the courts facing the question whether they nonetheless should enforce these tort responsibilities if the parties fit into categories that ordinarily would bear such duties.

For the requirement of agreement, see *Davidson v. Enstar Corp.*, 848 F.2d 574, 578-79 (5th Cir. 1988) (reciting intent requirement and finding "no partnership" language conclusive disproof of joint venture). *But see, e.g., Sigma Res. Corp. v. Norse Exploration, Inc.*, 852 P.2d 764, 766-67 (Okla. Ct. App. 1993) (reciting requirement of "whether the parties intended to establish such a relation," but then noting that the relationship may be inferred and that acts "speak more strongly than the expressed declarations" (citation omitted)); *Dime Box Petroleum Corp. v. La. Land & Exploration Co.*, 938 F.2d 1144, 1147-48 (10th Cir. 1991) (finding joint venture from "express agreement" to share profits and losses in oil and gas ventures, but then interpreting disclaimer language to show agreement on "a standard to measure operator's conduct which is different than that applicable to a fiduciary"). For the place of disclaimers in operator fiduciary jurisprudence, see *infra* Part VI.

40. 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435.1, at 506 (discussing mining partnership, which "more often than not...arises by implication"); *id.* § 437.1, at 525 (discussing joint ventures as a term used when parties did not have "any clearly defined formal agreement").

41. *Id.* at 506. At the same time, some states limit the managing partner's ability to bind the partners without written authority. See *id.* at 507.

42. 87 P.2d 1087 (Okla. 1939).

wanted to buy out its investors before drilling a second well on the joint property. The case centered on this concealment.⁴³ The investors, who sold their interests, sued when they learned of the later success of Blackstock's drilling operations.

The court decided that the investors should get their property back because they were parties to a joint venture.⁴⁴ For this reason, they were entitled to rest their "trust and confidence" in Blackstock.⁴⁵ Blackstock, in turn, had to give the "fullest and fairest explanation and communication of every particular resting in the breast of the one who seeks to establish a contract with the person so trusting him."⁴⁶ The advantage Blackstock seized by concealing geologic information voided its repurchase contract. The court affirmed the lower court's finding that the failure to reveal the prospects for the first well, including the possibilities of well stimulation through acidization (a procedure in which Blackstock was expert), breached its fiduciary duty.

Perhaps the most important feature of *Blackstock* is that the Oklahoma Supreme Court did not engage in a narrow, mechanical analysis. The fiduciary duty was to prevent "the party in whom confidence is reposed" from obtaining "an apparent advantage over the other in a transaction between them."⁴⁷ This is standard fiduciary analysis in other areas of the law, where courts exercise their equitable powers to protect the vulnerable.

Blackstock is representative of many courts that have found standard operating arrangements to be joint ventures as a matter of law. Having cited with approval the principle that a joint venture is "fiduciary in its character,"⁴⁸ the Oklahoma Supreme Court pointed to the nonoperators' delegation of power and the operator's duty to act for its partners. It likened the operating tie to other relations of confidence that "enable[] the person in which confidence or trust is reposed to exert influence," the operator to other parties given confidence who "obtain[] an apparent advantage," and the repurchase to other transactions "by

43. Blackstock's conduct was egregious. The plaintiffs, who prevailed in a bench trial, alleged among other things that Blackstock had hit a productive oil-bearing zone but kept drilling into salt water to conceal the good news; that it falsely told them the well "was a water well and would produce only a small quantity of oil" but that, as an expert in acidization, Blackstock quickly stimulated the well after buying back their interest and then produced a very successful well. *See id.* at 1088.

44. The court did not cite any test for a joint venture or, in this context, discuss the factual relationship between Blackstock and its investors, but instead simply recited the standard conclusion that a joint venture is fiduciary "in its character." *Id.* at 1089.

45. *Id.*

46. *Id.*

47. *Id.* (citation omitted).

48. *Id.* (citation omitted).

which the superior obtains a possible benefit."⁴⁹ Blackstock's assumption of a higher responsibility and the nonoperators' corresponding dependence were the key factors. This standard parallels Howard Williams' later prediction that those who act for others and handle their property would increasingly be held to fiduciary standards in the oilfield.⁵⁰ Tellingly, the court did not belabor the acts of cooperation technically required to prove a joint venture. It was the operator's superior position, not these elements, that explained Blackstock's fiduciary duty.

The Tenth Circuit followed *Blackstock* several decades later in *Britton v. Green*.⁵¹ The substantive dispute was whether the operator, Britton, had failed to drill enough wells, allowed drainage, billed excessive costs, and appropriated storage tanks from the joint property.⁵² The court ruled as a matter of law that entry of an "operating contract had the effect of constituting Britton the operating agent or trustee for all the co-tenants, in all matters respecting the operation of both leases."⁵³ A trust relationship does not exist generally between cotenants, but appointing one to manage their affairs created a fiduciary duty:

[W]hen as here, co-tenants undertake to designate a cotenant as operating agent, to exploit the cotenancy for their mutual profit, they become co-adventurers in the enterprise, and stand in a fiducial relationship to each other and to the operating agent....As operating agent, the co-tenant assumed to act for and on behalf of his co-tenants, and he is thus the trustee for his co-tenants and co-adventurers.⁵⁴

What the court was describing is the structure that exists among equity owners who use the standard JOA to designate their operator; consistent application of *Britton* would make the majority of operators fiduciaries.⁵⁵

49. *Id.* (citations omitted).

50. Williams, *The Fiduciary Principle*, *supra* note 10, at 274-75.

51. 325 F.2d 377 (10th Cir. 1963). The court cited *Blackstock* among other cases. *See id.* at 383.

52. For a full listing of the claims, see *id.* at 384, 385 (Phillips, J., concurring).

53. *Id.* at 383 (emphasis added). This ruling came as part of a hearing on appointing a receiver. The immediate question was narrow: whether notice to the operator was notice to nonjoined tenants. (It would be if they were in a joint venture.) The court gave no sign that it was resolving disputed facts, or doing anything other than describing the ordinary legal effect of the operating agreement, when it announced the legal standard it would apply to the operator/nonoperator relationship.

54. *Id.* (emphasis added).

55. A concurring judge brought the holding more specifically under joint-venture law: Under the law of Oklahoma, where one or more owners of undivided interests in an oil and gas lease enter into an agreement with another

Britton followed the equitable principle, drawn from trust and agency law, that one who chooses to act for others will be held to the highest standards as a matter of law. In explaining why appointing an operating agent creates a "fiducial relationship," the court mentioned the operator's assumption of a higher duty and its resulting control over the others. The "co-tenant assumed to act for and on behalf of his co-tenants, and he is thus the trustee."⁵⁶ In other words, the co-tenant assumed a higher duty of care by the nature of his undertaking. In addition, the co-tenant enjoyed special control as it was "in possession of the leaseholds, with the power and duty to operate them for the mutual profit of all co-tenants."⁵⁷

Neither *Blackstock* nor *Britton* applied a three-part joint-venture test. Under that test, the element of control or cooperation is the element that creates the "greatest difficulty."⁵⁸ All but a handful of the joint-venture and mining-partnership cases concentrate on this third element. When courts wanting to afford fiduciary protection do use these tests, they often pretend that the slightest nonoperator monitoring is "control" or "cooperation." Yet in reality, they strive to protect the same dependence as in *Blackstock* and *Britton*. An example is *Oklahoma Co. v. O'Neil*.⁵⁹ Here the Oklahoma Supreme Court ultimately imposed a duty of full disclosure in accounting and geologic details. The Oklahoma Company overstated its lease costs and other expenses, urged investors to rely on the report of an engineer whom it paid a secret commission, carved royalties from the joint property without notice, and misstated production.⁶⁰ Instead of discussing the operator's general duties like the *Blackstock* and *Britton* courts, the supreme court looked to see if the parties could satisfy the three-part joint-venture test: (1) a joint interest,

owner...to drill a test well on the lease and thereafter operate and manage the lease, *the relationship between the parties is that of joint adventurers*, and an undivided owner who is to manage and operate the lease stands in a fiduciary relationship to his coadventurers and is bound to exercise the "utmost good faith" in managing and operating such lease and reporting and accounting to his co-owners with respect to such management and operation.

Id. at 384, 387-88 (Phillips, J., concurring) (emphasis added).

56. *Id.* at 383.

57. *Id.* at 384.

58. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.2; Boigon, *Liabilities and Relationships*, *supra* note 3, at 8-12 (mutual control "often proves most important" in joint ventures as in mining-partnership cases); Hendrix & Golding, *supra* note 10, at 10-8 (mutual control requirement is "most likely to defeat" joint venture).

59. 440 P.2d 978 (Okla. 1968).

60. See *id.* at 985.

(2) an express or implied agreement to share profits and losses, and (3) "acts or conduct reflecting cooperation in the project."⁶¹

Though the court paid lip service to the need for "cooperation," it did not treat the requirement seriously. All the nonoperators did was make one visit to the well site and examine their leases.⁶² The court transmuted this passivity into "cooperation" in a holding that really meant that it was not requiring cooperation: "the defendants left the management and operation of the leases to the plaintiff. This conduct amounted to cooperation *under these circumstances*."⁶³ If such inconsequential acts really are "cooperation," then the standard operating agreement generally would be a fiduciary agreement.

61. *Id.* at 984–85. The court called this triumvirate the "well recognized requirements for determining whether a business relationship between two or more persons constitutes a joint adventure." *Id.* at 984.

62. *See id.* at 985.

63. *Id.* (emphasis added). The cases use the terms "cooperation" and "control" loosely in describing the third element of the joint venture. The terms have very different implications, with "cooperation," which means broadly "working together to same end," presumably easier to satisfy from limited activity than "control," the "power of directing, command; restraint." H.W. FOWLER, FOWLER'S CONCISE ENGLISH DICTIONARY 248, 250 (1989). The operator and nonoperator generally set out to share profits from the joint acreage, and so share the "same end," but with article V.A of the standard JOA delegating "full control" over the property to the operator, tests focusing on actual control often can only be satisfied in courts with a strong taste for fiction.

In *Oklahoma Co. v. O'Neil*, the existence of a fiduciary duty proved key to holding the operator liable. In a prior decision, the Supreme Court had found, by a five-to-four vote, that the Oklahoma Company's oral representations were merged into the operating agreement, which it believed was not breached, in the absence of a fiduciary's duty to speak. *See Oklahoma Co. v. O'Neil*, 333 P.2d 534 (Okla. 1958). The fact that the parties' agreement disclaimed any partner or mining-partnership relationship seems to have persuaded the panel to preclude a fiduciary duty. *See id.* at 542–43. In 1967, nine years later, after one Justice signed an affidavit that admitted that he had been bribed to vote for the defendants, the court declared its prior decision void and recalled the mandate. *Oklahoma Co. v. O'Neil*, 431 P.2d 445 (Okla. 1967). The 1968 decision discussed in text, in which the court treated the operator as a fiduciary and found it liable for many breaches, followed. There the court admitted parole evidence of fraud and breach of fiduciary duty in spite of the operating agreement's provision that it did not create a partnership-type agreement. 440 P.2d at 986.

One author has argued that *Oklahoma Co. v. O'Neil* should be read and distinguished as a fraud case and that the Court "arguably would not have been so willing to find the element of cooperation satisfied" otherwise. Philip Watts, *Contingent Liability of the Passive Working Interest Investor Under Operating Agreements in Oklahoma*, 54 OKLA. B.J. 2797, 2801 (1983) (analyzing case in article on mining-partnership liability). Watts claims that upon remand the court never revisited the disclaimer issue. *See id.* at 2802. Yet fraud is a distinct tort from breach of a mining partner's duty, and not a word in the case makes the partnership analysis turn on findings about fraud. Watts does correctly note that under the Oklahoma Supreme Court's analysis, the standard JOA should be enough to prove cooperation.

Though the outcome of *Oklahoma Co. v O'Neil* was the same as *Blackstock* and *Britton*, the approach was inexplicably different. Gone was the express emphasis on the operator's assumption of control and investor dependence. Now these factors were reversed, with the nonoperator required to prove its own control in order to qualify for extra protection, and the Oklahoma Supreme Court then having to pretend that the slightest acts were enough cooperation so that it could satisfy the three-part test but still protect the nonoperating investors as in the earlier cases.

The Texas Supreme Court endorsed a broad general approach to joint ventures in *Rankin v. Naftalis*,⁶⁴ even though ultimately it did not find a fiduciary breach. The parties shared an interest in one lease, the Melton lease, on which operator Rankin had promised to drill a well. But Rankin also promised that he would acquire an adjoining lease for the common venture. It turned out that his promise was not true. In one of the oilfield's classic frauds, Rankin used his promise to buy time and prevent his partners from bidding while he cornered the lease for himself.⁶⁵ The jury found the parties "were jointly engaged in the business of operating the Melton lease, sharing income and expenses accordingly to their ownership interests,"⁶⁶ and the court held that this finding established a joint venture.⁶⁷ It even claimed that the jury's

64. 557 S.W.2d 940 (Tex. 1977).

65. For the jury finding on Rankin's promise, see *Naftalis v. Rankin*, 542 S.W.2d 893, 895 (Tex. Civ. App. 1976), *rev'd on other grounds*, 557 S.W.2d 940 (Tex. 1977). Rankin's alleged conduct was egregious. Dr. Naftalis alleged that Rankin promised he would get the lease when the lessor, Orsak, "was in the right mood"; another plaintiff confirmed that Rankin promised he would obtain the lease for them all; and others testified that Rankin told them that "Mr. Orsak was difficult to deal with, for them to leave Orsak alone and that he, Rankin, would get the lease for them." *Rankin*, 542 S.W.2d at 896. Rankin marketed his properties with a map containing a red circle marked "location" on the Orsak lease. *Id.* at 895. He apparently also lied by telling the plaintiffs that he had not been able to get the Orsak lease, after he had secured it. See 557 S.W.2d at 942. Thus, *Rankin* is not a case where nonoperators refused to risk their money but then tried to horn in on a more entrepreneurial operator after it had risked its own funds to drill a producing well. Instead, it is one in which the operator lied to the nonoperators in order to exclude them from a benefit that they reasonably expected to share and did so to avoid the competition for leases that would have occurred had he told them the truth.

66. *Rankin*, 542 S.W.2d at 895.

67. The court of appeals cited such authorities as *Texas Jurisprudence* for the principle that this kind of shared activity creates a joint venture. See *id.* at 896. Given the very broad jury issue used in *Rankin* and the Supreme Court's strong language, *Rankin* is close to a case that treats the operating relationship as a fiduciary-joint venture as a matter of law. For this reading, see, for instance, *Fuqua v. Taylor*, 683 S.W.2d 735 (Tex. App. 1984), in which the court of appeals held a geologist who put an operating project together to a fiduciary duty after deciding that whether the duty exists was a legal question, treated *Rankin* as a case that "recognized that the relationship...of joint venturers for the development of a

finding was merely "confirm[ing] such facts."⁶⁸ Of course, almost all JOA parties are "jointly engaged" in operating their lease while sharing proportionate income and expenses.

The Texas Supreme Court reversed *Rankin*, but it blessed *Rankin's* basic fiduciary determination. Without specifically relying on the jury's joint-venture finding, it observed that "we recognize that the relationship between the parties in the Melton lease was fiduciary in character," that "[t]heir fiduciary duties arose from the relationship of joint ownership of the mineral rights of a particular mineral lease," and that this enterprise extended "to paying the production costs" and

particular oil and gas lease, is fiduciary in character," but, as in *Rankin*, held that the duty was limited "only to dealings within the scope of that relationship." *Id.* at 737-38. This meant that the defendant had to share leases within the parties' letter agreement, but not those outside it.

Rankin should not disguise the principle that, in general, an operator cannot acquire leases within the scope of the venture but withhold them from its coventurers. In *Peckham v. Johnson*, 98 S.W.2d 408 (Tex. Civ. App. 1936), *aff'd*, 120 S.W.2d 786 (Tex. 1938), two parties joined to acquire and operate leases, but one ended up taking over the active management of the properties. *See id.* at 410. When he began receiving quite valuable offers for the property, he bought out his supposed partner without telling him of the pending offer. *See id.* at 411. Here too, as in *Rankin*, an operator lied to conceal a benefit it wanted for itself. The court, which alternatively used language of partnership and joint ventures, seems to have treated them as partners as a matter of law. The court found that the parties had entered into a "mining copartnership" and refused jury issues that would have let the jury decide if the parties were acting at arm's length. *Id.* at 411-12. The court remanded the case for recalculation of damages, with the supreme court rejecting the court of appeals' separate holding that the fiduciary duty could be extinguished if the parties had such a falling out that they no longer subjectively trusted each other. *See Peckham*, 120 S.W.2d at 787-88. If "strained relations" were enough to defeat a fiduciary's obligation, then "a designing fiduciary could easily bring about such relations to set the stage for a sharp bargain." *Id.* at 788.

In *Whatley v. Cato Oil Co.*, 115 S.W.2d 1205 (Tex. Civ. App. 1938), the court reversed dismissal of the plaintiff's case and held that "the record, we think, discloses a joint enterprise" from the parties' written agreement appointing the defendant to operate certain properties. *See id.* at 1209. The court remanded the case, in which the defendant had acquired in its own name a lease bought, at least in part, with joint proceeds and whose purchase was "contemplated at the time of the formation of the joint enterprise." *Id.*

68. *See Rankin*, 542 S.W.2d at 896. *Rankin* admitted that the parties were "jointly engaged in the production of oil from the Melton lease" and had agreed to share proportionate income. The court of appeals and the supreme court did throw one wrench into the works by requiring, for the constructive trust remedy sought by Naftalis and his co-plaintiffs, that the fiduciary duty exist before and apart from the disputed agreement. *See id.* at 897; *Rankin*, 557 S.W.2d at 944. This requirement is not part of the ordinary three-part joint-venture or mining-partnership test. The court seems to have confused the longstanding relationship required to prove an informal relationship of trust and confidence, compare *infra* Part III.G, with the joint-venture duty that the *Rankin* plaintiffs were trying to prove.

"sharing the benefits" of that lease.⁶⁹ Moreover, the court equated Rankin with other per se fiduciaries—executors, administrators, guardians, attorneys, and partners.⁷⁰ This kind of analysis could make almost any joint development of an oil or gas property with shared costs and expenses a joint venture as a matter of law. But for the disclaimer cases discussed in Part VI, it is hard to see how any faithful post-Rankin court in Texas could fail to at least send the fiduciary issue to the jury.

Rankin's influence as a fiduciary case has been less than one might expect, however, because of the Texas Supreme Court's other finding, which was that the disputed lease lay outside the joint venture. The court was visibly troubled by the plaintiffs' failure to complain when they first learned that Rankin was drilling on the Orsak lease. Instead, the plaintiffs waited until they knew he had completed the other well as a producer.⁷¹ The court reversed the court of appeals, however, on an ostensibly different ground; it found no liability because Rankin's duty did "not extend past the development of the particular lease and

69. See *Rankin*, 557 S.W.2d at 944. The plaintiffs sought affirmation based on the jury's finding of a joint venture, a finding the Supreme Court duly reported. See *id.* at 943. The court wrote the rest of its opinion, however, without discussing why the contemplated second lease, which the parties had discussed as a joint concern, was not within the scope of their intended venture.

70. See *id.* at 944. Rankin holds clues to another problem that has bedeviled operator jurisprudence, that of partnership disclaimers. The plaintiffs tried to argue that they had a "broader partnership arrangement" with Rankin, one that extended beyond the Melton lease. In rejecting this argument, the supreme court cited the provisions that in 1977 were codified at Texas Revised Civil Statute Annotated, article 6132b, which in section 7 stated that operating a property under a JOA "does not of itself establish a partnership." See *Rankin*, 557 S.W.2d at 945. The court agreed that proof of a joint operating relationship would not sustain a formal partnership finding (which would not be limited to the specific venture). It cited one reference suggesting that this statute was intended to prevent unintended liability for other partners' debts. See *id.* at 946, 946 n.6. What is important about the court's approach is that it treated the joint-venture fiduciary issue as separate from standard partnership liability. The disclaimer of a partnership did not also disclaim a joint venture.

71. The delay, which clearly bothered the court, actually was very slight. Rankin leased the Melton property sometime after May 1973 and completed his well on it in May 1974. He bought the Orsak lease in August 1974 and filed it in October, but the plaintiffs did not learn of it until after Rankin completed his Orsak well as a producer in May 1975. They sued in May, but did not claim part of the Orsak lease until July 14, 1975, when they had learned that Rankin's well was successful. See *id.* at 942-43. This was at most a two-month delay. Rankin pled estoppel by silence, but the court of appeals rejected that defense because Rankin showed no fraud or misrepresentation by the plaintiffs. See *Rankin*, 542 S.W.2d at 900. Rankin apparently did not contest this on appeal, because the supreme court opinion does not address his estoppel defense. One way to read the supreme court's opinion is that it reached (overreached) for the excuse of the geographic limitation when it really wanted to punish the plaintiffs for their delay, but did not have a legal leg to stand on because the delay was so slight and the estoppel issue was not appealed to it.

activities incident to that development."⁷² Rankin did not have to share interests outside the venture's boundaries, so the court's strong language on operator duty is dictum.

Rankin's constriction of a fiduciary's duty in property acquisition to the geographic area of the joint investment is not only a Texas rule; it is the general rule for the industry.⁷³ The geographic limit is a

72. *Rankin*, 557 S.W.2d at 945. The court held that "evidence of a joint operating arrangement to develop a particular lease will not support a finding of a broader relationship." *Id.* at 946 (citations omitted). The oil and gas industry includes a wide variety of companies, including major oil companies and independents, that compete with each other across the country. The industry has devised its own legal forms, not just the joint operating agreement but also farmouts, leases, unit agreements, and a range of partnership and other contracts, to facilitate these combinations in individual ventures. This great inventory of possible legal relations allows parties to select among minute divisions of risk and benefits. These legal forms have helped this very capital-intensive industry raise the funds needed to support intensive exploration and development in the United States. Given the flexibility required by combinations on a project-by-project basis, it is little surprise that courts have restricted the geographic reach of operating projects. What is odd is that the Texas Supreme Court chose *Rankin*, whose facts justify a broader duty, as the lead case to represent appropriate geographic restrictions.

73. The *Rankin* court cited *Foley v. Phillips*, 508 P.2d 975 (Kan. 1973), for the same principle. The parties in *Foley* agreed that they were in a joint venture, and the court gave a strong definition of the resulting duty: "The relationship of coadventurers in oil and gas ventures is one of trust and confidence in all matters respecting the conduct and operation of the business for which the joint venture was formed...." *Id.* at 979. Yet it affirmed the trial court's determination that the defendant did not have to share mineral interests outside the initial lease area, on the principle that "[t]he fiduciary relationship created by a joint drilling venture does not forbid further acquisition and development of leases in the general area by individual venturers so long as these leases are not embraced within the scope of the enterprise or are not a natural outgrowth therefrom." *Id.* (emphasis added). *But see* Smith, *Duties and Obligations*, *supra* note 24, at 12-56 (arguing that *Foley* permits a reading that operator's duty can extend outside venture area to areas needed to fully exploit reservoir discovered).

For added cases, see *Warner v. Winn*, 197 S.W.2d 338, 341-42 (Tex. 1946) (operator in joint venture may stand in fiduciary relationship, but duty narrowed to leases involved in enterprise); *British American Oil Producing Co. v. Midway Oil Co.*, 82 P.2d 1049, 1053 (Okla. 1938) (rejecting nonoperator's effort to force operator to share leases, and reversing trial court to that extent, on leases operator had acquired in Oklahoma City area outside of leases listed in the venture's Exhibit A; even though fiduciary principles "apply here," they did only for "the property involved and the existing property rights."); *Colpitt v. Skelly Oil Co.*, 499 P.2d 415, 419-20 (Okla. 1972) (sustaining demurrer where unit owners had tried to force unit operator to share its interests in an adjoining property that benefited from the unit's waterflood; property was outside scope of enterprise even if unit was treated as joint venture). *Cf.* *Carey v. Humphries*, 107 N.W.2d 20 29-30, 33-37 (Neb. 1961) (in claim for right to share adjoining property, holding that arrangement in which lessee assigned its working interest to driller and kept only overriding royalty and some cash, was not joint venture, and in fact lacked virtually every element of a joint venture, but also stressing absence of any listing for disputed properties in Lots 1 and 2 in the underlying transfer agreement over Lot 3, so that even if the parties had been joint venturers, it "would not, necessarily, entitle appellants to an adjudication of a constructive trust.").

In *Jeanes v. Henderson*, 703 F.2d 855, 857 (5th Cir. 1983), the Fifth Circuit used the basic *Rankin* analysis to bolster a very stingy construction of a joint venture, which came into being to drill five wells but also to let the investor share in the operator's additional exploration and acreage acquisitions, as well as giving him a preferential right to purchase the operator's interest. The court limited the venture and its fiduciary duty to developing the first five wells. *See id.* at 858. It worried that "the financing of drilling ventures already inherently perilous could be further impeded by the increased risk of claimed breaches of fiduciary duty presented by ill defined obligations." *Id.* at 859. For this reason, it refused to extend the fiduciary duty to what it called "future development," in spite of clear language that the plaintiff was to share in the operator's additional exploration or leases and to have an "option to purchase all of his Interest should he ever decide to sell his Interest." *See id.* at 857. In violation of ordinary rules of contract construction—that clear language speaks for itself—the court let the operator testify that he did not "intend" the option to cover all of his acreage. *See id.* at 861.

For an interpretation of one AMI (area of mutual interest) clause, construing a formal partnership agreement that required sharing within the "area of interest owned" to extend at least to contiguous leases, see *Palmer v. Fuqua*, 641 F.2d 1146, 1154-55 (5th Cir. 1981).

Courts may limit joint ventures in time as well as in space. Thus, an operator's claim for expense reimbursement can be cut off, in spite of a joint adventure for the scope of the operating relationship, once the investor terminated the contract. *See, e.g., Wilcox Oil Co. v. Empire Oil of Tex.*, 195 F.2d 860, 862-63 (5th Cir. 1952) (company in joint adventure not liable for costs of drilling beyond consented-to days of drilling); *Smith v. Bolin*, 261 S.W.2d 352 (Tex. Civ. App. 1953) (affirming summary judgment requiring defendant to share property with plaintiffs when their written partnership had terminated, as had a joint venture that expired as the subject leases expired), *rev'd in part, aff'd in part*, 271 S.W.2d 93, 97 (Tex. 1954) (reversing in part because fact issues existed on existence of duty at time of acquisition on one of the disputed properties). The lower court opinion in *Smith v. Bolin* has a deceptive simplicity. The defendant let the underlying leases expire and then re-leased them in his own name little more than two months later. *See* 261 S.W.2d at 358. The court found no liability via a rigid holding that the plaintiffs had to prove that knowledge acquired during the partnership relation "must have been, of itself, the causative factor" in re-leasing, and that there was no evidence that information learned from the joint venture "was either sufficient unto itself" to cause the re-lease, or "was the causative factor." *Id.* at 366, 369 (emphasis added). The evidence showed that the operator made the new lease "at least in part, because of knowledge [defendant] acquired independently" from the trust relations. *See id.* at 369 (emphasis added).

Rejecting this all-or-nothing standard, the Texas Supreme Court understandably reversed to let a jury weigh the source of the defendant's knowledge. 271 S.W.2d at 95-96. It recited a few choice facts that give the case a decidedly different flavor than the lower court's rendition. For instance, when the defendant who later secured leases for himself was asked to renew the leases for the joint account, he said, "We could no more get that than we could get wings and fly to Heaven this afternoon." *Id.* at 95. Apparently he took this impossible flight, but on a solo trip, just a few months later.

Courts should treat whether a defendant used secret knowledge in re-leasing within months of the expiration of a primary lease as a fact issue. Parties who re-lease property within days or weeks of letting a lease lapse and do so for a profit should not be surprised by litigation that tests the information upon which they relied and the genesis of the later lease.

In a fairly recent twist on the temporal scope of the duty, the Oklahoma Supreme Court affirmed a summary judgment for the operator in *ENI Producing Properties Program*

Ltd. Partnership 1982-I v. Samson Investment Co., 977 P.2d 1086 (Okla. 1999). Samson was the unit operator under a 50-year term interest from the United States but had one of its subsidiaries lease the future interest three years before the term expired. The operating agreement required Samson to notify the nonoperators of any lease renewal and allow them to share the extension, but the court held that "lease of a future interest, maturing upon expiration of a term reservation, simply is not a renewal or extension of an existing lease." *Id.* at 1088. The court claimed that all parties had been aware of the term reservation, and so could have protected themselves. *Id.* at 1089. Though agreeing that the unit operator is a fiduciary, the court also found that, even though Samson was the unit operator over this geographic area when its subsidiary acquired the future interest, the dispute "does not involve Samson's operation of the unit." *Id.* at 1088. The court treated this future acquisition as just as remote as an operator's acquisition of property outside the unit area. *Id.* at 1089. All this begs the question. The fiduciary duty often imposes additional, unwritten duties on the operator, and the interest owners surely felt that the operator would not act against their mutual interest while it was operating the unit. Moreover, the nonoperators surely felt protected by their contractual right to share any lease renewal, a basic right that should not have been defeated by the technicality that, on this rare occasion, the renewal came in the form of a future interest. Samson's subsidiary acquisition is just a top lease by another name.

Though joint ventures can be terminated, courts should not require a preexisting fiduciary duty to find a joint venture. The requirement of a long, close relation applies in at least some states to the "informal" fiduciary relationship that must be proven from a close relation of trust and confidence, but it does not apply to per se fiduciary duties. See *Eglin v. Schober*, 759 S.W.2d 950, 953-58 (Tex. App. 1988) (discussing this issue where the jury found a joint venture to acquire certain acreage, but that a fiduciary relation did not precede disputed acquisition, and rejecting effort to require such a prior relationship as a condition precedent for a joint venture).

Naturally, a joint venture can contain a condition subsequent. In *Heritage Resources, Inc. v. Anschutz Corp.*, 689 S.W.2d 952 (Tex. App. 1985), the parties had a formal joint venture, but the plaintiff failed to pay the Authority for Expenditure (AFE) within the requested time and lost its right to share in a producing well. In *Luling Oil & Gas Co. v. Humble Oil & Refining Co.*, 191 S.W.2d 716, 720 (Tex. 1945), the Texas Supreme Court found the question of a joint venture not "the controlling issue" in a dispute over accounting charges. The contract "clearly fix[ed] the time of adjusting the accounts and the time when Humble was to pay whatever was due Luling" under it. *Id.* at 721. The court also seemed to believe that the contract's failure to authorize either party to create third-party liability precluded a partnership arrangement. It held that joint owners may appoint an operator "without creating a joint adventure or a mining partnership." See *id.* at 722.

In *Madrid v. Norton*, 596 P.2d 1108 (Wyo. 1979), the trial court found that the parties had entered three successive joint ventures to acquire leases for resale, but then terminated their arrangement. As a result, the defendant did not have to share its interest in a successful well drilled on a lease they had "discovered," but not acquired, during their earlier joint examinations. See *id.* at 1113. The Wyoming Supreme Court held that "an acquisition after the termination is outside the scope of the joint venture." See *id.* at 1121. The parties had ended their last venture on January 15, 1975, and the defendant began negotiating the new lease on January 29. See *id.* at 1112-13. It is too strong a reading to suggest that *Madrid* represents the principle that anything goes once a joint venture is terminated. The court put great weight on facts suggesting that the parties seem to have agreed that three leases should be treated like an area of mutual interest after the last venture expired (and that they in fact shared interests in these areas), but not the disputed property. See *id.* at 1115. In addition, the trial court was troubled by the plaintiff's waiting

until the disputed property was proven productive before suing. As the supreme court noted in agreement:

Courts look with disfavor upon the claims of those who lie idle awaiting the results of development. The waiting may be years, months, or days, depending on the circumstances. There is an inherent injustice in one purportedly holding a right to assert an ownership in property to voluntarily await the propitious event and then decide, when the danger which has been at the risk of another is over, to come in and claim a share of the profits.

Id. at 1120.

These cases over joint venture duration should not be read to suggest that an operator can sit on an offer within the area of interest until the venture expires, and then accept it for its own account. The lead case rejecting such a proposition is the lead fiduciary case, Justice Cardozo's decision in *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (Ct. App. 1928), in which the hotel operator did just that and was soundly rebuked, with damages following, by Cardozo. See *infra* notes 456-462 and accompanying text. For the principle in the oilfield context, see the Kansas Supreme Court's order affirming imposition of a constructive trust against joint venturers where one plaintiff had sent a letter announcing expiration of the mutual endeavor, but the other venturers had disagreed and not signed it. See *First Nat'l Bank & Trust Co. of Okla. City v. Sidwell Corp.*, 678 P.2d 118, 124-25 (Kan. 1984). The defendants had acquired their interest "solely on the valuable and confidential geological information generated and submitted to them by plaintiff Woolsey." *Id.* at 126.

Thus, if one boundary of the acreage cases is that parties will be free to compete vigorously outside any defined area of mutual interest (and that the scope of the venture will have to be decided as a question of fact, but it is likely to have some limit even if there is no written area of mutual interest), another is that joint venturers cannot use joint confidential information to their private advantage. Courts will strain to prevent them from doing so. See *Madrid v. Norton*, 596 P.2d at 1116 (distinguishing its facts from cases where courts have extended fiduciary protection because of use of confidential information); see also *Omohundro v. Matthews*, 317 S.W.2d 771, 774, 777 (Tex. Civ. App. 1958) (affirming judgment in joint venture among overriding royalty interest owners to obtain and secure development of leases, where defendant obtained new lease four days after joint lease expired and refused to share interest; jury found, among other things, that defendant concealed information about the new lease and used "information and materials" from joint activity to secure the separate lease; the court of appeals also rejected defendant's position that the parties' falling out and their decision to avoid future ventures permitted the defendant to escape his obligations on current venture), *aff'd*, 341 S.W.2d 401 (Tex. 1960).

One opinion that drew a tight restriction on the scope of a joint venture is *Patton v. Callaway*, 522 S.W.2d 252 (Tex. Civ. App. 1975). The parties set out to acquire leases for resale, with the purpose of sharing profits and royalties. *Id.* at 254. When the intended resale looked unlikely, one of them drilled a well on a loan from El Paso Natural Gas Company but kept the resulting 50% overriding royalty for itself. See *id.* The court found no joint venture based on plaintiffs' testimony that they were not to share costs (and so were not at risk in drilling) and that the resale project was solely under defendants' control. *Id.* at 256. Only the imperfection of joint-venture theory could let the court avoid the obvious conflict of interest for a party in this operator's position—allowing the operator to choose between having to share resale profits or keeping all of the gain for itself if it drills a well—and the apparent concealment of the drilling opportunity at a time when the defendants were supposed to be acting for the mutual interest in seeking a buyer.

compromise with the exigencies of an industry composed of many independent, competing companies.⁷⁴ This geographic limitation on the scope of the operator's duty increases the nonoperators' risk from inactivity (the risk of relying on the operator to develop a large area for the joint account) and, in general, favors development over asset holding.

On its facts, the final holding in *Rankin* seems unnecessarily harsh. It let Rankin deceive his nonoperators and lull them into inaction while swooping up choice outside territory.⁷⁵ It encourages operators to cheat their investors on properties just beyond the immediate scope of their venture.

Unfortunately, none of these joint-venture cases rigorously explains its holding. In *Rankin*, the Texas Supreme Court did not discuss why the standard operating arrangement is a joint venture.⁷⁶ In *Oklahoma*

Courts have restricted or denied an operator's joint-venture liability in other areas where liability would create odd results. An operator won summary judgment on its alleged failure to drill an additional well, when it knew of drainage from a well it drilled on an adjoining property in *Tenneco v. Bogert*, 630 F. Supp. 961 (W.D. Okla. 1986). The court found that "even though the present joint operating agreement may be seen to create a joint venture with attendant fiduciary duties," still, these duties were "controlled by the terms of the agreement between the parties." *Id.* at 967. The nonoperator, Tenneco, did not allege that the operator breached any term of the operating agreement. *Id.* at 966. Any party could propose drilling an additional well. *Id.* at 968. The court could "find no basis for reading into the parties' contract a fiduciary duty obligating Buck to drill an additional well" just because of the drainage. *Id.* at 969. For added discussion of *Tenneco v. Bogert*, see *infra* notes 310-313 and accompanying text.

For a court following *Rankin* in the somewhat different context in which an operator and investors sought to impose liability on their landman-partner, a party to what the court called an "oral partnership agreement," but with the duty again restricted to covered leases only, see *McAlpin v. Sanchez*, 858 S.W.2d 501, 508 (Tex. App. 1993) (the court finding a fact issue on another ground).

74. See *infra* note 233 and accompanying text.

75. It is worth reiterating that what really may have bothered the Texas Supreme Court was the nonoperators' waiting until Rankin had developed the property before claiming the outside acreage. See *supra* note 71. Yet Rankin pled estoppel, lost, and did not appeal on that defense. See *Rankin*, 542 S.W.2d at 900. It was hardly fair to gut the fiduciary duty just to resurrect a defense that might intuitively appeal to some Justices, but that Rankin could not sustain before the jury.

76. As a result, the robust portions of *Rankin* were quickly diluted by lower courts. In *Hamilton v. Texas Oil & Gas Corp.*, 648 S.W.2d 316, 321 (Tex. App. 1982), the court argued that Rankin permitted a fiduciary duty only upon a finding of a joint venture. In *Norman v. Apache Corp.*, 19 F.3d 1017, 1024 (5th Cir. 1994), the Fifth Circuit cited *Rankin* for the proposition that a JOA does not create a "'broader relationship,' such as a partnership or joint venture," even though the language cited from *Rankin* clearly was discussing a formal partnership but not a joint venture. See also *DERMAN*, *supra* note 3, at 81 (*Rankin* "has been cited to support the proposition that a joint venture or partnership does not exist or exists only in very narrow terms"); cf. *Boigon, Liabilities and Relationships*, *supra* note 3, § 8.03[2], at 8-30 (*Rankin* was "more difficult to classify," because the court so limited the duty it did

Co. v O'Neil, the Oklahoma Supreme Court used the three-part joint-venture test without explaining why investors should have to prove cooperation to qualify for higher protection, and then largely ignored the requirement. In *Blackstock* and *Britton*, neither court fully explained the link to basic principles of agency and trust law, even though the link seems obvious on their facts.

No doubt partly due to their poor articulation, per se analyses like *Blackstock* and *Britton* have not fully carried the day. The lack of clear explanation has encouraged some later courts to adopt inconsistent joint-venture analyses, refusing to find cooperation on similar facts when they do not see the same driving need to protect nonoperators. Though *Blackstock* and its progeny generally treat the existence of a joint venture as a matter of law, other joint-venture cases treat it as a question of fact.⁷⁷ While *Blackstock* and *Britton* turned on the operator's promise to act for others and its control over the fate of the investment, factors in the basic operating relationship itself, as the reason to protect nonoperators,⁷⁸ other courts have used the passive role reflected in that agreement as reason enough to deny a joint venture. And while cases like *Oklahoma Co. v. O'Neil* resort to the legal fiction of treating very limited rights as powers of control or cooperation (because in this way they can satisfy the three-part joint-venture test and so protect nonoperators), a number of other courts are much more stringent about these requirements, at the price of finding no joint venture.

The inconsistency between these cases is even greater than might appear from just reading the cases because the courts often fail to identify the agreement in dispute. Yet most oilfield projects occur under the standard JOA.⁷⁹ It is almost certain that many of the courts holding as a matter of law that their nonoperators' limited control is enough to prove cooperation and those holding as a matter of law that it is not are construing exactly the same agreement.⁸⁰

find). A proper use of *Rankin* is at least to acknowledge that a joint operating agreement establishes a joint venture within the project's area, even if it does not control drilling outside. *E.g.*, *Jeanes v. Henderson*, 703 F.2d 855, 858 (5th Cir. 1983).

77. For this division, see *infra* notes 423-426 and accompanying text.

78. See *supra* notes 42-57 and accompanying text.

79. See *supra* note 3 and accompanying text.

80. It is striking how rarely oilfield courts identify the exact operating agreement that they are interpreting, in spite of the fact that the vast majority of oil and gas investments use one or another version of the AAPL's standard JOA. As an example of how the failure to be clear can let courts pretend that they are not rejecting rules that, in fact, they are ignoring, see one Oklahoma federal court's distancing from the broad fiduciary principles of *Texas Oil & Gas Corp. v. Hawkins Oil & Gas, Inc.*, 668 S.W.2d 16 (Ark. 1984), primarily by arguing that that opinion "is also based upon the specific language of the agreement before that court." *Tenneco Oil Co. v. Bogert*, 630 F. Supp. 961, 966, 967 n.6 (W.D. Okla. 1986). It

b. The Third-Party Joint-Venture Cases

Most joint-venture cases arise in the entirely different context where third parties sue nonoperators to make them pay for the operator's debts. A large class of joint-venture cases concern third parties claiming a joint venture in an effort to recover against the nonoperators (a possibility that can become vitally important if, say, the operator goes bankrupt). Here the courts, knowing that no one intended this broad a liability, often strain to avoid such a windfall by finding no joint venture.

A representative third-party case is *Ayco Development Corp. v. G.E.T. Service Co.*⁸¹ In this case, four oilfield service companies sued to be paid for "supplies and services."⁸² In addition to entering judgment against the operator, the trial court directed a verdict against the nonoperators.⁸³ The court of appeals reversed and remanded on the assumption that the joint-venture issue had to be tried;⁸⁴ the Texas Supreme Court went further, ordering a take nothing judgment because investors, "as a matter of law,...are not liable as joint venturers."⁸⁵ The Court held that no joint venture existed because the nonoperators did not have a right to "control or management of the enterprise."⁸⁶ Instead of the make-believe "cooperation" of *Oklahoma Co. v. O'Neil*, the court admitted that such minimal activities as receiving records are not real control; "[v]isits to the mining site, as a matter of law, do not constitute proof of joint control."⁸⁷ *Ayco* is representative of many third-party cases that agree that the typically limited participation of nonoperators cannot sustain a joint venture, with its unlimited exposure to all who supply

would be hard to pen a more misplaced analysis. One of the striking aspects of *Texas Oil & Gas Corp. v. Hawkins* is that it contains virtually no discussion of the operative agreement, but instead relies on a strong statement of the "relationship of trust and confidence" between JOA parties. Were courts more up-front about the agreements they interpret, they would have been forced to clarify the rough edges of many operator cases. For another example, look at the lead case of *Reserve Oil, Inc. v. Dixon*, 711 F.2d 951, 952 n.2 (10th Cir. 1983), in which the Tenth Circuit tantalizes readers by stating that the agreements in dispute "are identical in all material respects," and even quotes a little from them but never identifies their particular JOA lineage.

81. 616 S.W.2d 184 (Tex. 1981).

82. *See id.* at 185.

83. *See id.*

84. *See Energy Fund of Am. v. G.E.T. Serv. Co.*, 610 S.W.2d 833, 838 (Tex. Civ. App. 1980), *aff'd in part, rev'd in pertinent part*, 616 S.W.2d 184 (Tex. 1981).

85. 616 S.W.2d at 186.

86. The nonoperators were "wholly excluded from participation in the drilling, operation, and control of the well" by their contract; and their only "joint participation" was that one of them "was present on two occasions at the drill site." *Id.*

87. *Id.*

benefits to the joint account.⁸⁸ Of course, if nonoperators do retain unusual rights to control or if they actually manage the project, they may have to pay third parties as a result.⁸⁹

88. An intermediate Texas court followed *Ayco* in *Smith v. L.D. Burns Drilling Co.*, 852 S.W.2d 40 (Tex. App. 1993), affirming summary judgment for nonoperators on the grounds that they "had and exercised no right to participate in the control or operation of the venture." *Id.* at 41. A driller tried to sue the nonoperators as well as the operator over the latter's failure to pay its bill, in a lawsuit seeking damages caused during a re-entry and sidetracking project. *Accord*, *Archer v. Bill Pearl Drilling Co.*, 655 S.W.2d 338, 344 (Tex. App. 1983) (operating agreement and defendant's appearing once at drill site held not enough, as a matter of law, to sustain joint-venture liability in third-party claim for damage to drilling equipment). The flipside of the *Smith v. Burns Drilling* issue, though, was that the drilling contractor, who allegedly negligently damaged the well, owed no duty directly to the investors, who were stuck without recourse when the operator released the driller from consequential damages in the drilling contract. *See Smith*, 852 S.W.2d at 42-43.

An oft-cited vendor's case with a similar result is *Youngstown Sheet & Tube Co. v. Penn.*, 355 S.W.2d 239 (Tex. Civ. App. 1962), *aff'd in part, rev'd in part on other grounds*, 363 S.W.2d 230 (Tex. 1962), in which the operating agreement gave the operator "'exclusive charge, control and supervision of all operations of every kind'" and indicated that the leases would "not be operated hereunder as a partnership venture," and that liability would be several, not joint. *See id.* at 241. The court treated liability as a question of law, based on its interpretation of the operating agreement, and found that the record lacked any sign of "joint operation of the leases nor mutual agency of the parties." *Id.* at 245. *See also* *Misco-United Supply, Inc. v. Petroleum Corp.*, 462 F.2d 75, 79 (5th Cir. 1972) (affirming judgment for nonoperating participants in suit brought by supply company. Even though letter agreements called them "joint venturers," they had a fixed cost (turnkey) arrangement in the initial test well. *See id.* at 78, 80-81. The evidence did not "contain enough evidence of joint operation" on the development well for liability to attach. *Id.* at 81.).

In *Bolivar v. R & H Oil & Gas Co.*, 789 F. Supp. 1374 (S.D. Miss. 1991), a federal district court granted summary judgment rejecting an effort to hold an interest owner who held a 0.38% interest in the property liable for wrongful death. Burns, the interest owner, had virtually no role in managing the property, to the point that he was not even aware of the identity of the operator. *See id.* at 1380. The court cited Mississippi law and *American Jurisprudence* for the proposition that legal duties between joint venturers might be decided on the subjective basis of whether they intended to create a joint venture. *Id.* at 1379 (citations omitted). Duties to third parties were governed by "objective manifestation[s]." *Id.* The barrier over which the plaintiffs stumbled was the usual one: mutual control. The court argued that it is not actual control, but "the right to exercise control" that was the key. *Id.* (citing *Shell Oil Co. v. Prestidge*, 249 F.2d 413, 417 (9th Cir. 1957) for proposition that parties who turned over actual operations still could be joint venturers if they kept the right to control). Here, Burns had no authority over well operations, therefore was not a joint venturer, and accordingly was not exposed to third-party liability, a position with which a "legion of authorities from major oil producing states which have addressed the issue are in accord." *Id.* at 1381.

In *Dunbar v. Olson*, 110 N.E.2d 664 (Ill. App. Ct. 1953), the trial court entered judgment against all defendants in a suit to recover material and labor costs. The court of appeals reversed, finding that the nonoperating defendants knew nothing about the well operations and had no knowledge about oil development, while the plaintiff had contracted only with the operator and looked to it. *Id.* at 665-66. The plaintiff could have filed a lien against the property, demanded advance payment, or an escrow, but did not. *See id.* Nonoperators could not be liable without "some choice and participation in control

Some courts have been willing to acknowledge that third-party cases raise different issues than those between operator and nonoperator. It certainly should be true that "cases address[ing] the relationship between the operator and third parties...are not dispositive of the duty issues raised" in internal operator/nonoperator disputes.⁹⁰ But in general, the oilfield cases carelessly mix operator-nonoperator and third-

and management." *Id.* The court went on to explain the economic function of this rule. Given the uncertainty of mineral development, "few persons are willing to risk their means in such an undertaking," and interests vary in amount and are frequently transferred, "so that it would be unjust to subject each proprietor to personal liability which might sweep away all his property in an undertaking created against his consent by those who could become members without his knowledge and against his wishes." *Id.* at 666-67.

Many of the third-party cases are decided under the related, and for practical purposes identical, mining partnership doctrines. *See infra* Part III.A.2.

89. In *Shell Oil Co. v. Prestidge*, 249 F.2d 413 (9th Cir. 1957), for instance, a worker hurt in a fire sued not only the drilling contractor, but also Shell, a royalty owner that had assigned leases to the contractor and retained a large royalty interest. It turned out that the parties shared both costs (Shell paid the first \$8250, the driller anything over that) and revenues (the driller as interest owner, Shell as a royalty owner), and agreed to joint control because, after reaching a certain depth, "the parties hereto shall determine that further drilling therein would not be warranted." *See id.* at 416. Shell's geologist gave various instructions at the drill site, including determining when tests should be taken and the like. *See id.* at 417. Shell's assumption of control did not preclude what the court described as "equal voice and joint control," because one party "may entrust actual control of the operation to another, and it still remains a joint venture." *Id.*

90. *See Johnston v. Am. Cometra, Inc.*, 837 S.W.2d 711, 715-16 (Tex. App. 1992). This case over an operator's duty to make a take-or-pay claim for its nonoperators is difficult to interpret. Even though the court distinguished the joint-venture analysis in cases brought by third parties from that for operator/nonoperator cases, and even though it noted that the standard no-partnership disclaimer was designed to shield nonoperators from liability to third parties, it nonetheless agreed that the summary judgment record before it established the absence of a joint venture. *See id.* at 716. On the distinction between third-party and operator/nonoperator cases, see *Bolivar*, 789 F. Supp. at 1379 (testing third-party case by "objective manifestation" of joint venture, while suggesting in dictum that operator/nonoperator disputes would be decided by subjective proof of parties' actual intentions).

Writing in 1989, Howard Boigon found that courts in co-owner disputes were "more than willing" to find a fiduciary tie with "minimal cooperation, or even without a showing of any participation," Boigon, *Liabilities and Relationships*, *supra* note 3, § 8.03[4] at 8-23, a liberal standard that raises the operator's responsibility, but courts were reluctant to find a joint venture and thus impose vicarious liability in the third-party cases. Here they required at least an "opportunity for participation," and in many cases, particularly those with "elaborate contractual relationships," actual participation. *See id.* § 8.04[1] at 8-35 to 8-40. Many cases support this reading even today, but the cases discussed in Part VII.C have no single pattern to explain the varying levels of behavior required to prove control or cooperation. Moreover, an "opportunity" to participate, which to some courts might just mean the right to consent, could sustain a joint venture with much less activity than "minimal cooperation."

party cases in an unholy brew without distinguishing which interest is at stake.⁹¹

c. Joint-Venture Cases on Other Issues

The third-party cases are not the only result-driven cases in which courts have used strict requirements of control or cooperation to reject joint-venture liability. Courts have strained to avoid a fiduciary duty in other contexts. Thus, in cases where a joint venture would have exempted the defendant from securities liability,⁹² where a fiduciary

91. The relationship between the operator's *internal* duty to its investors and possible joint liability to third parties comes up again when courts have to decide whether the no-partnership, several-liability terms in JOA article VII.A should apply to disputes between the parties, as well as claims brought by third parties. Though this clause seems to have originated to limit nonoperator liability to third parties, courts in recent years have applied it to narrow the operator's internal duty, too. See *infra* notes 301-315 and accompanying text.

92. In *Parvin v. Davis Oil Co.*, 524 F.2d 112 (9th Cir. 1975), a social and business acquaintance of Denver oilman Marvin Davis invested roughly \$200,000 with Davis Oil Company but got almost nothing back. In a first opinion, the Ninth Circuit reversed the lower-court determination that the investments were not securities, and that, if they were, they were exempt. On remand, the district court found that the securities did not qualify for the joint-venture registration exemption under California law (and, as a result, that Davis Oil was liable for a failure to register the securities). See *Parvin*, 655 F.2d 901, 903 (9th Cir. 1979). The Ninth Circuit applied the multi-factor joint-venture test discussed above, including that joint venturers must have "an 'equal right' or 'right in some measure' to control...the enterprise." *Id.* at 904. The court treated this as "primarily" a fact issue and affirmed the district court's finding of no joint venture where, at most, the investors had access to drill sites and participation in a decision whether to continue beyond casing point. In a realistic statement at odds with the fictions that equate such rights with "control," the Ninth Circuit noted that "those decisions most affecting the ultimate success or failure of the enterprise were to be made solely by [Davis Oil Co.]." *Id.* This contrasts sharply with a case like *Oklahoma Co. v. O'Neil*, where one visit to the well site and examining the leases was held enough to prove "cooperation." 440 P.2d at 985.

The securities/exemption cases are not uniform. In *Vicioso v. Watson*, 325 F. Supp. 1071 (C.D. Cal. 1971), another California federal court decision, a district court did find a joint venture and that the securities therefore were exempt, and rejected the investors' securities defenses to the operator's collection lawsuit. The court found the element of "control" even though it paradoxically accepted the investors' claim that they "did not in fact exercise any control over the drilling operations, and because of the distance and their lack of expertise, had no realistic expectation of control." *Id.* at 1075. The court treated the relevant question as whether they had a *right* to control, not whether they actually controlled the investment, and interpreted the limited rights of receiving reports, visiting the well, and paying expenses as rights of control. The court held that "[t]he right to control can exist even though there is not exercise of control or any expectation of such exercise. Furthermore, the right to control can be expressly or impliedly delegated to other members of a joint venture." *Id.* Stressing that the investors received reports, were "welcome" at drill sites, and paid their proportionate costs, the court announced that "the plaintiffs had a right to control the drilling operations, but deferred exercise of this control and chose to rely on the greater expertise of the defendant." *Id.* at 1076. "All parties were *potentially*

duty could have made an operator liable for failing to give early notice of abandonment⁹³ or nonoperators directly liable for an offshore platform injury,⁹⁴ where an operator might have had to share leases it acquired

involved in the activity on the leases *on a day-to-day basis*." *Id.* at 1078 (emphasis added). Investors generally do not have a right to daily involvement, and these did not if they had a standard joint investment, but unfortunately the court did not cite enough of the operating agreement to identify the dispositive agreement. It is true that if the evidence the court did cite proved "control" or "cooperation," almost every JOA venture would be a joint-venture and mining partnership.

In *Russell v. French & Associates*, 709 S.W.2d 312 (Tex. App. 1986), the court of appeals agreed that an investing group was not entitled to recover under the Texas Securities Act because it was a joint venturer. Its contract not only called the relationship a joint venture, but it gave this one partner an equal vote "concerning Joint Venture business." The court decided that this legal right of control, even if not exercised, was "present to create a joint venture as a matter of law." *See id.* at 315. Given the joint venture, the Texas Securities Act could not provide the liability to support the jury's damage findings (though common-law claims did).

As one would expect, many courts will perceive the joint-venture securities exemption as a question of fact. In *Sparks v. Baxter*, 854 F.2d 110, 110, 112 (5th Cir. 1988), a jury not surprisingly found a joint venture between the operator and defendants who helped it market 26 drilling ventures. The operator sued the latter after they stopped paying drilling expenses. The joint-venture finding precluded the defendants' Texas securities violation defense. *See id.* In *Anderson v. Vinson Explorations, Inc.*, 832 S.W.2d 657, 663-64 (Tex. App. 1992), in spite of evidence that the "ultimate control" lay with the operator and in the face of an agreement that "wholly excluded [the nonoperating investors] from participation in the drilling, operating and control of the wells in question," the exemption was a fact issue.

In *Vick v. George*, 671 S.W.2d 541, 547 (Tex. App. 1983), *rev'd in part on other grounds*, 686 S.W.2d 99 (Tex. 1984), the court of appeals upheld rescission based in part upon the Texas securities laws even though a jury found a joint venture or partnership among the defendants. The rule that sales among joint venturers do not fall under the Texas Act did not apply when there was no contention that plaintiffs, who had bought interests after the wells had been drilled, were joint venturers with defendants. *Id.* at 546; *compare* *J.R. Dunbar v. RKG Eng'g, Inc.*, 746 S.W.2d 314, 314-16 (Tex. App. 1988) (finding joint venture removed sales of fractional oil interests from coverage of Texas Securities Act).

93. In *Norman v. Apache Corp.*, 19 F.3d 1017 (5th Cir. 1994), interest owners sued Apache Corporation because it did not give them notice before abandoning their well. After a bit of indecision, the trial court granted summary judgment for the operator. *See id.* at 1020-21. Though the parties did not argue that their relationship was a per se fiduciary tie, but instead only that an "informal" fiduciary duty existed, the Fifth Circuit nonetheless opined that "Texas law is clear that [an operating agreement] does not of itself give rise to a fiduciary duty between the operator and non-operating working interest owners." *Id.* at 1025 (emphasis added). The Fifth Circuit affirmed the grant of summary judgment for Apache.

94. In *West v. Kerr-McGee Corp.*, 586 F. Supp. 493, 499 (E.D. La. 1984), *rev'd on other grounds*, 765 F.2d 526 (5th Cir. 1985), the court ignored a no-partnership disclaimer and minimized the control element (holding that the right to approve expenditures over \$10,000 and "to inspect the operations and the files" was enough to share control) in order to shelter the nonoperators under the Longshore and Harbor Workers' Compensation Act's joint-venture protection. *Id.*

after its operating interest terminated,⁹⁵ as well as where the court believed the protection was unnecessary because a more direct fiduciary duty existed,⁹⁶ courts have found that standard operating arrangements

95. The issue arose in *Crowder v. Tri-C Resources, Inc.*, 821 S.W.2d 395 (Tex. App. 1991). The operator signed an exploration and development agreement and an operating agreement, but neither had an AMI clause, which would have created an area in which any party acquiring property would have had to offer a proportionate interest to the other participants. *Id.* at 395. The operator sold all of its interest to another party. Some months later, when the operator acquired other leases in the area, its former joint venturer sued to share the new interests. The nonoperator, Crowder, seems to have put its hopes on proving an "informal" fiduciary duty arising from its longstanding trust and confidence, an effort that failed. *See id.* at 398-99. The court of appeals took pains to hold that Crowder was not "in partnership" with the plaintiff. *Id.* at 399. The opinion is not clear as to whether this was because a joint-venture relationship did not exist, or because whatever duty that had existed terminated when the operator sold its interest as operator, a point also emphasized in the opinion. *See id.* ("the relationship between Crowder and Tri-C ended when both assigned their interests..."). This is the same result as in *Rankin*—an operator has no duty to share acreage acquired outside the agreed joint project area—but it was achieved by finding no fiduciary duty, rather than by making the operator a fiduciary but then limiting it to the area expressly governed by the operating agreement.

In *James v. Nico Energy Corp.*, 838 F.2d 1365 (5th Cir. 1988), an option letter that accompanied the private placement memorandum indicated that the investor would get an "option to participate in subsequent wells on an additional 700 acres," but which acres would be "designated by Nico [the operator] from acreage it presently has under lease." *Id.* at 1367. The court dismissed most claims before trial, entered a directed verdict on the fiduciary claim, *see id.* at 1366, and a jury award for breach of contract was reversed on appeal. The Fifth Circuit affirmed the directed verdict because the investor could not prove the "mutual right of control" required for a joint venture. *Id.* at 1373. "Since James admits that his only involvement in the wells was limited to investment of capital and that Nico had the sole right of control in the drilling and operating of the wells, the element of mutual control was lacking." *Id.*

96. The well participant in *In re Mahan & Rowsey, Inc.*, 35 B.R. 898, 900 (Bankr. Okla. 1983), *rev'd on other grounds*, 62 B.R. 46 (W.D. Okla. 1985), *aff'd*, 817 F.2d 682 (10th Cir. 1987), invested its money with an operator who, about five months later, ended up in bankruptcy. The estate tried to treat the funds as part of the debtor's general estate; the participant claimed that the funds were separately earmarked joint-venture funds and moved for summary judgment to get them back. *See id.* at 901. The court began by citing *Oklahoma Co. v. O'Neil* for the proposition that a joint venture requires proof of its three component elements, a question of fact. *See id.* The court rejected the operator's claim that the partnership disclaimer in article VII of the JOA (the standard JOA disclaimer) limited the duty, noting that the Oklahoma Supreme Court had "[d]isregard[ed] language similar to that hereinabove quoted" in *Oklahoma Co. v. O'Neil*, but held that the general joint-venture issue involved disputed issues of fact. *Id.* at 902.

The court nonetheless imposed a fiduciary duty as a matter of law by relying upon another operator-fiduciary doctrine, the *Reserve Oil* duty read from the standard JOA that is discussed in the next section. Thus, the court's initial discussion of the three-element test was dictum. The district court affirmed the bankruptcy court and the Tenth Circuit stated that "[w]e, too, agree with the bankruptcy court's analysis of the constructive trust issue." *In re Mahan*, 817 F.2d at 683 n.1.

Certain other nonfiduciary operator cases present fact patterns where a court might want to avoid a fiduciary duty. In *Hamilton v. Texas Oil & Gas Corp.*, 648 S.W.2d 316 (Tex.

do not give nonoperators meaningful control. These cases rejected joint ventures as a matter of law or, at a minimum, found a fact question over the requirement of control.

2. *The Mining-Partnership Cases*

Mining partnerships are akin to joint ventures.⁹⁷ They carry the same high duties: "The rules of ordinary commercial partnerships respecting honesty and fair dealing are equally applicable to mining partnerships."⁹⁸ Like joint ventures, they require a joint interest or ownership,⁹⁹ an express or implied agreement to share profits and

App. 1982), a nonoperator apparently believed that it could avoid 400% nonconsent penalties by proving that the operator had breached fiduciary duties in managing what turned out to be a productive well (one where the plaintiff would rather not have nonconsented). *See id.* at 320. The court of appeals held that a joint operating contract can exist "without creating a joint venture or a mining partnership." *Id.* at 320 (citation omitted). It distinguished *Rankin* as a case where there was a "finding of joint control." *Id.* at 321. The court instead compared *Hamilton's* facts to *Ayco*, where the "defendants were by contract wholly excluded from participation in the drilling, operating and control of the well in question. The defendants paid part of the cost of drilling and visited the well site. The court held, as a matter of law, that the parties were not joint venturers." *Id.* The *Hamilton* court approved a similar outcome where the operator "had full control of all operations; the parties were severally, not jointly, liable under Sections 5 and 22 of the J.O.A." *Id.*

Taylor v. GWR Operating Co., 820 S.W.2d 908 (Tex. App. 1991), might be called an operator error case. The operator sued after a nonoperator refused to pay well costs, and the trial court granted partial summary judgment against the nonoperators' Deceptive Trade Practices Act, fiduciary, and good faith claims. *See id.* at 909. Unfortunately for the operator, it had alleged that a fiduciary duty existed (presumably trying to make the nonoperator's refusal to pay look more egregious) in its first two petitions. *See id.* at 911. The court of appeals claimed that, while the duty itself is a question of law, any disputed underlying facts (naturally) remain questions of fact. *See id.* at 911-12. Fact issues remained "[b]ecause GWR [the operator] plead that a fiduciary relationship existed between them." *Id.* at 912. *Taylor* is likely to have only meager effect because very few operators who want to avoid liability will be foolish enough to have nonetheless pled a fiduciary relationship.

97. *See*, for instance, the Fifth Circuit's effectively treating these concepts as the same in a case applying Oklahoma law (without expressly deciding that issue) in *Wilcox Oil Co. v. Empire Oil Co.*, 195 F.2d 860, 863 (5th Cir. 1952); *accord*, *Lane & Boggs*, *supra* note 11, at 203-04 (many courts use these terms interchangeably and whether a relationship is a joint venture or mining partnership "is immaterial to the issue of the duty owed among the parties," with *Lane and Boggs* arguing that joint ventures require some prior agreement while mining partnerships do not).

98. *Brimmer*, *supra* note 24, at 96-97 (citing list of cases imposing trust-like responsibility on mining partners); *accord*, *Lee Jones, Jr., Mining Partnerships in Texas*, 12 TEX. L. REV. 410, 410-11 (1934).

99. The interests shared under an operating agreement should easily satisfy this requirement. *See Watts*, *supra* note 63, at 2799; 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.1-04.2 ("some form" of concurrent ownership required) (citations omitted). One author has concluded that a shared tenancy in common generally will satisfy this

losses,¹⁰⁰ and joint operations.¹⁰¹ *Joint* operations predictably are the key element.¹⁰²

requirement; that a farmout, lease, or drilling contract interest will not in general; but that even parties holding these interests may risk liability if they take an active role in the venture. See Fiske, *supra* note 22, at 195–200; see generally Brimmer, *supra* note 24, at 88–89. A contingent interest generally is not enough to satisfy this element. See *id.* at 89.

Those seeking to avoid a mining partnership should be careful not to use the word “joint” in their agreement, and agree not to assign any interests until all drilling is complete. The reason for delay would be to “avoid joint ownership during the period in which the operator satisfies the conditions of the drilling contract,” in an effort to avoid joint liability for drilling-period claims. See Watts, *supra* note 63, at 2799; see also Brimmer, *supra* note 24, at 107–08 (listing as items (4) (a)–(f) ownership structures that might avoid joint ownership). Such a strategy might be effective against third-party claims, in which the delay would accurately reflect the operator’s control during drilling, but it is hard to believe that courts should lower the operator’s liability to its *co-venturers* when they so clearly would share the same expectancy throughout the drilling period.

Williams and Meyers mention that drafters might try to avoid a mining partnership by delaying the mineral transfer or manipulating the interest transferred, but correctly warn that, if the three mining-partnership elements are met, “the court may pierce the veil of the form of the transaction and find that the substance was joint ownership and hence a mining partnership.” See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435.2, at 511; see generally *id.* at 509–14. Efforts to define away the basis for joint liability are fraught with risk when reserving either a right “to exercise any control over operations” or actual exercise of control can sustain a mining partnership, “whatever the terms of the agreement.” See *id.* at 510.

100. See Fiske, *supra* note 22, at 211–12 (in spite of variations in court language, agreement can be implied, probably need not cover sharing of losses as well as profits, and sharing need not be equal); accord 2 KUNTZ, *supra* note 24, § 19A.7, at 115 (express agreement to share profits and losses not required; this element “ordinarily [is] a result of joint operation”; sharing losses may be met when one party loses its investments and others their time, knowledge, or labor); 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.3 (agreement to share profits and losses need not be express and loss responsibility “is said to be simply an incident of the partnership relationship”) (citations omitted); Brimmer, *supra* note 24, at 91 (agreement need not be express, shared losses may be implied); Conine, *supra* note 30, § 8.03[1][c] at 8–15 (shared loss requirement often ignored or implied by courts). Kuntz seems to backtrack in the supplement to his treatise when he claims that the JOA does *not* provide for shared profits and losses, apparently because the parties can opt to take their production in kind. See 2 KUNTZ, *supra* note 24, § 19A.7, at 70–71 (Supp. 2002). It is not clear whether he really endorses such a hypertechnical test. In any event, the courts never have; they have only looked to determine whether there is some general shared risk and gain, not whether each party actually made a profit or loss. The agreements in early mining cases involved literally shared profits and losses; the partners would sell their product as a single output, deduct costs, and then share the profits (or losses). See Jones, *supra* note 98, at 425.

As with joint interests, so with shared profits and losses there is a strategy to try to avoid creating a mining partnership. Some have suggested that take-in-kind clauses might avoid “shared” profits and losses. See Watts, *supra* note 63, at 2799–800. Yet the mutuality embodied in this requirement ought to be satisfied by the shared interest in discovery of paying production, and not turn on the parties’ having equal sagacity in finding buyers. In general, courts do not apply this kind of technically rigorous analysis to this element.

101. For the general requirements of the three-part test, see 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.1-504.3; 2 KUNTZ, *supra* note 24, § 19A.6, at 109-10. Two other factors, a community of interest and mutual agency, either are not required or are satisfied by the three core elements. See Fiske, *supra* note 22, at 212-13; 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435 at 504.3-504.4.

102. See Conine, *supra* note 30, § 8.04[3][b], at 8-28 (this element is "pivotal" for mining-partnership and joint-venture findings). This third prong is "difficult to define, and a determination of joint operation is difficult to make." 2 KUNTZ, *supra* note 24, § 19A.7, at 113. Control of activities "need not be equal" and, Kuntz claims, the nonoperator does not have to actually exercise its rights of control. See *id.* at 114. Kuntz points out the difficulty by noting that "[p]articipation can range from casual observation to sharing in routine decisions. Someplace in between is the joint operation required for a mining partnership." *Id.* Joint operations "create the greatest difficulty," and "there appears a wide variance in the cases as to what constitutes joint operation." 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.2-504.3. But the fact that one owner is the "managing partner" (*i.e.*, the concentration of control in the operator) "does not prevent the finding of joint operation required for the existence of a mining partnership." See *id.* at 504.3.

Conine's version of this last joint-operation element is minimal. He claims it can be met by "furnishing of advice, material, services or labor"; that control need not be equal; and that it can be delegated without destroying the partnership as long as a right to control is retained. See Conine, *supra* note 30, § 8.03[1][c], at 8-15. In spite of this liberal phrasing, Conine reads the cases as rejecting partnership status unless an unusual degree of control is present or the parties have what he calls a drilling venture. See *infra* note 431.

Clarence Brimmer has advanced what sounds like a very easily met test, under which even just contributing money or land could be enough to engage in joint operations, and participation need not be "extensive," but he notes that the test in practice "has been termed the most troublesome" of the required elements. Brimmer, *supra* note 24, at 89-90; see also Jones, *supra* note 98, at 422 (arrangements to share pro rata costs an "important element" in "uniting and cooperating," even though one co-tenant would have a right to charge another's interest with share of reasonable costs).

One early question was whether joint "operations" could exist before the actual discovery of minerals. Some believe that prospecting and the exploratory phase are not what should be meant by joint operations. See Jones, *supra* note 98, at 419-21. This issue has disappeared and it seems unquestionable that "operations" includes the exploratory phase of the JOA project. Any other rule would seem particularly ill-advised when so much of the risk and cost falls into the drilling of the exploratory well. There is no reason to think that special protection is less important in this critical phase of a joint project.

The control-or-cooperation prong has been central for a long time. Even back in 1954, Lee Jones was writing that the primary factor bedeviling mining-partnership cases was joint control, and that the cases were "by no means harmonious." See Jones, *supra* note 4, at 718. Jones cast his vote against strong interpretations of the JOA. He found any rule that would give owners of nonoperating interests partnership liability when one owner had "exclusive charge" of drilling "unsound and contrary to public policy." See *id.* at 719. To him, drilling and developing were not being in "business," particularly when the owners kept the right to market [this a somewhat hollow right when, as a practical matter, the operator does the marketing in most joint ventures], and paying costs and receiving production should not be "controlling." See *id.* at 718-19. In this context, though, Jones discussed agreements that did not have nonconsent votes for decisions like deepening a well, drilling new wells, or abandoning wells—powers nonoperators *do* get in the JOA. So he might well have agreed that JOA parties would be mining partners. Jones did caution that giving nonoperators "any voice in any phase of the management" was dangerous for

Like joint ventures, mining partnerships create a joint investment vehicle without the unlimited liability of a general partnership (the latter not being limited to a single project).¹⁰³ Mining partnerships are limited ventures.¹⁰⁴ Parties do not need a specific agreement to become mining partners (if they did, there would be much less to dispute).¹⁰⁵

anyone wanting to avoid partnership status, *id.* at 719, so his views are not necessarily inconsistent with courts that find joint operations under today's JOA.

Jones also discussed provisions trying to "negative" the operator's power to bind the other owners to third parties, who, as he pointed out, contract with the operator in his own name. *See id.* Here, he felt that liability should be limited to the nonoperators' commitment under the operating agreement, at least, unless the facts made the nonoperators liable to third parties under "the general principles of agency." *See id.* at 720 n.74.

103. *See Fiske, supra* note 22, at 192. Mining partnerships also solved the problem that a partnership dissolves at the death of one of the partners or if a partner transferred its interest; mining partnerships survive both events. *See id.* at 193, 214-15. For rules on the burdens a new partner assumes, and those a departing partner cannot leave behind, *see id.* at 216-17. For other summaries of a mining partnership's characteristics, see 2 KUNTZ, *supra* note 24, § 19A.7(a), at 111-12; 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435.1, at 504.4-09; Jones, *supra* note 98, at 431-32.

Clarence Brimmer explained some key differences between general partnerships and mining partnerships in his 1969 article. Mining partnerships do not give partners the right to control their associates, nor are they dissolved (absent agreement in the operative contract) by bankruptcy, death of a partner, or sale of a partner's interest. The reason is that mining partnerships were assumed, under the law of mining, to have more partners than ordinary partners and to need continuous working for their success. *See Brimmer, supra* note 24, at 91-92 (citing Justice Field's opinion in *Kahn v. Smelting Co.*, 102 U.S. 641 (1880)). The inability to determine one's partners, in turn, explains another key difference: mining partners cannot bind their fellows generally, which would not be fair when they have so little control over who becomes a partner, but instead are liable only for debts "necessary to carrying on its business or which are usual in like concerns." *See id.* at 92. Brimmer calls this differentiation a "dubious distinction" because few contract for debts that appear unnecessary. *See id.*

For another clear, early statement of the structural reasons why mining partnerships differ from ordinary partnerships, see Jones, *supra* note 98, at 412-14. Jones notes that the need for continuous operation is particularly acute in oil and gas operations because in at least some cases "irreparable injury would be brought about by even the slightest delay or cessation of field operations." *See id.* at 413. Even though oil and gas law borrowed the mining partnership from the law of mining, the fugitive nature of oil and gas, the rule of capture, and reservoir characteristics make the need for continuous operation even more critical, and so the doctrine is yet more fitting in this industry.

104. Fiske, *supra* note 22, at 218 ("Another very important characteristic of a mining partnership is its restriction to a single mining project.").

105. Parties rarely "intentionally select[] a mining partnership" and "invariably disclaim any partnership relationship." *Id.* at 187. The status usually "is not knowingly entered into," *id.* at 189; the partnership often arises as a "concealed thorn," *id.* at 194; it can arise tacitly by operation of law and without any "specific intent" to form a mining partnership, *see id.* at 213-14; *accord*, Hendrix & Golding, *supra* note 10, § 10.03[1][b], at 10-9 (mining partnership "most often arises by operation of law without prior agreement," and

is almost always an "implied" classification "to redress perceived evils") (citations omitted); 2 KUNTZ, *supra* note 24, § 19A.7(b), at 112-13 (partnership arises by operation of law from conduct of parties "whether or not there is an agreement to form such a partnership," and "is essentially a device used by the court to justify granting relief when it feels that relief should be granted"); 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504 (mining partnership may arise by agreement, but most cases concern partnerships arising by implication); *id.* § 435.1, at 506 (fact that written agreement provides partnership is not created "will not prevent the finding of a mining partnership if all the elements thereof are present"); *id.* § 435.2, at 510 (reserving right to "any control over operations" or actual control may show partnership "whatever the terms of the agreement"); Brimmer, *supra* note 24, at 92-93 (risk of implied mining partnership is a "most important distinction" from ordinary partnerships, and even partnership disclaimer will not prevent finding of mining partnership if "in fact their acts and conduct constitute that relationship as a matter of law"); Jones, *supra* note 98, at 410, 414 (mining partnership can arise by operation of law and is "intention-defeating...because in the normal case it is usually expressly provided that the agreement...is not to be construed as creating a mining partnership"); Jones, *supra* note 4, at 717 (if relationship "established by agreement essentially conforms to the partnership pattern partnership law will govern, at least as to strangers, whatever may be the expressed intention of the parties," so parties wanting to avoid partnership must be careful not to assume partner-like duties); Watts, *supra* note 63, at 2798 ("courts may disregard such disclaimers if the elements of a mining partnership are otherwise present").

Clarence Brimmer wrote a wonderfully entertaining criticism of mining partnerships some 30 years ago. See Brimmer, *supra* note 24. His main point was that virtually all of the goals of mining partnerships could be accomplished with limited partnerships, but with more security, because the mining-partnership doctrine is only marginally effective at limiting liability to third parties. To him, the doctrine, which he traced to the early 1800s in England and an 1863 California mining case in the United States, is "used only by the courts when all other theories have failed to fit the pattern that justice requires" and is a "last resort of [careless] creditors." *Id.* at 85, 87. The risk of the doctrine is that "owners of small interests are frequently liable for all of the indebtedness" of the joint operation. See *id.* at 103. The parties cannot limit this liability just by agreements among themselves. See *id.* at 103-04. So Brimmer found it fitting to cite the maxim "*Ubi mel ibi apes* (Where the honey is, there are the bees)," and called it a "joy of any creditors who may be operating on the theory of grabbing all the legs in sight in the pile-up." See *id.* at 101, 108. Brimmer does admit that mining partnerships have a few advantages, for instance ease of formation, the ability to sell interests without the other partners' agreement (though many JOAs have rights of first refusal), and their continuation through bankruptcy, death, and sale of members' interests. See *id.* at 106. But the price is the high one of risking "[l]egal responsibility for the contractual or tortious acts of another, over which one has not had control," which Brimmer calls "surely the most distasteful feature" of mining partnerships. See *id.* Of course, the irony is that to have mining-partner liability courts have to find "joint operation," but they do so by pretending that ineffective control is real control. As a result, nonoperators risk carrying all the burdens of joint control without having real, effective power over the venture. To Brimmer, it was clear in 1969 that "our age seems to have outrun the historic reasons for and advantages of a mining partnership." See *id.* at 107. He urges a "statutory *coup de grace*" to put the form out of its misery. See *id.* at 108. But habit and custom, and the advantages that Brimmer does chronicle, have kept the form alive and well.

As noted in the joint-venture discussion, courts generally treat the two doctrines interchangeably.¹⁰⁶ The law on mining partnerships suffers from the same inconsistency as its joint-venture cousin. In the same way that Howard Williams found courts using joint-venture theory "adjectiv[ally]" to justify a decision made on equitable grounds,¹⁰⁷ so the best explanation for many mining-partnership cases is that the term is "a characterization or a label, assigned or attributed ex post facto" by the court to serve justice, a "legal hook upon which the hat of judicial relief may be hung in appropriate circumstances."¹⁰⁸ The battleground is the same: here, too, proving joint operations through some active nonoperator role is the "keystone" of the duty.¹⁰⁹

A number of courts have treated operators as mining partners under typical operating arrangements. The reason third parties struggle to prove that the investors were in a fiduciary relationship is that, in this kind of partnership, liability opens each investor to claims for the entire project debt.¹¹⁰ For instance, in *Sparks v. Midland Supply Co.*,¹¹¹ the Oklahoma Supreme Court affirmed a trial court finding of a mining partnership, with the reluctant partner liable for materials where he had co-signed the drilling contract, furnished a credit reference, urged that "he saw no reason why plaintiff shouldn't sell them some material," asked to be sent copies of invoices, and asked to "attend" to certain issues raised by plaintiff's president.¹¹² *Sparks* is one of a number of cases

106. See *supra* note 97 and accompanying text. Mining partnerships sometimes are said to also require a "community of interest" and mutual agency, see 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.3; Brimmer, *supra* note 24, at 88 (citing these as early Texas requirements); Jones, *supra* note 98, at 414, 428-29 (taking elements from lead Texas case of *Wagner Supply Co. v. Bateman*, 18 S.W.2d 1052 (Tex. 1929)); but it is doubtful whether in practice these elements add much to the joint-venture requirements. Presumably sharing profits and losses, joint ownership, and joint operations define a community of interest, which as a separate requirement "appears undefined and undefinable," see 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.3; see also Jones, *supra* note 98, at 428 ("no question" of community of interest if other mining-partnership elements proven). Mutual agency is proven from proof of a mining partnership, rather than vice versa. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.3.

107. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437.1, at 524. If the test is this loose, then either a nonoperator's right of control or actual control "may" result in a court finding a mining partnership, *id.*, § 435.2, at 510, though the same looseness suggests that this result will not necessarily follow. Loose tests often are unpredictable tests.

108. Fiske, *supra* note 22, at 190-91.

109. *Id.* at 200.

110. See Jones, *supra* note 98, at 411.

111. 339 P.2d 1056, 1058 (Okla. 1959).

112. See *id.* at 1058-59. As the Oklahoma Supreme Court summarized this evidence, this purported nonpartner "co-operated in obtaining the contract with Hill, in obtaining credit with plaintiff, and in advancing financial aid for expenses." *Id.* at 1059-60. *Sparks* is a far cry from the ordinary nonoperator case. In another case of active involvement, the two

that find such liability to third parties.¹¹³ The risk of its approach to third-party liability is that even when nonoperators do not deal directly

defendants had drilled a well to 4400 feet, but encountered difficulties and invited a third party to join them by completing the remaining work. Not surprisingly, the Oklahoma Supreme Court affirmed liability without an extended review of the evidence. *See Robb v. Chapman*, 96 P.2d 1033, 1033-34 (Okla. 1939) (upholding mining-partnership liability found by trial court in material lien lawsuit).

The issue in the standard joint investment vendor case is whether investors who have not actually managed the venture, even though they receive reports, pay expenses, and may from time to time question the operator, are liable to third-party vendors. One of the reasons the industry has developed the joint-account format is for industry companies to be able to raise money from nonindustry and even other industry companies on projects where the investors' risk is limited to their proportionate share of expenses. *See generally Dunbar v. Olson*, 110 N.E.2d 554, 667 (Ill. App. Ct. 1953) (explaining rationale for limiting nonoperator liability in joint-venture case).

Neither the vendor nor the nonoperator expects the latter to have full, unlimited liability for 100% of the project's costs—for instance, neither expect that the nonoperators will have to step in if the operator goes bankrupt and has squandered their contributions, or spent them on other projects without paying vendors. The situation changes, though, under standard principles of tort and contract law, if a nonoperator or its representative actually deals with a vendor in a way that makes it reasonable for the vendor to believe the nonoperator is putting its financial resources and credit behind the project. That happened in *Sparks*. Some courts have held nonoperators to standards based on subjective intent when they are in a dispute with the operator, but to only objective manifestations of liability when asked to make nonoperators pay for what are really the operator's debts in third-party disputes. *See, e.g., Bolivar v. R & H Oil & Gas Co.*, 789 F. Supp. 1374, 1379 (S.D. Miss. 1991). Courts are protecting the same reliance interest as agency law generally: if a third party is reasonably led to believe that the nonoperator has put its credit behind a project, it can recover against that party.

113. In *Mud Control Laboratories v. Covey*, 269 P.2d 854 (Utah 1954), the Utah Supreme Court endorsed similar mining-partnership liability without similar justification. The operating agreement gave the two operators "sole right to explore and develop the land and to hire and control employees." *Id.* at 858. In spite of this standard provision, the Court upheld a trial court finding of a mining partnership (and, accordingly, of nonoperator liability). The court apparently divined an active role for the nonoperators from the fact that they did not have to pay until the operators began drilling the well; that the agreement specified standards for the drilling; that the nonoperators had free access to the well site and got copies of reports; and, finally, that they had a right to consent to abandonment. *See id.* at 858. A number of these rights, of course, are given to nonoperators in every standard agreement. The court concluded that the agreement gave the nonoperators "rights of control and protection of their investment beyond what mere investors ordinarily have." *Id.* Control did not have to be equal. *See id.* at 859. Then the court claimed that when a nonoperator "supplies money which is to be used in working the claim, he is engaged in such work as truly as is the one who devotes his own labor to the enterprise." *Id.* at 859 (citation omitted).

Under this test, almost any operating agreement would create a mining partnership. (The court did get one thing right. It held that a limit on the nonoperators' liability to \$16,000 in expenses did not limit their exposure to third parties. *Id.* at 859. Had the court been correct that third-party liability should exist at all, it was correct that the parties could not extinguish an exposure created by law under their own internal agreement.)

with vendors, courts may use very small amounts of cooperation to make nonoperators pay the operator's debts.¹¹⁴

Mud Control shows how courts can create very unexpected liability if they include in the "control" issue unexercised legal rights and not just actual control. *Mud Control* makes two mistakes. First, the nonoperators' failure to exercise their legal rights was but a symbol of a larger imbalance in control that favored the operator. Second, the type of control the court did mention, things like receiving routine reports and consenting to abandonment, had absolutely nothing to do with the materialmen liens at issue. In the ordinary investment, nonoperators have no say about which vendors and drillers are used and how the operator supervises well-site work. There is nothing to suggest that the *Mud Control* investors were any different. Moreover, in the ordinary investment, vendors and similar parties do not expect, and have no basis to expect, that they will be able to reduce their risk of operator insolvency by thrusting their fingers deep into the nonoperators' pockets.

In *Mountain Iron & Supply Co. v. Branson*, 8 P.2d 407 (Kan. 1932), the Kansas Supreme Court upheld a mining partnership in a lawsuit brought to recover the cost of certain drilling equipment. Even though the operator had been "in the active charge and management of the well and the leasehold" throughout, the trial court had found, from findings on "the surrounding circumstances and the conduct" of the defendants, that a mining partnership existed. *Id.* at 408. Because the Supreme Court only listed defendants' being co-owners and their regularly receiving production as underlying facts, but omitted the details of the trial court's findings, it is impossible to determine the full conduct upon which the judgment rested. *Id.* at 409; see also *Gilbert v. Fontaine*, 22 F.2d 657, 658-62 (8th Cir. 1927) (using mining-partnership theory to enforce operator's lien against nonoperator).

The Texas Supreme Court resolved a case of dueling liens using a mining-partnership theory in *Wagner Supply Co. v. Bateman*, 18 S.W.2d 1052 (Tex. 1929). *Wagner Supply Company* supplied pipes, casing, and similar material. The plaintiff, *Bateman*, had taken over drilling in return for a one-quarter share of the well and a partial cash payment for its labor. See *id.* at 1053-54. The trial court had found its lien of equal priority with the supply company's, a decision with which the court of appeals agreed but the Texas Supreme Court did not. The latter held that *Bateman* was "according to [his] own allegations," a partner. *Id.* at 1055. He shared costs because he absorbed much of the drilling cost, and even though he had what was called an overriding royalty, he was sharing profits from the well with the others (the court believed that this was not a true royalty because it did not derive from the landowner interest). See *id.* Citing the general principle that partnership rights are "inferior" to creditors' rights, the Texas Supreme Court accordingly held that his claims were secondary to *Wagner Supply Company's*. *Bateman* has been called the leading case in Texas on third-party issues. See *Brimmer, supra* note 24, at 102. For criticism of the court's treatment of *Bateman* as a partner even though his nominal interest was a royalty interest, see *Jones, supra* note 98, at 422-23.

114. As an example, consider the unhappy nonoperator *Dana* in *Dana v. Searight*, 47 F.2d 38 (10th Cir.), cert. denied, 283 U.S. 856 (1931), a case decided under mining partnership law even though the chain of litigation began when the owner who actually drilled the wells sued the other for expenses on a "joint adventure" theory. See *id.* at 39. The trial court and Tenth Circuit found *Dana* liable for all partnership debts and treated the existence of a mining partnership as a question of fact. The dispute, predictably, was over control. One of *Dana's* letters told the operator that he was "of course leaving you in full control of the actual business and operation of the parties," another that "You are drilling the wells, you know your business, go ahead." *Id.* at 40-41. The operator, on the other hand, claimed that he "frequently counseled" with *Dana*; that they "consulted constantly...in the management and operation of the property," including on building two storage tanks. See *id.* Although it

Other courts have found that ordinary joint-operating arrangements do *not* create a mining partnership. Most of the cases also stem from claims by vendors, service companies, and drillers.¹¹⁵ In

is not clear what he meant by "consulted," this record sounds hard to distinguish from the right of access and receiving reports in the ordinary, passive, non-mining-partnership case.

Where there is direct contact with vendors, as in *Sparks v. Midland Supply Co.*, it may be appropriate for liability to be a fact issue, but the real issue then should not be whether the parties were running a mining partnership or joint venture. Instead, it should be whether the nonoperator made direct representations or agreements or otherwise acted in a way that exposed its personal credit to the vendor. Consider not just *Sparks*, where this clearly happened, but *Bovaird Supply Co. v. McClement*, 177 N.E.2d 430 (Ill. App. Ct. 1961), a close-shave case that might well have been better decided for the vendor. Bovaird Supply Company was suing for equipment and supplies it had furnished. Bovaird had furnished equipment to three wells, but been paid for only two. The most active party had died, and his estate could not cover the debt on the disputed well.

Bovaird introduced evidence that when it set up an account to fund the first well, the defendant, McClement, came to the negotiations and gave his own credit references. Bovaird's sales representative was told at this meeting that McClement and the deceased were partners. *See id.* at 433. McClement had a 45/512th interest in the disputed Belle Dial lease. Bovaird also claimed that McClement "used his experience in directing the completion of the well." *Id.* at 432. It was undisputed that McClement had visited the well site and that he attended meetings where the drilling contract was signed; the driller believed that he was drilling for McClement as well as for his partners. *See id.* at 434.

The trial court refused to enter judgment against McClement, and the court of appeals affirmed. The court may have been influenced by McClement's testimony that he only received his assignments as security for an \$800 debt another defendant owed to him at McClement's grocery store; by the fact that he had not received any part of the salvage value from the Belle Dial lease; and by the apparent lack of evidence that he had given specific assurances or requested credit on that lease. *See id.* at 433-34. But the other uncontradicted evidence about McClement's activity, from his signing drilling leases to meeting with the vendor and supplying his own credit references, made him very unlike the ordinary passive nonoperator.

In *Arrow Petroleum Co. v. Ames*, 142 N.E.2d 479 (Ind. 1957) (en banc), an oil company sued for "money, services, and materials" it had advanced to the joint account. The defendants had relatively small interests, either 1/8th or 1/16th, and the operator agreed to negotiate contracts, select well locations, and "manage the affairs" of the project. *See id.* at 482. Unfortunately, the parties' agreements used the language of partnership and repeatedly called the venture a "co-partnership" (though purporting to limit liability to an investor's capital contribution). *See id.* at 481-82. The court treated the project as a partnership under general Illinois law, and rejected limited liability where the parties had not complied with limited partnership statutes. *See id.* at 483.

Other cases affirm a finding of mining partnership under the three-part factual test without any discussion of the evidence. *See, e.g., Conley Drilling Co. v. Rogers*, 132 P.2d 959, 961 (Okla. 1943); *Robb v. Chapman*, 96 P.2d 1033, 1033 (Okla. 1939).

115. Not all of these cases are third-party cases. *Schulte v. Apache Corp.*, 949 P.2d 291 (Okla. 1995), was a lawsuit by forcibly pooled interest owners who claimed they had a right to share in acreage earned by a producing well. Their operating agreement had a standard acreage contribution clause (one that entitles all interest owners to share acreage earned by their well) but it was crossed out. *See id.* at 294. The Oklahoma Supreme Court held that there could be no mining partnership because the plaintiffs had not "participated in the

Blocker Exploration Co. v. Frontier Exploration, Inc.,¹¹⁶ a seismic company tried to recover from the nonoperator after the operator took bankruptcy. The trial court granted summary judgment for the nonoperator because it did not share in joint operations, and the Colorado Supreme Court affirmed. The critical issue was control. A mining partnership could be proven if a co-owner took an "active role in the conduct of operations," or if the parties' agreement gave them "a right of participation in the management or control of the operations."¹¹⁷ The nonoperator's limited role did not rise to this level; "the rights to receive certain data, to have access to the site, or to be consulted do not convince us that Blocker actively controlled the exploration."¹¹⁸

Instead of extracting joint operations from the legal rights that nonoperators retain over some parts of the investment as in *Oklahoma Co. v. O'Neil*, for instance from such rights as consenting to completion and subsequent wells or receiving progress reports, courts in third-party cases generally expect more than limited, abstract legal rights. Courts require extensive, actual involvement in running the business or

promotion, conduct or management of Apache's business," nor did the evidence show that the parties had intended to form a partnership. *See id.* at 297.

Schulte is a good case for showing why operators should be held to fiduciary standards. Apache earned substantial acreage from drilling a joint well but it did not share this benefit with its interest owners. It did not dispute that it told the plaintiff that the deletion of the earned acreage clause was "no big deal. You don't get those acres until it's earned, so we don't worry about it until the well is completed." *Id.* at 298 (Summers, Vice-C.J., dissenting, joined by Kauger, C.J.). The jury had returned a \$1,730,133.00 verdict. The supreme court took the award away, as far as fraud and negligent misrepresentation were concerned, because it found that Schulte had decided to participate before learning of the earned acreage. The court would not let him sue on the operating agreement because he had not signed it (so he could not rely on it). And the court tossed his joint-venture/mining-partnership theories for the reasons already stated. *See generally id.* at 296-97 (majority opinion). This is a very harsh result given the sharp, unfair dealing.

116. 740 P.2d 983 (Colo. 1987).

117. *Id.* at 987.

118. *Id.* at 988. As stated by the court of appeals:

Such commonly accepted rights of nonoperators as the right to receive reports and statements, to take in kind, to advance limited funds or services or equipment, or to have access to the site, to inspect books, or the right to withhold approval or specified expenditures, do not, by themselves, rise to the level of such active participation or control of the operation so as to constitute "joint operations."

Frontier Exploration, Inc. v. Blocker Exploration Co., 709 P.2d 39, 42 (Colo. App.), *aff'd in part, disapproved in part*, 740 P.2d 983 (Colo. 1987). Creating unlimited liability on nonoperators would remove the utility of joint operations; "[t]o hold otherwise and thereby charge parties willing to risk their monies with the unlimited liability of a general partner, would not be in keeping with general policies of promoting investment and development." *Id.* at 43.

significant contract rights.¹¹⁹ In almost none of the third-party cases do the nonoperators supervise activities that involve suppliers or drillers.

119. In *Sparks Bros. Drilling Co. v. Texas Moran Exploration Co.*, 829 P.2d 951 (Okla. 1992), the driller and one supply company were not fully paid and sued Texas Moran, a nonoperator, to recover. The operator had "full control" of operations, even though the nonoperators had a legal right to override this control if they voted to do so (but they never had). *See id.* at 952. The case did not show actual nonoperator management. Neither plaintiff relied upon the nonoperators "in deciding to drill the well or to supply the casing materials." *Id.* at 953. The trial court had found Texas Moran liable, but the Supreme Court reversed. It held that these investor rights were not enough to prove significant "cooperation"; "[r]eceiving reports, questioning bills, hiring a pumper to evaluate the well in contemplation of taking over as operator, and other similar acts are things that any prudent investor would do to protect his investment." *Id.* at 954. Thus, Texas Moran would not be held jointly liable for all well costs. It was, of course, still "severally liable, that is liable only to the extent of its interest in the well." *Id.* at 952.

In *Templeton v. Wolverton*, 179 S.W.2d 252 (Tex. 1944), a passive nonoperator appealed to the supreme court on a judgment that it was jointly liable for overdue drilling costs. Though the investment agreement stated that the operators "shall expect your council throughout the entire operations," nothing in it "suggest[ed] that [the nonoperator] will participate in the actual development or operation of the property." *Id.* at 253, 255. The nonoperator had no role in drilling except advancing money. *See id.* at 256. The trial court and court of appeals had allowed the driller recovery from the passive owner as well as the two active operating owners; the supreme court reversed, finding that all this defendant had done was jointly own a lease and loan funds to the other two. The supreme court did not see any sign that this owner had any active role in development, or that he ever dealt with the driller. *See id.* at 256.

In *U.S. Truck Lines v. Texaco*, 337 S.W.2d 497 (Tex. Civ. App. 1960), the court of appeals followed *Templeton* and affirmed the trial court's refusal to let a road builder sue nonoperator Texaco directly for rental costs on a board road. Not only did the agreement give the operator "exclusive charge, management and control of all development," but the agreement also stated that the parties did not intend to establish a partnership and, separately, that liability would be several, not joint. *See id.* at 498. Texaco did not participate in any negotiations or agreement with the road builder. *See id.* A partnership did not result just because of "proof of counseling, presence at the well, interest in the result of the drilling and knowledge of the existence of such a contract [like the road building contract]." *Id.* at 500.

Another court of appeals case followed *U.S. Truck Lines*, and was affirmed by the supreme court, in *Youngstown Sheet & Tube Co. v. Penn.*, 355 S.W.2d 239 (Tex. Civ. App. 1962), *aff'd in part, rev'd in part on other grounds*, 363 S.W.2d 230 (Tex. 1962). The operating agreement gave the operator "exclusive charge, control and supervision of operations of every kind." *Id.* at 241. It also disclaimed a partnership. *See id.* Though the issue was presented as one of law, not fact, the court agreed that the nonoperators were not partners and, therefore, not directly liable on certain materialmen liens. *See id.* at 245.

In *McAnally v. Cochran*, 46 P.2d 955 (Okla. 1935), the Oklahoma Supreme Court reversed a judgment imposing labor and material charges on nonoperators. A mining partnership could arise by express or implied agreement or "from the relation and conduct of the parties." *Id.* at 956. But where there was no evidence the parties had contemplated or agreed to a partnership, the operator had exclusive control over drilling, and the other parties were not consulted and had no authority to act, there was no mining partnership. *See id.* at 958-59.

In *Berchelmann v. Western Co.*, 363 S.W.2d 875 (Tex. Civ. App. 1963), the trial court had held nonoperators liable to creditors who supplied material and services to the account. The court of appeals reversed because the operator "was given exclusive charge, management and control of all operations of every kind to be conducted on the Shannon A lease for the development, production, treating and handling of oil and gas." *Id.* at 877. The plaintiffs had extended credit based on the operator's credit, not the nonoperators'. *See id.* at 876.

For what can be viewed as an escaped-insult-to-injury case, see *Edwards v. Hardwick*, 350 P.2d 497 (Okla. 1960). The defendant agreed to furnish some tubing to the driller, in return for a 7/32nd interest in the property and repayment for the tubing from production, only to have other supply companies try to enforce their liens against him. A "present partnership" did not exist because the partnership, and all of Edwards' recovery, was contingent upon the well's being completed as a commercial well. *See id.* at 499-501. There was no mining partnership because this required Edwards to have been "actively joining in the promotion, conduct or management of the joint venture." *Id.* at 502. All Edwards did was supply casing and tanks.

One problem with the continuing availability of the joint-venture and mining-partnership doctrines to create nonoperator liability to third parties is that a vendor's own confusion may expand the investors' risk where none should exist. In *Continental Supply Co. v. Dickson Oil Co.*, 153 P.2d 1017 (Okla. 1944), the vendor billed the nonoperator, an oil company, as well as the operator, even though it had not been told to do so. The nonoperator's field superintendent apparently accepted a delivery even though it advised that the bill should go only to the operator. The vendor made out the account in their joint name without authorization. *See id.* at 1019. The operator assumed responsibility over drilling, though it and the nonoperating defendant agreed that they would "jointly, operate the property" if production was found. *See id.* at 1018. The Oklahoma Supreme Court affirmed the trial court's determination, on "facts [that] were in sharp dispute," that there was no mining partnership. *See id.* at 1020; *see also* Katnig v. Johnson, 383 P.2d 195, 197-99 (Okla. 1963) (affirming jury finding of no mining partnership where defending interest owner denied authorizing a second well or agreeing to pay for it in suit brought by interest owner who had drilled the well).

See Williston Oil & Gas Co. v. Phoenix Ins. Co., 271 F.2d 745, 746-47 (10th Cir. 1959) (finding no evidence of "cooperation" as mining partnership where oil company did not execute drilling contract and had no authority over drilling equipment or work, in case where driller's insurers were trying to recover for fire damage to drilling company's truck; reversing judgment for plaintiff insurers); *Anderson v. Keystone Supply Co.*, 220 P. 605, 605-06 (Okla. 1923) (reversing judgment against nonoperator; driller sued after operator "absconded from the realm," but facts did not show "commercial or trading partnership" given that defendant had no dealings with driller, did not hold himself out to creditors, and they did not extend credit on his account; he "did not do anything whatever in conjunction with [driller] in the particular work of drilling this well, or procuring the drilling of same"); *Bolding v. Camp*, 6 S.W.2d 94, 95-96 (Tex. Comm'n App. 1928) (reversing court of appeals' finding of liability where all defendant had done was pay \$600 for a 1/16th interest in property (with record not even clear if this was a leasehold interest); appear at the well site, which just showed "a natural curiosity"; and mention to the driller that he was "interested" in the property and wanted to talk to operator about paying debts).

As with joint ventures, so a mining partnership may have existed but been terminated, in which case there is no continuing obligation. *See, e.g., Gilroy v. White Eagle Oil Co.*, 201 F.2d 113, 115-16 (10th Cir. 1952) (defendants did not owe any duty as partners

When they do, courts can impose liability under ordinary contract, agency, and tort principles.¹²⁰

In general, the mining-partnership cases harbor the same conflicts and inconsistencies, including the lack of a clear rationale and the unwise combination of third-party and internal-duty cases, as the joint-venture cases.¹²¹ They too require a demonstration of control or cooperation—proof of a nonoperator's increased ability to protect itself—before they will extend extra protection.

to plaintiffs for letting lease lapse when plaintiffs did not have interest in the same lease, but only in a later-acquired lease on same property).

An ordinary farmout does not create a mining partnership, even if the farmor agrees to pay something for the well. *See Jenkins v. Pappas*, 383 P.2d 645, 647–48 (Okla. 1963); *see Fiske*, discussed *infra* note 121; *Conine*, discussed *infra* note 431. Actually, a farmout may fail all three joint-venture and mining-partnership tests: the retained royalty interest is not really “joint” with an acquired working interest; farmors ordinarily do not share losses and they do not really share “profits,” because their return (unlike the lessee's) does not depend upon revenues exceeding costs (even though their share may increase at some predefined payout); and they do not have a role in managing the drilling operation.

120. Indeed, courts that do grant creditors relief against nonoperators really seem to do so because they understand that more basic principles point in this direction. *Cf., e.g., Brimmer*, *supra* note 24, at 101 (courts finding for creditors generally note limited power of managing partners but then use doctrines like estoppel or waiver to find for creditor); *Jones*, *supra* note 98, at 432 (estoppel may apply if cotenants hold themselves out as partners to creditors who reasonably rely on this appearance).

121. In his review of mining-partnership law, Terry Fiske concludes that either actual participation or a right to participate or control, even a mere right to get drilling reports or other information, can be enough to prove joint operations, even though a single factor “[r]arely, if ever, . . . form[s] the basis of a decision upon mining partnership existence.” *Fiske*, *supra* note 22, at 200–03. The text shows that the uncertainty over the standard runs deeper than this; the opinions on joint operations in fact are unreconcilable. Fiske is right that courts are less likely to make outside investors mining partners than industry players. *See id.* at 203. He explains this with the observation that in most of these cases the operator gets all control. *See id.* at 204. Yet most of these deals are structured by the JOA, and there nonoperators get the kind of right to drilling reports and other information that Fiske had just discussed as potentially being enough to sustain joint operations. While tying liability to nonoperator control makes sense when third-party liability is at stake, it perversely lowers protection to those most needing it when courts apply this rule to operator/nonoperator disputes.

Fiske's position seems to be that courts should require more than a right to control. He argues that the ordinary farmout or operating agreement should not create a mining partnership, even for industry parties, as long as the nonoperator is disengaged from operations, and that the better-reasoned cases stick to this rule even if there is “some consultation” (the kind envisioned under the JOA). *See id.* at 207–08. He is right that “actual disassociation from operations is vital”; virtually all courts will find partnership liability when nonoperators clearly manage the common venture.

B. Courts Have Imposed "Trustee-Type" Duties via the JOA

Joint ventures and mining partnerships, with their requirements of control, are an aberration among fiduciary cases. They deviate from common-law fiduciary concepts and even from other oilfield fiduciary cases by requiring investors to have more control over the project before the investors qualify for heightened protection. Ordinarily, one would expect those *less* in charge to deserve *more* judicial assistance. A prominent line of operator cases more in the mainstream bypasses the intricacy of these theories and construes part of the standard operating agreement as creating a "trustee-type" relationship as a matter of law. These cases call the resulting duty "fiduciary" and apply to the operator's handling of investors' funds. The rationale for protection is exactly opposite that of cases requiring investor control or cooperation to raise the operator's duty; here the operator's control and nonoperators' dependence create liability.

The lead case for finding a trustee-type duty in the JOA is a Tenth Circuit case, *Reserve Oil, Inc. v. Dixon*.¹²² The operator, Dixon, allegedly sold production belonging to Reserve Oil, an interest owner, but then used the proceeds to pay for operating costs and shares of other owners.¹²³ The trial court dismissed Reserve Oil's claims,¹²⁴ but the Tenth Circuit reversed. The court noted that the operating agreement gave ownership of its share of production to each owner. Proceeds from an investor's production were earmarked funds; the operator could invade an investor's proceeds only to pay that owner's unpaid costs.¹²⁵ Nothing authorized the operator to commingle these funds or to use one owner's money to pay another's obligation.¹²⁶ The court treated the operator as a trustee laboring under fair dealing or fiduciary standards:

122. 711 F.2d 951 (10th Cir. 1983).

123. *See id.* at 952. The operator used the money to help its top officers and their friends and relatives. *See id.* A companion case alleged that the defendants committed other acts of misconduct. The Tenth Circuit described these as "various acts of misconduct" but did not offer any more detail. *See id.*

124. The trial court rejected conversion arguments because it did not find an obligation to return any "specific" money, denied that the operator had any duty to keep interest-owner revenues separate from its own, and denied that the operating agreement created an agency relationship. *See id.*

125. *See id.* at 952-53.

126. *See id.* at 953. The court interpreted the agreement to let the operator use investor revenues "for its own use only to the extent necessary to cover the owner's unpaid proportionate share of the costs of production." It could find nothing "authorizing the commingling of funds." *Id.*

We therefore hold that this contract created a trustee type relationship imposing a duty of fair dealing between the operator and the non-operator owners in the matter of distribution of shares among the owners. We do not mean to imply that there is a general agency relationship as to third parties, which of course is specifically disavowed in the contract itself.¹²⁷

Reserve Oil is one of the most influential operator cases. Unfortunately, while the Tenth Circuit relied on trust and agency principles and prior fiduciary case law,¹²⁸ it did not explain in much detail why *Reserve Oil* should be decided under these principles. The reasons for the holding and its scope therefore remain obscure. The court cited none of the many prior Tenth Circuit joint-venture or mining-partnership cases,¹²⁹ nor did it say why the operating agreement transformed Dixon into a fiduciary as a matter of law when so many joint-venture cases treat the operator's duty as a question of fact.¹³⁰

127. *Id.* (emphasis added). Thus, the doctrine avoids the unintended third-party liability that a joint venture or mining partnership may bring.

128. Because the Tenth Circuit reversed a trial court decision that was predicated on the belief that the operating agreements did not create an agency relationship, and because the circuit court restricted its holding by stating that it did "not mean to imply that there is a general agency relationship as to third parties," it seems fair to imply that the court did believe there was an agency relationship, at least in "the distribution of shares among owners," from operator to nonoperator. See *id.* at 952, 953. The court also used general trust language; it called the operator's duty a "trustee type relationship imposing a duty of fair dealing." See *id.* The court also drew from more general fiduciary principles when it cited with seeming approval the unit operator-fiduciary rule. See *infra* note 129.

129. The Tenth Circuit did cite one prior case, but that case was decided as a unit-operator case, not as a joint-venture or mining-partnership case. *Reserve Oil* cited as authority that "the Oklahoma Supreme Court has held that the operator of a unitized oil field stands in a position similar to that of a trustee with respect to those interested in the oil production," citing *Young v. West Edmond Hunton Lime Unit*, 275 P.2d 304 (Okla. 1954), appeal dismissed, 349 U.S. 909 (1955). See *Reserve Oil*, 711 F.2d at 953 n.4. *Young* is the lead unit-operator case and stands for a group of cases that treat unit operators as fiduciaries without using standard joint-venture analysis. See *infra* Part III.D. But the *Reserve Oil* opinion does not explain why this unit-operator citation was relevant—it does not indicate, for instance, that the properties were unit properties.

Hendrix and Golding have cited *Reserve Oil* as an example of courts imposing a constructive trust "in connection with the duty to account for money or property received." See Hendrix & Golding, *supra* note 10, at 10-10. Whatever the true origin of the *Reserve Oil* rule, it is clear that in some ways courts do impose fiduciary obligations on operators.

130. Hence, it perhaps is not surprising that the court's implication of a broad fiduciary duty case drew an attack that it "promotes specious litigation by encouraging disgruntled nonoperators to sue on the basis of the operator's presumed 'fiduciary duty.'" See Henry Eyring, Note, *The Oil and Gas Operator's Duty to Nonoperating Working Interest Owners*, 1987 BYU L. REV. 1293, 1300.

The Tenth Circuit limited its holding to a trustee-like duty "in the matter of the distribution of shares among the owners."¹³¹ Here too, though, its intent was unclear. The court did not say whether it would extend the same duty to shared costs and expenses or to other operator activity, although logic suggested that it should. After all, the operator acts just as much for the joint benefit in collecting funds and spending them, in planning the wells and overseeing operations, as it does in distributing proceeds of production. Nor did the court say whether its prohibition on commingling proceeds of production (the joint account's revenues) extends to other commingled funds, like the money investors pay for well costs (the project's funding). The narrow holding on commingled production is also odd because commingling is a common, accepted industry practice.¹³²

Though the Tenth Circuit did not explain the precise basis for the JOA's trustee-type duty (or its exact scope), it said enough to make clear that *Reserve Oil* is an independent basis for the operator's fiduciary duty, one judicially constructed as a matter of law from the JOA.¹³³ That this contract-based duty is distinct from traditional joint-venture and mining-partnership cases was almost immediately confirmed by the

131. *Reserve Oil*, 711 F.2d at 953.

132. The industry has danced around the commingling/escrow issue for years. The first draft of the proposed 1989 JOA contained a provision that, at the election of the operator or a majority of owners, the operator would establish an escrow account for each project (though apparently not for each investor). The measure was derailed by industry opposition. See John Burritt McArthur, *A Twelve-Step Program for COPAS to Strengthen Oil and Gas Accounting Protections*, 49 SMU L. REV. 1447, 1476 & nn.63-64 (1996) [hereinafter McArthur, *Twelve-Step Program*].

The 1989 JOA states that operators shall hold funds advanced for the joint account, and that the funds remain joint-account funds until "used for their intended purpose or otherwise delivered to the Non-Operators." 1989 JOA, art. V.D.4. Nonetheless, this seemingly good start is destroyed by the qualifier that "[n]othing in this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree." *Id.* On the other hand, while it does not itself expressly impose a fiduciary duty, article V.D.4 also contains language indicating that it does not intend to overturn a fiduciary duty over the handling of funds. See *infra* notes 241-242, 333 and accompanying text. Commingling funds without any protection for the separate investors' accounts—even if the protection is the operator's general solvency—should be improper. For a sign of the stringency with which courts have treated trust funds in another major oilfield context, see *Shutts v. Phillips Petroleum Co.*, 567 P.2d 1292, 1300 (Kan. 1977) (company had no right to interest on royalty-owner share of suspended money on escrowed funds from regulated price increase).

133. Perhaps keying to the use of trust and agency principles and to the fact that the Tenth Circuit resolved the operator's duty as a matter of law, several cases call this an "equitable" duty. See, e.g., *In re Mahan & Rowsey, Inc.*, 817 F.2d 682, 684 (10th Cir. 1987) (claiming that, in *Reserve Oil*, the constructive trust was "imposed involuntarily upon the Debtor by operation of equity" (citation omitted)).

bankruptcy court opinion of *In re Mahan & Rowsey, Inc.*¹³⁴ The investor in what turned out to be a dry hole was overbilled but could not get its money back when the operator, Mahan & Rowsey, filed for bankruptcy. The investor sued for breach of fiduciary duty on the theory that Mahan & Rowsey held its funds in trust, so they could not become part of the bankruptcy estate.¹³⁵

Whether the parties were in a joint venture was a fact issue that the court refused to decide on summary judgment, but this did not stop it from finding a fiduciary duty.¹³⁶ The court found *Reserve Oil's* independent trust-type duty "dispositive" as a matter of law. On this basis, it held that the JOA created a "fiduciary-beneficiary" relationship "in the matter of collection of non-operator owners' percentage of well costs."¹³⁷ This part of its holding was affirmed by both the federal district court and the Tenth Circuit.¹³⁸ Other courts have cited with approval

134. 35 B.R. 898 (Bankr. Okla. 1983), *aff'd on pertinent grounds*, 62 B.R. 46 (W.D. Okla. 1985), *aff'd after remand*, 817 F.2d 682, 683 (10th Cir. 1987).

135. The plaintiff moved for summary judgment on a constructive trust theory. It argued that Mahan & Rowsey was a fiduciary, that it therefore held the investor's money in a trust that did not become part of the debtor's estate, and that it had to account for the excess funds. *See id.* at 901. The estate and creditors, in contrast, wanted the nonoperators to stand in line for whatever lesser share of their money they would get under bankruptcy priority rules. It should be added that even if *Mahan & Rowsey* is right about the nature of an operator's duty, this may not end the battle over funds. Federal bankruptcy courts may not be bound by state law of constructive trusts, at least if a state court has not already issued a determination on this issue. *See In re Franklin Sav. Corp.*, 159 B.R. 9, 30 & nn.8-9 (D. Kan. 1993). In addition, bankruptcy courts may refuse to give property interests created under a constructive trust theory the same protection as those formed by an express trust. *See In re Foos*, 183 B.R. 149, 157-60 (N.D. Ill. 1993).

136. *See Mahan & Rowsey*, 35 B.R. at 901-02 (finding fact issues under standard joint-venture test, but holding, "we may nonetheless dispose of the matter on other grounds").

137. *Id.* at 903.

138. The district court affirmed the finding of a trustee duty because "[t]his court also recognizes the persuasiveness of *Reserve Oil, Inc. v. Dixon*, 711 F.2d 951 (10th Cir. 1983)...." *Mahan & Rowsey*, 62 B.R. at 47. The court did reduce the plaintiff's recovery from the bankruptcy estate to the lowest intervening balance in the debtor's account. *See id.* at 47-48.

When the Tenth Circuit affirmed, it showed the confusion that can arise from the uncertain source of *Reserve Oil's* trust duty. In the main, it acknowledged that this duty arises from the contract as a matter of law. Thus, the opinion recites that "[t]he bankruptcy court, relying upon *Reserve Oil, Inc. v. Dixon*,...held that the operating agreement between the parties was a 'trustee-type relationship'...." *Mahan & Rowsey*, 817 F.2d at 683. The court described its own prior decision in *Reserve Oil* as holding "that an operating agreement of the type present in this case created a 'trustee type relationship imposing a duty of fair dealing between the operator and the non-operator owners in the matter of distribution of the shares among the owners." *Id.* at 684; *see also id.* (referring to "the fiduciary relationship imposed upon Debtor in the operating agreement").

At the same time, the Tenth Circuit framed the deciding issue in fact-based language: "(t)he principal issue is whether the district court correctly held that a trust arose out of the conduct of the parties." *Id.* at 684 (emphasis added). This phrasing is curious when

Reserve Oil's holding that the operating agreement generates a fiduciary duty in certain areas sua sponte.¹³⁹

the bankruptcy court, in the decision that set the various appeals in motion, expressly refused to decide issues based on the conduct of the parties; this is what it meant when it found questions of fact surrounding joint-venture liability. See *Mahan & Rowsey*, 35 B.R. at 901-02. This is why the court turned to the parties' agreement instead. Moreover, the Tenth Circuit did not explain what it meant by an operating agreement "of the type present in this case," when both cases (*Reserve Oil* and *Mahan & Rowsey*) seem to involve the standard JOA used in the great majority of oil and gas investments. Nor do the opinions in *Mahan & Rowsey* give any detailed explanation for expanding *Reserve Oil* from the distribution of shares to the handling of joint account funds. The bankruptcy judge did discuss constructive-trust principles as well as *Reserve Oil* and noted that "this Court is hard pressed to find why we should not extrapolate" the *Reserve Oil* rule from the distribution of shares to collecting costs, when the costs "hopefully, make the profits possible." *Id.* at 903.

139. See *Envirogas Inc. v. Walker Energy Partners*, 641 F. Supp. 1339, 1345 (W.D.N.Y. 1986) (reading *Reserve Oil* for principle that "operator of oil wells served in a fiduciary capacity, as a trustee, to the working-interest owners"; cautioning against giving *Reserve Oil* "too broad a sweep" because it is "based upon the specific operating agreements at issue in that case," but still finding *Reserve Oil* a "useful analogy"; and concluding in denying an injunction that would have prevented majority owner in 940 of operator's 1400 wells from seeking to remove operator that "it appears likely from all of the terms of the contract" as well as from parties' relationship that defendant was a fiduciary); cf. *Andrau v. Mich. Wis. Pipe Line Co.*, 712 P.2d 372, 375 (Wyo. 1986) (treating *Reserve Oil* as creating a "narrow" trustee-type duty in distribution of shares, but not one that could force operator to collect debts in "least onerous manner" when operating agreement spelled out alternative remedies for nonoperator default). Given the absence of a clear explanation for the *Reserve Oil* duty, it is not surprising to find a case like *Connaghan v. Maxus Exploration Co.*, 5 F.3d 1363, 1365 (10th Cir. 1993), holding that the operating agreement does not create a fiduciary duty, when the correct holding would be that such a duty exists but that the agreement may limit its applicability. There seems to be a continuing confusion over what kind of fiduciary duty *Reserve Oil* creates. See, e.g., *Doheny v. Wexpro Co.*, 974 F.2d 130, 134-35 (10th Cir. 1992) (citing *Reserve Oil's* holding that "contract created a trustee type relationship," but finding that less than fiduciary standard applied to gas balancing dispute where agreement did not outline such duties, "nor are they duties that would naturally arise as corollaries to the obligations set forth in the agreement").

Even though *Reserve Oil* does not seem to have been a unit case, several courts have cited its footnoted dictum, 711 F.2d at 953 n.4, that a unit operator stands as a fiduciary to its investors. See *Shearn v. Ward Petroleum Corp.*, 808 F. Supp. 1530, 1532 (W.D. Okla. 1992); *Leck v. Continental Oil Co.*, 800 P.2d 224, 228-29 (Okla. 1989). The oddity of this reliance is, again, that *Reserve Oil* was not a unit case. It involved an investor in one well, a few partnerships in another case, and the court just "constru[ed] the parties' contracts." *Reserve Oil*, 711 F.2d at 952, 953 n.4. The root of the problem is the mischievous footnote 4, in which the Tenth Circuit discussed the *Young* holding for unit operators. See *id.* at 953 n.4.

For an argument that the trust portion of *Reserve Oil* was not necessary to the decision, see Eyring, *supra* note 130, at 1300. Hendrix and Golding have argued that *Reserve Oil* is a "rare" case where a trust could be inferred from an agreement, see Hendrix & Golding, *supra* note 10, at 10-10, and try to discount its follower, *Mahan & Rowsey*, as an anomalous case. See *id.* at 10-18 & n.48, 10-23 & n.60 (describing *Mahan & Rowsey* as part of duty to account for money). But what they leave out is that these responsibilities for handling partners' money arise in every standard JOA venture. The many cases following *Reserve Oil* suggest that the reach of its duty is broader than such dismissive comments

Reserve Oil can be a pyrrhic victory for nonoperators. In the absence of a better explanation for a trust duty, *Reserve Oil's* adherence to a contract approach can make it easier for courts to conclude that the parties can disclaim this duty.¹⁴⁰ A good example is *Dime Box Petroleum*

suggest. When Hendrix and Golding later argue that a fiduciary duty should arise under a JOA venture only if there is a right of participation or if the operator places itself in a position of trust, they move on without addressing the fact that the operator does so in every JOA investment by the nature of its undertaking.

Some other courts both before and after *Reserve Oil* have read a fiduciary duty directly from an operating agreement, without discussing the three-part joint-venture or mining-partnership test, but independent of the *Reserve Oil* cases. See, e.g., *First Nat'l Bank & Trust Co. of Okla. City v. Sidwell Corp.*, 678 P.2d 118, 124 (Kan. 1984) (confirming constructive trust on property defendants acquired in area of mutual interest, after trial court seems to have divined joint venture from "the agreement when considered in its entirety"); *Beadle v. Daniels*, 362 P.2d 128, 129-30 (Wyo. 1961) (finding with plaintiffs who had argued that operating agreement created fiduciary duty and so prevented operator from charging investors higher price on pumping equipment than operator had paid, although opinion also turns on officers' fiduciary duty to their corporation); cf. *Rankin v. Naftalis*, 557 S.W.2d 940, 944-46 (Tex. 1977) (although jury was asked a variety of issues about parties' duties, see *id.* at 943, the Texas Supreme Court also stated that "we recognize that the relationship between the parties in the Melton lease was fiduciary in character," but limited duty because claims were made to leases outside area of venture); *Tex. Oil & Gas Corp. v. Hawkins Oil & Gas, Inc.*, 668 S.W.2d 16, 17 (Ark. 1984) (affirming finding that operator could not acquire title in its own name after learning of defect in nonoperator title because "[t]here was a relationship of trust and confidence between the parties as a result of their execution of the Joint Operating Agreement").

For an unusual case that might suggest an unexpected extension of *Reserve Oil*, though it does not cite the case, see *People v. Fullop*, 837 P.2d 215 (Colo. App. 1992) (upholding theft conviction where company in operating position had specifically agreed to hold investor funds in separate account, but then used them for its own purposes). This court followed *Blocker Exploration Co. v. Frontier Exploration, Inc.*, 740 P.2d 983 (Colo. 1987), in finding that there was not enough participation to create a mining partnership, see *Fullop*, 837 P.2d at 217, and instead based the criminal conviction on the company's agreement to segregate the funds.

140. An early case usually cited as justification for letting an operating agreement disclaim or reduce fiduciary duties is *Frankfort Oil Co. v. Snakard*, 279 F.2d 436, 443 (10th Cir. 1960), a case in which the Tenth Circuit rejected fiduciary claims by showing how the operating agreement controlled the items in dispute. The operating agreement gave both the operator, Frankfort Oil, and its complaining investor the right to drill development wells if the initial well was a success. The plaintiff complained that Frankfort had concealed geological information and inflated its bills, but primarily that it had allowed leases to lapse by failing to drill on them. The trial court entered judgment for the plaintiff after a summary proceeding in which the court ruled after receiving evidence. The Tenth Circuit decision does not indicate how the case was tried, but the lack of reference to a jury makes it fairly clear that the judge decided the case. The Tenth Circuit criticized the trial court for not showing the disposition of all claims. *Id.* at 438. In an unusual procedure, this deficiency apparently was overcome by the parties' stipulating to the treatment of most major issues. See *id.*

The Tenth Circuit reversed summarily. It deduced a joint venture from the parties' contracts, which sponsored "a common undertaking involving jointly-owned property and

*Corp. v. Louisiana Land & Exploration Co.*¹⁴¹ Dime Box invested with operator Louisiana Land and Exploration (LL&E). Dime Box learned that LL&E was billing equipment to its wells without crediting standard discounts. When Dime Box asked about the prices, LL&E said that its prices were appropriate because the equipment came from its inventory, even though this statement was not true.¹⁴² The contract disclaimed joint liability and limited the operator's exposure to liability for negligence or willful misconduct.¹⁴³

In a bench trial, the court treated the dispositive issue as whether a fiduciary relationship arises from the JOA as a matter of fact or by operation of law.¹⁴⁴ It mixed the general and *Reserve Oil* theories of liability, holding that whether a joint venture exists is always a question of fact, but citing *Reserve Oil* and *In re Mahan & Rowsey* for the principle that a trustee-type duty can arise from the operating agreement "as an equitable matter."¹⁴⁵ Having established that this trust duty can attach as a matter of law, the court cited *Mahan & Rowsey* for the proposition that the duty can be disavowed.¹⁴⁶ Given Dime Box's sophistication and a contract that "specifically disavows a joint undertaking," there was no joint venture and "no fiduciary relationship was created by the JOAs."¹⁴⁷

a sharing of profits." *Id.* at 443. As a result, "the relationship so created was fiduciary in character and required the utmost good faith on the part of both parties." *Id.* Thus, the court agreed that a fiduciary duty could be read from the terms of the agreements. The court quickly qualified its holding, however, in language with great potential for mischief, by ruling that the extent of this relationship "is determined by the written agreements between the parties." *Id.* Because the contracts did not specifically require disclosure of the geological information the plaintiff sought, the operator had not breached its duty by not furnishing this information. *See id.* at 443-44. Moreover, because the contracts allowed either party to initiate an election to drill, but neither required Frankfort to drill added wells, its failure to do so could not be a breach of contract. *See id.* at 441-42, 445.

A number of courts beside *Frankfort* and *Dime Box* have used standard contract terms to preclude a fiduciary duty. The trend seems to be increasing. *See generally infra* Part VI.

141. *Dime Box Petroleum Corp. v. Louisiana Land & Exploration Co.*, 717 F. Supp. 717 (D. Colo. 1989), *aff'd*, 938 F.2d 1144 (10th Cir. 1991).

142. For the general issues, see *Dime Box*, 717 F. Supp. at 721. For the fact that some of these pipes were not from inventory but were being bought under above-market-price "buyback" agreements, see *Dime Box*, 938 F.2d at 1146.

143. *See infra* note 150 and accompanying text.

144. *See Dime Box*, 717 F. Supp. at 720.

145. *Id.* at 721-22.

146. *See id.* at 722. The court also cited *Frankfort Oil v. Snakard*, 279 F.2d 436 (10th Cir. 1960), for the proposition that the parties' agreement controls their relationship; for a discussion of *Frankfort*, see *supra* note 140.

147. *See Dime Box*, 717 F. Supp. at 722. The disclaimers were in article VII, the JOA's assertion of several liability and not making a mining or other partnership, see *id.* at 721, language that *Reserve Oil* held was just intended to apply against third parties, see *Reserve*

On appeal, the Tenth Circuit affirmed the conclusion that Dime Box disclaimed LL&E's fiduciary duties, but it rewrote the theory of liability. Unlike the trial court, the court of appeals thought that LL&E was a fiduciary, given its controlling position.¹⁴⁸ But the issue remained whether the JOA "modified this obligation."¹⁴⁹ The court concluded that the disclaimer of liability except for gross negligence or willful misconduct in the standard JOA contracted for a "measure" of conduct or "yardstick" different from, and less than, a fiduciary's.¹⁵⁰ Though acting as if the parties actually discussed this clause, the court gave no indication whether it understood that the disclaimer is a boilerplate provision that appears without any discussion or negotiation in most JOAs. It is a term that operators have succeeded in imposing on the industry.

At a minimum, *Reserve Oil's* per se extension of protection for a wide (even if not fully defined) range of nonoperator interests suggests a stronger operator duty than any fact-based standard. Commentators have discussed the duty favorably.¹⁵¹ The 1989 JOA itself, though adding

Oil, 711 F.2d at 953 & n.5; and the provision in article V.A that the operator would only be liable for gross negligence or willful misconduct, *Dime Box*, 717 F. Supp. at 721.

148. Though the existence of a joint venture ordinarily is a question of fact, here the Tenth Circuit noted that "undisputed evidence" established a joint venture, given the sharing of profits and conduct showing that the parties "were cooperating in this venture." *Dime Box*, 938 F.2d at 1147. Oddly enough, though the court correctly indicated that some kind of active participation by the nonoperators is needed for a joint venture, it also stressed that under this agreement LL&E as operator controlled Dime Box's income and expenses and "was in full control." See *id.* This hardly sounds like cooperation. The Tenth Circuit inexplicably did not cite *Reserve Oil*, the obvious precedent. Given that Wyoming is in the Tenth Circuit along with Oklahoma, the court's failure to cite *Blackstock*, *Britton*, or *Reserve Oil* betrays sloppy, cursory consideration.

Had the Tenth Circuit followed *Reserve Oil* as expanded by *Mahan & Rowsey*, it almost certainly would have acknowledged that LL&E was a fiduciary in the matter of billing costs and passing back credits. Instead, the court gutted those tests by letting LL&E disclaim all fiduciary duties. It ignored the fact that *Reserve Oil* used contract language to create a trustee-type duty – to expand liability, not to limit it. Moreover, the holding left LL&E free from liability for charging the joint account considerably more than the market price of equipment, all to serve its hidden buyback arrangement, even though "[t]he evidence suggests that LL&E lied to Dime Box concerning its inventory and pipe pricing practices." *Id.* at 1146.

149. See *id.* at 1147.

150. See *id.* at 1147–48.

151. See *Hendrix & Golding*, *supra* note 10, § 10.04[3][a], at 10-22 to 10-26 (accepting fiduciary duty "to account for money or property received by the operator"); Smith, *Duties and Obligations*, *supra* note 24, at 12-10 to 12-11 (likening this obligation to that of anyone with duty to "account for money or property received"); Ernest Smith, *Duties Owed by an Operator to a Non-Operator Under Voluntary Agreements & Compulsory Orders* 3-17 (unpublished manuscript, on file with Natural Resources Journal) [hereinafter Smith,

a much more express disclaimer of an overall fiduciary duty, left room for a fiduciary duty in the operator's handling of money "advanced or paid to the Operator" when it is "for the conduct of operations hereunder."¹⁵² When the operator acts like a traditional trustee with control over the money of another, it will be treated as a trustee.¹⁵³

C. Operators Marketing Production Are Agent/Fiduciaries

In recent years, a series of Texas court of appeals cases launched another fiduciary doctrine when the operator markets production for its investors. In *Johnston v. American Cometra, Inc.*,¹⁵⁴ the lessee and working interest owners sued when a successor operator failed to pursue a claim for breach of a take-or-pay gas purchase contract. The nonoperators argued that their hiring of American Cometra to "operate and manage a well for Appellants" made it their agent and so a fiduciary to them.¹⁵⁵ The Texas court of appeals agreed, holding that if the operator sold gas on behalf of the nonoperators, it owed "all those duties owed by an agent to its principal."¹⁵⁶ In other words, the operator's undertaking to act for its investors and their dependence led to its raised responsibility.

A year later, in *Arco v. Long Trusts*,¹⁵⁷ another Texas court of appeals faced a JOA of the same vintage¹⁵⁸ and agreed that "an agency

Voluntary Agreements & Compulsory Orders]; Guy Wall, *Joint Oil and Gas Operations in Louisiana*, 53 LA. L. REV. 79, 100 (1992).

152. 1989 JOA, art. V.D.4.

153. That this ethical perception is written into law is nothing new. See generally LOUIS D. BRANDEIS, *OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT* (1914).

154. 837 S.W.2d 711, 713 (Tex. App. 1992).

155. Appellants' Brief at 32-34, *Johnston*, 837 S.W.2d 711 (No. 03-90-00249-CV). In response, the operator's brief set out in detail arguments based on both article V.A and article VII.A, as well as the claim that Texas law treats the operating tie as "strictly contractual." For the article V.A argument, see Appellee's Brief at 11, 14-16, *Johnston*, 837 S.W.2d 711 (No. 03-90-00249-CV); for article VII.A, see *id.* at 23; for the caselaw sections, see *id.* at 12-13, 18, 23-24.

156. See *Johnston*, 837 S.W.2d at 716. The operator cited a long line of cases holding that "no fiduciary relationship exists between the operator and the non-operators." *Id.* at 715. Those cases "address the relationship between the operator and third parties," and therefore "are not dispositive of the duty issues raised by appellants' pleadings." *Id.* at 715-16. *Johnston* has been read to give rise to a duty only to perform in a workmanlike manner, John Reeves & J. Matthew Thompson, *The Development of the Model Form Operating Agreement: An Interpretative Accounting*, 54 OKLA. L. REV. 211, 229 (2001), but this reading ignores the rationale of the decision and the agency language that the operator "owes to the non-operators all those duties owed by an agent to its principal." *Johnston*, 837 S.W.2d at 716.

157. 860 S.W.2d 439 (Tex. App. 1993).

158. The language the court cited from its JOA, the take-in-kind paragraph VI.C (see *Long Trusts*, 860 S.W. 2d at 442), was in the 1977 and 1982 JOAs.

relationship does arise when an operator is selling gas belonging to a nonoperator."¹⁵⁹ A variety of prominent commentators, as well as several other courts, have endorsed this agency marketing duty.¹⁶⁰ The 1989 JOA

159. *Long Trusts*, 860 S.W.2d at 445.

160. For academic approval of the marketing fiduciary duty, see Robert Bledsoe, *The Operating Agreement: Matters Not Covered or Inadequately Covered*, 47 ROCKY MTN. MIN. L. INST. 15-1, 15-6 (2001) (arguing that, when the operator handles funds or markets production, it "appears logical that the Operator should function in the same manner as other fiduciaries who handle money belonging to other parties, much the same as trustees, agents, banks, brokers, and other representative parties"); Hendrix & Golding, *supra* note 10, at 10-22 to 10-26 (making exception for fiduciary duty "to account for money or property received by the operator"); Smith, *Duties and Obligations*, *supra* note 24, at 12-10 to 12-11 (likening this obligation to that of anyone with duty to "account for money or property received"); Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-9, 3-17; Margaret Sullivan, *Negotiating Joint Operating Agreements*, 23 OIL, GAS & MINERAL L. 3, 5, 9 (1998); Wall, *supra* note 151, at 100; see also Melanie Bell, *The Evolution of the Onshore Model Form Operating Agreement*, 26 OIL, GAS & ENERGY RESOURCES L. 32, 40-41 n.67 (2002) (noting that several authors have suggested "different levels of liability for different Operator functions," including fiduciary duties for marketing production and handling funds).

Both *Johnston* and *Long Trusts* cited work by Ernest E. Smith on the operator's duty when marketing production. See, e.g., *Johnston*, 837 S.W.2d at 714-15 (citing Ernest E. Smith, *Gas Marketing by Co-Owners: Disproportionate Sales, Gas Imbalances and Lessors' Claims to Royalty*, 39 BAYLOR L. REV. 365, 370 (1987) [hereinafter Smith, *Gas Marketing*] (for proposition that operator may act as agent in selling nonoperators' gas)); *Long Trusts*, 860 S.W.2d at 445 (citing Smith, *Gas Marketing*, *supra*, at 373).

On subsequent cases, see *Jonalstem, Ltd. v. Corpus Christi Nat'l Bank*, 923 S.W.2d 701, 705 (Tex. App. 1996) (finding that operator's "act of selling for the other appellants...made him their agent," citing *Johnston*, 837 S.W. 2d 711, but in an unusual context in which this holding let the court dismiss the case on res judicata grounds because the operator's loss in a prior lawsuit barred plaintiffs' claims); *El Paso Prod. Co. v. Valence Operating Co.*, 112 S.W.3d 616, 625-26 (Tex. App. 2002) (holding fact issue existed over whether operator acted as agent to working interest owner during period when operator marketed interest owner's gas); *Castle Tex. Prod. Ltd. Partnership v. Long Trusts*, 134 S.W.2d 267, 278 (Tex. App. 2003) (operator who refused to sell interest-owners' gas and instead banked that gas did not become their agent or have fiduciary duty). Another later Texas case, *Holloway v. Arco*, 970 S.W.3d 641, 643 (Tex. App. 1998), found the duty inapplicable when the nonoperators' gas had not been dedicated to the gas purchase contract, so the operator could amend the gas purchase agreement without violating (in its view) any fiduciary duty to the plaintiffs. In *Holloway*, the agreement presumably was a standard JOA. The contract had the JOA's pre-1989 "best price obtainable" language, which the court cited as it held that operator Arco might have breached this contract duty. *Id.* at 642. *Holloway* did not rely upon article V.A or article VII.A in agreeing that no fiduciary duty existed on its facts.

A federal court approving the national settlement of oil posted-price claims cited both *Long Trusts* and *Johnston* without criticism, but, in approving a settlement that paid out less for working interest owners than royalty owners, seemingly distinguished them because they concerned natural gas, not oil. *In re Lease Oil Antitrust Litigation*, 186 F.R.D. 403, 426 (S.D. Tex. 1999). Yet none of the legions of JOA cases suggest that this form contract imposes one marketing duty in wells that happen to turn up natural gas, another lesser duty if they strike oil. The opinion states that counsel for defending oil companies

expressly leaves room for courts to hold that the operator is a fiduciary when handling funds "paid to the Operator...as a result of the sale of production from the Contract Area."¹⁶¹

D. Courts Long Ago Began Treating Operators of Unitized Properties as Fiduciaries

Most courts treat the operators of unitized properties as fiduciaries. "Fiduciary principles appear to be applicable to the relationship of the operator under a pooling, unitization or joint operating agreement and persons having interests in the premises affected by such agreement."¹⁶² In these cases, it is the operator's relatively exclusive control and the nonoperators' dependence that require fiduciary responsibility. Courts that might require factual showings of cooperation or control to treat an ordinary operator as a fiduciary nonetheless have settled per se fiduciary duties on unit operators. Moreover, unit operators are fiduciaries as a matter of law, with no requirement that nonoperators exercise control or cooperation in the unit venture.

A unit operator has the same general function as the ordinary operator, but for a larger territory. Unitized properties are mineral interests combined into an area that bounds a producing formation.¹⁶³

claimed that, "even if a crude oil JOA Claim were legally feasible (which he believed was not the case), only a small percentage of the Working Interest Owners would be in a position to assert such a claim." *Id.* Unfortunately, nothing in the opinion indicates the basis upon which the defense lawyers made that representation.

For the language in the 1989 JOA leaving room for the marketing fiduciary duty, see *infra* notes 241-242, 333 and accompanying text.

161. See 1989 JOA, *supra* note 152. Article V.D.4 states that nothing in the paragraph "shall be construed to establish a fiduciary relationship between Operator and non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided." *Id.* Such language almost certainly reflects an intent to incorporate *Reserve Oil* as well as duties like the marketing fiduciary rule.

162. 6 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 990, at 869-70. Williams and Meyers' treatment is somewhat dated because they do not address the extent to which fiduciary status is or should be limited to involuntary pooling and unitization.

163. According to Williams and Meyers,

Although the terms "pooling" and "unitization" are frequently used interchangeably, more properly "pooling" means the bringing together of small tracts sufficient for the granting of a well permit under applicable spacing rules whereas "unitization," or, as it is sometimes described, "unit operation," means the joint operation of all or some part of a producing reservoir.

Id. § 901, at 1-2. The terms are indeed used interchangeably. See, e.g., *Gerard J.W. Bos & Co., Inc. v. Harkins & Co.*, 883 F.2d 379, 381 (5th Cir. 1989) ("little distinction between field-wide utilization and single-unit pooling"). Unitization generally is sought to avoid waste. It

Unitization can come about through voluntary agreement or involuntarily by operation of state law. Even when forced by statute, the change generally leads to entry of a unit agreement and unit operating agreement, two contracts that then control the relationship. Unitization causes at least two major changes: first, a single operator will be thrust upon nonoperators who may have had no role in its selection; and, second, combining a larger group of nonoperators dilutes each nonoperator's vote.

Some courts have stated that the unit operator's fiduciary duty (unlike that of other operators) is an indirect creature of statute, a result of the unit statute's intervention rather than of the parties' contract.¹⁶⁴ But the statutory loss of control that these courts mention is not that different from the structural dependence created under the standard JOA, as is shown by the fact that unitization statutes are implemented by agreements very like the ordinary operating agreement and, indeed, can even provide nonoperators with more protection than the standard agreement.¹⁶⁵

The source of the venerable rule that the unit operator is a fiduciary is *Young v. West Edmond Hunton Lime Unit*.¹⁶⁶ In *Young*, a royalty owner case that the Oklahoma Supreme Court announced could apply to working interests as well, royalty owners in a producing unit sued their operator for allegedly underpaying for their share of the unit's oil. The operator was delivering oil under pre-unitization contracts, even

should benefit both lessor and lessee. See generally 4 KUNTZ, *supra* note 24, § 48.3, at 188. Such combinations may even be "essential" to develop a given property. See *id.* at 187. Even though the case for unitization often may be economically compelling, it can prove difficult to get all parties to voluntarily agree to develop their properties jointly. See 6 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 910, at 85-86; see also *id.* § 901, at 2-4 (discussing similar background for pooling). Some may want to gamble that their properties are more valuable than surrounding properties. See *id.* at 85. For that reason, many states enacted compulsory unitization statutes. Williams and Meyers have recounted this history. See *id.* § 912. For the history of compulsory pooling, which apparently began with controls at the municipal level, see *id.* § 905.1. Some courts also impose pooling under the doctrine of "equitable pooling," in which they imply powers like the compulsory pooling power from general regulatory statutes. See *id.* § 906.

164. See, e.g., *Leck v. Cont'l Oil Co.*, 800 P.2d 224, 229 (Okla. 1989) ("This is not a duty created by the lease agreement but rather by the unitization order and agreement."); see *infra* notes 167-169 and accompanying text.

165. See *infra* notes 391-396 and accompanying text.

166. 275 P.2d 304 (Okla. 1954). In a later opinion, *West Edmond Hunton Lime Unit v. Young*, 325 P.2d 1047 (Okla. 1958), the Court clarified the prices that should be used to determine the underpaid royalties. In a 1962 article, Howard Williams counted 21 cases holding that unit operators are fiduciaries. See Williams, *The Fiduciary Principle*, *supra* note 10, at 261-62. For his early discussion of *Young*, a discussion that no doubt helped bolster its prominence, see *id.* at 264-66.

though it could have found a higher price in the marketplace. In holding the operator bound to pay the highest available market price, the court pointed to the nonoperators' lack of control over the sales as the critical factor.¹⁶⁷ It stressed that the unit statute deprived the plaintiffs of the right to develop their properties or, seemingly, to control their production.¹⁶⁸ Because the law applying to the unit "afforded [the interest owners] no voice in the organization or management of the unit

167. The court claimed that, "by statute," the mineral right owners "lose the right to produce or control the disposition of the production from the particular tract and that right passes exclusively to the unit organization." See *Young*, 275 P.2d at 308.

168. See *id.* at 306 ("This deprived the various lessees of any further right or authority or duty to operate their respective leased premises, or to produce oil therefrom."). The unitization statute compelled mineral owners to:

surrender all right to produce and take oil from the particular tract...[owners] lose the right to produce or control the disposition of the production from the particular tract and that right passes exclusively to the unit organization....And upon unitization the landowner lessors lost their right to have their contracted lessees develop and produce their individually owned acreage for the joint benefit of lessor and lessee....Thus by statute when a tract of land becomes a part of a field brought under unitized management the owners of the mineral rights and interests in such particular tract lose the right to produce or control the disposition of the production from the particular tracts and that right passes exclusively to the unit organization.

Id. at 308.

Other parts of the opinion seem to stress the mineral owners' general loss of control, not their impotence to market production from their original leases, the issue in dispute. See *id.* at 309 ("The law applicable to this unitization required no notice to royalty owners and afforded them no voice in the organization or management of the unit or in the selection of the unit operator.").

In reality, the unit "plan," which is the contractual agreement implementing the unit statute's dictates, seems to have let at least some interest owners take their production in kind, so perhaps the royalty owners could have sold the production attributable to their share of the unit (even if it would not literally have been taken from their particular leases). See *id.* at 309 (citing portion of unit plan that begins "[t]o the extent that any person entitled to take and receive in kind any portion of the Unit Production..."). Take-in-kind rights for royalty owners, the plaintiffs in *Young*, are more common in oil leases than in gas leases, but these properties apparently were "productive of oil and gas," see *id.* at 306, and it is hard to see why the court would cite the take-in-kind language unless it applied to *Young's* royalty owners. Surely the court did not believe that the relevant loss of control was the inability to take possession of the particular hydrocarbons produced from the royalty owners' property, if they remained able to take in kind the correct volumes attributable to their share of the larger area. (Whatever the rights of royalty owners, one would expect the working interest owners, to whom the Tenth Circuit announced *Young's* principles would apply in equal measure, to have rights to take-in-kind.)

It is a key question under *Young* whether the significant loss of control is measured by the overall operator/nonoperator relationship, or only by the relative balance of rights concerning the matter in dispute. If the former, operators are likely to be under a general duty that is set as a matter of law; if the latter, their duty is more likely to turn on a factual analysis that will vary by case.

or in the selection of the unit operator," the unit operator "stands in a position similar to that of a trustee for all who are interested in the oil production either as lessees or royalty owners."¹⁶⁹

Once the Oklahoma Supreme Court decided it would treat the operator like a trustee, it found trust standards violated. The operator paid royalty owners one price even though a better price was available. It had to account to the unit owners "at the highest market price available at the time of such production."¹⁷⁰

Young is a royalty case, but the court extended the holding to working interest owners as well—to "all who are interested in the oil production either as lessees or royalty owners."¹⁷¹ The fact that even royalty owners, whom courts generally do not allow fiduciary protection, fall under the *Young* rule is one sign of the unit rule's stringency.¹⁷² Many courts have followed *Young* to make unit operators

169. *Id.* at 309.

170. *Id.* at 310. This holding applied, at least, when the owners had not received their share in kind or authorized shipment to a particular purchaser. For the take-in-kind right, see *supra* note 168.

171. *Young*, 275 P.2d at 309.

172. While the *Young* court stressed that the royalty owners had no voice in the organization or management of the unit, or in selection of the unit operator (who was chosen by a committee of lessees, not lessors), this does not distinguish these royalty owners from royalty owners who are not pooled or unitized. Ordinarily a royalty owner has nothing to do with the organization or management of the joint account. It does select its lessee, in some cases knowing that this lessee will become the operator, but often even that is not true: the lessee frequently subleases and a third party becomes operator.

Young's equation of royalty and working interest owners is important because it is clear and unambiguous, and because it is so counter to one of the main doctrines of oil and gas law: the *inequality* between royalty owners and working interest owners. The courts generally refuse to give royalty owners as high a formal protection as the one that, in many cases, they will extend to working interest owners. The common rule is that the operator is in a position of at least heightened trust toward its working interest owners (of good faith, utmost good faith, or, as this article shows, that of a fiduciary), but that it owes only a contract duty to royalty owners.

This gap between these two groups of interest owners is narrowed and muddled, however, by the implied covenants that courts add to oil and gas leases. As Howard Williams has claimed, the implied covenants are "consistent with the application of fiduciary principles." See Williams, *The Fiduciary Principle*, *supra* note 10, at 215. Yet the lack of a fiduciary standard has hurt royalty owners in key areas. The most blatant example is in take-or-pay pass-through cases, in which a majority of courts have been quite happy to let operators sell out existing take-or-pay contracts without paying their royalty owners a penny. The operators keep the settlement proceeds for themselves and the other working interest owners—in essence, splitting whatever part of the settlement was due to the royalty owners' share. For an analysis and critique of the take-or-pay majority position, see John Burritt McArthur, *The Mutual Benefit Implied Covenant for Oil and Gas Royalty Owners*, 41 NAT. RESOURCES J. 795, 830–66 (2001).

The reason usually given for offering working interest owners more protection than royalty owners is that the royalty owners are not at risk for ("do not contribute" to)

fiduciaries in both working interest and royalty cases.¹⁷³ As with some other fiduciary duties, this rule probably will not apply in Texas.¹⁷⁴

well costs, and are not the “direct beneficiaries” of operator contracts. In *Diamond Shamrock v. Hodel*, 853 F.2d 1159, 1167 (5th Cir. 1993), for instance, Judge Brown based his analysis in large part on the distinction, which he pulled out of his hat, that take-or-pay payments are “intended to compensate primarily the producer, not the owner of the minerals, for the risks associated with development production.” Cf. *Pritchett v. Forest Oil Corp.*, 535 S.W.2d 708, 710 (Tex. App. 1976) (punitive decision refusing to protect royalty owner from whom reservoir information was concealed, and refusing *Young’s* protection to royalty owner because it was “not charged with the cost of production”). Yet when the substance, and not the form, of the two relationships is analyzed, royalty owners and other interest owners share very similar risks. They both contribute things of value to the well—the royalty owner usually property, the working interest owner usually money. In many situations, royalty owners, like working interest owners, suffer when money is skimmed through hidden discounts, delay payments, overpriced acreage or equipment, or other accounting malfeasance. Both royalty and working interests are affected if improper charges damage the economic viability of a well, or affect whatever production or postproduction costs are deductible under the applicable state law. Even overriding royalty owners are affected if operator wrongdoing destroys the economics of a well, or reduces the amount of production to be sold and revenue to be collected.

Royalty owners lose less from unitization than interest owners in one way because they ordinarily have no vote in the way the property is developed anyway. Thus they have no vote to be diluted. But their lack of voice makes them more dependent, not less, and more in need of an operator who hews to a high standard of care.

Patrick Martin has asked why, if a typical royalty owner has only prudent operator protection, a nonoperator (here he picks Chevron) should be better protected. Martin, *supra* note 27, at 116. He is right in that royalty owners typically are less knowledgeable, have smaller interests, get less information, and generally need even more protection than working interest owners. Were the test some balance of relative experience, as it is on “informal” trust relationships, a higher percentage of royalty owners than interest owners would qualify for fiduciary protection. But both groups share the structural dependence of the nonoperator and the legal implications of the operator’s promise to act for others as well as itself. Royalty owners often are in dire need of fiduciary protection, as the take-or-pay and posted-price cases demonstrate. But that does not mean that working interest owners have no problems.

For the very important issue over whether nonoperators’ protections should include implied covenants, compare Smith, *Duties and Obligations*, *supra* note 24, § 12.05[5], at 12-32 to 12-38 (exploring possibility that implied covenants might apply to operator), with Scott Lansdown, *The Contractual, Fiduciary, and Ethical Obligations of a Party to a Joint Operating Agreement That Owns or Operates a Facility That Serves the Joint Operation*, 41 ROCKY MTN. MIN. L. INST. 13-1, 13-34 to 13-35 (1995) (arguing that lease relationship is fundamentally different from working-interest tie because lessor’s interest is free of costs, and, conversely, because interest owners do not intend prudent operator standard to govern “most decisions” of their detailed agreement).

173. The Oklahoma Supreme Court recently reaffirmed *Young’s* basic unit fiduciary rule, although limiting it to statutory unitization in *Howell v. Texaco*, 112 P.3d 1154 (Okla. 2004). For purposes of this Article, post-*Young* cases can be divided into working interest cases following *Young* as a unit rule, royalty owner cases following *Young* as a unit rule, and cases citing *Young* for a general operator fiduciary duty without acknowledging it as a unit rule.

For working interest cases citing *Young* with approval for the rule that unit operators are fiduciaries, see *Reserve Oil, Inc. v. Dixon*, 711 F.2d 951, 953 n.4 (10th Cir. 1983) (working interest owners suing over operator's improper distribution of production revenues in lead case establishing trustee-type duty, citing *Young* for rule that "operator of a unitized oil field stands" in trust position); *Shearn v. Ward Petroleum Corp.*, 808 F. Supp. 1530, 1532 (W.D. Okla. 1992) (citing *Young*, as well as *Reserve Oil* and other cases, for proposition that "a unit operator stands in a fiduciary or trustee-type status as to the interest owners in a well" in unit interest owner lawsuit for distribution of production proceeds). See also *Garfield v. True Oil Co.*, 667 F.2d 942, 944 (10th Cir. 1982) (citing *Young* as unit case but finding it inapplicable to net profit holders' dispute over handling of field equipment and production sales to affiliate); but see *Doheny v. Wexpro*, 974 F.2d 130, 135 (10th Cir. 1992) (distinguishing *Young* as statutory case and refusing to apply fiduciary duty in unit interest owners' gas balancing dispute when neither agreement nor statute created duty sought by owners).

In *Andrau v. Michigan Wisconsin Pipe Line Co.*, 712 P.2d 372 (Wyo. 1986), something of an oddball working interest case, the Wyoming Supreme Court held that there was no fiduciary duty requiring a unit operator to exercise its contractual powers to foreclose a lien in the "least onerous" way. The defendant had not paid all well costs. It took the position that the operator, as a fiduciary, had a duty to reduce its unpaid bill by crediting the investor's underproduced gas at the high price the operator received under its own contracts. See *id.* at 373-74. In other words, an investor that did not have the foresight to enter a high-priced, long-term gas sales agreement was trying to free ride on the operator's prudence in handling its own production. It is not clear whether the Wyoming Supreme Court agreed that unit operators are fiduciaries as a matter of law or not. The indebted plaintiff had cited *Young*, as well as *Beadle v. Daniels*, 362 P.2d 128 (Wyo. 1961), and *Reserve Oil, Inc. v. Dixon*, 711 F.2d 951 (10th Cir. 1983), to argue that it was "well-accepted that a Unit Operator stands in the position of a fiduciary or trustee to nonoperators." *Andrau*, 712 P.2d at 374. The court distinguished *Young* because its interest owners purportedly had been compelled by statute "to surrender all rights to produce from the unit." *Id.* at 375. The court treated *Young* as a statutory loss-of-control case. It distinguished *Reserve Oil* as involving a narrow, contract-based trustee-type duty not in issue. *Id.* Citing authority that fiduciary obligations can be limited contractually, the court held that the alternative lien foreclosure provisions gave the operator the right to foreclose in any manner it chose. *Id.* at 376-77.

Andrau thus does not rest, at least not plainly or unambiguously, on a finding of whether a fiduciary duty exists or not. The court did not explain whether it rejected the view that unit operators are always fiduciaries, or just believed that the duty was not as broad as alleged. See *id.* at 374 ("While these cases do support appellant's contention that there is often a fiduciary or trustee-type relationship between operator and nonoperator owners, they do not provide support for the fiduciary duty appellant claims is owed in this case....[T]he operating agreement...expressly negates such a duty.") (emphasis added), 377 ("The claimed fiduciary duty does not exist.") (emphasis added).

One of the lead *Young* royalty owner cases is *Leck v. Continental Oil Co.*, 800 P.2d 224, 229 (Okla. 1989), applied after certified question decided, 971 F.2d 604 (10th Cir. 1992). In this drainage dispute, the Oklahoma Supreme Court summarized *Young* and its progeny as follows: "Therefore, we have recognized the existence of a fiduciary duty owed by a unit to the royalty owners and lessees who are parties to the unitization agreement or subject to the order creating the unit. This is not a duty created by the lease agreement but rather by the unitization order and agreement." The court generically described the plaintiffs as "mineral rights owners," see *id.* at 225, but the parties sued on their lease and the opinion relies heavily on an operator's duty as lessee, see *id.* at 226-29, including a unit operator's

fiduciary duty to royalty owners. For other royalty cases citing the unit rule, see *Shutts v. Phillips Petroleum Co.*, 732 P.2d 1286, 1298 (Kan. 1987), a multi-state interest-suspense royalty class action citing *Young* for the rule that a unit operator is "the agent and trustee of all royalty owners." See also *Pritchett v. Forest Oil Corp.*, 535 S.W.2d 708, 710 (Tex. App. 1976) (describing *Young* as holding that "unit organization and its operator were held to occupy a position similar to that of a trustee for the benefit of all those interested in the oil production, either as lessees or royalty owners," but then blessing operator's concealment of accurate reserve information from royalty owner who was thinking of selling its interest by holding that the duty to provide reserve data did not implicate any fiduciary duty); *Finley v. Marathon Oil Co.*, 75 F.3d 1225, 1229 (7th Cir. 1996) (royalty drainage case citing *Young* as one of "many cases" that hold "the unit operator...is a fiduciary to the owners of the field," but refusing to treat communitization agreement as legally equivalent to unitization); cf. *Candelaria Indus., Inc. v. Occidental Petroleum Corp.*, 662 F. Supp. 1002, 1005 (D. Nev. 1984) (citing *Young* as representing fiduciary duty arising from special relationship "such as unit development," but refusing to extend it to net profits interest); *Fransen v. Conoco*, 64 F.3d 1481, 1487 (10th Cir. 1995) (not citing *Young* in royalty drainage case, but citing its successor *Leck v. Continental Oil* and seemingly accepting that "improper operations" in unit might give rise to fiduciary claim; finding none where Oklahoma Corporation Commission had denied permission to drill more wells); *Carroll v. Caldwell*, 147 N.E.2d 69, 74 (Ill. 1957) (deciding independently to impose constructive trust to protect royalty owner's interest in unit after finding that unit "venture possessed all the recognized attributes of a joint adventure"). But see *Gerard J.W. Bos & Co. v. Harkins & Co.*, 883 F.2d 379, 381-82 (5th Cir. 1989) (refusing to apply *Young* to royalty owner's dispute over gas pricing in forcibly integrated unit, where pooling order did not give operator authority to market, and it instead voluntarily assumed that duty; "crucial distinction" that operator's duty was "voluntarily assumed"); *Yokel v. Hite*, 809 N.E.2d 721, 726-29 (Ill. App. 2004) (refusing to apply unit fiduciary duty in *Carroll v. Caldwell*, *supra*, to dispute over alleged termination of lease for nonproduction on double grounds that plaintiffs had forfeited the argument, but also that unit fiduciary duty applied to formation of unit but not to its operation; also distinguishing *Carroll's* unit agreement as giving lessor as well as operator right to decide if unitization should be attempted). The Tenth Circuit just a few years ago refused to apply *Young* under Colorado law, although it left open the possibility that unit operator Arco still might have a fiduciary duty to the lessors under Colorado's informal fiduciary standard. See *Atlantic Richfield Co. v. Farm Credit Bank of Wichita*, 226 F.3d 1138, 1162-63 (10th Cir. 2000). The court cited Gary Catron for the incorrect proposition that the unit rule should be viewed as just an Oklahoma rule. *Id.* at 1162 n.12 (citing Catron, *supra* note 23). As this footnote shows, the court severely understated the actual reach of *Young's* unit-fiduciary rule. In a concurring opinion in *Goodall v. Trigg Drilling Co., Inc.*, 944 P.2d 292, 295-96 (Okla. 1997) (Summers, J., concurring), Justice Summers urged the Oklahoma Supreme Court to "provide some useful guidance" on the royalty-operator relationship after citing *Young* for the general unit fiduciary rule.

Young also can be cited as a general fiduciary rule, without being limited to units. See *Teel v. Public Serv. Co.*, 767 P.2d 391, 396 n.9 (Okla. 1985) (in interest owner accounting case, using *Young* for general proposition that when cotenants name one of their group as operator, "they become coadventurers in the enterprise and stand in a fiduciary relationship to one another"); *Coosewoon v. Meridian Oil Co.*, 25 F.3d 920, 931 (10th Cir. 1994) (citing *Young* for operator's fiduciary duty to get highest market price for royalty owners); *Harding v. Cameron*, 220 F. Supp. 466, 471 (W.D. Okla. 1963) (citing *Young* for duty to get best price when buying production at gas compressor); but see *Davis v. TXO Prod. Corp.*, 929 F.2d 1515, 1519 (10th Cir. 1991) (citing not *Young*, but *Teel*, with apparent approval of "an implied covenant" of good faith "arising from a recognized fiduciary

duty" between cotenants, without mentioning unit issue, but finding that nonoperator's statements against operator's unit plan did not violate any provision of operating agreement).

For a final application of *Young*, see *Olsen v. Texaco, Inc.*, 587 P.2d 976, 984-85 (Okla. 1978). *Olsen* was a unit royalty owner case in which the trial court relied heavily on *Young* in holding that Texaco had a high duty to determine the true interest owners. See *id.* at 984. On appeal, the Oklahoma Supreme Court found that

[t]he pivotal issue here is not the relationship between a unit operator and a mineral owner but the critical concern involves the legal effect of resort to the police powers of the state on the part of a lessee (Texaco) in the unitization proceedings which modified and amended existing legal rights without constitutionally sufficient notice of such proceedings to the lessor (Olsens).

Id. at 985. But the high court affirmed the trial court. Texaco had mistakenly failed to pay royalties to the Olsens, but they in turn had failed to give Texaco a contractually required notice of change in ownership when they got their interests. Texaco had gone right on paying their predecessors in interest, who understandably had not complained about the mix-up. The Olsens' contract oversight did not extinguish their right to royalties because Texaco had not followed the proper statutory procedures; the statute created duties independently of the contract. See *id.*

One bold author has argued that *Young* is not really good authority for a fiduciary rule. See *Catron*, discussed *infra* note 202. Two recent authors have noted, with at least implicit criticism, that cases like *Young*, *Reserve Oil*, and *Texas Oil & Gas Corp. v. Hawkins*, 668 S.W.2d 16 (Ark. 1984), "appear[] to disregard the specific language of the various versions of the Model Form Operating Agreement and focus[] on the substance of the relationship between the parties, finding a trustee-type or fiduciary relationship." Reeves & Thompson, *supra* note 156, at 220. In claiming that courts "disregard[ed] the specific language," however, they themselves ignore the purpose of the language, which those courts honored.

Commentators have not necessarily agreed that the unit operator should be a *per se* fiduciary. The most frequent writer on this issue, Ernest Smith, has advocated the same standard he advocates for the run-of-the-mill operator, namely, a fact specific test that looks at the parties' relationship, their contract, the duty in issue, and other factual factors. See generally Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-1. Smith distinguishes between parties to voluntary pooling or unitization agreements, and those force pooled or unitized. See *id.* at 3-2. Most unitization statutes require that some percentage of the parties have voluntarily agreed to a unit plan, see *id.*, and many envision "voluntary" pooling agreements after the spacing order is issued, see *id.*, so there is overlap between these categories; yet some "voluntary" agreements may be bowing more to the inevitable than true arms-length bargains. Among voluntarily entered unit agreements, the federal form gives the operator exclusive control and so to Smith seems to defeat any requirement of joint control or cooperation; the private and state-owned forms, like the API model form, retain "overall supervision and control" among interest owners and so seem to satisfy the joint-venture control requirement; and the standard pooling agreement has a JOA-like disclaimer (and so faces disclaimer issues like the JOA). See *id.* at 3-5 to 3-6. Smith compares the force-pooled and forcibly unitized operator to a receiver with trust-like responsibilities, see *id.* at 3-16 to 3-18, a parallel that certainly fits the *Young* line of cases.

Smith admits that many parties who enter pooling or unitization agreements may not do so voluntarily, see *id.* at 3-10, which suggests that the division between "voluntary" and "compulsory" may not be that firm and may not justify allowing a higher standard of care only to nonoperators who are subject to formal compulsion. See also 6 WILLIAMS &

MEYERS TREATISE, *supra* note 10, § 902, at 6.1 ("In a sense, perhaps, virtually all pooling is compulsory rather than voluntary, since it is motivated by the compulsion of economic factors or of zoning or spacing regulations.").

174. In *Rutherford v. Exxon*, 855 F.2d 1141, 1145 (5th Cir. 1988), lessors sued claiming that they had been fraudulently induced to agree to unitization by misrepresentations about the benefits of combining their properties with others, only to see their production drop sharply. They tried to avoid limitations by claiming that Exxon's breach of its fiduciary duty prevented limitations from accruing. The court, in rejecting that claim, argued that Texas law does not create fiduciary duties from lessor or unitization status. *See id.* at 1145-46. Though *Rutherford* involved only royalty interests, *Young* claimed that the unit fiduciary rule applied to royalty and working interest relations, and the Fifth Circuit rejected a general unit fiduciary duty under Texas law, albeit without discussing *Young*.

Several lower Texas courts and, in 1999, the Texas Supreme Court have held that lessees will be held to only a duty of good faith when exercising pooling powers, that is, the contractual rather than statutory power to combine properties. This is at least conceptually a different issue, of course, from the duty that should apply post-pooling, *see generally* Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-16 to 3-17 (suggesting that standard applied after pooling may differ from that applied for pooling and drawing on standard operator cases to endorse agency duties in marketing production and trust-like responsibility when handling funds and property). For cases on the exercise of the pooling power, *see Southeastern Pipe Line Co. v. Tichacek*, 977 S.W.2d 393, 396-97 (Tex. App. 1998) (discussing the good faith pooling standard under which jury had been instructed, and finding no bad faith even though lessee had pooled properties just before lessor's lease expired, but affirming liability for drainage), *rev'd in part on drainage issue but using good-faith test*, 997 S.W.2d 166 (Tex. 1999). *See also* *Vela v. Pennzoil Producing Co.*, 723 S.W.2d 199, 205-06 (Tex. App. 1986) (applying good-faith standard and remanding pooling dispute for trial); *Amoco v. Underwood*, 558 S.W.2d 509, 512 (Tex. App. 1977) (affirming judgment for lessors who persuaded jury that lessee acted in bad faith in "gerrymandering" unit boundaries); *Elliott v. Davis*, 553 S.W.2d 223, 226-27 (Tex. App. 1977) (applying good faith standard to dispute challenging unit boundary and reversing summary judgment for lessors because of fact issues about good faith); *Banks v. Mecom*, 410 S.W.2d 300, 303 (Tex. App. 1966) (affirming summary dismissal of challenge to pooling when plaintiffs had conceded good faith); *Tiller v. Fields*, 301 S.W.2d 185, 189 (Tex. App. 1957) (affirming judgment for lessees under good faith standard in challenge to pooling under clause that had neither acreage restrictions nor specification of pooling area, where lessors had not raised bad faith issue); *cf. Amoco v. First Baptist Church*, 579 S.W.2d 280, 284-85 (Tex. App. 1979) (describing pooling power as subject to good-faith duty in dispute over implied covenant to market). In *Jones v. Killingsworth*, 379 S.W.2d 362, 369 (Tex. App. 1964), *rev'd on interpretation of pooling clause*, 403 S.W.2d 325 (Tex. 1965), the court resolved a fairly simple dispute over the contractually permitted size of the unit for the operator, applying a general good faith standard. The parties had stipulated to the operator's good faith, *see Jones*, 379 S.W.2d at 364, but called the relationship "analogous to that of a principal and agent," *see id.* at 368.

All of these pooling cases raise royalty disputes, not working interest disputes. The courts no doubt approached them under the general presumption that the royalty relationship is not a fiduciary one. Texas courts give pooling clauses a broad construction. For another case that defers to the lessee's power, *see Mengden v. Peninsula Production Co.*, 544 S.W.2d 643, 647 (Tex. 1976).

In a somewhat odd case, *Circle Dot Ranch v. Sidwell Oil & Gas*, 891 S.W.2d 342 (Tex. App. 1995), the court of appeals applied a good-faith test to pooling but went on to call the "express covenant of consolidation" an implied covenant that should fall under the

reasonable prudent operator standard. The court did not comment on the many cases and authorities, for instance Lee Jones' executive rights article, see Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569 (1948), that treat a contract duty of good faith as a step up from the prudent operator standard (though still below a fiduciary level). The Amarillo court remanded for trial where unitization prevented the imminent expiration of five of the six consolidated tracts, reduced the plaintiff's interest by 81%, and excluded certain productive sands. See *Circle Dot*, 891 S.W.2d at 347. A little confusion may be understandable because the difference between reasonable prudence and good faith may seem insignificant, as long, that is, as good faith remains objective and does not require operators to subordinate their interests. The disarray does create sympathy for the somewhat baffled federal court in Oklahoma that announced, "We do not know what the prudent operator standard is," though the court understood it well enough to know that "it is necessarily very narrow if it is left up to the operating company to make all decisions at the same time." *Amoco Prod. Co. v. Jacobs*, 746 F.2d 1394, 1401 (10th Cir. 1984).

The Texas Supreme Court waited a long time to address the standard of care that should control the pooling power. See *Circle Dot*, 891 S.W.2d at 345-46 ("Insofar as the parties' and our own research has shown, the Supreme Court has not directly articulated the duty or standard of care of a lessee in exercising the pooling power."). In *Mengden*, *supra*, the supreme court cited the good faith cases with seeming approval. In *Sunpac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 803-05 (Tex. 1967), a case over the lessee's entering a second lease, the supreme court found no fiduciary duty and noted that fiduciary standards ordinarily require specific language or an unusually close relationship. The court did seem to approve the principle that language providing that an overriding royalty would extend to subsequent leases could create a fiduciary duty. See *id.* at 804. The mystery came to an end in *Southeastern Pipe Line Co. v. Tichacek*, 977 S.W.2d 166, 170 (Tex. 1999), where the court expressly approved the lesser good-faith standard. See also *Mission Res., Inc. v. Garza Energy Trust*, 166 S.W.3d 301, 316 (Tex. App. 2005).

Some now-overruled Texas intermediate courts described the pooling duty as a fiduciary one in now superceded opinions. See *Expando Prod. Co. v. Marshall*, 407 S.W.2d 254, 260 (Tex. App. 1966) (reversing to allow lessee to add 1.92 acres to 10.1-acre unit after initial pooling, and thus to dilute the shares of existing interest owners, but penning strong dictum that "[t]here is no doubt but what there is a fiduciary obligation on the part of the lessee to exercise the utmost good faith toward the lessor in exercising the power granted under a pooling provision. Unitization cases in practically all jurisdictions so hold."). The court in *Expando* also held that good faith was of "paramount importance" when pooling came after production began, apparently treating good faith as a fiduciary level. See also *McCarter v. Ransom*, 473 S.W.2d 235, 238 (Tex. Civ. App. 1971) (citing *Expando* with approval in section of opinion about pooling as court resolved venue dispute); *Texaco v. Letterman*, 343 S.W.2d 726, 732 (Tex. App. 1961) (in upholding lessee's right to pool after first unit terminated, citing with approval cases analogizing lessor/lessee relationship to principal/agent relationship and holding that pooling power is a broad power "limited by the duty owed by the agent to exercise a high degree of good faith and loyalty" toward the principal's interests); cf. *Pritchett v. Forest Oil Corp.*, 535 S.W.2d 708, 710 (Tex. Civ. App. 1976) (dictum about "cases which recognize that certain fiduciary obligations exist where the lessee pools under the contractual unitization clause in the lease [citing *McCarter*, *Expando*, *Banks*, and *Tiller*]," though claiming that these cases do not impose a "conventional trust relationship" or apply to disclosure of information). It is worth noting that not one of these cases decided a pooling dispute for the lessor, in spite of their strong statements on pooling responsibility.

The pooling power is in some ways like the executive right. It enables a party in a controlling position to enter agreements for the development of other parties' interests, as

well as its own. The agreements entered are likely to set the value of the shared property. None of the Texas pooling cases tries to reconcile their position with the fiduciary duties of an executive rights holder in *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984), discussed *infra* Part VII.A.6, an issue that would seem to be worth addressing given that *Manges* imposed a fiduciary duty on executive rights holders. If the executive is appropriately subject to a fiduciary duty, it is hard to see why the pooling right is not similarly rigorous. Or, to put it another way, if *Manges* saw fit to equate the duty of utmost good faith with a fiduciary duty, at a time when "good faith" had become the label for a tort duty in other areas, shouldn't the Texas Supreme Court apply the same equation in pooling cases?

The conflict in pooling cases arises whenever an interest owner would earn more (or thinks it would earn more) if its properties were developed separately, rather than as part of the larger pool. The inability to know exactly how reservoirs lie under the ground makes it impossible to define, and contract, for exact allocations based on the production under each area. See *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926, 933 (10th Cir. 1954) (broad pooling power needed because neither side could know, when they entered the lease, "the facts with respect to which it will be necessary for the lessee to apply his power").

Under the rule of capture, if any well would develop the full unit area, each landowner would have an incentive to drill first and appropriate as much of the production as possible. Everyone would have the same incentive to win this race. Far more wells would be drilled than necessary to drain the field efficiently. Unitization and pooling (as well as state proration rules) are an effort to avoid this waste while giving each party a fair share of the production. The expectation is that the pool or unit will yield at least as much production with fewer wells at lower cost. See *JOLLY & BUCK*, *supra* note 4, at 2-3 (unit or joint operation should have lower cost than operations by separate companies).

One problem is that each owner's percentage of the pool or unit production will fall (although obviously everyone hopes the pie will grow so much because of the efficiencies of unitization that everyone's actual return will go up). In *Expando Production Corp. v. Marshall*, 407 S.W.2d 254, 256 (Tex. App. 1966), the dilution was minor, with only 1.92 acres added to a 10.1-acre unit. In *McCarter v. Ransom*, 473 S.W.2d 235, 236 (Tex. App. 1971), however, a plaintiff who had a good producing well on her tract saw her share fall from 1/8th to 1/48th of 8/8ths, enough to make even fairly oblivious royalty owners sit up and take notice. In theory, the parties expect production to increase more than proportionately so that the royalty owner's monthly check goes up. Operators seeking unitization have every incentive to promise that the change will increase total production because they want wide mineral control to help protect their capital investment.

Even if unitization (and pooling) did not affect total production at all, it might enable the operator to develop the same area with fewer wells. *Cf., e.g., Froholm v. Cox*, 934 F.2d 959, 961 n.2 (8th Cir. 1991) ("The rationale for units is that in some situations and geologic formations, it is more economical and better designed to recover more of the oil reserve if fewer wells are drilled than would otherwise be permitted.").

Unitization and pooling can also be a way for an operator to lock up a much larger acreage without drilling as many wells as it would have to on separate leases. Other things being equal, operators prefer drilling fewer wells. A number of cases involve operators who pool just before the primary term expires to preserve acreage without drilling. This fact alone generally has not been enough to stop the pooling. The operator can point out that royalty owners, who do not bear well costs, have an opposing incentive to demand even uneconomic wells if they will increase production.

If a landowner believes that the most prolific reserves are under its property, it will not want to have its leases pooled. If the landowner already has a producing well and believes the well may be draining surrounding acreage, it will be even less attracted to

unitization. Even if surrounding landowners drill their own wells, the first to drill may be able to recover a disproportionate share of the reserves within the potentially pooled surface area.

Courts in other jurisdictions have followed the good-faith standard for the decision to pool. *See, e.g.,* *Gorenflo v. Texaco*, 566 F. Supp. 722, 727-28 (M.D. La. 1983) (operator in Louisiana unit satisfied good faith test where unit was most efficient way to develop acreage, even though it admitted it formed unit to protect its equity position), *aff'd*, 735 F.2d 835 (5th Cir. 1984); *Sotrana-Tex. Corp. v. Mogen*, 551 F. Supp. 433, 435-38 (D.N.D. 1982) (claiming good-faith unitization test is a "restrictive," objective test satisfied whenever geologic justification for unit exists, rejecting subjective intent as too hard to prove; lessor protected as long as unit increased production with judicial scrutiny limited to geologic justification, a rule that supposedly will encourage unitization); *Froholm*, 934 F.2d at 962-63 (affirming trial court summary judgment for lessees that followed *Sotrana* and held that geologic justification made good faith irrelevant); *Amoco v. Heimann*, 904 F.2d 1405, 1411-12 (10th Cir. 1990) (applying good faith test and rejecting fiduciary standard as "altogether too strict," *id.* at 1411-12; rejecting reading of prior Tenth Circuit law that operator had affirmative disclosure duties, *id.* at 1412-13; and then finding good-faith inquiry "unnecessary" because plaintiffs were collaterally estopped by New Mexico Oil Conservation Commission's approval of unit plan—judicial inquiry would therefore be a "waste of judicial resources," *id.* at 1414); *Amoco v. Jacobs*, 746 F.2d 1394, 1397-1402, 1404 (10th Cir. 1984) (broad opinion that, though ultimately applying good faith standard and affirming judgment for lessee, noted the operator's lack of accountability in million-acre lease, *see, e.g., id.* at 1402; expressed concern that unit might "hold these lay people to a complex unitization agreement provision in small print that was signed ten years before and which was, at that time, primarily a lease," *id.* at 1401, and about the conflict raised because Amoco owned so much of unit, *id.* at 1402; and then concluded somewhat ambiguously by warning that unitization is not "the sole function of the lessee—that it is a joint effort in which the lessors within their limited scope are entitled to participate with the lessee in the development"); *Diggs v. Cities Serv.*, 241 F.2d 425, 426-27 (10th Cir. 1957) (affirming district court judgment for lessee under good faith test in case where lessee filed declaration of unit just before expiration of primary term, but apparently treating test as a subjective one, *see id.* at 427); *Boone v. Kerr-McGee Oil Indus.*, 217 F.2d 63, 64-66 (10th Cir. 1954) (applying good faith test to unitization a few months before lease expiration, with court finding that drilling more than one well would have been wasteful). *Boone* made clear that combining properties just before a lease expired is not, of itself, a conclusive sign of bad faith, even if it saved the lessee from drilling wells it otherwise would have had to drill to preserve its acreage position. *See id.* at 65-66. Little more than a month after the *Boone* decision, the Tenth Circuit hinted at a higher standard in *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926 (10th Cir. 1954). Phillips had formed a unit in Utah and sued for a declaratory judgment that its exercise of the pooling power was proper when 32 lessors would not consent to the combination. The opinion contains an extended discussion of the pooling relationship as "analogous to that of principal and agent," one "in the nature of a power coupled with an interest." *See id.* at 933. The pooling power had to include a broad grant of power to the lessee because neither side could know, when the lease was entered, "the facts with respect to which it will be necessary for the lessee to apply his power." *See id.* The court described the lessee's duty as one of good faith, *see id.* at 934-35, but then issued a one-sided discussion of the mutual interest of Phillips and its lessors, *see id.* at 934. For a discussion of some of the early cases, at a time when it was "too early" to define the precise duty, *see Williams, The Fiduciary Principle, supra* note 10, at 223-31; for a general discussion of the good-faith standard, *see* 4 KUNTZ, *supra* note 24, § 48.3(g), at 222-67.

Not many courts after *Young* tried to explain why unit operators should be fiduciaries. Many just cite *Young* as binding precedent. Courts that do address the basis for the duty emphasize the unitized investors' forcible or involuntary loss of control over their interests, the factor mentioned in *Young* itself.¹⁷⁵ Part VII.A of this Article shows that dependence, which is built into the operator relationship whether in a unit or not, is the traditional foundation for a fiduciary duty.¹⁷⁶ This foundation should underlie protection for all interest owners in certain activities, not just those in pooled and unitized properties.¹⁷⁷

175. For *Young's* language on loss of control, see *supra* text accompanying notes 167-169. In *Garfield v. True Oil Co.*, 667 F.2d 942 (10th Cir. 1982), the Tenth Circuit distinguished the net profits contract in dispute from *Young* by pointing to the unitized interest owners' loss of control: "The relationship so created wherein the operator does handle the property and affairs of the royalty owners can place a different duty on the operator. The Oklahoma units were created *by statute regardless of the interest owner's consent.*" *Id.* at 944 (emphasis added). For other cases emphasizing the loss of control under a unitization statute, see also *Doheny v. Wexpro*, 974 F.2d 130, 135 (10th Cir. 1992) (finding no duty to cash balance in absence of balancing agreement, and distinguishing *Young* as involving a "statute [that] required operator to account to owners"); *Andrau v. Michigan Wisconsin Pipe Line Co.*, 712 P.2d 372, 375 (Wyo. 1986) (*Young* unit was "forcibly created by statute" and statutes "compelled interest owners to surrender all rights to produce from the unit") (emphasis added); *Pritchett v. Forest Oil Corp.*, 535 S.W.2d 708, 710 (Tex. App. 1976) (distinguishing *Young* as production revenue dispute "where the unit operator was permitted, without any control, to supervise, manage, and conduct the development and operation of the unit for production of oil and gas"). Cf. *Gerard J.W. Bos & Co. v. Harkins & Co.*, 883 F.2d 379, 382 (5th Cir. 1989) (citing *Young* as case in which unit plan "authorized the defendant to operate the unit and to market the product") (emphasis added).

The apparent ability of at least some *Young* interest owners to take their production in kind (see *Young*, *supra* note 168 and accompanying text) means that they had at least one way to avoid the "compulsion" of the unit statute on the disputed issue. They could have sold on their own (but only at the price of losing one of their main rights, the right to rely on the operator's marketing expertise). The legitimate basis for *Young* is one shared with non-unit cases: the general structure, implemented in standard *and* unit JOAs, that shifts actual control to the operator in many areas not open to nonoperator scrutiny and oversight. This is part of the difference between Smith's approach and the one here: he focuses on presumptions about the actual relation and sophistication of the parties, but not the structural dependence that occurs in all standard operating arrangements.

176. See *infra* Part VII.A.

177. Putting the duty on the basis of statutory compulsion, rather than on the structure of relations between the unit operator and investors, suggests that courts might not treat the unit operator as a fiduciary when the unit had been assembled voluntarily (by contract), rather than mandated by statute. For this reason, *Young's* fiduciary duty is easier to attack than one based directly on the operator's responsibility to act for the joint account. Cf. *Gerard J.W. Bos & Co. v. Harkins & Co.*, 883 F.2d 379, 381-82 (5th Cir. 1989) (finding *Young's* unitization "little different" from pooling at issue, but not following *Young* because applying Mississippi law, not Oklahoma law, and because, in contrast to the situation in *Young*, "the order in this case authorized the defendant to operate the unit but the order did not authorize the defendant to market the product.... Assuming, without deciding, that the forced integration and appointment of Harkins as operator imposed on it a fiduciary

E. Grubstake Holders Are Fiduciaries

Oilfield law has incorporated another fiduciary duty for grubstake holders. A grubstake or prospecting venturer raises funds to explore for reserves on behalf of a shared account.¹⁷⁸ The JOA operator is in a similar position when it drills a first test well and then ordinarily has to return to its partners to see if they will consent to join in the well's completion and in drilling subsequent wells.¹⁷⁹

It is well-established that the grubstake explorer is a fiduciary as a matter of law.¹⁸⁰ Courts wield their equitable powers to ensure that this explorer holds all discoveries in trust for the other investors in proportionate shares.¹⁸¹ Though the doctrine has its deepest roots in mining law, it is also well-established in oil and gas law that grubstake or prospecting agreements are fiduciary agreements.¹⁸²

duty with respect to the royalty owners, that duty is limited by Harkins' authority under the state's order.").

178. "A grubstake agreement is one whereby one party undertakes to prospect or secure leases or other interests in minerals and agrees to yield to the other, who furnishes money or supplies for the enterprise, a certain proportionate interest in any minerals discovered or secured." 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 436, at 515. The agreements have been more common in mining than in oil and gas. *See id.*

179. *See* 1989 JOA, arts. VI.B-C.

180. *See* 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 436, at 515 ("A fiduciary relationship exists between the parties to a grubstake agreement so that one party may not acquire benefits as a result of the operation without sharing such benefits with the other party."); Williams, *The Fiduciary Principle*, *supra* note 10, at 262-63. It is true that many joint operating cases require an operator to share acreage acquisitions, even without a fiduciary duty, particularly if the contract provides an area of mutual interest. *See supra* note 73. The categorical identification of the grubstake explorer as a fiduciary, and the corresponding willingness to use a constructive trust to protect the nonoperators' share of the acquired properties creates a clearer obligation than the joint-venture and mining-partnership doctrines.

181. *See* 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 436, at 515 n.3 ("[T]he grubstake party must share with the financing party any interests acquired as a result of the discovery or location during the continuance of the agreement."); Lane & Boggs, *supra* note 11, at 201 (grubstake is "perfectly viable legal relationship," though not used frequently and "something of an anachronism" because limited to exploration); *see Webster v. Knop*, 312 P.2d 557, 560 (Utah 1957) (constructive trust arose to protect grubstake parties' interests in oil lease).

182. For cases treating the grubstake doctrine as applicable to oil and gas matters, *see*, for example, *Austin v. Hallmark Oil Co.*, 134 P.2d 777, 780, 782-83 (Cal. 1943) (finding funder entitled to keep oil interest acquired pursuant to earlier grubstake); *Gillespie v. Shufflin*, 216 P.2d 132, 134 (Okla. 1923) (parties had grubstake to acquire lease, but no agreement to develop the area around it and so no duty to share interest in second well); *Webster v. Knop*, 312 P.2d 557, 560 (Utah 1957) (financier prevented from top-leasing grubstake oil interest where original titles failed for purely technical reasons). *See also* *Bradley v. Andrews*, 14 P.2d 1086 (Colo. 1932) (grubstake or prospecting agreement had existed between parties for oil and gas exploration but was terminated when plaintiff failed to fund venture); *Pederson*

Courts impose the grubstake fiduciary duty without looking for acts of cooperation or subjective reliance or other case-specific facts. As with most fiduciary duties, the fixed structure of the relationship has created an unvarying rule. The main difference between the grubstake explorer and the ordinary operator is the stage of the investment and, in some cases, a greater geographic separation from its investors.¹⁸³ The grubstake doctrine developed in a time of limited communications and transportation, when the staked operator explored in the field for long periods of time, physically beyond the reach of the investors.¹⁸⁴ A classic example is the Wyoming investor who staked \$500 on an Alaskan gold mining venture.¹⁸⁵ Operating agreements are unlike grubstake agreements in that they often include a provision for a first test well, spell out how drilling and development should occur, and generally apply for the lifetime of any fields discovered.

In their categorical imposition of a fiduciary duty, the grubstake cases stand in opposition to joint-venture and mining-partnership cases that refuse fiduciary protection whenever investors lack "joint control" over the investment. Here it is dependence upon the active party, the

v. Lothman, 320 P.2d 378, 381 (N.M. 1958) (rejecting grubstake or "prospecting" claim to certain Mid-Continent properties where plaintiff admitted he was to bear his own expenses (and so had not been staked)); *Mattocks v. Gibbons*, 162 P. 19 (Wash. 1916) (railroad agreed to stake funds and drilling equipment to explore for oil and gas, but its financial stake was limited to agreed amount; there was no joint property, and so no partnership liability to unpaid employee); cf. *United States v. Adamant Co.*, 197 F.2d 1, 9 n.1 (9th Cir. 1952) (discussing grubstake doctrine in oil lease case, but finding it inapplicable when royalty owners merely advanced funds to complete drilling, with their reward to come in 2:1 payment out of production).

183. And the difference may be even less than this. Lee Jones has written that the true difference lies in the nature of the interest earned during the exploratory phase. He would confine the grubstake to those who earn "only an interest in the oil, if and when produced and saved, and where no interest in the leasehold estate passes." See Jones, *supra* note 98, at 421.

184. According to a classic grubstake case, [t]he old form of grubstake agreement whereby the man who had no time or aptitude for prospecting could furnish the burro, beans and bacon to another for a half share of any discoveries made, has its modern day version in the loaning to a friend, for the weekend, of one's scintillator or counter on shares of whatever is found.

Smaller v. Leach, 316 P.2d 1030, 1036 (Colo. 1957) (enforcing grubstake in dispute over uranium claims). In *Smaller*, defendants, parties to a uranium prospecting agreement, breached their duty by staking 22 claims in their own names. See *id.* at 1038.

185. *Hartney v. Gosling*, 68 P.2d 1118, 1123 (Wyo. 1902). *Hartney* was uncharacteristic in that the funder apparently then went to Alaska before the exploration was over, *id.* at 1120, and thus had more contact with the grubstake holder than many investors have with their operator.

trust and confidence left in the operating defendant,¹⁸⁶ that receives protection. Grubstakes expand protection because of the investors' dependence.

F. Operators Can Be Fiduciaries as Partners

Formal drilling partnerships have been used in many oil and gas investments, including some quite large projects.¹⁸⁷ Partners are fiduciaries.¹⁸⁸ The major difference between an ordinary partnership and the mining partnerships already discussed is that a partnership ordinarily is not limited to a single venture. Partners therefore face a wider range of risk for each other's actions than mining partners.¹⁸⁹

186. See *Smaller*, 316 P.2d at 1037 (discussing "trust and confidence" as reason for protecting uranium grubstake interests).

187. For instance, the much discussed, fraudulent billion-dollar funds marketed by Prudential Insurance Company's energy arm during the 1980s were put in partnership forms. For a general discussion of these investments and their problems, see John Burritt McArthur, *Coming of Age: Initiating the Oilfield into Performance Disclosure*, 50 SMU L. REV. 663 (1997) [hereinafter McArthur, *Coming of Age*].

188. See, e.g., *Huffington v. Upchurch*, 532 S.W.2d 576, 579 (Tex. 1976) (as managing partner, Roy Huffington "owed...one of the highest fiduciary duties recognized in the law"; putting burden on managing partner to prove plaintiffs' financial incapacity for Indonesian opportunity that he appropriated); *Palmer v. Fuqua*, 641 F.2d 1146 (5th Cir. 1981) (affirming directed verdict for limited partner in formal partnership agreement, and jury's award of punitive damages for breach of fiduciary duty, where general partner had excluded it from lands within "area of interest owned"). When oilfield parties use general words of partnership, of course, they will not be able to claim the benefits of a limited partnership, with its restriction on liability, unless they comply with the formal requirements of the applicable state limited partnership statute. See, e.g., *Arrow Petroleum Co. v. Ames*, 142 N.E.2d 479, 483 (Ind. 1957) (holding parties to agreement labeled "co-partnership" liable for money, service, and material vendor provided to well, even though they had interests of as little as 1/16th in wells).

189. The rationale for such higher power is, not surprisingly, each partner's control of the other partners' affairs: "[s]o intimate and confidential is the relation, so important and dangerous, if abused," given the power "of one partner to subject the others to liability..." that the courts carefully require proof of agreement to form an ordinary partnership. See F.F. MECHEM, *ELEMENTS OF THE LAW OF PARTNERSHIP* § 4, at 7 (2d ed. 1920).

Relationships like the royalty tie and production payments are not really (as opposed to legally) that different from standard partnerships. These interest holders may "pay" costs in a different way, generally by contributing their acreage interest or some other good or service rather than cash, and ordinarily are not billed for all well costs, yet they too pool their resources with the operator's. Their fortune too is entirely dependent upon the operator's honesty and competence. It is also not entirely true that royalty owners do not bear costs in a real economic sense. The royalty owner usually has contributed a substantial thing-of-value to the joint operation: it has leased its mineral interest, and the operator earns its rights by arranging to drill on that property. The royalty is the amount repaid for the lessor's property contribution. The lost alternative use of this property is a true economic cost to the royalty owner. It just occurs at the start of the venture, when the ultimate value of the contribution may be hard to predict (even if its current market value

The partnership relationship that the average JOA investment most resembles is the limited partnership, not a general partnership. In a general partnership, all partners have the power to manage the venture. In contrast, in a limited partnership, the "limited" partners are supposed to be passive investors and have virtually no management powers.¹⁹⁰ Tellingly, limited partners can retain such controls as a right to approve financial commitments over a given amount (powers in many JOA investments) and the right to consent to certain kinds of transactions—say, mergers (like the JOA investor's right to vote on completion and subsequent wells).¹⁹¹ Limited partners have a right of access to the books (much like the JOA COPAS [Council of Petroleum Accountants Societies] right to audit), and the general partner has a duty to maintain books on the venture.¹⁹² These partial rights and controls of the limited partners do nothing to defeat fiduciary protection.

The limited partner's protected status is tied directly to its dependence. If the limited partner receives too many powers, courts will treat the arrangement as a general partnership.¹⁹³ Conversely, in the absence of such powers, it is the limited partner's dependence and the general partner's power that makes the general partner a fiduciary. Here, in contrast to the oilfield joint-venture and mining-partnership cases, "[w]ith power of management comes responsibility: fiduciary duty and possible liability for mismanagement....The concentration of management powers in the general partners justifies the fiduciary duties of general partners intended to protect limited partners from general partners' abuse of power."¹⁹⁴ The general partner's fiduciary duty is stronger than in a general partnership because of the limited partners' dependence and lack of control.¹⁹⁵

The joint-venture and mining-partnership cases turn this commonsense principle on its head, holding that only with the nonoperators' power of management (with their "cooperation" or

may be fairly predictable). Even overriding royalty owners ordinarily "pay" the costs after the point of production—that is, they are paid revenues out of the net revenue stream—once the well comes on line and begins to flow. See generally WILLIAMS & MEYERS MANUAL, *supra* note 1, at 859–66.

190. See IV ALAN BROMBERG & LARRY RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 16.03, at 16:40–16:42 (2003).

191. *Id.* at 16:44.

192. *Id.* §§ 16.05(b), at 16:50–16:51 (duty to keep books), 16.05(c)(i), at 16:52–16:53 (scope of access).

193. *Id.* § 16.03(b), at 16:44.

194. *Id.* § 16.03, at 16:43.

195. *Id.* § 16.07(a), at 16:85.

"control") does the fiduciary duty appear, and requiring a diffusion of powers to the other partners before extending protection.

G. Operators Can Be Fiduciaries from Long-Standing Relationships of Trust and Confidence

Finally, in addition to formal fiduciary relationships,¹⁹⁶ parties in an oilfield project can find themselves in an "informal" fiduciary duty "whenever one party trusts and relies upon another."¹⁹⁷ Courts sharply limit such informal relationships, however. Not only must the nonoperator put its trust and confidence in the operator, but generally it must do so in a long-standing or at least preexisting relationship to qualify for fiduciary protection.¹⁹⁸

Almost every victim of fraud will say that it trusted the perpetrator of its injury. If this were all it took to establish a fiduciary relation, every bad investment would become a breach-of-fiduciary-duty case. Fear of transforming all contract cases into tort cases is why the courts require the plaintiff to have enough prior dealings with the alleged fiduciary that it "is justified in relying on the other to act in his best interest."¹⁹⁹ It is also why courts often recite that "subjective trust" is

196. Some courts treat fiduciary relationships like partnerships, in which duties are imposed as a matter of law because of the "technical" or "formal" structure of the relationship. *See, e.g.,* *Tex. Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 507-08 (Tex. 1980).

197. *See id.* at 507-08. This informal fiduciary relationship is what the *Restatement (Second) of Trusts* describes as a "confidential relationship," which exists "between two persons when one has gained the confidence of the other and purports to act or advise with the other's interest in mind." RESTATEMENT (SECOND) OF TRUSTS § 2 cmt. b (1959). This duty "is particularly likely to exist where there is a family relationship or such a relation of confidence as that which arises between physician and patient or priest and penitent." *Id.*

198. *See, e.g.,* *Consol. Gas & Equip. Co. v. Thompson*, 405 S.W.2d 333 (Tex. 1966); *cf. MacDonald v. Follett*, 180 S.W.2d 334 (Tex. 1944) (in dispute among joint owners of overriding royalties on duty to share royalty from lease renewal, fiduciary duty would exist if plaintiff proved prior relationship of trust and confidence; remanding for trial on this issue); *Patton v. Callaway*, 522 S.W.2d 252, 255-56 (Tex. Civ. App. 1975) (no informal fiduciary duty between parties who entered project to acquire leases for resale in absence of long prior relation); *Hendrix & Golding, supra* note 10, at 10-21 (describing long prior relationship as one basis for fiduciary duty). It is an oversimplification to just focus on a long prior relationship as the basis for a fiduciary duty; this informal duty arises only if there is a long prior relationship *and* the plaintiff can show that there was a true relationship of close trust and confidence with the defendant, a question that usually will go to the jury. *See also Norman v. Apache Corp.*, 19 F.3d 1017, 1025-26 (5th Cir. 1994) (affirming summary judgment dismissing informal fiduciary duty claim after noting that subjective trust is not enough to sustain that claim). The Texas Supreme Court noted the viability of informal fiduciary relationships from "[c]lose friendly or familial relationships" in *Rankin v. Naftalis*, 557 S.W.2d 940, 945 n.5 (Tex. 1977), but the issue was not raised by the pleadings.

199. *See Blue Bell, Inc. v. Peat Marwick*, 715 S.W.2d 408, 416 (Tex. App. 1986).

not enough to establish the requisite tie of trust and confidence.²⁰⁰ In a sense, the informal duty is a backstop doctrine that shields one last form of dependence if all other fiduciary doctrines fail to apply.

Every one of these oilfield fiduciary theories except the joint-venture and mining-partnership cases imposes a heightened duty because the operator has special control over the nonoperators' affairs. Part VII.A of this Article shows that this is the basis upon which courts impose higher duties in and out of the oilfield; Part IX.B shows that the emerging fiduciary duty has come to center around these ties of control and dependence.

IV. OPERATOR FIDUCIARY ANALYSIS BY JURISDICTION

One way to group the oilfield fiduciary cases is by their theory of the operator's duty. From this perspective, the fiduciary cases are a competition among the various legal categories just discussed: joint venturer, mining partner, trustee-like dispenser of funds, unit operator, marketing agent, grubstake holder, ordinary partner, or informal partner. Two other approaches are to divide the cases by jurisdiction, or by category of operator behavior.

Looked at by jurisdiction, the top five producing states are, in order, Louisiana, Texas, Alaska, Oklahoma, and New Mexico.²⁰¹ Among major producing jurisdictions, Oklahoma and the Tenth Circuit are the clear leaders among fiduciary proponents.²⁰² The strongest joint-venture

200. See, e.g., *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 177 (Tex. 1997) ("[M]ere subjective trust does not, as a matter of law, transform arm's-length dealing into a fiduciary relationship."); *Consol. Gas & Equip. Co. v. Thompson*, 405 S.W.2d 333, 336 (Tex. 1966); *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1962) ("[M]ere subjective trust alone is not enough....Businessmen generally do trust one another....If we should permit respondents to set aside their conveyances on such slender evidence, the security of contracts and conveyances in this state would be seriously jeopardized.").

201. These combined oil and gas rankings are estimated for January–October 2004 by Barry Pulliam and Washington Lem of EconOne, the economic consulting firm based in Los Angeles, from data published by the Energy Information Administration (EIA). While the pecking order can change a little from year to year, basic rankings have been fairly consistent for a number of years.

202. In an exotic reading of Oklahoma law, Gary Catron argued in 1993 that Oklahoma courts "[f]or many years" did not treat the operator/nonoperator relationship as fiduciary, and that more recent Oklahoma cases "do not really mean there is a fiduciary relationship" or that when they say so it is only in dictum. See Catron, *supra* note 23, at 2764. Catron's effort to demonstrate this misreading of fiduciary law began with an unrepresentative swath of other states' cases, primarily disclaimer cases. As for Oklahoma cases, he focused primarily on *Young*, but skipped the broad rationale provided in the trio of early, strong working interest fiduciary cases: *Blackstock Oil Co. v. Gaston*, 87 P.2d 1087 (Okla. 1939); *Oklahoma Co. v. O'Neil*, 440 P.2d 978 (Okla. 1968); and *Britton v. Green*, 325 F.2d 377 (10th Cir. 1963). See *supra* notes 42–63 and accompanying text.

and mining-partnership cases come from the 1939 decision in *Blackstock Oil Co. v. Gaston*,²⁰³ the 1968 opinion in *Oklahoma Co. v. O'Neil*,²⁰⁴ and the Tenth Circuit's decision in *Britton v. Green*.²⁰⁵ The trustee-based duty applying to the distribution of shares, handling of production, and an as-yet undefined range of other financial activities is based on *Reserve Oil*, the Tenth Circuit opinion in an Oklahoma dispute.²⁰⁶ Almost all of the courts that have followed *Reserve Oil* so far have been in the Tenth Circuit and related state courts.²⁰⁷ The key unit operator case, *Young v. West Edmond Hunton Lime Unit*, is a 1954 Oklahoma Supreme Court case,²⁰⁸ and most of the many cases following *Young* are from Oklahoma or within the geographic bounds of the Tenth Circuit.²⁰⁹

Texas has most heavily litigated the operator's duty and is the state most resistant to per se fiduciary tests.²¹⁰ The Fifth Circuit has suggested that Texas would not follow *Young*, one intermediate state

As for *Young*, Catron discussed it as if the outcome "may not have depended on the establishment of a fiduciary obligation." Catron, *supra* note 23, at 2765. But this reading cannot be reconciled with the Oklahoma Supreme Court's strong language: "[T]he unit organization with its operator stands in a position similar to that of a trustee for all who are interested in the oil production either as lessees or royalty owners." *Young*, 275 P.2d at 309. To read *Young* without its fiduciary rationale is like driving from Dallas to Tulsa without using roads.

203. See *supra* notes 42-50 and accompanying text.

204. See *supra* notes 59-63 and accompanying text.

205. See *supra* notes 51-57 and accompanying text.

206. See *Reserve Oil, Inc. v. Dixon*, 711 F.2d 951 (10th Cir. 1983); see also *supra* notes 122-133 and accompanying text. The only authority *Reserve Oil* cited was *Young*, the lead Oklahoma unit operator case. *Reserve Oil*, 711 F.2d at 953 n.4.

207. See *supra* notes 134-139 and accompanying text.

208. See *supra* notes 166-172 and accompanying text.

209. See *supra* notes 173-174 and accompanying text.

210. It is for this reason that Howard Boigon wrote, in the late 1980s, that most typical joint operating arrangements would give rise to a fiduciary relationship in third-party suits in states "other than Texas." See Boigon, *Liabilities and Relationships*, *supra* note 3, at 8-39; Boigon, *Hostile Environment*, *supra* note 3, at 5-5 (JOA creates more than cotenancy or service contract in most states except Texas). As the text has shown, Texas respects the general joint-venture/mining-partnership rule if its elements are proven, but it has not adopted the stronger affirmations of the duty by the Oklahoma courts.

Texas used to provide by statute that "[o]peration of a mineral property under a joint operating agreement does not of itself establish a partnership." TEX. REV. CIV. STAT. ANN. art. 6132b, § 7(5) (1970). The purpose of this seemingly straightforward clause, however, was to limit nonoperator liability to third parties for the operator's conduct. See *Johnston v. Am. Cometa, Inc.*, 837 S.W.2d 711, 715 (Tex. App. 1992). See generally *infra* notes 302-305 and accompanying text. But see 2 KUNTZ, *supra* note 24, § 19A.6, at 109 n.24 (citing Tex. Ann. Civ. Stat. Art. 6132(b) as proof that JOA alone does not create larger duty without discussing the statutory purpose). Article 6132(b) prevented supply companies, drilling contractors, and others who do business with operators from suing every investor individually if the project goes bad and the operator does not pay them. It did not settle the level of duty that runs from operator to investor.

court has refused to apply it to disclosure of geologic information, and a number of Texas cases have applied a lesser good-faith standard in royalty pooling and unit cases.²¹¹ Some Texas cases include broad pronouncements that the operating agreement does not create a fiduciary relationship, pronouncements that often ignore *Rankin v. Naftalis*.²¹²

The idea that Texas never treats operators as fiduciaries, however, oversimplifies Texas law. In *Rankin*, the Texas Supreme Court spoke of the JOA as if it sometimes can make the operator a fiduciary as a matter of law (even though *Rankin* did go to the jury).²¹³ The Texas Supreme Court applied strong fiduciary standards to the related situation of executive rights holders in *Manges v. Guerra*.²¹⁴ Although a handful of Texas lower courts have been waging guerilla war against that opinion ever since, the court cited *Manges* with approval just a few

211. In *Rutherford v. Exxon*, 855 F.2d 1141, 1145-46 (5th Cir. 1988), the Fifth Circuit denied fiduciary protection to unit lessors who claimed that Exxon had lied to them about the benefits of unitization in order to trick them into letting Exxon include their unusually productive acreage in the unit. They had argued that Exxon's status as unit operator was one reason for this duty. See also *Pritchett v. Forest Oil Corp.*, 535 S.W.2d 708, 710 (Tex. Civ. App. 976) (citing *Young* with seeming approval but not applying unit fiduciary duties to operator's duty of disclosing geological information). In *Mitchell Energy Corp. v. Samson Resources Co.*, 80 F.3d 976, 985 (5th Cir. 1996), the Fifth Circuit rejected fiduciary claims to unleased co-tenants in a producing unit, from whom the unit operator had concealed the existence of a quite productive well. For the Texas pooling cases, see *supra* note 174.

One federal trial court has refused to apply *Reserve Oil* under Texas law. See *In re Wilson*, 69 B.R. 960, 964-66 (N.D. Tex. 1987) (distinguishing *Reserve Oil* as an Oklahoma rule and claiming "that Texas courts would hold that an operating agreement does not create a trustee-type relationship between an operator and the non-operators.").

212. See, e.g., *Texstar N. Am. v. Ladd Petroleum*, 809 S.W.2d 672, 678 (Tex. App. 1991) (finding no Texas law supporting claim of implied duty of mutual cooperation between working interest owners). *Texstar* was an unusual case in which an operator sued a nonoperator for its refusal to consent to a fracturing procedure when the agreement expressly required consent of all parties. See *id.* at 674-75).

Texas courts also have not been reluctant to enforce disclaimers. See, e.g., *Norman v. Apache Corp.*, 19 F.3d 1017, 1023-24 (5th Cir. 1994); *Ayco Dev. Corp. v. G.E.T. Serv. Co.*, 616 S.W.2d 184, 185 (Tex. 1981); *Luling Oil & Gas v. Humble Oil & Ref. Co.*, 191 S.W.2d 716, 722 (Tex. 1945); *Crowder v. Tri-C Res., Inc.*, 821 S.W.2d 393, 399 (Tex. App. 1991); *Taylor v. GWR Operating Co.*, 820 S.W.2d 908, 911-12 (Tex. App. 1991); *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316, 320-22 (Tex. App. 1982).

213. See *supra* notes 69-70 and accompanying text. As discussed in Part III.A.1.a, courts and commentators often cite *Rankin* for the proposition that the operator is *not* a fiduciary because of its holding that its operator did not have to share acreage acquired outside the venture's geographic boundaries, but the supreme court nonetheless analyzed the facts using a strong fiduciary standard. See generally *supra* notes 64-70 and accompanying text. Texas once provided by statute that a joint operating agreement alone did not create a partnership, but the purpose of this provision was to avoid third-party liability. See *infra* note 302.

214. See *infra* notes 373-378 and accompanying text.

years ago.²¹⁵ Furthermore, the marketing-agency fiduciary duty has emerged from a series of intermediate Texas state court decisions.²¹⁶

Louisiana has no recent or high-court authority on this issue. It does, however, have an unfavorable intermediate state court decision, and has been the victim of a casually careless Fifth Circuit opinion, both cases enforcing standard industry disclaimers to negate the fiduciary duty.²¹⁷ Moreover, Louisiana has a statute that a joint project will not create a partnership "unless the contract expressly so provides."²¹⁸ Although the Texas Supreme Court held in *Rankin* that similar statutory language does not preclude a joint venture finding within the joint-account area,²¹⁹ it is uncertain how this common-law reading will apply in the Code state of Louisiana.

215. For the stubbornly dissenting lower courts, see *infra* notes 385–386 and accompanying text. For the Supreme Court's recent confirmation that *Manges* remains the law, see *infra* notes 384–385 and accompanying text.

216. See *supra* notes 154–161 and accompanying text.

217. In *Prentice v. Amax Petroleum Corp.*, 220 So. 2d 783 (La. Ct. App.), a Louisiana court of appeals interpreted standard no-partnership and several liability provisions as negating any fiduciary relationship. The dispute was whether the defendant had to share an interest it acquired through a secret top lease when the underlying lease expired. The court found that these terms "expressly negative the creation of any type of joint venture, fiducial obligation or similar, though innominate, relationship." *Id.* at 787. It was not moved by the accusation that it was enforcing "the usual 'boiler plate.'" See *id.* In a summary of Louisiana law, Guy Wall observed that Louisiana courts have enforced these standard disclaimers. See Wall, *supra* note 151, at 98. Wall does argue that, when disclaimers are absent, a trust relationship "may be appropriate in nonoperational spheres," but given the prevalence of the disclaimers, this will be small comfort to most Louisiana nonoperators. See *id.* at 100.

The Fifth Circuit has dabbled in Louisiana's fiduciary standard. In *Caddo Oil Co. v. O'Brien*, 908 F.2d 13 (5th Cir. 1990), the Fifth Circuit addressed the operator/fiduciary issue in one carelessly abrupt paragraph. The operator had sued for unpaid expenses, and two nonoperators counterclaimed challenging the number of development wells and several billings. The Fifth Circuit, in addition to finding the claims barred by limitations, held that there was no fiduciary duty when the operating agreement made the operator liable only for "willful misconduct." See *id.* at 17. Though the court did not cite the exact contract language, presumably it is the standard JOA liability limitation. It cited none of the cases holding that this language is intended to limit liability to third parties only nor did it cite the voluminous caselaw on the operator's duty. See generally *infra* notes 302–304 and accompanying text. It cited no Louisiana cases nor any evidence of industry custom. In an area filled with such abundant caselaw, to simply read the contract language with no attempt to place it in its common-law setting hardly creates an opinion deserving weight. Louisiana has established by statute that holders of executive rights are subject to a duty of good faith and, thus, not a fiduciary duty. See *infra* note 387.

218. LA. REV. STAT. ANN. § 31:215 (West, Westlaw through 2004) ("A written contract for the joint exploration, development, or operation of mineral rights does not create a partnership unless the contract expressly so provides.").

219. See *infra* note 308 and accompanying text.

Alaska's oil and gas development came relatively late, and Alaskan courts have not yet addressed the operator/fiduciary issue.²²⁰

New Mexico, the fifth largest producer as of late 2004, has not squarely addressed the operator/nonoperator fiduciary issue, though its courts have mentioned an operator's fiduciary duty in dictum.²²¹

In California, despite its leading role in the oil industry early in the twentieth century and its continuing rank among large producers, the California Supreme Court has not addressed any of the recent doctrines discussed here in oil and gas cases. No California courts address such doctrines as the *Young* unit rule, the *Reserve Oil* trust duty, or the marketing agency. Some courts of appeals have applied the

220. Not only did the major Alaska drilling occur late in the last century, but another factor that may explain the absence of litigation is that the primary players were a relatively small number of major oil companies.

221. In two cases, New Mexico courts have recognized in dictum that JOA relations can sustain a fiduciary duty. In *Jack v. Hunt*, 410 P.2d 403 (N.M. 1966), the New Mexico Supreme Court addressed a drilling and operating agreement between the lessee of a federal lease and a drilling company, which earned an 87.5% interest by drilling, with the lessee retaining a 7.5% royalty (the rest going to the government). In the face of a new federal law that increased its royalty to 12.5%, the court affirmed a trial court holding that the operating agreement created a fiduciary relationship between the parties. *Id.* at 411. This duty apparently never was in dispute; the parties agreed that a fiduciary duty existed. *See id.* at 409.

In *Skaggs v. Conoco*, 957 P.2d 526 (N.M. Ct. App. 1998), the heirs of the lessor and his wife challenged a similar operating agreement, claiming that it was void because New Mexico law had required her to sign the operating agreement. They tried to surmount their decades of delay by arguing, in part by citing *Jack*, that the operating agreement created a fiduciary relationship that tolled limitations. *See id.* at 530. Though the appellate court affirmed a laches finding for Conoco, the court agreed on the basic standard: "Plaintiffs correctly interpret the foregoing cases as recognizing that execution of certain types of agreements may indeed give rise to the existence of a fiduciary relationship...." *See id.* Unfortunately, neither court explained why an operating agreement that spawned a royalty interest deserved fiduciary protection under New Mexico law.

New Mexico pretty clearly rejects any extension of this fiduciary duty, a la *Young*, to the royalty relationship. In *Amoco Production Co. v. Heimann*, 904 F.2d 1405, 1410-12 (10th Cir. 1990), a dispute over the operator's pooling of a carbon dioxide unit, the Tenth Circuit applied a good-faith standard because the unit was a voluntary unit. It rejected a fiduciary standard as "altogether too strict." *Id.* at 1412; *see supra* note 174. In *Murdock v. Pure-Lively Energy*, 775 P.2d 1292, 1295-96 (N.M. 1989), the New Mexico Supreme Court adopted a nonfiduciary utmost good faith standard for executive rights cases and declined a fiduciary standard. *See id.* at 1295-96. Somewhat oddly, the court claimed to apply the duty of utmost good faith from *Manges*, which, as shown in Part VII.A.6, is a fiduciary duty in Texas. In *Continental Potash, Inc. v. Freeport-McMoran, Inc.*, 858 P.2d 66 (N.M. 1993), *cert. denied*, 510 U.S. 1116 (1994), a royalty lawsuit over some very dated claims, the New Mexico Supreme Court ambiguously held that "a fiduciary relationship did not automatically arise from these circumstances in which defendants were essentially handling their own property." *Id.* at 701 (emphasis added).

standard multi-factor test to oil ventures,²²² a doctrine that the California Supreme Court has been applying in mining cases well back into the nineteenth century.²²³

In Kansas, a major gas producing state and home to such strong fiduciary statements as *Foley & Loomis v. Phillips*,²²⁴ the state supreme court recently issued one of the strongest affirmations of the operator fiduciary duty. Deciding yet another acreage-acquisition dispute, the court held that "parties to a joint venture stand in a close relationship of trust and confidence and have the right to demand and expect from the other full, fair, open, and honest disclosure of everything affecting the relationship."²²⁵ While defendants could argue that this holding should be limited to the traditionally fiduciary area of acreage acquisitions, the language is far stronger and confirms Kansas' central place in the strong fiduciary camp.²²⁶

222. See, e.g., *Goldberg v. Paramount Oil Co.*, 300 P.2d 329, 332-33 (Cal. Ct. App. 1956) (applying multi-factor joint-venture test, and finding no joint venture and hence no exemption from securities law, in absence of control or participation and rejecting position that consultation was equivalent to participation); *Stoddard v. Goldenberg*, 119 P.2d 800, 802 (Cal. Ct. App. 1942) (rejecting joint venture in absence of community of interest).

223. *Treat v. Murdock*, 65 P.2d 881, 883-84 (Cal. 1937) (rejecting effort to convert creditor relationship into mining partnership in absence of joint interest in mine or shared activity in carrying on mining operations); *Harper v. Sloan*, 169 P. 1043, 1045-46 (Cal. 1917) (finding mining partnership even though defendants only contributed funds and holding that "[w]here one of them supplies money which is to be used in working the claim, he is engaged in such work as truly as is the one who devotes his own labor to the enterprise") (citation omitted); *Prince v. Lamb*, 60 P. 689, 690-91 (Cal. 1900) (rejecting mining partnership in absence of agreement to share profits and losses; joint ownership; or joint association to carry out project); *Skillman v. Lachman*, 23 Cal. 198, 203 (Cal. 1863) ("[I]t is clear that where the several owners unite and cooperate in working the mine, then a new relation exists between them, and, to a certain extent, they are governed by the rules relating to partnerships.").

224. 508 P.2d 975 (Kan. 1973), discussed *supra* note 73.

225. *Amoco Prod. Co. v. Charles B. Wilson, Jr., Inc.*, 976 P.2d 941, 949 (Kan. 1999). For a critical but misguided analysis of *Amoco v. Charles B. Wilson*, see Richard James, *Kansas Oil and Gas Law: Defining the Duty Between Participants in a Joint Operating Agreement*, 39 WASHBURN L.J. 128 (1999). James mistakenly paints Kansas as an extreme jurisdiction that, along with Arkansas and Michigan and a few other supposedly aberrant states, is out of step with the "decades of well-developed mineral law" in Texas and Oklahoma denying a fiduciary duty. See *id.* at 134. This analysis ignores the main thrust of Oklahoma law and even such Texas cases as *Rankin*. The well-developed oilpatch operator-duty standard is that the operator is a fiduciary in many of its responsibilities.

226. Arkansas endorsed a strong fiduciary duty in *Texas Oil & Gas Corp. v. Hawkins Oil & Gas, Inc.*, 668 S.W.2d 16, 17 (Ark. 1984), one in the seemingly endless series of cases in which an operator secretly acquired acreage in property that it had agreed to develop jointly with the nonoperators. Adopting one of the strongest rules, the Arkansas Supreme Court held that "[t]here was a relationship of trust and confidence between the parties as a result of the execution of the Joint Operation Agreement." *Id.* Michigan is in the fiduciary

These variations by jurisdiction leave wide room for very different outcomes in similar cases. None of these jurisdictions, however, have rejected the possibility of a joint venture and mining partnership when some version of the three-part test is met, and all are certain to give effect to the JOA's disclaimer and exculpatory provisions in some circumstances.²²⁷ The Oklahoma Supreme Court clearly is more willing to protect nonoperators than its Texas counterpart. Operators in Texas, even if faced with a generally fiduciary category like a unit operator or an operator marketing production, will argue that there is a general "Texas rule" that operators are not fiduciaries. In executive rights cases, they will argue that the policy that makes the ordinary operator a nonfiduciary should apply to the executive rights holder and urge the very conservative, business-oriented Texas Supreme Court to abandon the executive/fiduciary rule.²²⁸ On the other hand, nonoperators in states like Oklahoma will argue that the Oklahoma courts have imposed this higher duty in so many situations that they have effectively made all operators fiduciaries.

In theory, such a welter of state jurisdictions could provide ideal laboratories to experiment with different policies. The existence of a division among major producing states is not necessarily a bad thing. It would be productive, for instance, if there were strong arguments for different fiduciary duties and the states systematically experimented with different legal rules. The oil and gas industry is divided over such other major issues such as the treatment of take-or-pay payments to royalty owners, which costs are borne by the operator, and the effect of changes in market prices under a "market value" lease. Such divisions might reflect an admirable testing of alternative policies.

Unfortunately, the haphazard way in which the operator cases have developed, as well as the variations within states and the role of the "cooperation" and "control" hurdles, suggest that the law on the operator's duty has sprawled in various directions without careful reflection. The end product is not a demonstration of glorious, multihued variation via common-law experimentation, but instead confusion and uncertainty from lack of careful analysis.

camp, too. See *Schmude Oil Co. v. Omar Operating Co.*, 458 N.W.2d 659, 664-66 (Mich. Ct. App. 1990).

227. For the disclaimers, see *infra* Part VI.

228. For a general discussion of this executive rule, see *infra* notes 370-388 and accompanying text.

V. THE FIDUCIARY DUTY BY FUNCTION

In addition to doctrinal categories and variations by jurisdiction, the operator fiduciary cases can be grouped by function. Indeed, the most likely fiduciary standard, the test slowly emerging from the case law, will vary by function. Underlying the general operator-duty standards are rough rules the courts have hammered out for certain kinds of behavior. The *Reserve Oil* trustee duty and the operator's marketing agency are the latest examples of this doctrinal growth. Yet the fiduciary duty is not fully consistent by function across jurisdictions. The duty has yet to find a firm foundation in a clearly articulated, overarching theory that explains the places where courts have adopted inconsistent holdings on control, cooperation, or the general standard of care for the operator. Today's partial rules are not a good substitute for a clear legal picture of the operator relationship. One can generalize from them to predict which activities are more or less likely to gain fiduciary coverage. In addition, one can see the outline of the larger and more consistent duty that makes the operator a fiduciary in areas where its interests diverge from its investors' interests.

A. The Operator Is a Fiduciary for JOA Property Acquisitions

One of the core oilfield fiduciary rules is no surprise: courts impose a high duty of loyalty in property acquisitions and in the use of joint-account information to acquire property within the JOA's geographic area. This is the holding of the Texas Supreme Court in *Rankin v. Naftalis*,²²⁹ a trio of Kansas Supreme Court cases that includes *Foley & Loomis v. Phillips*,²³⁰ the Oklahoma Supreme Court in *British American Oil Producing Co. v. Midway Oil Co.*,²³¹ and numerous other cases.²³²

229. See *supra* notes 64–72 and accompanying text.

230. 508 P.2d 975 (Kan. 1973); see also *supra* note 73 and accompanying text.

231. 82 P.2d 1049 (Okla. 1938); see also *supra* note 73 and *infra* note 233 and accompanying text.

232. For these other cases, see *supra* note 73; accord *DERMAN*, *supra* note 3, at 73–75; *Boigon, Hostile Environment*, *supra* note 3, at 5–12 to 5–16; *Hendrix & Golding*, *supra* note 10, § 10.04[3][a], at 10–22 to 10–26 (making exception to general rejection of fiduciary duties for “property dealings within the contract area that have not been disclosed”); *Wall*, *supra* note 151, at 104 (AMI “often used” to require sharing in areas outside fiduciary duty). See generally *Smith, Duties and Obligations*, *supra* note 24, §§ 12.03(8)(b) (discussing provisions on lease renewal and the like in JOA), 12.04[c] (acquisitions outside contract area).

One reason that courts have been willing to limit the geographic scope of the operator's duty undoubtedly is the frequent presence of an AMI clause, a standard area-of-mutual-interest clause defining the area within which the parties must share mutually

The Oklahoma Supreme Court described the reason for the geographic limit on the duty to share acreage acquisitions in *British American Oil*, a case in which the crowded drilling sites in Oklahoma City generated a good exposition of the larger issue:

The oil field in and about Oklahoma City is highly developed, the wells in many instances are on adjoining blocks....It must often happen that an oil company in drilling on one block, even on contract to drill for mutual benefit with a leaseholder, would obtain information of great value in the drilling or operation of its other wells in the Oklahoma City oil fields.²³³

In other words, courts have decided that the actualities of this industry, with its many competing companies, requires them to limit the area within which participating in a single project constrains the operator's ability to compete on other property for its own account.

An often-overlooked part of *Rankin*, as well as these other property acquisition cases, is that the courts acknowledge the operator is a fiduciary in its property acquisitions within the JOA area. Thus, these cases stand for a high duty within the scope of the JOA, even though they are more often cited for their no-duty holding for acquisitions outside those bounds. They are cases that can expand obligations in the central operator/nonoperator relationship as well as restrict them outside that boundary.²³⁴ The parties have come together to jointly develop a property for their mutual benefit. The operator receives an unusual amount of proprietary information just because of its position as

acquired interests. For discussion of AMI clauses, see 2 KUNTZ, *supra* note 24, § 19A.4, at 87-93; DERMAN, *supra* note 3, at 158-61 (sample language). The parties also routinely share acreage and cash contributions earned by their joint operation, another sign of an intent to share benefits at least within the Contract Area. See generally DERMAN, *supra* note 3, at 100-03. Strict interpretations of the AMI rule, though, conflict with another longstanding rule, namely, that the operator cannot take a separate benefit if based on information paid for by the joint account. See generally Smith, *Duties and Obligations*, *supra* note 24, at 12-54 to 12-57; see also Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-19 (operator cannot "use venture information or opportunities for its personal benefit"). Mining partnerships also are projects limited in geographic scope. See Fiske, *supra* note 22, at 218-19. Indeed, this is one way that they differ from the law of partnership generally. See *supra* note 103 and accompanying text.

233. *British Am. Oil Producing Co. v. Midway Oil Co.*, 82 P.2d 1049, 1052 (Okla. 1938).

234. In a pre-*Rankin* article, Lee Jones used *Warner v. Winn*, 197 S.W.2d 338 (Tex. 1946), an early case about property acquisitions, as part of a discussion concluding that the operator is not "strictly a trustee, [but] it is equally clear that in some respects he has a fiduciary relation to the non-operators. This relationship, however, exists only with respect to the specific property described in the operating agreement." Jones, *supra* note 4, at 720-21. For *Warner v. Winn*, see *supra* note 73.

operator. The operator has access, paid for in large part by its partners, to the most detailed geologic information about the property around the area of the JOA. Parties seeking to buy or sell acreage are more likely to contact the operator instead of other interest owners. The operator has a duty to use its superior position for the joint account.

The settled rule thus far is that any duty to share acquired property stops at the joint-property's boundaries, but *Rankin* is a good example of why the duty should be broader than the JOA, at least when the operator makes broader commitments about property acquisitions or uses information acquired from joint-account activity. In *Rankin*, the operator allegedly promised to acquire property outside the JOA for the joint interest.²³⁵ The nonoperators, trusting him because he was, after all, the leader of their venture, assumed that he would acquire this property. This was a reasonable assumption when the operator was acting on behalf of the nonoperators for many other facets of the operation. Not only was their reliance reasonable, but what could be more efficient than to appoint one party to lease adjoining acreage, rather than having the operator and all its nonoperators bid against each other and drive up the cost of the property they wanted to acquire? Instead of acquiring the property for the joint interest, however, Rankin used his promise to buy time and prevent his partners from bidding while he cornered the lease for himself. Yet the Texas Supreme Court let Rankin off the hook by allowing him to go unpunished.²³⁶ The court might have thought that imposing the geographic limit was a necessary accommodation to the conflicts of interest in this industry of frequent joint operations, but even if this were a good rule for operators who had not spoken or induced reliance, it is a harsh, punitive rule when the operator spoke, as here, and lied.²³⁷

At a minimum, it is clear that operators cannot use joint account information to acquire added interests for their own account within the JOA or within any contractual area of mutual interest, that courts will treat operators as fiduciaries within these boundaries, and that operators

235. See *supra* note 65.

236. See *supra* notes 71-72 and accompanying text.

237. Given the strength of the fraud evidence, it is perhaps surprising that the plaintiffs did not sue for fraud, but they did not. See *Rankin v. Naftalis*, 557 S.W.2d 940, 943 (Tex. 1977). Faced with the jury's somewhat inconsistent refusal to find that the plaintiffs were justified in believing that Rankin would act in their mutual interest and their finding of estoppel, however, the plaintiffs might have ended up no better off. See *id.* The case nonetheless is a real fraud case, and had the plaintiffs pled it that way, they might have focused more directly on proving fraud, where the facts seemed to lie strongly in their favor.

risk finding themselves on shaky ground if they exploit joint-account information outside this area.

B. The Reserve Oil Trust Duty in Handling Joint Account Funds

A second area that has become well-settled in almost all states is that the operator is a fiduciary when handling payments received or revenues earned from the joint account. Most courts seem to agree, following *Reserve Oil's* holding that "a trustee type relationship" exists "in the matter of distribution of shares" of production, and the duty has extended to overbillings and other accounting areas.²³⁸ Commentators have endorsed this fiduciary principle as well.²³⁹

That this duty has been accepted, and has not been extinguished even in conservative industry circles, is illustrated by the language reserving the possibility of a fiduciary duty for the "custody of funds" in the 1989 JOA. This generally conservative revised form included language designed to extinguish a general fiduciary duty.²⁴⁰ Yet the article covering custody of funds states that the JOA does not establish a fiduciary relationship "for any purpose other than to account for Non-Operators funds as herein specifically provided."²⁴¹ Article V.D.4 "herein specifically provide[s]" for funds "advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production."²⁴² Thus, even changes designed to reduce the operator's liability provide fiduciary protection or, at a minimum, leave room open for courts to impose it for the operator's handling of money paid in and the proceeds of production.

If developed logically, the *Reserve-Oil* trust-like duty could regulate many common oilfield disputes by being extended to related accounting areas that are rife with self-dealing. Thus, the duty should require full disclosure in such areas of traditional self-dealing as special profits collected through affiliates, the failure to pass on the benefit of volume discounts or delay payments, and other special arrangements.²⁴³

238. See *supra* notes 122-139 and accompanying text.

239. See *supra* note 151 and accompanying text.

240. See 1989 JOA, art. VII.A.

241. *Id.* art. V.D.4 (emphasis added).

242. *Id.*

243. There has been relatively little litigation over volume discounts and similar opportunities for operator self-dealing, in part because, when they are uncovered by joint-interest audits or otherwise, the operator often pays up. See, for instance, the operator in *Gilbert v. Nixon*, 429 F.2d 348, 357-59 (10th Cir. 1970), who preferred to make restitution when faced with a securities fraud claim on this and other grounds. For a general discussion of practices like these, and the COPAS provisions that require the operator to pass on all such benefits, see McArthur, *Twelve-Step Program*, *supra* note 132, at 1462-68.

A fully developed *Reserve Oil* duty should put an end to situations like that in *True Oil v. Sinclair Oil Corp.*, in which the operator promised to drill a very expensive overthrust well at its own cost ("at Dave True's cost"), but then billed additional and undisclosed profits using affiliated companies.²⁴⁴

Some operators argue that article V.D.4 of the 1989 JOA section titled "custody of funds," which ends by rejecting a duty to establish separate accounts for nonoperators, has to do only with the most menial aspects of handling funds. They deny that it extends to such issues as an overall duty to get the best price for production, to rates paid to affiliates, or to the treatment of special accounting bonuses like volume discounts and delay payments. Yet a fiduciary duty over handling funds "for the conduct of operations" would be hollow if operators could appropriate investor money by secret arrangements, be they via related companies, special agreements with vendors, or other undisclosed arrangements that profit the operator at its investors' expense. This heightened responsibility for handling nonoperators' funds and assets also undergirds the next fiduciary activity, the marketing of nonoperator production.

C. The Operator's Agency Duty in Marketing Production

Courts have carved out a separate fiduciary duty when the operator markets its investors' production, as shown in *Johnston v. American Cometra, Inc.* and progeny.²⁴⁵ Nonoperators ordinarily have the right to take their production in kind, but most are not equipped to do so, and do not. The JOA provides that if the nonoperator fails to take in kind, the operator has the "right...but not the obligation" to purchase the nonoperator's production or sell it to others "for the account of the non-taking party."²⁴⁶ Under the most recent version of the JOA, the sale is to

244. For the Wyoming Supreme Court's ultimate blessing for this operator's malfeasance via an extreme display of appellate fact finding in *True Oil Co. v. Sinclair Oil Corp.*, 771 P.2d 781 (Wyo. 1989), see McArthur, *Twelve-Step Program*, *supra* note 132, at 1469 n.46. See also *id.* at 1470. Under the 1989 JOA, financial self-dealing and concealed profiteering should violate the duty of good faith that the 1989 JOA's drafters did accept. See 1989 JOA, art. VII.A.

245. See *supra* notes 154-161 and accompanying text. In *Atlanta Richfield Co. v. Long Trusts*, 860 S.W.2d 439 (Tex. App. 1993), a Texas appellate court found that this language gave Arco a "special agency" toward its nonoperators and barred it from taking a special profit on sales of their production. Even *Young v. West Edmond Hunton Lime Unit*, 275 P.2d 304 (Okla. 1954), reached the same substantive conclusion that the operator cannot make an extra or secret profit when marketing production, even if the case came clothed in unit-operator attire. See *supra* notes 166-172 and accompanying text.

246. See, e.g., 1977 JOA, art. VI.C.

be "in a manner commercially reasonable under the circumstances."²⁴⁷ The traditional rule until 1989 required the operator to get the "best price obtainable."²⁴⁸ As with *Reserve Oil's* duty of care in handling funds, so the fiduciary duty for marketing production has met substantial approval from mainstream commentators.²⁴⁹

The marketing cases apply the broad principle that the "act of selling for another implies a principal-agent relationship."²⁵⁰ The 1989 JOA, even though trying to extinguish the operator's general fiduciary duty, excluded from that clause all funds "received by [the Operator] as a result of the sale of production."²⁵¹

This marketing duty closely parallels the responsibility that the implied covenant to market imposes on the operator to get the "best price possible" or "best price reasonably possible" for its royalty owners.²⁵² It would be odd if the operator had a high duty to get the best price for those interest owners, but a much lower responsibility to its equity owners in exactly the same activity of marketing production. Even if royalty owners may be less experienced and so somewhat more dependent upon the operator, the JOA relationship is also one of structured dependence. In many ways, nonoperating investors have much more risk than royalty owners. The royalty owner's contribution is limited to the mineral interest, while the operator has wide discretion to commit nonoperators for a proportionate share of large and uncertain

247. 1989 JOA, art. VI.G.

248. 1977 JOA, art. VI.C. The amendment in 1989 to just a "commercially reasonable" sale does *not* mean that the operator does not have to get the best price possible. Rather, it was designed to prevent nonoperators who had not committed their own production from suing operators who *had* committed theirs, with all the risk that entails, to a long-term production sales contract. This should not mean, however, that the operator marketing production does not have a duty to get the "best price obtainable" at the time of sale; it just means the operator does not have to guarantee the impossible and, in a fallen market, share a long-term contract price that the operator may have had the foresight to secure for its own production but is unable to secure currently for the nonoperators' production.

It is interesting, in view of the many disputes over the basis for royalty settlements and the decades of precedent defining what different royalty price terms mean, that the JOA did not try to define the price the operator should get, not even to the extent of the proceeds/market value definitions common in leases.

249. See *supra* note 160 and accompanying text.

250. See Smith, *Duties and Obligations*, *supra* note 24, at 12-43.

251. 1989 JOA, art. IV.D.4. See generally *supra* notes 241-242 and accompanying text.

252. The duty to market traditionally attached to all leases. See 5 WILLIAMS & MEYERS TREATISE, *supra* note 10, §§ 853-856; 5 KUNTZ, *supra* note 24, § 60.2. The Texas Supreme Court recently has held that the duty does not apply to market value leases, on the novel and certainly unsupported idea that there the market sets an "objective" measure of value and so the implied covenant is not needed. *Yzaguirre v. KCS Res., Inc.*, 53 S.W.3d 368 (Tex. 2001); *Union Pac. Res. Group v. Hankins*, 111 S.W.3d 69 (Tex. 2003). Thus far Texas is a minority of one on this issue.

expenditures. Nothing in the operator/nonoperator relationship suggests that the operator should have a lower duty here than it has to royalty owners, who do not even incur the general costs of exploration and development.

D. The Fiduciary Duty on Affiliate Operations

Large oil companies frequently operate through affiliates. Indeed, it is standard for oil companies to run their drilling and development projects through an exploration and production company, but then sell or trade the production in a related-company transaction to a marketing affiliate. In the now-deregulated natural-gas industry, operators sometimes diffuse services even more by having a separate company gather the gas, a different affiliate process the gas, and yet another affiliate market it.

The oil posted price litigation and current natural gas royalty litigation both contend, usually based on the operator's implied duty to market, that operators have to pay royalties based on their first true outside sale. In royalty cases, it is well settled that, when the operator's interests diverge from the royalty owners', courts will give its conduct added scrutiny and that affiliate activity qualifies for such extra scrutiny.²⁵³ Courts generally have rejected efforts by lessees to underpay their royalty owners by using an artificially low affiliate price as the basis for royalty settlements.²⁵⁴ Though there has been much less working-

253. See generally *Amoco v. First Baptist Church of Pyote*, 579 S.W.2d 280, 286 (Tex. Civ. App. 1979) (citing 5 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 856.3, for proposition that "where the interests of the [lessor and lessee] diverge and the lessee lacks incentive to market gas, closer supervision of his business judgment will be necessary"). See generally *Lansdown*, *supra* note 172, at 13-21 ("[A] court will tend to scrutinize an operator's actions more closely where an operator is dealing with itself and obtains some benefit on both sides of the transaction").

The Texas Supreme Court recently has made the first exception to the self-interest rule in its holding that market-value leases do not contain a duty to market, even in cases of self-dealing. See generally *Union Pac. Res. Group v. Hankins*, 111 S.W.3d 69 (Tex. 2003).

254. In the royalty arena, operators who try to use affiliates to underpay royalty owners (having an affiliate buy the production at a low price, upon which royalties are paid, but then sell the production for more) have been sued repeatedly. For classic affiliate abuse in the royalty context, see *Texas Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24, 27-28 (Tex. App. 1984) (affirming judge's finding that sales to affiliate were a "sham" when affiliate resold gas for more, and forcing it to share proceeds from this "unfair device to deprive plaintiffs of their rightful royalties" with royalty owners), *aff'd in part, rev'd in part*, No. C-3768, 31 Tex. Sup. Ct. 140, 1987 WL 47847 (Tex. Dec. 16, 1987), *opinion withdrawn for settlement*, 760 S.W.2d 960 (Tex. 1988). In *Wegman v. Central Transmission, Inc.*, 499 So. 2d 436, 439, 441, 443, 448 (La. Ct. App. 1986), the court affirmed a jury award of higher royalty where the lessee assigned leases to a partnership that then resold gas from the properties for more than the royalty owners received. "The framework of the 'scheme,' according to plaintiffs, was that

interest litigation over affiliate transactions, the strong fiduciary marketing duty suggests that courts will be as strict with operators when they use affiliates to sell nonoperators' production as when they pay royalty owners. In *Atlantic Richfield Co. v. Long Trusts*,²⁵⁵ for instance, the

CTI assigned the leases it obtained from the plaintiffs to the limited partnerships controlled by CTI. CTI then purchased the gas from the limited partnerships at a low price. CTI's purchase of gas from the partnerships at a low price established a low market or well head value. CTI then sold the gas to IMC at a much higher price." *Id.* at 443. The Arkansas Supreme Court affirmed a jury verdict against an operator that made no effort to enforce a take-or-pay contract against an affiliated buyer in *Seeco v. Hales*, 22 S.W.3d 157, 170-71 (Ark. 2000). The court noted that "[t]here was a conflict of interest in this case because of SEECO's affiliation with AWG." *Id.* at 171. See also *Tyson v. Surf*, 196 So. 336, 339 (La. 1940) (affirming holding that affiliate prices were not binding and plaintiffs were entitled to fair market value). This issue also came up in the oil posted price cases, most of which settled in a consolidated class action in Corpus Christi, Texas, in 1999. See *In re Lease Oil Antitrust Litig.*, 186 F.R.D. 403 (S.D. Tex. 1999).

Efforts by major oil companies to reduce their royalty payments to the Minerals Management Service (MMS) on federal property via marketing affiliates have been rejected as well. In *Texaco Exploration & Production, Inc.*, No. MMS-92-0306-O&G (May 18, 1999), a final Department of the Interior administrative decision co-signed by the Secretary of the Interior, the agency affirmed MMS's rejection of Texaco's effort to pay royalties based on the transfer "posted price" between its production company TEPI and marketing affiliate TTTI, which resold the oil for much more. Applying a gross proceeds standard, the agency pinpointed the "fundamental flaw" in Texaco's position:

[I]t allows any lessee to avoid the gross proceeds requirement by the simple and facile device of creating a wholly owned subsidiary and then first transferring the production to the affiliate, for a price the lessee determines unilaterally, before selling the production at arm's length at a higher price. Texaco's theory would confine gross proceeds to the intra-corporate transfer price....

Id. at 7. Federal circuit courts have indicated disapproval of the oil company position on affiliates in two decisions ruling on discovery disputes (disputes in which the companies refused to even produce documents showing their downstream sales). See *Shell v. Babbitt*, 125 F.3d 172, 176-78 (3d Cir. 1997) (holding in passing that "[i]f Shell Ex sold the oil at a premium above the market price, federal royalties would be based on that premium price. Shell appears to be arguing that it can avoid this result by purchasing the oil from Shell Ex at the market price and then reselling it at a premium itself."); *Santa Fe Energy Prod. Co. v. McCutcheon*, 90 F.3d 409, 412-24 (10th Cir. 1996) (upholding MMS's rejection of argument that affiliate transaction set royalty valuation).

The industry currently is experiencing a wave of affiliate-claim lawsuits over natural gas. The first major case seems to be a nationwide royalty (and working interest) class action against Meridian Oil for not passing on the price received by its affiliates. See generally Plaintiff's Second Amended Original Petition, *Altheide v. Meridian Oil, Inc.*, No. 92-026182 (113th Dist. Ct., Harris County, Tex. filed Sept. 23, 1994). Meridian settled the lawsuit. A federal qui tam action against major natural gas producers is underway in Texas. Third Amended Complaint, *United States ex rel. Harold Wright et al. v. Chevron*, No. 9-98CV30 (E.D. Tex. filed June 13, 2000).

255. 860 S.W.2d 439 (Tex. App. 1993).

court interpreted this duty to force Arco to share the much higher price its affiliate received when it resold the nonoperator's gas.²⁵⁶

Affiliate issues come up on the cost side as well as the revenue side. Because operators so often supply equipment and material as well as services through affiliated companies, the COPAS accounting exhibit, attached as Exhibit C to the JOA, imposes many limits on what the operator can charge. The underlying standard is an actual-cost basis. The operator is not to gain or lose from the joint account, but instead to profit only if the venture is successful in the true currency of oil and gas.²⁵⁷ This principle, which is the counterpart to the idea that the operator cannot extract extra profits on the revenue side, has been litigated in some of the largest partnership cases and in royalty cases.²⁵⁸

Although the courts have been clogged with royalty challenges to affiliate pricing schemes, there have been relatively few cases on the interest-owner side. One reason may be that working interest owners have very detailed audit rights on the cost side via the COPAS accounting exhibit, but none on the revenue side, and oversight therefore has tended to focus on costs. Even cost litigation has been relatively rare because the audit process resolves most of those disputes one way or the other (and the short two-year period for challenging invoices in the standard JOA's COPAS attachment cuts off many claims²⁵⁹). Another reason for the paucity of working-interest revenue litigation may be that if the operator's and nonoperators' production is sold under the same contract, there appears to be less likelihood of cheating than when the operator supplies services and equipment via an affiliate. As a result,

256. Arco sold the gas to its affiliate for between \$1.40 and \$1.60 per mmbtu, but its wholly owned subsidiary then resold the gas for \$2.90 per mmbtu. *Id.* at 445-46.

257. See, e.g., Council of Petroleum Accountants Societies, Inc. (COPAS), *Material Transfer Valuation*, 1 (May 1, 1992) ("A basic concept of Joint Operations is that the Operator should neither gain nor lose economically from being the Operator of a joint property.") As the late John Jolly, former executive director of COPAS, has written, "It has always been the intent of the Operating Agreement that the Operator should not make a profit or conversely suffer a loss just by the fact that he is the Operator of the joint operations." JOLLY & BUCK, *supra* note 4, at 108; see also *id.* at 203 ("It has also been stressed many times that an operator should neither gain nor lose just because he is the operator."); accord, C.M. Kennedy, *Joint Venture Accounting a la COPAS-1962*, in NAT'L INST. PETROLEUM LANDMEN 157, 159 (Armine Carol Ernst, Southwestern Legal Foundation ed., 1964) ("It is a well established principle in our industry that an operator is not supposed to profit from the operation, at the expense of his co-venturers.").

258. In perhaps the worst affiliate cost treatment, the Tenth Circuit thoroughly muddled the issues in *Sinclair v. True Oil*, 771 P.2d 781 (Wyo. 1989). Operator Dave True had promised to drill a very expensive overthrust well in Utah at "Dave True's cost" but then subverted his promise by collecting profits via an affiliate. For a fuller discussion of these affiliate issues, see McArthur, *Twelve-Step Program*, *supra* note 132, at 1469 n.46.

259. See *infra* note 331.

interest owners may not sense a need to be vigilant on revenues. Finally, in the absence of an overall fiduciary duty, royalty owners have an easier time bringing revenue-pricing claims under the duty to market than nonoperators who are not protected by such a duty. In the national posted-price litigation, for instance, a working-interest class received a substantially lower return on the dollar than the royalty class, and the court, in approving the settlement, noted that the royalty owners had stronger legal claims.²⁶⁰ Although this reading of the law seems doubtful given the marketing agency duty,²⁶¹ it is one more sign of the way in which the lack of a better defined operator fiduciary duty has distorted oilfield law.

The cases provide courts the opportunity to link the operator duty with the trust and marketing cases. If the operator is a fiduciary when it handles investor money, it will have to act with the highest degree of fidelity when it bills the joint account for goods and services provided by affiliates. It will have to disclose if it is making more than its actual cost in doing so. Given the operator's fiduciary duty as marketing agent, when the operator sells production to one of its own affiliates, it should not be allowed to use a corporate shell to pay its investors less than it receives when the affiliate sells the production to a third party. Such core affiliate deceptions should fall before the operator's fiduciary duty.

E. Gross Negligence and Willful Misconduct Will Remain the Standards for Physical Operations

The activity where courts are *least* likely to impose a fiduciary duty involves physical operations. The JOA's article V.A gives the operator "full control of all operations on the Contract Area," with a duty to act "in a good and workmanlike manner," and bars liability to "the other parties for losses sustained or liabilities incurred" unless damage results from the operator's "gross negligence or willful

260. In *In re Lease Oil Antitrust Litigation*, 186 F.R.D. 403 (S.D. Tex. 1999), the court was skeptical about JOA-based marketing duty claims because working interest plaintiffs only raised them at the final fairness hearing and the working interest claimants had not demonstrated that these arguments had merit to the court's satisfaction. See *id.* at 416 n.21, 426-27; see also *id.* at 426 n.36.

261. Judge Jack distinguished *Johnston v. American Cometra*, 837 S.W.2d 711 (Tex. App. 1992), because it was a gas case, and hence (apparently) not obviously applicable to the posted price oil dispute. *Id.* at 426. But the operator's role as marketing agent does not differ just because it is selling hydrocarbons that came out of the ground as oil, not gas (or liquid condensate), and nothing in the logic of the marketing cases supports such a distinction.

misconduct."²⁶² Some broad readings of this language apply the gross-negligence and willful-misconduct barrier to all of the operator's conduct.²⁶³ Even courts more closely attuned to the JOA's purpose and more careful to follow its intent accept that it effectively makes the operator a nonfiduciary in its conduct of physical well operations. Many commentators agree with this core reading of article V.A.²⁶⁴

The exculpation for physical operations does not raise the self-dealing concerns present when the operator acquires acreage, handles investor money, or sells its investor's production. In those financial areas, operators have an incentive to self-deal, a risk that can be handled on the cost side by a rigorous application of *Reserve Oil* and on the revenue side by the marketing agency cases. In physical operations, however, the operator and its investors should have the same incentive in geological and engineering terms to discover and develop as much production as possible as cheaply as possible.²⁶⁵ Just as in royalty cases,

262. 1989 JOA, art. V.A. For a general discussion, see *infra* part VI. Somewhat amusingly, two experienced industry hands have claimed that the gross negligence and willful misconduct limitations make legal action rare because "the terms are indefinable and virtually impossible to prove in a court of law" — an exaggeration, but one probably close to the effect intended by article V.A.'s more convinced proponents. See JOLLY & BUCK, *supra* note 4, at 49. In whatever area that it applies, the standard may exculpate the operator unless it fails to "use even slight care." See Boigon, *Hostile Environment*, *supra* note 3, at 5-26. Hendrix and Golding find a "dearth of case law" interpreting what the exculpatory provisions really mean, but they believe that the thrust can be summed up as requiring "extreme carelessness or recklessness or a conscious disregard for the rights of others." See Hendrix & Golding, *supra* note 10, at 10-34 to 10-35. They then find "willful misconduct" a more stringent standard. See *id.* at 10-36. It will be a rare jury that does not treat both of these tests as very deferential toward the operator.

263. See, e.g., *Stine v. Marathon Oil Co.*, 976 F.2d 254, 260 (5th Cir. 1992).

264. See, e.g., Hendrix & Golding, *supra* note 10, at 10-6 to 10-7 & n.11 (cautioning that fiduciary duties must be kept distinct from other theories of liability, that duty does not necessarily make operator liable for mere negligence, and comparing operator to trustee whose general administrative duty may remain that of an ordinarily prudent man in his position); Lane & Boggs, *supra* note 11, at 223-24 ("The high standards of fiduciary duty do not impose an exceptional obligation on the operator in the actual conduct of venture operations," though in dealing with each other "parties are held to the highest standard of conduct."); Smith, *Duties and Obligations*, *supra* note 24, § 12.03[4][a], at 12-29 to 12-30 (even if duty applies, "the operator would normally be required to exercise only the same skill and diligence expected of a reasonably prudent operator"); Wall, *supra* note 151, at 110-11 ("In the actual conduct of drilling and production operations, the operator is not governed by a fiduciary duty even in those common law jurisdictions willing to find a joint venture in the face of a disclaimer.").

265. There is not a perfect symmetry in incentives even here. For instance, one can imagine an operator developing uneconomic properties because it makes a positive return when its profits on operations are added to its return from production. But such classroom hypotheticals fortunately are far removed from the ordinary oilfield project: considering just returns from production, with everything else given, both operator and nonoperator should benefit from the most efficient, low-cost operations.

where courts defer to operators when their incentives align with the royalty owners,²⁶⁶ so here too it is understandable that courts will be more deferential because the operator and nonoperator share the same interest.

The exculpatory language in article V.A of the JOA can be read to contradict other parts of the 1989 JOA, because article VII.A requires the parties to act in "good faith in their dealings with each other with respect to activities hereunder."²⁶⁷ Nonetheless, article V.A's traditional, long-established limit on liability is likely to prevail in the operator's physical activities. Courts presumably will decide, for instance, that an operator negligently trying to develop a property, but doing so without gross recklessness or willful misconduct in physical operations, satisfied the good-faith test in this area. One can expect courts to assume that the drafters intended these two standards to be harmonious and that the 1989 JOA did not mean to remove most of the meaning of the gross-negligence and willful-misconduct provisions in their core area of application. (On the other hand, if the operator were to engage in self-dealing in the provision of material and services or in marketing production, even without a fiduciary duty it would be hard to believe that such violations could be consistent with good faith.) The operator is likely to command wide deference in its physical decisions on the wellsite.

F. Third Parties Generally Will Not Benefit from Joint Fiduciary Liability

It is well settled that vendors, drillers, and other third parties cannot claim that the operator/nonoperator are in a fiduciary relationship, via a joint venture or mining partnership, in an effort to transfer their third-party claims against the joint account to the private assets of the nonoperators.²⁶⁸ This is the core ruling of *Ayco v. G.E.T.*

266. See *supra* note 253 and accompanying text.

267. 1989 JOA, art. VII.A.

268. Vendors ordinarily do not get to attach the nonoperators' interests directly, as long as the nonoperators have received the assignment of their interest. See Barron Dowling, *Lien on Me: Oil & Gas Materialman's and Mechanic's Liens in Texas*, 23 ST. B. TEX. SEC. REP. OIL, GAS & ENERGY RESOURCES L. 12, 18 (Sept. 1998) (on file with the Natural Resources Journal). The vendor's lien attaches not only to property it has supplied, but also to the affected land, other machinery and equipment owned by the same owner, and even other wells of the same property owner. See *id.* at 13. The lien attaches to the signatory's interest "in all contiguous acreage operated as a single unit...." *Id.* The lienholder can attach production proceeds, collect from interest owners who still owe money to the operator, demand repayment before the property is sold, foreclose on the lien, and will be a secured creditor if there is a bankruptcy. See *id.* at 16. Naturally, lienholders would prefer to be able

Service Co. and the many joint-venture cases following it.²⁶⁹ A similar line of reasoning guides mining-partnership cases.²⁷⁰ Courts that *do* find liability generally purport to find evidence of actual participation by the nonoperators and reliance by the third party.²⁷¹ The legitimate claims of vendors and service companies can be handled by the ordinary law of agency and estoppel.

The rationale behind this limit on liability to third parties is easy to state. The third parties have not dealt with the nonoperators. Third parties may not even be able to name the nonoperators. The attraction of joint operations, in which inexperienced investors can participate in oilfield explorations by staking a limited set of funds and relying on an experienced company, would be defeated if they were exposed to a risk potentially much greater than their pro-rata individual investment without having any real management authority over the enterprise.

This principle is perhaps so obvious in the oilpatch that it may have been most directly stated by a lower court in a minor oil and gas jurisdiction. Some years ago, an Illinois appellate court explained that few people would "risk their means" in such uncertain undertakings if they had this added liability. "[I]t would be unjust to subject each proprietor to personal liability which might sweep away all his property in an undertaking created against his consent by those who could become members without his knowledge and against his wishes."²⁷²

to sue nonoperators individually for the full amount of their claim as well, but no smart vendor or service company expects to be able to do so. They do not lose any reasonable expectation if the industry contract and standard contract forms spell out the fact that nonoperators are individually beyond the reach of third-party collections. For an influential early argument against such liability, see Jones, *supra* note 4, at 719.

269. See *supra* notes 81–88 and accompanying text.

270. See *supra* notes 115–119 and accompanying text.

271. See, e.g., *supra* notes 89, 111–113 and accompanying text.

272. *Dunbar v. Olson*, 110 N.E.2d 664, 665–66 (Ill. App. Ct. 1953). The court's perhaps overly sinister-sounding language about undertakings created without consent by unselected members presumably refers to the fact that one nonoperator ordinarily cannot control the identity of the others. Nonoperators do have some opt-out rights at various stages in the standard joint venture, so it is something of an exaggeration to say that the "undertaking" could be "created against his consent." But the basic point, that the nonoperators are in no position to oversee and limit the operator's (or other nonoperators') commitments, is valid, and with it the reality that nonoperators rarely would invest in a proportionate share of a joint project if they could be jointly liable for the whole thing. Even though nonoperators would have counterclaims against the operator, their risk would increase sharply because they would have to worry that (1) the courts would have to function perfectly, so that they could be sure of recovering against the operator; (2) they would risk losing their claims because of the JOA's exculpatory clauses, which could impose a greater burden of proof on them than on third parties; and (3) they would be exposed if the operator went bankrupt, a not infrequent occurrence in an industry with so many small independent companies.

G. Geological Misrepresentations Probably Will Remain Subject to Standard Fraud Law for Some Time to Come

In general, courts have not imposed a fiduciary's duty of disclosure upon the operator for initial representations and ongoing reporting during the joint project. Because many oil and gas programs qualify as securities, a number of the major oilfield fraud cases have been packaged as securities lawsuits. Others have come in conventional fraud terms. However, strikingly few disclosure lawsuits have been brought on a fiduciary theory absent other traditional fiduciary violations.

Fraud is no stranger to the oil and gas industry. Although the industry has many companies with enviable records of achievement and honesty, the uncertainty of oil and gas ventures can make it easier to misrepresent a prospect, while the possibility of lucrative discoveries often stokes investors' most speculative instincts. It is no accident that one of the first fraud cases under the federal securities laws, *SEC v. Joiner Corp.*,²⁷³ involved fractional interests in oil and gas. In *Joiner Corp.*, "Doc" Joiner mailed over 1000 false brochures to investors around the country.²⁷⁴ In this foundational securities case, the Supreme Court observed that undivided oil and gas interests "were notorious subjects of speculation and fraud...."²⁷⁵

Operators have found it profitable to overstate their programs by improperly comparing a new prospect to a successful nearby venture; by reporting success ratios that include uneconomic wells; and by grossly exaggerating the prospects for new discoveries, often before a well has enough production history to make confident estimates. In a number of cases, operators have used recent discoveries to sustain long-running Ponzi schemes in which they keep luring new investment as

273. 320 U.S. 344 (1943).

274. Joiner's promotions included some of the industry's classic lines: "We feel that if we are to get the law of average that one or both these wells should be producers....Remember, if you do not make money on your investment it will be impossible for us to make money....Fortunes made in oil go to those who invest." *Id.* at 346 n.3. Everyone has their favorite efforts at persuasion. Certainly high on the list should be the operator who proclaimed the sincerity of his own risked stake in a project by lamenting (or bragging) that "he made a sacrifice to enter the deal himself, because his wife had to sell her fur coat and Cadillac in order for Jones to raise his half of the money." *Nor-Tex Agencies, Inc. v. Jones*, 482 F.2d 1093, 1095 (5th Cir. 1973).

One operator's brazen trick to make his projects look better than they were was to simply count recaptured frac oil as a discovery well. *Donohoe v. Consol. Operating & Prod. Corp.*, 982 F.2d 1130, 1134 (7th Cir. 1992). For the equally unfortunate adventures of an Iowa millionaire in a Middle East drilling project fraught with misrepresentations on the cost and geologic sides, see *Sedco International, S.A. v. Cory*, 522 F. Supp. 254 (D.C. Iowa 1981), *aff'd*, 683 F.2d 1201 (8th Cir. 1982).

275. *Joiner*, 320 U.S. at 352.

long as they have some new discoveries to show, even if their overall operations are hopelessly uneconomic. The author has discussed the facts in each of these schemes in an article on oilfield performance disclosure.²⁷⁶ Other classic schemes include the operator's failure to disclose volume discounts, delay payments, equipment buybacks, carried acreage interests, and other self-dealing financial arrangements.

Courts facing these schemes have struggled and often failed to handle operator misrepresentations adequately. In the absence of a fiduciary duty, courts have often protected misstatements and omissions that no fiduciary would be allowed to make. However, the trend suggests that courts are likely to continue to deal with ordinary misrepresentations under traditional fraud and securities fraud standards. At the same time, because full and fair disclosure is a hallmark of any fiduciary arrangement, one can predict that, once courts unify the operator's separate fiduciary responsibilities in a single standard, courts may well also realize that they are dealing with a party that has a heavy fiduciary responsibility in this area. This is the one area in which the logic of the fiduciary obligation suggests expanding the operator's responsibility if courts expand it at all.

In the absence of a uniform fiduciary obligation to make full disclosure to investors, various courts have taken an oddly punitive stance toward nonoperators. In *Oklahoma Co. v. O'Neil*,²⁷⁷ the Oklahoma Supreme Court failed to hold an operator guilty of fraud for allegations of overstated lease costs and other expenses; a secret payment to the engineer whose report the operator used to sell the project; royalties

276. For a factual illustration of these mechanisms, see McArthur, *Coming of Age*, *supra* note 187, at 673-74 ("Some Operators Make False Analogies to Nearby Areas"); 674 ("Some Operators Make False Analogies to Specific, Particularly Impressive, Wells"); 675-83 ("Some Operators Overemphasize Early Results and Completion Statistics"); 685-89 ("Longhorn Oil and Gas: Fabricating a Track Record, Concealing Losses, Inflating Reserves"); 689-95 ("Home-Stake: Running the Ponzi Scheme"); 695-708 ("Prudential: Converting the Ponzi Scheme into a High Art Form"); and 709-11 ("Petro-Lewis: Concealing Failure Occurring After Periods of Success").

The author has discussed the facts in some of the industry's most prominent schemes in his article on oilfield performance disclosures. *See id.* at 673-74 & n.16 (the Joiner promotion), 673 n.16 (Julian Petroleum), 685-89 (Longhorn Oil and Gas), 689-95 (Home-Stake Production Company), 695-708 (the Prudential partnerships), 708-09 (John King companies), and 709-11 (the Petro-Lewis partnerships). In addition, the article contains an extended discussion of Marvin Davis and Davis Oil Company, another very large operation until the early 1980s in which most investors nonetheless lost money. *See id.* at 675-83. The Davis Oil operations are particularly apropos for this Article because the company often drilled over a hundred wells a year, yet consistently used the joint-venture structure.

277. 440 P.2d 978 (Okla. 1968).

secretly carved from the joint property; and misstated production.²⁷⁸ It was only after the court treated the case as a fiduciary case on a second appeal that the operator was found liable.²⁷⁹ In *Gilbert v. Nixon*, the Tenth Circuit affirmed dismissal of securities fraud claims about wells on which there were no individual misrepresentations, despite the fact that the overall tenor of the operator's representations colored the investment decisions.²⁸⁰ Consider also *Calpetco 1981 v. Marshall Exploration, Inc.*, litigated under the liberal provisions of the Texas Deceptive Trade Practices Act, where the Fifth Circuit went out of its way to reject liability for allegedly false promotional statements about a highly successful track record, a three-to-one to four-to-one return, and an average well life of ten to twenty years.²⁸¹

278. For these allegations, see *id.* at 985.

279. For the difference the fiduciary duty made, see *supra* note 63.

280. See generally *Gilbert v. Nixon*, 429 F.2d 348, 358-63 (10th Cir. 1970). On wells where there was not an individual misrepresentation, the court held that

appellants must establish more than a general atmosphere of favorable but misleading reports in order to recover their consideration for leases individually submitted on the basis of data directly relating to them when there is found to be no direct geological connection between the leases subject to false reports and those for which recovery is sought.

Id. at 358-59. This pie-in-the-sky factual analysis ignores the fact that investors do not pick wells in isolation, any more than operators market them in isolation. An exaggeration of the prospects for some wells will spill over into the investors' views about the operator's capability and overall program. Although *Gilbert v. Nixon* was a bench trial, so that the court's conclusions can be taken as fact findings, the Tenth Circuit opinion reads as if these were issues of law, not fact. Questions of the distorting effect of individual representations, including whether they can stray over to other projects offered by the same operator, are fact questions and should be left to the factfinder.

281. 989 F.2d 1408, 1417-19 (5th Cir. 1993). Even for the Fifth Circuit, the eagerness to resolve disputed facts was notable. On operator Marshall Exploration's claim that its programs had yielded 75 percent to 90 percent in "successful wells," the court found that this statement was not "false when made" because the brochure had said that "these reasons are no guarantees of reward." *Id.* Yet past performance is an indicator of future prospects. If these statements were untrue—and they are objective statements that could be tested—it would materially reduce the attractiveness of the prospect. The court similarly pooh poohed a statement that the venture would only entertain wells with a "prospect" of a three-to-one return, a statement that again would be clearly untrue if Marshall had no basis for such projections. See *id.* at 1418. And, in its greatest stretch, the court found that no sophisticated investor would rely on the representation that Marshall's wells would have average lives of ten to twenty years. *Id.* Though the Fifth Circuit was merely affirming the trial court's findings on this point, both courts seem to have pulled this conclusion out of their respective hats. In any event, average well life is part of the expected decline curve that petroleum geologists routinely calculate. Calpetco was entitled to discovery and proof at trial that there was no basis for this statement—and Marshall to try to prove that there was.

For similar eagerness to reach out in order to extinguish liability, see the Seventh Circuit's pure speculation that two promoters who helped set up a series of limited

Each of these cases would have come out differently (as *Oklahoma Co. v. O'Neil* in fact did) had the courts held that the operator had a fiduciary duty. If courts began from the premise that the operator has a duty to disclose the basic financial information about its past performance and accurate information about the ongoing project, the nonoperators would have gotten to the jury. In each case, an obvious fraud could have been prevented.

Because of the industry's complexity, operators control most of the information and use this leverage to attract investors. Even when nonoperating investors are other major oil companies, the investors often lack detailed geologic information held by the promoting operator. Nonetheless, if existing law is any guide, it will take time for courts to treat operators as fiduciaries in representations about past success and the prospects for sale. Yet imposing a fiduciary duty to require full disclosure is a logical extension of the emerging duty. Towards this end, courts should take seriously Howard Williams's vintage prediction that a fiduciary duty should be found where one party has power over another's interest in the oilfield.²⁸²

H. Courts Will Continue to Disfavor Nonoperators Who Wait to See How Things Turn Out before Suing

In general, parties that delay claiming an interest until after a successful well has been drilled (and financed) by the operator face great judicial skepticism. In some oilfield contexts, as for instance in the payment owed by operators to royalty owners for their share of production, costs are largely irrelevant. However, because nonoperators are often billed for costs as they are incurred (often without consent), the operator's distribution of these costs has a significant effect on project economics. In an equity project, the risk to nonoperating investors occurs when the wells are being drilled. An investor could gain a major

partnerships could not be liable for securities fraud, RICO (Racketeer Influenced and Corrupt Organizations Act), or common-law fraud for a long list of misrepresentations because they were not themselves knowledgeable. See *Donohoe v. Consol. Operating & Prod. Corp.*, 982 F.2d 1130, 1136-38 (7th Cir. 1992). For the Tenth Circuit's apparent approval of findings that an obvious scheme to conceal a carried interest was not fraud, see *Woodward v. Wright*, 266 F.2d 108, 112 n.1, 113-15 (10th Cir. 1959). And, for one last judicial factual diversion, see *Cowles v. Dow Keith Oil & Gas, Inc.*, 752 F.2d 508, 512 (10th Cir. 1985), finding that omitted geologic information was not "material" to a small operator drilling shallow wells but might be for a "big operator drilling deeper holes." In the absence of a fiduciary duty, too many courts have been unable to resist wading into the facts in a quest to deprive oilfield investors of reasonable protection against operator profiteering.

282. Williams, *The Fiduciary Principle*, *supra* note 10, at 273.

advantage if it could avoid paying drilling costs until the completed well has proved up reserves, and only then claim the now-certain benefits.

This judicial reluctance to let investors avoid the risk of their joint project, a skepticism really based on estoppel or waiver, best explains the outcome of *Rankin v. Naftalis*. Although the operator, Rankin, appears to have lied to its nonoperators,²⁸³ the Texas Supreme Court took pains to point out that the nonoperator plaintiffs had waited to raise their claims. They consulted a lawyer immediately after learning about Rankin's new operations, but they did not claim an interest in the adjoining property until after it was clear that Rankin had drilled a producer.²⁸⁴ Rankin sought and secured jury findings that the plaintiffs had learned about his drilling before he began, but stayed silent; that he relied on their silence; and that he would not have drilled had they spoken up.²⁸⁵ Though the Texas Supreme Court's disposal of the case on geographic-scope grounds meant that it did not have to decide estoppel issues, it is hard to believe the court would have described this evidence so carefully if the plaintiffs' delay had not influenced its opinion.

In *Madrid v. Norton*, a Wyoming district court determined that a convoluted series of joint ventures had come to an end on January 15, 1975, but the plaintiff venturer waited until the defendant operator struck production the following November to lodge its complaint.²⁸⁶ The trial judge found it "most significant that Madrid's demands arose after it was known that the lease had become productive. Up until this occurred, he evidenced no particular interest in Norton's activities."²⁸⁷ On appeal, the Wyoming Supreme Court took an even blunter stance:

Courts look with disfavor upon the claims of those who lie idle awaiting the results of development. The waiting may be years, months, or days, depending on the circumstances. There is an inherent injustice in one purportedly holding a right to assert an ownership in property to voluntarily await the propitious event and then decide, when the

283. See *supra* note 65.

284. *Rankin v. Naftalis*, 557 S.W.2d 940, 942-43 (Tex. 1977).

285. *Id.* at 943. Given the strong evidence that Rankin had promised his investors to acquire surrounding property for the joint account, *Rankin's* geographic restriction seems to have served as a cloak for fraud. See *supra* note 65 and accompanying text. It is hardly fair that the *Rankin* parties should have had to assume all the costs and risks of litigation before they even knew there was anything worth fighting about. For courts that so often claim to be guided by economic efficiency in this post-Chicago School world, a better rule would be that silence or inaction before a party knows there is anything of value at stake should *not* be construed as waiver or estoppel.

286. *Madrid v. Norton*, 596 P.2d 1108, 1113 (Wyo. 1979).

287. *Id.* at 1116 (citing trial court's conclusions of law).

danger which has been at the risk of another is over, to come in and claim a share of the profits.²⁸⁸

In fact, it is perfectly rational for nonoperators to avoid the expense and disruption of a lawsuit until a property has proven to have some value. Why waste time fighting over a dry hole? Plaintiffs should not be barred from recovery if, prior to drilling, they did not believe a claim had any value. But as *Rankin* and *Madrid v. Norton* so clearly show, the courts too often strain to protect the producer's reliance interest, and not the investors' right to full disclosure. The price of silence by the nonoperator may be foregoing its right to object to underpayments or overbillings, and losing the right to share profits in what should have been a joint property.

I. A Separate Unit-Operator Rule Will No Longer Be Necessary

A more clearly stated operator fiduciary duty could remove the need for the separate unit-operator rule. As part VII.A.7 suggests, the unit-fiduciary rule rests on the nonoperator dependence that characterizes *all* standard joint-account investments. While unit

288. *Id.* at 1120 (citing *Merrill v. Rocky Mountain Cattle Co.*, 181 P. 964 (Wyo. 1919)). For more detail on *Madrid v. Norton*, see *supra* note 73. *Madrid v. Norton* and other cases showing the peril of oilfield interest owners who delay raising their claims were followed in *Moncrief v. Sohio Petroleum Co.*, 775 P.2d 1021 (Wyo. 1989), in which the plaintiffs became aware that they had not received a notice they thought due in 1977, but did not sue until 1984, a period during which the value of the lease in dispute "increased dramatically." *Id.* at 1023-24, 1027. The Court caustically observed that "for several years appellants lacked sufficient interest in the Day lease to pursue their claim, until it became apparent that the Day lease was quite valuable." *Id.* at 1027. Though appellants continued to fund other development in the area, "they nevertheless did not contribute costs attributable to the Day lease, and they simply were not interested in pursuing their asserted right to participate in that lease until its value became apparent." *Id.*

The Moncriefs struck out again for their failure to complain in *Moncrief v. Williston Basin Interstate Pipeline Co.*, 174 F.3d 1150 (10th Cir. 1999). There the Moncriefs had told their gas buyer that they would not sue over its gas prices, even though they refused to sign a proposed contract amendment and had accepted lower payments without complaint from 1984 until they finally sued in 1993. See *id.* at 1157-58, 1167-68 n.12. It did not help that the Moncriefs were "knowledgeable, experienced professionals" and so aggressive in protecting their rights generally that the court devoted a footnote to listing some of their other oil and gas litigation. *Id.* at 1168 n.12.

For another skeptical view of delay, see *Heritage Resources, Inc. v. Anschutz Corp.*, 689 S.W.2d 952 (Tex. Ct. App. 1985). The court in *Heritage Resources* held that a party to a formal joint-venture agreement who did not make a time payment before the well spudded could not "remain silent, 'ride the well down' and once it was determined that the well was commercially productive...claim a one-half interest." *Id.* at 956. Not surprisingly, the jury found that the defendant did not breach its fiduciary duty, and the court of appeals affirmed the judgment. *Id.*

nonoperators may have less say in the selection of the operator, investors in an ordinary joint-account investment really have no greater voice in the general management. Accordingly, if courts raise an overall fiduciary duty in the primary areas of divergent interest—property acquisitions, handling funds and financial details, and marketing production—the need for a separate duty that applies only to unit operations will be eliminated. It is overoptimistic to predict such a rational end to *Young*.²⁸⁹ Yet, if courts finally recognize the operator's fiduciary duty for core accounting and marketing activities, there would be much less need for a specialized unit-operator rule. In addition, courts would gain confidence in treating the executive rights holder as a fiduciary²⁹⁰ and might bring the same standards to the operator's exercise of its pooling powers.²⁹¹

VI. WHEN THE OPERATING AGREEMENT SEEMS TO NEGATE FIDUCIARY RESPONSIBILITY

The JOA's exculpatory and disclaimer clauses pose a separate problem.²⁹² Because of recent efforts to expand the reach of these limited liability clauses, they deserve separate discussion. JOA article V.A limits the operator's liability in at least some areas to gross negligence and willful misconduct, and article VII purports to disclaim a general fiduciary duty.

The liability-limiting provisions have had a varied history. The early fiduciary opinions, cases like *Oklahoma Co. v. O'Neil* and *Blackstock Oil Co. v. Caston*,²⁹³ disregarded such terms when they found a fiduciary responsibility. Then, in the late 1980s and 1990s, several courts enforced these clauses to extinguish a fiduciary duty with almost no discussion of the large body of contrary cases. At least two new fiduciary doctrines (*Reserve Oil's* trust duty and *Johnston v. American Cometra's* marketing agency²⁹⁴) arose in roughly the same period. Each survived the JOA's disclaimers. The 1989 JOA implicitly acknowledges some fiduciary

289. Any case that spawns as many subsidiary opinions as *Young*, see cases cited *supra* note 172, will not go quietly into the dark night of superceded cases.

290. See *infra* Part VII.A.6.

291. For the pooling cases, see *supra* note 174. If the courts do rigorously unify the oilfield fiduciary duty around positions of control and dependence, they would make the pooling operator a fiduciary just as many courts have made, say, the executive rights holder and the unit operator fiduciaries.

292. The author has previously published an extended discussion of the JOA disclaimers. See John Burritt McArthur, *Judging Made Too Easy: The Judicial Exaggeration of Exculpatory and Liability-Limiting Clauses in the Oilfield's Operator Fiduciary Cases*, 56 SMU L. REV. 925 (2003).

293. See *supra* notes 42–50, 59–63 and accompanying text.

294. See *supra* Part III.B–C.

duties by making a special exception to its overall fiduciary disclaimer for the operator's handling funds and production in article V.D.4. Finally, a few cases have held recently that the disclaimers were never intended to apply to breaches of contract; by extension, such disclaimers should not necessarily cut off all claims for breach of fiduciary duty.

As a general rule, "[i]n the absence of an operating agreement....," combining working interests in drilling projects "would almost certainly be deemed to have created a mining partnership or joint venture."²⁹⁵ The operator's duty has remained clouded only because some courts have read the JOA as a barrier to fiduciary liability. An effort to abandon fiduciary liability is also evidenced by the increasing conservatism of certain scholarly commentary in this era of tort reform. At least until the 1980s, any review of articles on the operator's duty would have concluded that the operator is generally a fiduciary, with some disagreement over whether the parties can narrow particular aspects of its duty by contract. The cornerstone writing, a 1962 article by Howard Williams, assumed that the operator increasingly would be held to a fiduciary's responsibility.²⁹⁶ Several influential articles in the mid-1980s generally agreed, though sometimes assuming that parties could narrow and define specific duties (but not disavow the duty entirely).²⁹⁷

295. Smith, *Voluntary Agreements and Compulsory Orders*, *supra* note 151, at 3-3; Smith, *Duties and Obligations*, *supra* note 24, at 12-5; *see also* Hendrix & Golding, *supra* note 10, at 10-7 ("In the absence of a joint operating agreement, the relationship between an operator and a nonoperator is likely to be that of a fiduciary.") (citations omitted); 10-11 (JOAs often have terms "in conflict with the equitable doctrine of fiduciary duty"). Hendrix and Golding believe that the chance of classifying an operator as fiduciary "decreases dramatically once a joint operating agreement is in place." *Id.* at 10-7. They believe that if there is a written operating agreement, courts will not find a fiduciary relationship, or if they do, they will restrict its obligations to the contract. *See id.* at 10-37 to 10-38. They find this trend "justified and appropriate" because of their fidelity to contract and contract alone: imposing higher duties would be "contrary to the rights of the parties to agree to the standard under which the operator will be judged." *Id.* at 10-38. *See generally infra* Part VIII.D.

296. *See* Williams, *The Fiduciary Principle*, *supra* note 10, at 274-75. Readers of Williams' article would not conclude that disclaimers, which got all of one paragraph, were a major issue in operator jurisprudence. *See id.* at 272-73. They would have been correct; until the last decade or so, disclaimers were far from center stage in operator/nonoperator disputes.

297. *See generally* Smith, *Duties and Obligations*, *supra* note 24; Boigon, *Hostile Environment*, *supra* note 3; Boigon, *Liabilities and Relationships*, *supra* note 3; Lane & Boggs, *supra* note 11. (These articles are discussed more fully *supra* note 27.) There were some dissenting, more negative views in the 1980s. *See, e.g.,* Eyring, *supra* note 130. However, the Smith, Boigon, and Lane & Boggs articles provided a major updating and restatement of the oilfield's fiduciary law for the period after Williams' groundbreaking article.

For added authorities, *see* DERMAN, *supra* note 3, at 27-29 (courts have been "reluctant to sanction exculpatory or indemnity provisions which insulate a party from his own negligence," so gross negligence disclaimer should be "clear and conspicuous"), 78-83

A number of recent articles, however, have had a tort-reform dismissiveness of fiduciary liability. They reduce all duties to the contract and the contract alone.²⁹⁸ At least two well-known authors have

(discussing disclaimer cases). See also Keefe, *supra* note 3, at 18-12 n.34 (courts "generally" will impute fiduciary duty "unless the agreement specifically provides otherwise" and "some dispute" arises over enforceability of disclaimers). The most frequently cited article on mining partnerships noted that boilerplate disclaimers probably could not thwart liability to third parties, but that they might have an "unintended consequence," namely, that they "may nullify" a fiduciary link between the parties. Disclaimers or express limitations "probably are" of "limited value" toward third parties, but "should have greater significance" between the parties. See Fiske, *supra* note 22, at 235-36. This kind of general treatment of the issue belongs to the industry's age of innocence, before the drive to disclaim all tort liability reached its full strength.

298. See, e.g., Hendrix & Golding, *supra* note 10, § 10.04[2][a], at 10-15 to 10-19 (arguing that JOA negates fiduciary relationship because courts either will enforce express disclaimer or, if one is absent, many courts will not impose any duties beyond those defined in contract), 10-23 (arguing that cases imposing fiduciary duty "did not really address" conflict with JOA exculpatory clause); Martin, *supra* note 27 (arguing that courts should treat JOA as contractual relationship and enforce disclaimers, and claiming that this is the emerging standard). The change perhaps can best be seen in articles like the Lansdown article. See generally Lansdown, *supra* note 172. Lansdown treats the operating agreement as not establishing a fiduciary tie as if everyone knows that the disclaimers will be enforced, all without acknowledging that this is a sharply disputed position. See *id.* at 13-9, 13-23 to 13-29 (fiduciary duty does not exist because of disclaimers or can be sharply narrowed by agreement). See generally 2 KUNTZ, *supra* note 24, § 19.A6(c), at 108-10 (discussing JOA as entirely contract relationship).

For an additional example of the cramped perspective that has gained currency in some circles, see another article by Scott Lansdown, *The Dozen Most Significant Cases Concerning Operating Agreements*, 23 ST. B. TEX. SEC. REP. OIL, GAS & ENERGY RESOURCES L. 17 (1999) (on file with the Natural Resources Journal). Of Lansdown's even-dozen "significant" cases, not one of the key fiduciary cases discussed here, neither *Rankin* nor *Oklahoma Co. v. O'Neil* nor *Britton v. Green* for joint ventures, *Reserve Oil* for the trustee-type duty, *Young* for unit operators, or even one of the marketing-agency cases, makes an appearance. Fully six of Lansdown's twelve cases are essentially disclaimer or no fiduciary cases. See *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316 (Tex. App. 1982) (standard JOA no fiduciary duty); *Tenneco v. Bogert*, 630 F. Supp. 961 (W.D. Okla. 1986) (a key case for using the JOA as a shield against fiduciary responsibility); *True Oil Co. v. Sinclair*, 771 P.2d 781 (Wyo. 1989) (using JOA terms to limit fiduciary obligation); *Dime Box Petroleum Corp. v. La. Land & Exploration Co.*, 938 F.2d 1144 (10th Cir. 1991) (holding that disclaimer had narrowed fiduciary obligation); *Exxon v. Crosby-Miss. Res., Ltd.*, 775 F. Supp. 969 (S.D. Miss. 1991) (treating COPAS's two-year claims limitations period as creating "conclusive presumption of correctness" to block claims more than two years old); *Stine v. Marathon Oil Co.*, 976 F.2d 254 (5th Cir. 1992) (giving broadest reading to article V.A's limit of operator's liability to gross negligence or willful misconduct and holding that it reaches all acts done under JOA authority). A seventh case, *TexStar North American, Inc. v. Ladd Petroleum Corp.*, 809 S.W.2d 672 (Tex. App. 1991), held that any implied obligation was blocked when the issue was covered by JOA terms. It too stands for the proposition that the JOA limits any outside duties. The effort to so heavily tilt the industry's "significant" cases to cases that limit the operator's duty, while ignoring the many cases that impose duties beyond the contract, is par for the course among a group of industry-oriented theorists of recent years.

proposed to reject decades of precedent by arguing that the standard JOA may not satisfy *any* of the three joint-venture requirements.²⁹⁹ Finally, in 1989 the industry inserted a pointed disclaimer in the JOA, a term that has yet to be battle tested in litigation.

The two major theories that limit or extinguish the operator's duty are based on the JOA: article VII's declaration of several liability and no-partnership and article V.A's limit of liability to gross negligence and willful misconduct.³⁰⁰ Article VII.A has long made the liability of JOA parties several, not joint, and provided that the parties do not intend to form a partnership.³⁰¹ At least until 1989, however, the article's purpose was not to limit the operator's obligation *to its investors*. As the Fifth Circuit has noted, the several liability and no-partnership language "itself belies" the no-fiduciary argument: "The full text of this paragraph addresses the relationship of Apache and the owners only insofar as it concerns potential liabilities or obligations *to third parties*."³⁰² In *Johnston*

299. Patrick Martin has argued that the standard arrangement may not satisfy *any* of the joint-venture elements, the many courts finding to the contrary notwithstanding. See Martin, *supra* note 27, at 104-11. Gary Conine now argues that what the courts really were doing (though they never gave the slightest hint that they understood this) was to enforce a duty only for "drilling ventures," but not for other joint operations. See *infra* note 431.

300. Some courts have cited the absence of an express fiduciary duty in the JOA, or the presence or absence of terms covering the activity in dispute, as key factors. Specific contract clauses like the COPAS limitations clause can restrict the right to sue. See *infra* note 331 and accompanying text.

301. 1989 JOA, art. VII.A. A narrower and readily distinguishable JOA clause, one aimed solely at tax status, article IX, provides that "[t]his agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto," even though it is to receive tax partnership treatment. 1989 JOA, art. IX. For a list of similar provisions in a variety of operating agreement forms, see Hendrix & Golding, *supra* note 10, at 10-12 n.30.

302. See *Norman v. Apache Corp.*, 19 F.3d 1017, 1024 (5th Cir. 1994) (emphasis added) (interpreting mid-1970s operating agreement and citing *Johnston v. Am. Cometra, Inc.*, 837 S.W.2d 711, 715-16 (Tex. App. 1992)). The *Norman* court went on to say that the "mere existence" of a JOA will not prove a joint venture, citing *Rankin* of all cases, but not really addressing the issue because the nonoperators had not claimed a joint venture. See *Norman*, 19 F.3d. at 1025.

A number of commentators have agreed that the purpose of article VII is to limit liability to third parties. See Hendrix & Golding, *supra* note 10, at 10-12 ("[It is] likely that its original purpose was not to negate a fiduciary relationship, but rather to permit the parties to escape joint liability."); Lane & Boggs, *supra* note 11, at 230 (stating that no-partnership language was developed to limit liability to creditors and third persons but is "essentially ineffective to that end"), 236 ("[It is] doubtful that...clauses were intended to control issues of the liability of the parties as between themselves. Rather, they are 'boiler plate,' developed and used to avoid liability to third parties."); Smith, *Duties and Obligations*, *supra* note 24, at 12-7 (discussing delegation of power to operator and article V.II as intending to shield nonoperators from outside liability); Watts, *supra* note 63, at 2798 (stating that the "reason for a disclaimer is quite clear" and then discussing third-party liability); Williams, *supra* note 10, at 272 (stating that purpose "is to avoid liability by one participant for the

v. American Cometra, Inc., a Texas court of appeals interpreting a 1977 JOA agreed that the no-partnership cases cited to it involved third parties and were "not dispositive of the duty issues raised" between operator and nonoperator.³⁰³ The Kansas Supreme Court endorsed this interpretation just a few years ago.³⁰⁴ These courts were reluctant to let the parties disclaim a joint venture by invoking clauses like article VII.³⁰⁵

torts or contracts of other participants," even if the article also might be viewed as negating duty among parties). Lane and Boggs argue that parties may be able to limit fiduciary liability, "but not to waive that liability *in toto*." See Lane & Boggs, *supra* note 11, at 228. They urge parties to specifically authorize actions that might otherwise violate a fiduciary duty, as well as to try to define a less-than-fiduciary standard. See *id.* at 236. Though Williams and Meyers note that article VII's goal is to avoid third-party liability, they also observe that the standard disclaimer is "of doubtful utility" to investors because it probably will not bind other persons with tort or contract claims, *i.e.*, the appropriate third-party claims, but it may "deprive" the investor of rights against the operator or other participants on a fiduciary claim. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435.2, at 514.

Howard Williams does admit that article VII.A-type language "might be viewed as negating a fiduciary relation between or among the parties." Williams, *supra* note 10, at 272. Generally, however, his article predicted that courts increasingly would impose fiduciary duties where one owner had power "in respect to" another's property. Compare *id.* at 274-75. Trying to turn this approach on its head, one author has claimed that joint-venture theory itself was intended only to treat liability to third parties, so the doctrine should not be used to create a fiduciary duty among the parties. See Eyring, *supra* note 130, at 1297.

The limited purpose of defeating third-party liability also seems to be the point of such statutes as Texas' former art. 6132(b) which stated that a JOA "does not of itself establish a partnership." As Rankin shows, this language may have disclaimed a general partnership duty but it should not have governed the internal obligations of a mining partner or joint venturer. See *infra* note 308 and accompanying text. Louisiana has a similar code provision in article 215 of the Mineral Code: "a written contract for the joint exploration, development, or operation of mineral rights does not create a partnership unless the contract so expressly provides." LA. REV. STAT. ANN. § 31:215 (West, Westlaw through 2004).

303. 837 S.W.2d 711, 715-16 (Tex. App. 1992). But the court then seems to have agreed that a joint venture did not exist. See *id.* at 716.

304. In *Amoco Production Co. v. Charles B. Wilson, Jr., Inc.*, 976 P.2d 941 (Kan. 1999), the Court held:

Section 22, LIABILITY OF PARTIES, does say the parties do not intend to create a mining partnership or render them liable as partners. It does not say they are *not* joint venturers in the development of oil and gas interests in a designated area of designated property. It does not remove the duty of both the operator and nonoperator to deal with each other in a fair and equitable manner.

Id. at 954.

305. The Kansas Supreme Court decision in *First National Bank v. Sidwell Corp.*, 678 P.2d 118 (Kan. 1984), illustrates this principle. The parties had agreed to share certain acreage interests, but their contract said that their relationship should not be deemed a mining or other partnership. See *id.* at 121. The trial court considered but ultimately disregarded this clause because the agreement "in its entirety" established a joint venture. See *id.* at 124.

This judicial reluctance traces back to some of the most influential operator cases. For instance, in *Oklahoma Co. v. O'Neil*, the Oklahoma Supreme Court ignored a no-partnership clause as it reached claims of fraud and breach of fiduciary duty.³⁰⁶ In *Reserve Oil*, the Tenth Circuit disregarded similar language in imposing the "trustee type" duty on the operator.³⁰⁷ In *Rankin v. Naftalis*, the Texas Supreme Court held that one now-expired Texas statute, which provided that mere "operation" of a property under a JOA "does not of itself establish a partnership," may preclude a general partnership relationship; but that the statute did not preclude the jury's finding of a joint venture within the geographic area of the specific joint project.³⁰⁸

Literal interpretation of article VII.A without regard to its original purpose of limiting third-party liability is also directly at odds with the many cases holding that the mining-partnership doctrine can be an intention-defeating doctrine. Courts use mining partnerships to

In *West v. Kerr-McGee Corp.*, 586 F. Supp. 493 (E.D. La. 1984), *rev'd on other grounds*, 765 F.2d 526 (5th Cir. 1985), minority owners of an offshore platform won a summary judgment motion declaring that, as joint venturers, they were immune under the Longshore and Harbor Workers' Compensation Act from tort liability for offshore damage. The court held that intent was an element of a joint venture, and the parties' operating agreement had declared it was not their intent to be liable as a mining partnership or similar association, or as partners. *See id.* at 495-96. Construing the issue as the parties' "real" intent, the court found the parties' label for their relationship "irrelevant" when the structure of their venture proved all elements of a joint venture. *See id.* at 499-500.

In *Misco-United Supply, Inc. v. Petroleum Corp.*, 462 F.2d 75, 77-81 (5th Cir. 1972), the Fifth Circuit approved sending the joint-venture issue to the jury, even though the standard several liability clause was struck and the investors were on a turnkey basis, given the dispute over whether letter agreements calling the parties "joint venturers" were signed.

306. *Oklahoma Co. v. O'Neil* is a classic case for refusing to let no-partnership language reduce the operator's liability to its nonoperators. In the first opinion, the Oklahoma Supreme Court rejected a fiduciary duty, placing heavy reliance upon a no-partnership clause. *See* 333 P.2d 534, 542-43 (Okla. 1958), *rev'd*, 440 P.2d 978 (Okla. 1968). But on remand a number of years later, the court disregarded this language because the trial court had found fraud. *See Okla. Co.*, 440 P.2d at 986-89.

307. *See Reserve Oil, Inc. v. Dixon*, 711 F.2d 951, 953 n.5 (10th Cir. 1983) (listing contract language that disclaimed joint liability and intent to create a mining or other partnership, which the court held precluded a "general agency relationship" but not the trust-type duty). Article VII.A language was no more a barrier in *In re Mahan & Rowsey, Inc.*, 35 B.R. 898 (Bankr. Okla. 1983), *aff'd in part, rev'd in part on other grounds*, 62 B.R. 46 (W.D. Okla. 1985), *aff'd after remand*, 817 F.2d 682, 683 (10th Cir. 1987). *Mahan & Rowsey* followed *Reserve Oil*. *See supra* notes 132-136 and accompanying text. The parties had an operating agreement with "substantially similar" language to the agreement in *Reserve Oil*. *See Mahan & Rowsey*, 35 B.R. at 903.

308. Compare the Texas Supreme Court's discussion of this statute in *Rankin v. Naftalis*, 557 S.W.2d 940, 945-46 (Tex. 1977), with the jury's finding reported at 542 S.W.2d 893, 895 (Tex. Civ. App. 1976).

impose fiduciary duties regardless of the parties' intentions if their arrangement otherwise satisfies the requisites of mining-partnership law.³⁰⁹

As the industry has become more militant about disclaimers, some courts have applied article VII.A very broadly. An oft-cited example of the aggressive approach is *Tenneco v. Bogert*,³¹⁰ in which an Oklahoma district court rejected efforts to force the operator to drill an additional well when it knew of a draining well. The plaintiff's claim sounded fanciful because both sides had the right to propose a new well; the operating agreement did not allocate this responsibility to the operator. In rejecting the fiduciary claim, the court cited the JOA's no-partnership language, as well as article V.A.³¹¹ Arguing that the term "fiduciary" is "bandied-about without precision," the court held that the "existence and extent" of the duty was defined (and so limited) by the JOA.³¹² The additional well sought by the plaintiff was not within that contractual field, so there could be no fiduciary responsibility.³¹³

309. See Brimmer, *supra* note 24, at 92 (disclaimer of partnership not effective to prevent mining partnership if its elements otherwise are met by acts and conduct); Jones, *supra* note 98, at 414 (stating mining partnership is "intention-defeating" because it usually exists in spite of contract language that denies mining partnership); Jones, *supra* note 4, at 717 (disclaimer of partnership, while "of value as indicating intention, is not legally controlling" and will not avoid partnership duties when they have been assumed). See generally 2 KUNTZ, *supra* note 24, § 19A.7(b), at 112 (mining partnership duty is imposed by law and does not require specific intent to form arrangement); 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435.1, at 506 (mining partnership arises by operation of law and denial of partnership "will not prevent the finding of a mining partnership if all the elements thereof are present."). Even in some joint-venture cases, it is not the parties' label but the legal intent that is determinative. See, e.g., *West v. Kerr-McGee Corp.*, 586 F. Supp. 493, 498-99 (E.D. La. 1984) (disregarding disclaimer of partnership or similar association where relationship contained all elements of joint venture), *rev'd on other grounds*, 765 F.2d 526 (5th Cir. 1985).

310. 630 F. Supp. 961 (W.D. Okla. 1986).

311. See *id.* at 966.

312. See *id.* at 966-67. Other courts have used several liability or no-partnership language as grounds to reject a joint venture or mining partnership. See *Doheny v. Wexpro Co.*, 974 F.2d 130, 134-35 (10th Cir. 1992) (applying no-partnership and several liability provisions to find no co-tenancy, and then finding no fiduciary or good-faith duty where gas imbalance claim did not implicate any particular contract clause); *Dime Box Petroleum Corp. v. La. Land & Exploration Co.*, 717 F. Supp. 717, 722 (D. Colo. 1989) (listing article VII, as well as V.A, in opinion holding in part that JOA "specifically define[d] the standard by which the operator's conduct is measured"), *aff'd*, 938 F.2d 1144 (10th Cir. 1991); *Prentice v. Amax Petroleum Corp.*, 220 So. 2d 783, 787 (La. Ct. App. 1969) (rejecting claim to share property on joint-venture theory when agreements had no-partnership and several liability disclaimers); *Youngstown Sheet & Tube Co. v. Penn.*, 355 S.W.2d 239, 241-45 (Tex. Civ. App. 1962) (referring to, inter alia, separate liability, no-partnership clause and a lack of joint operation in sustaining summary judgment that no partnership was created and nonoperators were not liable on vendor claim), *aff'd in part, rev'd in part on other grounds*, 363

Ironically, some courts have gone farther and suggested that the parties may be free to extinguish the operator's liability within their venture, but not to third parties.³¹⁴ Under these circumstances, the "no-partnership" and several liability clauses may not be effective in the area where they originated. Naturally, parties cannot extinguish their liabilities to third parties simply because they say so. Were that the case, partners and joint venturers could evade statutory requirements by contracting them away.³¹⁵ However, these courts have not offered a

S.W.2d 230 (Tex. 1962); *U.S. Truck Lines v. Texaco*, 337 S.W.2d 497, 498-500 (Tex. Civ. App. 1960) (referring to no partnership and several liability clauses in opinion that reviewed facts but also held that agreement itself "negatives" intention to form partnership and spared nonoperator Texaco from liability to road builder); *cf. Archer v. Grynberg*, 738 F. Supp. 449, 452-53 (N.D. Utah 1990) (discussing no partnership language in farmout agreement as one ground to reject partnership among parties to operating agreement), *aff'd*, 951 F.2d 1258 (10th Cir. 1991); *Misco-United Supply, Inc. v. Petroleum Corp.*, 462 F.2d 75, 78, 80 (5th Cir. 1972) (finding disclaimer effective at limiting liability to third parties, even though parties had amended language to state that it was "[a]s between the parties"); *Smith v. L.D. Burns Drilling Co.*, 852 S.W.2d 40, 41-42 (Tex. App. 1993) (referring to no partnership clause in opinion affirming summary judgment that dismissed service company's joint-venture theory, but not indicating what weight court gave this clause); *Adobe Res. Corp. v. Newmont Oil Co.*, 838 S.W.2d 831, 836 (Tex. App. 1992) (holding Louisiana courts would not find partnership among parties to AMI agreement where operative letter held it "shall not be construed as creating a partnership"). *But see also* *Davidson v. Enstar*, 860 F.2d 167 (5th Cir. 1988) (following *Bertrand v. Forest Oil Corp.*, 441 F.2d 809 (5th Cir. 1971) in reversing on rehearing Fifth Circuit's prior decision in 848 F.2d 574, 577-78 (5th Cir. 1988), thereby affirming summary judgment holding defendants immune under the Longshore and Harbor Workers' Compensation Act because of joint venture in spite of no-partnership clause).

In another oft-cited early Texas Supreme Court opinion, *Luling Oil & Gas Co. v. Humble Oil & Refining Co.*, 191 S.W.2d 716 (Tex. 1945), the supreme court affirmed the judgment below that there was no partnership because "the contract in suit negatives the existence of an intention to create a partnership relation." *Id.* at 722. But the next sentence added that the contract did not authorize either side to create binding third-party liability. *See id.* So it is not clear whether the contract had the standard express disclaimer (surely the most likely possibility), or just did not address the issue and the Court was holding that a party needed express authority to create liability for another.

313. It is hard to tell whether the *Bogert* court thought that the JOA language extinguished the fiduciary duty, or narrowed it. Parts of the opinion, like the discussion of article V and of the existence of detailed contract obligations, sound as if the overall duty was extinguished. *See Tenneco v. Bogert*, 630 F. Supp. 961, 966 (W.D. Okla. 1986). Others, like the careful review of particular contract terms and a cite to the *Restatement (Second) of Trusts* about the agreement defining the scope of the duty, sound as if the court merely narrowed the duty. *See id.* at 967.

314. *Bolivar v. R & H Oil & Gas Co., Inc.*, 789 F. Supp. 1374, 1379 (S.D. Miss. 1991); *see also Sparks Bros. Drilling Co. v. Tex. Moran Exploration Co.*, 829 P.2d 951, 954, 956-57 (Okla. 1991) (Opala, C.J., dissenting).

315. *See, e.g., Mud Control Labs. v. Covey*, 269 P.2d 854, 859 (Utah 1954) (stating that if parties could contract away third-party liability, they would, "by private agreement

justification for using an article aimed at third parties to reduce the operator's internal duty to its interest owners. The result can be an oilfield Catch-22: where article VII.A is intended to prevent liability (versus third parties), it may not work, but where not intended to limit liability (on the operator's internal duty), it may do so.

In addition to the article VII.A cases, a second line of cases turns on the liability-limiting language in article V.A. This article gives the operator "full control of all operations" and makes the operator perform its duties in a "good and workmanlike manner," but bars liability to "the other parties for losses sustained or liabilities incurred" unless damage results from the operator's "gross negligence or willful misconduct."³¹⁶ This standard may exculpate the operator unless it fails to "use even slight care."³¹⁷

Article V.A generally holds the operator to the reasonably prudent operator standard in its operational performance (drilling wells, siting drilling rigs, fishing pipe out of the hole, etc.). Under this reading, "all parties generally will be held to have assumed the risk of loss arising from bad judgment or honest error by the operator."³¹⁸ Logically, the limit of liability to gross negligence in activity performed for the joint account is separate from the traditional fiduciary issues of disclosure, loyalty, and avoidance of self-dealing. The latter are tort duties that require disclosing all relevant facts and not profiting off the nonoperator except as formally agreed.³¹⁹

Nonetheless, in the most exculpatory article V.A opinion, *Stine v. Marathon Oil Co.*,³²⁰ the Fifth Circuit took an absolutist approach.

between themselves, obtain the advantages of limited partnership without complying with the statutory requirements").

316. 1989 JOA, art. V.A.

317. See Boigon, *Hostile Environment*, *supra* note 3, at 5-26.

318. *Id.* at 5-15. Howard Boigon posits that the reasonable prudent operator standard "does not seem affected" by the fiduciary duty—these are different duties that fall in different places. *Id.* If so, reducing one should not discount the other. Discussing the liability limitations in article V.A, Boigon adds that those must be limited to third-party claims and property losses or else the prudent operator standard would have little meaning. See *id.* at 5-26. Otherwise, the operator could be negligent without any consequence (as long as it was not grossly negligent). Yet the conflict between these two provisions is not going to go away, given the broad language in article V.A. Obviously, nonoperators should prefer to delete article V.A's exculpatory provisions and leave the prudent operator standard intact. See *id.* at 5-27. In addition, they should want to limit the article to, at most, issues involving third parties or damage to the joint property.

319. This is the obverse of the principle that, even if a fiduciary duty applies, and even if the operator has duties of loyalty, disclosure, and avoiding self-dealing, the standard that applies to many areas of the operator's conduct will remain that of the reasonably prudent operator. See generally *supra* Part V.E (discussing standard for physical operations).

320. 976 F.2d 254 (5th Cir. 1992).

Applying Texas law, it precluded claims over an alleged failure to drill in a timely manner, refusal to share information, overcharges, and interference with a gas purchase agreement. The court refused to limit article V.A to "physical acts by the operator within the geographic limits of the contract area."³²¹ Instead, the court extended article V.A to "administrative and accounting duties," indeed, to "any acts done under authority of the JOA 'as operator.'"³²² Though the court discussed two

321. *Id.* at 259.

322. *See id.* at 261. Ernest Smith accurately interprets *Stine* and its aggressive reading to stand for a "global standard of limited liability binding on [nonoperators] and the operator in all circumstances." *See* Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-7. *Stine* clearly is at the "outer limits" of exculpation. *See* Hendrix & Golding, *supra* note 10, at 10-30. Other cases apply article V.A to limit operator liability. *See* Dime Box Petroleum Corp. v. La. Land & Exploration Co., 938 F.2d 1144, 1147-48 (10th Cir. 1991) (citing article V.A as evidence that parties "contracted for a standard by which to measure operator's conduct rather than utilizing the standards imposed upon a fiduciary"); *Caddo Oil Co. v. O'Brien*, 908 F.2d 13, 17 (5th Cir. 1990) (rejecting fiduciary argument in glib opinion by referring to language close to article V.A's, that is, the operator was liable only "in cases of Operator's willful misconduct"); *Tenneco v. Bogert*, 630 F. Supp. 961, 966-69 (W.D. Okla. 1986) (citing article V.A as well as provisions seemingly governing information and drilling issues in holding that parties limited fiduciary duty by contract); *Archer v. Grynberg*, 738 F. Supp. 449 (C.D. Utah 1990) (holding that article V.A "will normally prevail" over general law of fiduciaries, and rejecting fiduciary duty in farmout dispute concerning operator's alleged failure to develop unit area); *Shell Rocky Mountain Prod., L.L.C. v. Ultra Res., Inc.*, 266 F. Supp. 2d 1331, 1337 (D. Wyoming 2003) (applying article V.A to well costs without suggesting limit to physical operations only); *see also* *Huggs, Inc. v. LPC Energy, Inc.*, 889 F.2d 649, 652-53 (5th Cir. 1989) (affirming trial court's finding of no liability when exculpatory paragraph provided operator would not be liable for "mistake or oversight" in failing to pay rentals); *Oryx Energy Co. v. Tatex Energy*, 779 F. Supp. 144, 146 (D. Colo. 1991) (enforcing broader limit of operator liability "to any party for anything done or omitted to be done by it in the conduct of operations" unless in bad faith, in lawsuit over lease lost when operator plugged well); *Grynberg v. Dome Petroleum Corp.*, 599 N.W.2d 261 (N.D. 1999) (enforcing provision in farmout context).

In a contrasting case, *Grace-Cajun Oil Co. v. Damson Oil Corp.*, 897 F.2d 1364, 1366 (5th Cir. 1990), an interest owner succeeded in holding an operator liable for its losses from the operator's failure to file a Natural Gas Policy Act well determination, in spite of a clause like article V.A. The clause provided that the operator was not liable except for damages "such as may result from gross negligence" or breach of the contract provisions. The court treated the gas purchase agreement as separately creating "responsibility for tasks necessary to its performance of that agreement." *Id.* The trial court had found the operator grossly negligent but the appellate court did not reach this issue. *See id.* at 1366-68.

For an example of what presumably was the core intent of article V.A, see *Transcontinental Gas Pipe Line Corp. v. Mr. Charlie*, 294 F. Supp. 1025, 1031 (E.D. La.) (using limit on operator's negligence liability to justify splitting burden for damage to underwater pipeline among owners in their proportionate shares, in spite of court's finding operator clearly negligent in siting offshore drilling platform, where parties had agreed to share liabilities with third parties), *aff'd in part and rev'd in part on other grounds*, 424 F.2d 684 (5th Cir. 1970). *See also* *Palace Exploration Co. v. Petroleum Dev. Co.*, 316 F.3d 1110, 1114 (10th Cir. 2003) (applying gross negligence standard to dispute over well location).

well-known authorities on the operator's JOA duties, it seems to have relied primarily on a simple reading of the words of article V.A without discussing the article's origin or purpose, or the detailed body of law on the operator's duty.³²³ The court made no effort to distinguish the authorities who have noted that the article's language was designed to have much narrower effect. Nor did it address the gap created if the operator is to have a duty of acting in a good and workmanlike manner (and in good faith), yet is only liable for gross negligence in any activity. A negligent operator surely is not a workmanlike operator, yet the *Stine* court would have to conclude that there is no remedy for damages caused by its unworkmanlike behavior absent gross negligence.

It is unlikely that the JOA imposes no higher duty on the operator to its investors than the duty that third parties (like drilling contractors or service companies) owe to the joint account.³²⁴ Moreover, the language in article V.A should not be used to establish a single standard for the entire operator/nonoperator relationship. Parts of article V.A are clearly concerned only with third-party issues. For instance, in the 1989 JOA, the drafters inserted an independent contractor clause, which holds that the operator shall not hold itself out as the nonoperators' agent when dealing with third parties.³²⁵ The focus

The article V.A opinions almost always focus on the article's gross-negligence language. Patrick Martin has concluded that the article's centralization of "full control" in the operator should itself negate the third element of joint ventures and mining partnerships. See Martin, *supra* note 27, at 107. Martin cites several cases as examples of courts using the operator's high control to negate a joint venture. See *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316, 321 (Tex. App. 1982) (referring to the operator's "full control" under the JOA in denying a joint venture); *Luling Oil & Gas Co. v. Humble Oil & Ref. Co.*, 191 S.W.2d 716, 721-22 (Tex. 1945) (noting the lack of authority for either party to create third-party liability but relying primarily on the contract's fixing the time for payment in the accounting dispute). Yet if the JOA operator's "full control" always precluded a joint venture or mining partnership, every one of the bountiful joint-venture and mining-partnership cases that concern anything like the JOA could have been decided summarily as a matter of law – and the industry would not need its treasured express disclaimer.

323. See *Stine*, 976 F.2d at 260-61.

324. A drilling contract routinely requires performance in a "good and workmanlike manner." See 2 KUNTZ, *supra* note 24, § 19A.5, at 98-100. This is another sign that such language is intended to be used in relation to physical operations on the well. Perhaps even more striking as a contrast to the operator cases is that even in these distant relations courts do not lightly enforce general exculpatory clauses. See *id.* at 104 (discussing definiteness of language, position of parties, and compensation before deciding whether to enforce). Parties with superior bargaining power generally cannot gain exculpation from their own negligence. *Id.*

325. See 1989 JOA, art. V.A. Patrick Martin opposes using this language to limit article V.A's reach. He urges that the independent contractor language in the article "mak[es] clear that the disclaimer of partnership is not limited to the operator's relations with third parties." Martin, *supra* note 27, at 111. But this language seems much more concerned with

on "losses sustained or liabilities incurred"³²⁶ does not sound like a clause intended to reduce the operator's duty to disclose or allow it to profit secretly off its partners. Rather, "losses sustained" sounds like damages to the joint property—from a drilling accident—and "liabilities incurred" sounds like contract obligations the operator incurred for the joint account. Yet in recent years, a growing number of courts have treated this gross-negligence language as a general redefinition of the operator/nonoperator relationship that removes all traces of its fiduciary character.

The *Stine* reading sets up the conflict between article V.A and other parts of the JOA discussed above.³²⁷ If the operator never could be liable for less than willful misconduct or gross negligence, it could fall well below the workmanlike standard and still not be liable for a run-of-the-mill breach of contract absent intentional conduct or gross recklessness.³²⁸ And how can a reading that treats gross negligence/willful misconduct as a gloss on all operator activities explain the good-faith duty articulated in article VII.A? Moreover, *Stine*'s absolute reading would have the odd effect that the operator remains under the prudent operator standard to its royalty owners but is free to act negligently in the same areas toward its nonoperating working

damage that diminishes the joint account, instead of with the direct operator-nonoperator relationship and the operator's own malfeasance. Martin says he "feel[s] certain" that the joint-venture test "should mean that each of the partners or venturers is able to act on behalf of the common endeavor." *Id.* at 107. This is a hurdle that neither the actual-participation nor legal-right-to-control courts have applied, but one that would disqualify the standard operating arrangement with its centralization of active power in the operator as a matter of law.

326. See Lane & Boggs, *supra* note 11, at 223–25 (urging that gross negligence limit should be honored in "operational matters," but only when neither side is enriched at other's expense); Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-10 to 3-11 (noting that language of article V.A, with its limits to "Contract Area" and its "good and workmanlike" standard, "seems more appropriate to physical activity than to billings, purchasing and administrative decision making" and that usual reason for exculpatory clause is to avoid liability for catastrophic damage, not to immunize breaches of contract). Smith endorses a reading in which article V.A's "good and workmanlike" would apply as the reasonable prudent operator standard "to purely physical activities, such as drilling and testing...." See *id.* at 3-15.

327. See *supra* note 267 and accompanying text.

328. Ernest Smith bases his suggestion that article V.A should include violations that would amount to a breach of contract on the fact that the 1956 JOA made operators liable for breach of contract as well as for gross negligence, but this preservation of express contract liability was replaced by the willful misconduct terminology. See Smith, *Duties and Obligations*, *supra* note 24, at 12-30 to 12-31. The Fifth Circuit cited Smith with approval in *Stine*. See *Stine*, 976 F.2d at 260. Yet is it plausible that parties entering a JOA imagine that the operator can escape scot-free if it carelessly breaches the JOA, as long as it is not willful or reckless about it?

interest owners.³²⁹ No commentator or court has yet suggested why *working* interest owners should be relegated to second-class citizenship in this way.³³⁰

Although there are subsidiary liability-limiting theories, JOA articles VII.A and V.A pose the major barriers.³³¹

329. Hendrix and Golding have predicted that courts will treat the conflict between the prudent operator standard and the disclaimer by lowering the operator's standard of care. See Hendrix & Golding, *supra* note 10, at 10-33 to 10-34. It is one sign of a certain rush to overprotect operators that courts or commentators might suggest jettisoning this standard that has embodied the operator's basic obligation for so long, and that remains its duty to royalty owners under the general implied covenant standard. Cf. 5 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 806.3, at 36.

330. The use of article V.A to define the operator's tort duty internally creates an implicit conflict *across* the JOA as well as with every court that thinks that article VII.A addresses the operator's internal duty. The reading assumes that, even though the parties dealt expressly with the scope of internal liability in article VII (regardless of whether the proper reading of that article is as an attempt to emasculate ordinary tort law only for third-party cases, or internally as well), they already had treated the same question in article V.A. The JOA has turned into an embarrassment of riches for disclaimer advocates. This expansive reading violates the familiar canon that courts should not interpret a contract to render any clause duplicative—every word should have some meaning. See RESTATEMENT (SECOND) OF CONTRACTS § 203(a) (1981).

331. There are other variants to the disclaimer cases. A few courts have denied fiduciary protection because the operating agreement does not announce that the parties are fiduciaries. See *Connaghan v. Maxus Exploration Co.*, 5 F.3d 1363, 1365 (10th Cir. 1993) (finding no fiduciary exposure even though operator breached contract's requirement of unanimous consent for settlement, where "the terms of the agreement [did] not expressly or impliedly giv[e] rise to" a fiduciary duty); see also *Tenneco v. Bogert*, 630 F. Supp. at 966-67 (finding no fiduciary violation for failing to drill wells or provide information when operating agreement did not require these acts). Parties "were [not] incapable of including an express provision...had they intended or desired to do so." *Id.* This is a somewhat bizarre conclusion for what is, after all, a tort duty that courts impose because of something in the relationship of the parties, not because of their contract alone.

Other cases say more narrowly that there can be no fiduciary duty unless the contract imposes a specific duty in the area in dispute—that the duty is coterminous with the operator's specific contract obligations. See *Doheny v. Wexpro Co.*, 974 F.2d 130, 135 (10th Cir. 1992) (seemingly requiring conduct to be governed by specific contract provision before considering fiduciary or good-faith claims); *Davis v. TXO Prod. Corp.*, 929 F.2d 1515, 1519 (10th Cir. 1991) (holding no breach of good faith duty, which it equated with fiduciary duty, "absent a breach of a specific contractual provision"—a standard the plaintiff could not remotely meet in a suit claiming that nonoperators have a duty not to make false statements about the operator's unit management). *Tenneco v. Bogert*, 630 F. Supp. 961, discussed *supra* notes 310-313 and accompanying text, flows from the same sense that contractually assumed obligations should be the limit of any fiduciary responsibility.

The *Reserve Oil* line of cases, which ties fiduciary liability to the performance of certain contract duties, can be read as taking this approach. The *Reserve Oil* cases exhibit heightened sensitivity to contract language when they rest a trust-like duty on certain JOA terms, but they do *not* limit the duty to this basis. For instance, the court applied *Reserve Oil's* trust-type duty as a matter of law in *In re Mahan & Rowsey, Inc.*, 35 B.R. 898, 901-03 (Bankr. Okla. 1983), *aff'd in part, rev'd in part on other grounds*, 62 B.R. 46 (W.D. Okla. 1985),

aff'd after remand, 817 F.2d 682, 683 (10th Cir. 1987). However, the court noted that the operator also might have had a joint-venture fiduciary duty as a matter of fact. *See id.* at 901-02. Thus, the general approach of these cases would not necessarily support *limiting* all fiduciary duties just because one of them seems to be rooted in contract. At the same time, the *Reserve Oil* cases do not themselves support a full fiduciary duty, because the scope of their "trust-like" duty, while not clearly set, is less broad than the JOA.

In direct conflict with cases requiring a contract provision to find a fiduciary duty, other courts have held that, where the operating agreement has a specific provision, a fiduciary duty cannot supplant or bolster this duty. *See Crosby-Miss. Res. v. Saga Petroleum U.S.*, 767 F.2d 143, 147 (5th Cir. 1985) (provision in operating agreement giving operator option to pay market value for nonoperator condensate when they failed to take their production preempted any claim of breach of joint-venture obligations); *Andrau v. Mich. Wis. Pipe Line Co.*, 712 P.2d 372, 374-77 (Wyo. 1986) (provisions allowing operator to sue over damages and foreclose lien precluded superimposing fiduciary duty that might have required operator to first credit nonoperator debts against its favorable gas balance); *Frankfort Oil Co. v. Snakard*, 279 F.2d 436, 443-44 (10th Cir. 1960) (no fiduciary breach in failing to disclose geological information because no contract duty to disclose it); *see also True Oil Co. v. Sinclair Oil Co.*, 771 P.2d 781, 793-94 (Wyo. 1989) (sharply limiting fiduciary duty by contract that provided for billings "at Dave True's cost," and ignoring profit-taking via affiliate); *cf. Carlson v. Flocchini Inv.*, 106 P.3d 847, 855-56 (Wyo. 2005) (following *True Oil* in an unusual royalty context).

In the aggressive manner in which some courts have expanded the disclaimers, the agreement may bar fiduciary liability even if the court thinks that the relationship is a fiduciary one. This is about the only way to explain a case like *Dime Box Petroleum Corp. v. Louisiana Land & Exploration Co.*, 717 F. Supp. 717 (D. Colo. 1989), *aff'd*, 938 F.2d 1144 (10th Cir. 1991), discussed *supra* notes 141-150, in which the Tenth Circuit reversed to find a fiduciary relationship but held that the agreement among sophisticated parties essentially removed all fiduciary responsibility. Two authors have argued that *Dime Box* is part of an effort to make the fiduciary question "irrelevant in determining the duties owed by the operator to the nonoperator." *See Hendrix & Golding, supra* note 10, at 10-26. In other words, they believe courts will take two bites at the apple. Even if they find a strict duty, they will gut it in application.

In yet another contract barrier to recovery, albeit one that works by limiting the time to sue rather than scope of liability, a "COPAS" accounting provision attached to the JOA treats joint account bills as conclusively "presumed to be true and correct" unless challenged within two years of the calendar year in which the bill is dated. 1984 COPAS, art. I.4; 1995 COPAS, art. I.4.A. Courts have applied the COPAS barrier with considerable harshness. *See Calpetco 1981 v. Marshall Exploration, Inc.*, 989 F.2d 1408, 1414-16 (5th Cir. 1993) (finding neither counterclaim in litigation nor two years of negotiations over audit issues were specific enough to form "claim for adjustment," so neither tolled COPAS bar); *In re Antweil*, 115 B.R. 299, 301, 304 (Bankr. D.N.M. 1990) (barring claim of nonoperator who had been in divorce proceedings when he noticed overcharges, and who had never been credited with equipment he furnished to joint account). "The [c]ourt finds the result in this case distasteful due to the fact that the defendant is now liable for a debt for which he was over billed and for which he was not given credit for materials he provided." *Id.* at 305. For related enforcement in a farmout context, *see Grynberg v. Dome Petroleum Corp.*, 599 N.W.2d 261, 266-67 (N.D. 1999). The COPAS bar is a two-way limit; it equally prevents the operator from bringing older claims against its investors. *See Woods Petroleum Corp. v. Hummel*, 784 P.2d 242 (Wyo. 1989). The bar is limited in one sense. Because joint account bills only cover project costs, not revenues, it should not bar a challenge to an operator's

In the next generation of operator cases, courts will have to grapple with the disclaimer language added to the JOA in 1989. The revised article VII.A not only continues the standard several-liability language, but, in addition, it provides that the parties do not create "a mining or other partnership, joint venture, agency relationship or association" and "shall not be considered fiduciaries or to have established a confidential relationship," but that they must act in "good faith."³³² At the same time, article V.D.4 leaves room for a fiduciary duty in the operator's handling of funds and marketing production.³³³ Thus, the industry seems to be moving toward fiduciary status in traditional trust and agency areas, but not in other areas of the operator's activity.

The failure to ground the oilfield fiduciary duty on a fully reasoned principle based on the operator's control and nonoperators' corresponding dependence has left the duty vulnerable to cases like *Stine*. Doctrinal disarray has made it easier for some courts to act as if the fiduciary duty is just another contract term that can be disclaimed as simply as if the parties were extending their agreement another year or adding another party.³³⁴ Yet courts ordinarily restrict the extent to which

failure to pay proper joint-account revenues. *Castle Tex. Prod. Ltd. P'ship v. Long Trusts*, 134 S.W.3d 267, 275-76 (Tex. App. 2003).

But the COPAS bar is not a good example of tort limitations because it does not fully extinguish a tort duty, because it does not reduce the level of care during the period when nonoperators can sue, and because courts seem to agree that this contract shield is not a barrier to claims of fraud. On the claims limitation not turning into a shield for fraud, see *Calpetco*, 989 F.2d at 1408, 1413-14; *Caddo Oil Co. v. O'Brien*, 908 F.2d 13, 17 (5th Cir. 1990); *Exxon v. Crosby-Miss. Res., Ltd.*, 775 F. Supp. 969, 976 (S.D. Miss. 1991); *Cass v. Stephens*, 156 S.W.3d 38 (Tex. App. 2004). *Cass v. Stephens* is particularly instructive because one of the acts of concealment was the operator's providing only a very abbreviated accounting even though he maintained much more detailed records. *Id.* at 65. Presumably the COPAS bar should not block a claim for breach of fiduciary duty any more than it does one for fraud. Ultimately, then, the COPAS cases may stand more as a reproach to the disclaimer cases than as support for them.

Another contract-limit example would be the restriction of any duty to the geographic area of the joint venture, or to that defined in an AMI clause. For the geographic limits on the operator's ability to acquire competing interests for itself alone, see *supra* notes 64-74 and accompanying text. See also *supra* Part V.A.

332. 1989 JOA, art. VII.A.

333. See *supra* notes 241-242 and accompanying text.

334. Williams made the point at the beginning of his 1962 article that the fiduciary duty crops up through the "intervention of courts of equity." Williams, *The Fiduciary Principle*, *supra* note 10, at 206. Thus, it stands in necessary opposition to the results of simple contract litigation. Even though lawyers are not well-trained to think of equity as a free-standing body of law, the principles of equity have hardly dimmed on the common-law landscape. Cf. *id.* at 274 (courts in equity "have disappeared from the curricula of many law schools," an observation that is even more true today). With the duty an equitable matter, courts' willingness to let the parties contract away the full duty may well depend upon whether they interpret the fiduciary duty as one of contract or of equity. See generally

companies can contract their way out of tort duties. Even in negligence cases, the law protects against blanket abandonment of tortious responsibility: disclaimers have to be conspicuous and spell out the activity covered.³³⁵

Recently, courts have suggested new ways to temper *Stine's* harshness. One pioneering Texas court of appeals limited article V.A to physical operations in *Abraxas Petroleum Corp. v. Hornburg*.³³⁶ The case was another internal joint-account dispute. The working interest owners, who had not paid the most recent bills, sued a newly installed operator whose term had been marked by sharp cost increases and a disastrous performance that ended with its plugging three of their four wells.³³⁷ The nonoperators did not file a fiduciary claim but alleged negligence, gross negligence, willful misconduct, breach of contract, and waste. Operator Abraxas argued that a jury finding that it breached the JOA by sending an improper AFE was defective because the jury had not found that it acted with gross negligence or willful misconduct,³³⁸ *i.e.*, the contract claim was blocked by article V.A. The interest owners disagreed and contended that article V.A. "applies only to causes of action arising from lease operations...."³³⁹

Ruling on the breach-of-contract claim, the Texas court of appeals agreed that article V.A does not apply to breaches of the JOA itself. It reasoned that the article is limited not by cause of action, but by type of activity, to drilling operations. Article V.A is "an article which

Martin, *supra* note 27, at 102 (if duty is independent of agreement, courts have to decide whether parties can negate a tie "heretofore in existence," and strongly urging that they can); *cf.* *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (holding in executive rights context that its fiduciary duty "arises from the relationship and not from express or implied terms of the contract or deed").

335. One recent treatment of the Texas standard concludes that, for article V.A, it is "unlikely that the JOA Exculpatory Language would be effective" to disclaim liability for negligence, because it is not conspicuous and does not specifically identify the acts of negligence. Dick Watt et al., *A Litigation Perspective: Selected Thoughts on the Express Negligence Doctrine, Exculpatory Clauses, and Indemnity in Joint Operating Agreements*, 26 ST. B. TEX. SEC. REP. OIL, GAS & ENERGY RESOURCES L. 14, 23 (2001). Another review that covers all major oilfield jurisdictions concludes that exculpatory clauses, at least under certain conditions including that the exculpation be clearly expressed, are likely to be enforced in four states that lack anti-indemnity statutes (Colorado, Montana, Oklahoma, and Utah) and two (Texas and Louisiana) that exclude operating agreements from such statutes; but that New Mexico and Wyoming, two other major oilfield jurisdictions, would not enforce them. Bledsoe, *supra* note 160, at 15-4 to 15-18.

336. 20 S.W.3d 741 (Tex. App. 2000).

337. *Id.* at 747-48. The transformation was so severe that within two years of the new operator's taking over, production had fallen from 1000 barrels per month to just thirty barrels.

338. *Id.* at 758-59.

339. *Id.* at 759.

concerns the operator's authority to conduct operations in the contract area." "[M]ore significantly," the limits are "linked directly to imposition of the duty to act as a reasonably prudent operator, which strictly concerns the manner in which the operator conducts drilling operations on the lease."³⁴⁰ Another Texas court of appeals followed *Abraxas* and allowed a breach-of-contract claim over well charges to proceed in spite of article V.A.³⁴¹ According to the same logic, not only breach of contract claims, but also breach of fiduciary duty claims should not be affected by article V.A unless, of course, the alleged violation concerns physical drilling itself.

340. *Id.*

341. *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147, 154-55 (Tex. App. 2001). The unhappy nonoperator pled a variety of causes of action, including one for breach of fiduciary duty. *See id.* at 152. The court's discussion of article V.A, however, occurred in a section on well charges that couched the issue in terms of "breaches of specific terms of the agreement" and that the court viewed as "in the nature of an accounting." *Id.* at 155.

Abraxas and *Cone* have been followed in *IP Petroleum Co. v. Wevanco Energy, L.L.C.*, 116 S.W.3d 888 (Tex. App. 2003). Investors argued that the operator should have drilled to a deeper depth before abandoning the well, even though they had failed to take over the well and deepen it themselves after receiving notice that the operator was going to abandon it. The court of appeals, citing *Abraxas* and *Cone* with approval, first held that this was the kind of operational activity to which those courts had agreed the gross-negligence or willful-misconduct disclaimer applies. *Id.* at 894-96. It then held that the evidence was insufficient to meet this stringent standard. *Id.* at 897-98.

The Tenth Circuit also has precedent on this issue. In *Shell v. Ultra Resources, Inc.*, 415 F.3d 1158 (10th Cir. 2005), the district court had held that article V.A barred the nonoperator claim against Shell for breaching the JOA by charging excessive costs. *Id.* at 1161-62. In reversing on this point, the Tenth Circuit noted the lower court's failure to discuss the scope of the exculpatory clause or past judicial decisions on its application. While article V.A would apply to "tortious acts related to the performance of the contract, such as an error in dealing with a third party," it did not apply to duties actually imposed by the contract. *Id.* at 1170.

Thus, the exculpatory clause has no application to claims that an operator has failed to abide by specific duties and express contractual duties assigned in the JOA. Rather, it applies to tortious actions and, as the section A clause plainly states, implied duties that come with the covenant of good and workmanlike performance.

Id. *Ultra Resources* cited *Palace Exploration Co. v. Petroleum Development Co.*, 374 F.3d 951, 953-55 (10th Cir. 2004), in which the court held that the operator was not negligent in siting a well within a location described in the JOA, and the parties stipulated that article V.A "set the standard for determining PDC's liability as operator for breach of duties not affirmatively set forth in the agreements," *id.* at 954 n.2; and *Amoco Rocmount Co. v. Anschutz Corp.*, 7 F.3d 909 (10th Cir. 1993), in which the Tenth Circuit refused to apply the exculpatory clause to claims that Amoco had improperly shifted costs in violation of the JOA because "[t]he breaches at issue here are nonperformance of duties imposed by the contract, and do not hinge on whether the breaching party's failure to perform was negligent, grossly negligent, or willful." *Id.* at 923.

Because *Stine* and many of the strong disclaimer cases simply ignore contrary precedent, the resolution of the disclaimer cases and the trust and marketing cases lies in the future.³⁴² But with even the more restrictive 1989 JOA paying obeisance to special duties for handling costs and revenue funds, only a minority of courts are likely to hold that there is no fiduciary duty in the core areas of handling funds and marketing production. If the law ends up trying to protect nonoperators in areas where the operator's interest diverges from theirs, as it has with royalty owners,³⁴³ the operator's ultimate duty is likely to encompass at least disputes over handling joint account funds, marketing production, acquiring acreage, and using joint account information. In each of these settings, the operator and nonoperator have such conflicting interests that deference to the operator is not warranted and higher responsibility is needed.

VII. THE DISARRAY AND UNINTENDED CONSEQUENCES OF CURRENT LAW

This Article has discussed a wide body of cases about the operator's standard of care. There is now a highly developed jurisprudence, with dozens, perhaps hundreds of cases decided over several generations in various jurisdictions, all addressing the operator's duty. General trends have emerged by theory, by jurisdiction, and by function. Yet, though courts have used a number of different principles to make operators fiduciaries, the law remains inconsistent. Today's doctrines repeatedly force courts to choose between fidelity to legal fictions about nonoperator control and denying a protection that should be allowed on other grounds. Courts have found relatively clear and emergent rules for operators handling investor funds and marketing production, but they have not yet integrated these fiduciary duties with

342. It is not just case precedent that *Stine* and other disclaimer cases ignore, but also commentators. Compare Brimmer, *supra* note 24, at 104 (limitations of liability "are chiefly a boon to the paper industry and may be disregarded by courts as well as taxing authorities"); Lane & Boggs, *supra* note 11, at 230 ("[I]t appears to be uniformly recognized that the clause will be essentially ineffective to [disclaiming third-party liability]. There are volumes of authority...that such contract language will not be effective to negate the joint venture/partnership relationship." (citations omitted)).

343. See generally 5 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 856.3, at 411-12 ("Ordinarily, the interests of the lessor and lessee will coincide; the lessee will have everything to gain and nothing to lose by selling the product. Where the interests of the two diverge and the lessee lacks incentive to market gas, closer supervision of his business judgment will be necessary."). This imbalance of power at the royalty level is, of course, the reason that courts have seen the need to create the implied covenants and to restrict the operator's freedom to benefit itself at the other owners' expense.

the inconsistent dictates of joint-venture and mining-partnership theories. These last two doctrines only extend protection for investors who have a role in running the joint investment. Partial, unpredictable, ex-post fiduciary duties do not send the clear message that courts seek when they impose heightened responsibility upon operators.

Though operators often satisfy at least one of the tests for imposing fiduciary duties, courts have left the area littered with overlapping doctrines. Operators may be fiduciaries as a matter of law, or only as a question of fact. They may be fiduciaries only if nonoperators share a reasonable amount of control, as in strict joint-venture and mining-partnership doctrine, or only if they are highly dependent upon the operator, as in the trust, marketing, unit, and grubstake cases. The courts have yet to fully articulate a uniform theory of the operator relationship, and the patchwork of available fiduciary theories fails to provide the structure to derive the correct result in all cases. This doctrinal turbulence demonstrates the need for a clear restatement of the law. Both supporters of a uniform fiduciary duty and advocates of lesser duties (which can range down to no duty) should agree that today's doctrinal inconsistency is a problem.

The most direct problem, of course, is the gulf between the two major fiduciary approaches (the joint-venture and mining-partnership theories) and other fiduciary doctrines. The joint-venture and mining-partnership theories' cooperation-control standards contradict the common-law principle that a fiduciary relationship exists to protect dependent parties from those handling their affairs. Joint-venture and mining-partnership cases contradict the general basis for protection in a wide variety of areas, including in partnership and securities law; the tort duty of good faith; the "informal" fiduciary duty; and core principles of trust and agency law. The approach in joint-venture and mining-partnership cases also contradicts other groups of oil and gas cases—the executive rights cases, unit cases, grubstake cases, and royalty implied covenant cases.

This is not a victimless inconsistency. Joint-venture and mining-partnership theories carry a high and unnecessary price: they can expose passive partners to full liability for the operator's torts and breaches of contract. This unintended outcome penalizes nonoperators and can confer a windfall on service companies and other lucky third parties.³⁴⁴

344. The use of inappropriate reasoning to reach a defensible end perversely may also create fiduciary obligations from the nonoperator to the operator. A joint-venture finding has another, albeit less frequent, unintended result: it can exempt the operator from duties that otherwise might be imposed under the securities laws. *See supra* note 92.

The stress under which both joint-venture and mining-partnership cases labor is evident when courts apply the principles of third-party cases to the internal workings of JOA ventures, and vice versa. Courts make "control" or "cooperation" as vague and minimal a burden as possible when they want to make an operator a fiduciary to its partners, then spring back and define it as a high barrier to avoid a fiduciary finding that would unfairly expose nonoperators to vendors and drillers with whom the nonoperators never dealt. The ensuing result-oriented jurisprudence cannot but reduce respect for the larger legal system and provide ammunition for those who argue that judges really are just policy makers with a fancy language and a few odd rituals.³⁴⁵

The lack of a more stable foundation also has left the fiduciary duty more vulnerable than necessary to disclaimers and exculpatory clauses. The protection is a substandard, discounted protection. Courts generally do not let fiduciaries contract away duties of disclosure and their duty to avoid secret self-dealing and profit-taking. But in the oilpatch, some courts have begun enforcing blanket disclaimers in industry-dominated form contracts without exercising the care ordinarily taken to decide whether contracts can limit tort duties. As a result, some courts are well on the way to immunizing operators for wrongdoing kept secret from their partners.

A. In the Common Law, In and Out of the Oilfield, Courts Generally Protect Dependent Parties, Not Those in Control

American courts impose *per se* fiduciary duties, or at least heightened responsibility, in many legal relationships both within and without the oilpatch. The common thread is usually found when an undertaking to act for the interests of another is coupled with a structural dependence that requires protection. Courts hold those who are in a position of unusual control over the fortunes of others to a higher standard than ordinary, arms-length parties. Examples of such relationships include agents, trustees, parties subject to the tort duty of good faith, partnerships, informal fiduciary duties, and securities sellers and promoters. Some of these general principles, like the marketing agency and *Reserve Oil's* trust principles, find frequent oilfield applications. Specific oilfield examples include executive rights holders, unit operators, grubstake holders, the operator's duty of good faith, and the lessee's implied-covenant duties to its lessors. The bodies of law

345. See *infra* note 509 and accompanying text.

covering these areas are directly at odds with an oilfield jurisprudence that too often makes fiduciary status turn on the beneficiaries' "control" or "cooperation" and allows a form industry contract to disclaim the duty.³⁴⁶

1. The Agent Is a Fiduciary Because of Its Control and the Principal's Dependence

The agent is a classic common-law fiduciary. The agent earns its responsibility as a matter of law because of the structure of its relationship to the principal. The principal does not need to prove any level of trust or understanding in order to be afforded fiduciary protection. The agreement to act on behalf of the principal causes the agent to be a fiduciary. The agent's duty is "created by his undertaking, to act primarily for the benefit of another in matters connected with his undertaking."³⁴⁷ The large and well-known literature addressing the agency incentive problem perfectly illustrates the vulnerability of the dependent principal who cannot fully control the agent,³⁴⁸ just as nonoperators cannot control the operator.

When the production marketing cases treat the operator as a fiduciary, courts impose this responsibility based on the assumption that the operator exercises effectively unsupervised control on behalf of a dependent interest owner. In so doing, the production marketing cases lay one of the foundation stones necessary to bridge the current gap between the unruly state of oil and gas law and the larger principles of the common law.³⁴⁹

346. Others have noted the counter-intuitiveness of the joint-venture and mining-partnership rules and their poor fit with the larger body of law. See Boigon, *Liabilities and Relationships*, *supra* note 3, at 8-34 ("Ironically, then, it is the very lack of control of the parties who feel wronged that supports their invocation of enterprise responsibilities, while as we shall see in the next section it is the same lack of control that is pleaded by nonoperators as a defense to enterprise liability when suits by third-party creditors are involved."); Eyring, *supra* note 130, at 1297 (joint-venture analysis between parties can "yield counterintuitive results," because "increased control by the operator should increase, not decrease, the duty owed" (citation omitted)).

347. RESTATEMENT (SECOND) OF AGENCY § 13 cmt. a (1958) (emphasis added).

348. For the classic articles, see generally Michael Jensen & William Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Steve Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 AM. ECON. REV. 134 (1973); Michael Spence & Richard Zeckhauser, *Insurance, Information, and Individual Action*, 61 AM. ECON. REV. 380 (1971).

349. Ernest Smith has objected to a general agency interpretation of the operator duty because (1) many joint projects may not fit the traditional model in which the owners jointly appoint their operator, and (2) the nonoperators supposedly do not retain the rights of control of an ordinary principal. Smith, *Duties and Obligations*, *supra* note 24, at 12-8 to 12-9. On the first element, the structure of the standard investment does fit a model in which

2. A Trustee Is a Fiduciary Because of His Control and the Beneficiaries' Dependence

A trustee's fiduciary duty is also the product of control over a dependent beneficiary. A trust is created when three elements are present: a trustee, who is obligated to administer the trust for a beneficiary; a beneficiary, the person who receives the fruits of the trust; and trust property, some property administered for the beneficiary.³⁵⁰ A trustee, like an agent, is in a relationship that is by definition fiduciary.³⁵¹

The operator does not, of course, hold title to the nonoperators' interests. In addition, while the nonoperator cannot arbitrarily cancel its interest, it does have greater powers of termination in the standard agreement than a trust beneficiary.³⁵² Finally, the operator benefits from the same corpus—the joint property—in a way that trustees ordinarily do not (although if each proportionate interest is viewed as a separate property, the operator is not to profit off the nonoperators' property except on agreed fees-for-services, in much the same way as a trustee collects for its services).

These differences are not material to the need for ensuring a high standard of care in the operator's exercise of its powers over nonoperator property. The operator administers the joint property with the same degree of control as a trustee. The primary differences—the nonoperators' limited rights to go nonconsent in a few places and, in some agreements, to approve Authorizations for Expenditure over pre-agreed amounts, and their right to sell their interests—do not change the nonoperators' basic reliance on the operator's discretion. These rights may make it a little easier to escape an investment that seems to be going bad, but they do not provide the nonoperator an effective means of policing to stop it from becoming a bad investment. Moreover, the major

the investors each delegate their powers to a single operator. On the second, Smith suggests that "[a]n understanding that the person with managerial or operational authority is not subject to control with respect to the manner of performance is normally determinative of the absence of an agency relationship." *Id.* at 12-9. Yet Smith seemingly does not object to the marketing agency duty. *See id.* Moreover, just as courts have crafted the mining partnership without requiring every strict technical characteristic of partnerships generally, there is no reason that they cannot impose a larger fiduciary duty when the operator so clearly acts for the interests of its investors.

350. RESTATEMENT (SECOND) OF TRUSTS § 2 & cmt. h (1959). For the general definition of these elements, see *id.* section 3 and comments a-d.

351. *See id.* § 2 & cmt. b.

352. Unlike an agency relationship, a trust normally cannot be terminated (by the beneficiary or trustee). *Id.* § 8 cmt. g.

means of nonoperator control, the joint-interest audit, is parallel to power held by trust beneficiaries to audit and to an accounting.³⁵³

While the operator may not have a trustee's control over all aspects of the nonoperators' affairs, courts focus on those core activities where the operator acts like a trustee. Just as courts have treated the operator as an agent when it markets nonoperators' production, so they have treated the operator as a trustee in its classic trust activity—handling money belonging to another.³⁵⁴ When the operator selects a vendor, decides whether to negotiate a volume discount or delay payment that it might pocket for itself, or uses an affiliated company, the operator is committing other peoples' money yet generally acts without any oversight. Under these circumstances, courts hold operators to the utmost standard of diligence and faithfulness—precisely the *Reserve Oil* duty.

The courts have yet to define the final boundaries of the *Reserve Oil* duty. The range of facts on which the principle has been applied is still expanding. Yet in other contexts, oilfield jurisprudence already has established clear rules that an operator cannot engage in self-dealing on either the revenue side or spending side of an investment. There are dozens of royalty cases that prohibit an operator, with its trust-like duty to secure the "best price reasonably possible" for the royalty owner, from using corporate formalities or secret arrangements with other companies to secure a higher price for itself.³⁵⁵ Royalty cost litigation is less frequent because the royalty is supposedly an interest "free of costs" and is only supposed to be burdened by certain post-production costs, so the opportunity for self-dealing is less. But in dealing with categories of post-production royalty costs, courts have prevented affiliate profiteering.³⁵⁶

The issue is more complex in the operator/nonoperator setting, because the standard COPAS form lays out detailed standards that allow the operator to earn a reasonable fee when it provides competitive services. The basic principle, however, should be clear. As Jolly and Buck wrote in a standard industry text, "an operator should neither gain nor lose just because he is the operator."³⁵⁷ Over time, this principle should

353. *Id.* §§ 172-173.

354. One of the founding documents in the modern law of trusts is Louis Brandeis' aptly titled *Other People's Money*, *supra* note 153.

355. *See supra* note 252 and accompanying text.

356. In *Wegman v. Central Transmission, Inc.*, 499 So. 2d 436 (La. Ct. App. 1987), for instance, the court prevented the lessee from charging a higher transportation charge on a \$30,000 pipeline than that applicable to a million-dollar pipeline in the same area. *See id.* at 448, 454.

357. *See* JOLLY & BUCK, *supra* note 4, at 203.

make clear that secret surcharges or finder's fees, unshared volume discounts and delay payments, and other profiteering arrangements each violate the operator's basic trust duty.

3. *The Duty of Good Faith (Be It a Tort Duty or Contract Duty) Is Keyed to Control and Dependence*

Another major change in strict contract doctrines involves duties of good faith imposed on contract parties. At some times and in some activities, these are tort duties; in other instances, they are merely added contract responsibilities that do not give rise to punitive damages. The good-faith duty articulated in the 1989 JOA is a contract duty.³⁵⁸

In the long-running disagreement over *tort* duties of good faith, both advocates and critics agree that the capstone for the duty is some special vulnerability (with disagreement over how to define this vulnerability and how often it exists). Breach of this fiduciary duty is generally a tort, even though it can arise from contract relations.³⁵⁹ When the Texas Supreme Court adopted a tort duty of good faith in insurance contracts, for instance, it made clear that the heightened responsibility rests on the insured's dependence upon the insurer. It found the insurance relationship a "special relationship" because of "the parties' unequal bargaining power," because the relationship lets insurers exploit their policy holders, and because the insurers hold "exclusive control" over claims.³⁶⁰ Even though oil producing states in general have rejected

358. See 1989 JOA, art. VII.A.

359. California pioneered the imposition of tort duties of good faith on contract parties. Its lead cases involved insurance companies' decisions to defend and settle litigation. See *Crisci v. The Sec. Ins. Co. of New Haven*, 426 P.2d 173 (1967); *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 200 (1958). Interestingly, the supreme court described the duty as arising from implied covenants (non-tort obligations). See *Crisci*, 426 P.2d at 176; *Comunale*, 328 P.2d at 200-01. Yet it still found that the duty is a tort obligation. See *Crisci*, 426 P.2d at 178; *Comunale*, 328 P.2d at 203. What really gave this duty teeth is that insurers, in refusing to settle, could become liable for the entire judgment *even if in excess of the policy limits*. See *Comunale*, 328 P.2d at 201-02.

The insurer's incentives obviously differ from the policyholder's, in that it wants to pay out as little as possible on its policies while still maintaining some reputation as a reliable insurer. California courts reasoned that the insurer "should not be permitted to further its own interests." *Crisci*, 426 P.2d at 176-77. The doctrine forced the insurer to give the insured's interest "at least as much consideration as it does to its own interest." *Comunale*, 328 P.2d at 201. California courts later backed off some of the broader applications of the duty of good faith. See, e.g., *Foley v. Interactive Data Corp.*, 765 P.2d 373 (Ca. 1988) (no tort duty in employment cases); *Moradi-Shalal v. Fireman's Fund Ins. Co.*, 758 P.2d 58 (Ca. 1988) (no tort duty from insurer to third party).

360. See *Arnold v. Nat'l County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987). The Texas Supreme Court re-emphasized the insured's dependence a year later when it extended *Arnold* to worker's compensation claims. See *Aranda v. Ins. Co. of N. Am.*, 748

expansions of this *tort* duty to noninsurance cases, the insurance cases display a general agreement that it is the insured's dependence that justifies special protection.³⁶¹

The good-faith cases are a prime example of how one party's controlling position and another's vulnerability justify making the dominant party a fiduciary. The approach is flatly inconsistent with joint-venture and mining-partnership approaches to fiduciary responsibility because (1) courts base those duties on the nonoperator's control, not its dependence; and (2) those duties often are decided by microscopic factual differences in individual cases, rather than derived as a matter of law from the general relationship of the parties.

The good-faith cases are particularly interesting because the American Association of Petroleum Landmen inserted a contract-based duty of good faith in article VII.A of the 1989 JOA. The JOA gives no indication of how the courts should interpret this duty, or exactly how the duty fits with the JOA's disclaimer and exculpatory language. Yet the inclusion of good faith is itself recognition that the operator needs some regulation beyond naked contract terms to protect its nonoperators. In this way, at least this part of the JOA acknowledges that operators and nonoperators are not in the same position as ordinary, arm's-length contract parties.

4. General Partners Have Higher Duties Because of Their Control

The law of partnership offers yet another illustration of how the common law ordinarily imposes higher duties on parties who agree to act for others and exercise unusual control as a means to protect the

S.W.2d 210, 212-13 (Tex. 1988). For a case discussing *Arnold* but refusing to extend it into the oilfield in a gas purchase agreement dispute, see *American National Petroleum Co. v. Transcontinental Gas Pipe Line Corp.*, 763 S.W.2d 809, 819-20 (Tex. App. 1988), *issue avoided on appeal*, 798 S.W.2d 274, 280 n.1 (Tex. 1990) (Gonzalez, J., dissenting).

Oklahoma has adopted the insurance good-faith rule but only for insurance cases. See *Christian v. Am. Home Assurance Co.*, 577 P.2d 899, 904-05 (Okla. 1977) (adopting duty after discussing California cases); *McCorkle v. Great Atl. Ins. Co.*, 637 P.2d 583, 586-88 (Okla. 1981) (rejecting invitation to overturn *Christian* rule). *But see* *Rodgers v. Tecumseh Bank*, 756 P.2d 1223, 1225-27 (Okla. 1988) (refusing to extend duty beyond insurance contracts to banking).

New Mexico recognizes the insurance fiduciary duty, and in addition permits awards of punitive damages for "malicious, fraudulent, oppressive" breaches of contract or those "committed recklessly or with a wanton disregard for the Plaintiff's rights." See *Romero v. Mervyn's*, 784 P.2d 992, 998 (N.M. 1989).

361. The 1989 JOA imposes a general duty of good faith on the parties in language that suggests any limitation of liability to gross negligence and willful misconduct was *not* intended to block a higher duty between the parties in at least some areas. See 1989 JOA, art. VII.A.

dependent party. A partnership is an association of at least two people as co-owners in a business run for profit.³⁶² Partner obligations are generally determined under standard agency principles.³⁶³ Each partner can bind the entire partnership, so each partner has to trust the other parties entirely. Unlike mining partners, partnerships generally are not limited to a single project.³⁶⁴

The JOA relationship is closest to a limited partnership because of its severe limits on the nonoperator's powers and the operator's explicit right to control the venture through not only article V.A but also the many other powers the JOA grants to operators. The law of limited partnership allows passive partners to restrict their exposure to their own investment, rather than being at risk for the overall venture's debt. Limited partnership status protects limited partners by making the operator a fiduciary, as long as the limited partners do not control or manage the venture.³⁶⁵ The managing partner's responsibility is even greater in a limited partnership than in a general partnership precisely because of the limited partners' dependence.³⁶⁶ The same heightened fiduciary duty applies even in general partnerships when one of the partners is the managing partner, a position that indicates extra control.³⁶⁷ This is the exact opposite of the oilfield's nonsensical requirement that nonoperators have to demonstrate control and participation before courts will impose a fiduciary duty on the operator.

5. The Securities Laws Impose Higher Responsibility on Promoters and Sellers Handling Other People's Money

The securities laws frequently govern oil and gas disputes. This major body of law takes special care to protect those in need of more protection (not less). Companies selling securities are held to a higher duty of disclosure and truthfulness based on their superior knowledge and control over the investment. This duty, of course, is the exact opposite of the joint-venture doctrine, which requires the nonoperator to exercise control as a prerequisite to protection.

One does not have to look far to see that the securities laws are intended to protect dependent investors. The Supreme Court traditionally interpreted a "security" as a common investment "with profits to

362. RESTATEMENT (SECOND) OF AGENCY § 14A (1958) (citing Uniform Partnership Act § 6(1)).

363. *Id.*

364. Compare *supra* note 104 and accompanying text.

365. See *supra* Part III.F.

366. See *supra* notes 194–195 and accompanying text.

367. See, e.g., *Huffington v. Upchurch*, 532 S.W.2d 576, 579 (Tex. 1976).

come solely from the efforts of others,"³⁶⁸ *i.e.*, investors need protection when they are relying on another to manage their investment. More recently, courts have backed away from that investment contract test (whether the investor's interests are dependent "solely" on the efforts of others) and instead evaluate whether the manager is making "significant efforts" to produce profits.³⁶⁹ The old investment-contract test produced the same classification problems that the oilpatch still suffers when it requires elements of cooperation and control to find a joint venture or mining partnership. The new securities test accurately describes the JOA investment, in which the operator's efforts are the undeniably significant ones. Yet while the securities laws now focus on the operator's control to justify added protection, joint-venture and mining-partnership law still fail to provide similar protection because they treat even limited nonoperator power as a means to deny control.

6. Courts Hold Executives to Fiduciary or Good-Faith Duties Because of Their Power over Nonexecutives

In certain other oilfield contexts, the operator has a more-than-contract duty to every other party dependent upon the operator's performance. Indeed, the more one looks at the executive rights holder's standard of care, the operator's duty to its royalty owners, the grubstake owner's responsibilities, and the operator's marketing and *Reserve Oil* duties, the more clear it becomes that the *one* major area where the courts have yet to clarify the operator's heightened responsibility is the operator/nonoperator relationship itself.

The executive rights cases are a good example of how courts impose a heightened, often fiduciary, standard in the oilfield as a matter of law simply because of the operator's superior control. The executive's power is in many areas similar to the operator's, even though an operator need not hold executive rights and many executive rights holders are not operators. The executive rights cases are another sign of the legal system's categorical failure to develop a fully logical standard for the operator's fiduciary duties. The controlling principle, that dependence is the key to protection, remains irreconcilable with the joint-venture and mining-partnership cases but is entirely in accord with the common-law mainstream.

368. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

369. III BROMBERG & RIBSTEIN, *supra* note 190, § 12.14(a), at 12:139. In another parallel, it is this passive role that preserves the limited partners' limited-liability position. See *id.* at 12:140-41.

An executive right is the right to control a property's mineral development rights.³⁷⁰ It is created when a group of landowners centralizes control in one of their number, or a landowner sells part of its mineral interest but keeps full control of development.³⁷¹ An executive right can also be created when a landowner sells only part of its property but tries to get the best price by tossing in the development rights.³⁷²

The cases are split on whether the executive is a fiduciary or just owes the nonexecutives a more-than-contract duty of good faith, but all jurisdictions agree that the nonexecutive's dependence justifies imposing some higher duty upon the executive as a matter of law. The leading fiduciary case is *Manges v. Guerra*,³⁷³ an opinion of the Texas Supreme Court. Flamboyant Texas rancher, oilman, and executive Clinton Manges leased to himself, on below market terms, the property he shared with nonexecutives.³⁷⁴ He later farmed out the acreage in an arrangement that left him a 50 percent back-in interest.³⁷⁵ The trial court instructed the jury that, given his executive right, Manges owed the Guerras a duty "to use the utmost good faith and fair dealing."³⁷⁶

The Texas Supreme Court initially limited *Manges* to a nonfiduciary duty of utmost fair dealing. On rehearing, however, it affirmed the trial court in a much broader ruling that found a fiduciary duty and held that this executive "fiduciary duty arises from the relationship of the parties and not from the contract."³⁷⁷ The duty "requires the holder of the executive right...to acquire for the non-executive every benefit that he exacts for himself."³⁷⁸

370. See WILLIAMS & MEYERS MANUAL, *supra* note 1, at 412-13 (defining "executive leasing power," also known as executive right, as "power to execute an oil and gas lease on an interest in land from which the lessor will not derive some or all of the usual lease benefits").

371. 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 339.2, at 202.

372. Conversely, a landowner wanting to retain some control over the final terms of property development could retain the right to join in future leases to protect itself against unfair dealing. See *Elick v. Champlin Petroleum Co.*, 697 S.W.2d 1, 4 (Tex. App. 1985). But its veto would lower the value of the property to potential purchasers, and so might reduce the price it could collect for any mineral interest that it sold.

373. 673 S.W.2d 180 (Tex. 1984).

374. See *id.* at 181-83 (detailing the terms of *Manges'* various self-dealing arrangements).

375. See *id.* at 182-83.

376. *Id.* at 183. The jury found that Manges had breached this duty and found actual damages of \$382,608, plus half a million dollars in punitive damages. *Id.*

377. See *id.* at 183. For a clear description of the first Texas Supreme Court decision, see Smith, *supra* note 27, at 376-78.

378. See *Manges*, 673 S.W.2d at 183. In an earlier executive case, though the court avoided the invitation to formally define the executive relationship, it described it as a confidential relationship and prefaced the conclusion upon "the power entrusted to

In *Dearing, Inc. v. Spiller*,³⁷⁹ a lease was being kept alive by a single well under a lease first entered in 1944. The executive turned down a new lease that offered twice the existing royalty plus a bonus of \$100 an acre (\$60,000 in all), and a continuous drilling obligation. Instead, it entered a new lease with a family corporation at essentially the old unfavorable terms.³⁸⁰ The Texas Court of Appeals explained that *Manges* had elevated utmost good faith to a fiduciary level and that it imposed such a duty "[b]ecause the non-participating royalty owner must depend upon the mineral fee owner for the enjoyment of his interests."³⁸¹ Dependence was the key. The critical fact was the executive's "exclusive power" to lease the land, "the fact that [it was the] only party who held the right to develop the land at all."³⁸² Many Texas cases have applied the *Manges* fiduciary rule.³⁸³ In 2003, the Texas

respondents and their superior knowledge." *Andretta v. West*, 415 S.W.2d 638, 641 (Tex. 1967).

379. 824 S.W.2d 728 (Tex. App. 1992).

380. *Id.* at 730-31.

381. *See id.* at 732. With the lease calling for a royalty of "no less than" one-eighth, "the entire percentage return is left to the efforts of the executive." *See id.* The jury found *Dearing* breached its duty of good faith and awarded actual and punitive damages. *See id.* at 731.

382. *Id.* at 732, 733.

383. In one of these cases, the executives leased their rights to one executive's son, whom the jury found re-leased to an operator for an abnormally low royalty (which the plaintiffs shared) but also took an overriding royalty (which they did not). The court affirmed an award of actual and punitive damages because even though this oilpatch fiduciary duty did not require the executive to "subordinate its own interest to those of the nonparticipating interest owner," it nonetheless "charges the fiduciary with acquiring for the non-executive every benefit that he extracts for himself." *See Mims v. Beall*, 810 S.W.2d 876, 879-80 (Tex. App. 1991) (discussing and following *Manges*).

Manges' fiduciary principles were applied in *Comanche Land & Cattle, Co. v. Adams*, 688 S.W.2d 914 (Tex. App. 1985), in which the court held that an executive could not circumvent its obligation to pay "royalties on leases," the phrasing in the executive contract, by entering a joint venture and calling the payments "working interest (no royalty)." *Id.* at 915-16. It could not enter an agreement "calculated to defeat the rights of the royalty owners." *See id.* at 916. In *Luecke v. Wallace*, 951 S.W.2d 267, 274-75 (Tex. App. 1997), the court of appeals affirmed a partial summary judgment based in part on *Manges* in a case over whether an executive's subsequent assignment extinguished the nonexecutive's interest. The fiduciary rule was acknowledged as well in *Cambridge Oil Co. v. Huggins*, 765 S.W.2d 540, 544 (Tex. App. 1989) (lessor/lessee dispute over effects of termination of farmout agreement for failure to pay royalties). The court read *Manges* as creating a fiduciary duty from the relationship of the parties where parties were co-tenants and "the benefits received by the Guerras depended solely upon *Manges'* management, creating a fiduciary relationship." *Id.* *See also* *Day & Co., Inc. v. Texland Petroleum, Inc.*, 718 S.W.2d 384, 391-92 (Tex. App. 1986) (citing with approval *Manges'* duty "of utmost good faith" in affirming summary judgment that executive rights' holder's attempt to re-lease interests to company president was invalid), *aff'd*, 786 S.W.2d 667 (Tex. 1990); *Mafrige v. United States*, 893 F. Supp. 691, 702-04 (S.D. Tex. 1995) (refusing to dismiss claim for breach

Supreme Court again cited *Manges* with approval and confirmed that in Texas the executive labors under a fiduciary responsibility when he or she enters the lease.³⁸⁴ The supreme court stressed that the core purpose

of fiduciary duty over government's allegedly sloppy job of drafting deed and its failure to secure highest royalty, relying on *Manges* and noting that it was "not until" *Manges* that the Texas Supreme Court "equated" the executive's duty of utmost good faith with a fiduciary obligation").

Other courts have seen a conflict between *Manges* and some later lower court decisions but have avoided entering the fray (not that a lower court should be "correcting" the supreme court). In *Hawkins v. Twin Montana, Inc.*, 810 S.W.2d 441, 445-46 (Tex. App. 1991), a case seeking appointment of a receiver, the trial court held that the executive breached its fiduciary duty by entering a lease with a lower royalty than available elsewhere. The court of appeals observed that *Manges* had been criticized but found it unnecessary to "consider this controversy" because it would affirm the trial court even under a mere good-faith standard. In *Shelton v. Exxon Corp.*, 921 F.2d 595, 600 n.2 (5th Cir. 1991), the Fifth Circuit observed that some courts have deviated from *Manges* when the parties were not cotenants, but found the standard irrelevant because under a prudent operator or fiduciary standard the King Ranch had authority to enter a challenged settlement with Exxon (the plaintiff having given it "exclusive" authority to execute lease amendments, as well as other broad powers to amend leases and enforce them). See *id.* at 598-99. The court cited with approval a portion of the trial court's opinion. *Id.* at 601. Although the district court cited *Manges*, the decision turned more directly on the finding that the ranch received no benefits not shared with the other interest owners (including the plaintiff Shelton) and, as the "crucial factor," that Shelton had only named Exxon (which had no fiduciary obligation), as a defendant. See *Shelton v. Exxon Corp.*, 719 F. Supp. 537, 544-45 (S.D. Tex.), *aff'd in part, rev'd in part*, 921 F.2d 595 (5th Cir. 1991).

In *Exxon v. Jarvis Christian College*, 746 F. Supp. 652, 655-56 (E.D. Tex. 1989), the court found issues of material fact on whether Exxon, which had paid the Treasury Department over two billion dollars for violating its two-tier (old oil/new oil) price controls in the 1970s, could sue its working and royalty interest owners for reimbursement. The court held that Exxon owed the royalty owners "a quasi-fiduciary duty," citing *Manges* as a fiduciary rule. *Id.* at 655. It added that even if Exxon owed the royalty owners "at least" a prudent operator's care—a lower than quasi-fiduciary standard—its pricing violated even that low standard. See *id.*; see also *Texstar N. Am. v. Ladd Petroleum*, 809 S.W.2d 672, 677-78 (Tex. App. 1991) (citing *Manges* as an example of a special relationship fiduciary duty, though finding no such duty between working interest owners under standard JOA).

Some courts in other jurisdictions have agreed that the executive is a fiduciary. In *Donahue v. Bills*, 305 S.E.2d 311, 312-13 (W. Va. 1983), the West Virginia Supreme Court treated the executive relationship as "an agency coupled with an interest." *Id.* at 312. "In effect, the Bills are fiduciaries for the Donahues and will be held to strict fiduciary standards." *Id.* at 313. The *Donahue* court mentioned the efficiency gains from centering the leasing power in one party; it can be a reasonable measure that avoids the "nightmare" of trying to negotiate a lease "acceptable to all owners." See *id.* at 312. See also *Teas v. Twentieth Century-Fox Film Corp.*, 178 F. Supp. 742, 745, 748-49 (N.D. Tex. 1959) (describing executive as both trustee and agent in making it share a 50% "variable participating royalty" that court believed was an effort to skirt the executive's obligation to share any bonus), *rev'd in part on contract grounds*, 286 F.2d 373 (5th Cir. 1961).

384. In *re Bass*, 113 S.W.3d 735, 744-45 (Tex. 2003); accord *HECI Exploration Co. v. Neel*, 982 S.W.2d 881, 888 (Tex. 1998); see also *Marrs & Smith P'ship v. D.K. Boyd Oil & Gas Co.*, 2005 WL 3073794, at *7 (Tex. App. 2005); *Sauceda v. Kerlin*, 164 S.W.3d 892, 916 (Tex. App.

of the heightened duty is to protect against self-dealing and unjust enrichment in the executive's lease decisions.³⁸⁵

Another line of executive-rights cases, some even in Texas, give the executive a less-than-fiduciary duty, but they are notable here because they still impose more than contract duties because of the nonexecutives' dependence.³⁸⁶ These courts generally require "good faith" or "utmost good faith" and hold executives to a high contract, but not tort, duty.³⁸⁷ Thus, even these cases, while unfaithful to *Manges*,

2005); *Grinnell v. Munson*, 137 S.W.3d 706, 718-19 (Tex. App. 2004); *Hlavinka v. Hancock*, 116 S.W.3d 412, 419-20 (Tex. App. 2003).

385. *In re Bass*, 113 S.W.3d at 744-45. For a discussion of the fiduciary executive, a review of competing standards, and a defense of *Manges's* fiduciary standard, see Joshua M. Morse & Jaimie A. Ross, *New Remedies for Executive Duty Breaches: The Courts Should Throw J.R. Ewing out of the Oil Patch*, 40 ALA. L. REV. 187 (1988). Morse and Ross zero in on the key problem with lesser duties, whose adherents generally claim that the executive has to be free to pursue its self-interest. *See id.* at 217-19, 226-27. If the executive is indeed free to pursue its self-interest, a right that to be meaningful must mean self-interest even when it conflicts with the nonexecutive's rights, then what is wrong with *Manges's* self-dealing? If the answer is only that *Manges* leased to himself, do lesser-duties adherents think that he should have been free to enter such a one-sided contract, one so harmful to the *Guerras*, as long as the lessee was a third party?

386. For instance, in one well-known case just a few years after *Manges*, a lower Texas court rejected an effort to push the executive into an economically hopeless oil tar development (a claim that should have failed under any standard) using a test of "utmost good faith." The court admitted that executives owe "some kind of duty," but argued that "there may be a variance concerning the standard." *Pickens v. Hope*, 764 S.W.2d 256, 264 (Tex. App. 1988). The court did agree, but grudgingly, that to the extent conveying executive rights had given *Manges* a duty to manage the property, "this duty to manage is certainly fiduciary in nature." *See id.*

387. *Pickens v. Hope*, 764 S.W.2d 256 (Tex. App. 1988), was followed in *Marathon Oil Co. v. Moye*, 893 S.W.2d 585, 591-92 (Tex. App. 1994) (coal dispute over letter of intent, in which the court distinguished *Manges* as involving cotenants and as a case in which "[a]lso, the court found a relationship of trust and confidence between the parties, which created a fiduciary relationship" (citation omitted)). *See generally* *Pilcher v. Turner*, 530 So. 2d 198, 200-01 (Ala. 1988) (holding defendants not required to share bonus and delay payments, that deed reserving executive rights did not create express or implied trust, but that it protected nonexecutives without fiduciary duties). But see the earlier, same-year decision of the same court. *Dauphin Island Prop. Owners Ass'n v. Callon Institutional Royalty Investors I*, 519 So. 2d 948, 952 n.3 (Ala. 1988) (holding that nonparticipating royalty does not violate rule against perpetuities, but adding in dictum that "the executive has a fiduciary duty to the non-executive"). For other nonfiduciary cases, see *Schroeder v. Schroeder*, 479 N.E.2d 391, 397-99 (Ill. App. Ct. 1985) (surveying standards and adopting "utmost good faith"). This court somewhat oddly cited *Manges* on rescission of the executive right without addressing the opinion's much greater significance, its holding on the fiduciary nature of the executive's duty. *Id.* at 399. Tennessee also has followed the "average" or ordinary prudent landowner test. *See J.M. Huber Corp. v. Square Enter., Inc.*, 645 S.W.2d 410, 414-15 (Tenn. Ct. App. 1982).

Given *Manges's* treatment of the Texas "utmost good faith" standard as a fiduciary one, it is not clear how courts that cited the pre-*Manges* cases with approval should now be

nonetheless confirm that efforts to treat the operator as an ordinary,

read. See, e.g., the pre-*Manges* Florida case, *Welles v. Berry*, 434 So. 2d 982, 984-88 (Fla. Dist. Ct. App. 1983) (adopting *Kimsey's* utmost good faith as an implied covenant where defendants were granted 25-year nonparticipating royalty but then refused to lease property, even turning down proffered leases, until after period expired). Counsel should be able to argue that Florida should adopt *Manges's* fiduciary interpretation of utmost good faith.

In Louisiana, until 1975 there was a well-developed body of caselaw that executives bore no fiduciary duty and could bargain for lease terms that favored them over the hapless nonexecutive, or just wait until the nonexecutive's interest, usually a term royalty, expired before they took action. See *Gardner v. Boagni*, 209 So. 2d 11, 15 (La. 1968) (noting that Louisiana had rejected fiduciary or agency theories and holding that executive could exclude nonexecutives from overriding royalty when underlying partition agreement gave nonexecutives right to share royalties and excess royalties, but not bonuses, rentals, or other consideration); *Uzee v. Bollinger*, 178 So. 2d 508 (La. Ct. App. 1965) (rejecting fiduciary duty for executive and holding executive had no obligation to get plaintiff more than one-quarter base royalty, and could take all other benefits in payments it did not have to share); *Vincent v. Bullock*, 187 So. 35 (La. 1939) (upholding cancellation of royalty under 10-year prescription statute in spite of, inter alia, later stipulations, lease extensions, and even defendants' effort to pool property and include royalty owners in pooling); *Spiner v. Phillips Petroleum Co.*, 94 F. Supp. 273 (W.D. La. 1950) (following, inter alia, *Vincent* in holding that mineral royalty interest without executive right did not include power to force leasing or drilling before interest died from prescription). In 1975, Louisiana amended its Mineral Code so that the executive "is not obligated to grant a mineral lease, but in doing so, he must act in good faith, and in the same manner as a reasonably prudent landowner or mineral servitude owner whose interest is not burdened by a nonexecutive interest." LA. REV. STAT. ANN. § 31:109 (West, Westlaw through 2004). See *Tidelands Royalty "B" Corp. v. Gulf Oil Corp.*, 804 F.2d 1344, 1351-52 (5th Cir. 1986) (summarizing early Louisiana caselaw before applying statutory good-faith standard in drainage dispute). The court in *Tidelands Royalty* defined the good-faith duty as prohibiting the executive from "structuring his conduct to gain an advantage that is derived solely by avoiding the burden of the royalty." *Id.* at 1353.

The good faith standard has received a great boost because of the heavy influence of two law review articles urging this standard. What can be viewed as the foundation work is Lee Jones, *Non-Participating Royalty*, 26 TEX. L. REV. 369 (1948). Utmost good faith got what is turning out to be an equally prominent endorsement almost 40 years later in Smith, *Fiduciary Implications of Executive Right*, *supra* note 27. See also Mack McCollum, Note, *Manges v. Guerra: The Executive Right Holder Undergoes Close Scrutiny*, 38 BAYLOR L. REV. 189 (1986). Smith's article seems in part an effort to defuse and limit the shift *Manges* made to a fiduciary standard. Williams and Meyers treat utmost good faith as the most widely used standard, with apparent approval, but define it as synonymous with the ordinary prudent landowner standard. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 339.2, at 212-15. Howard Williams endorsed that standard in his well-known article on the larger fiduciary issue. See Williams, *The Fiduciary Principle*, *supra* note 10, at 239-52; see especially *id.* at 242-43. So it is little surprise that courts often use this standard. Williams and Meyers identified seven different descriptions of the duty. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 339.2, at 210-11. Patrick Martin provides a useful review of the cases and of habitual executive disputes in an important, more recent article. See Patrick Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop Oil and Gas Interests*, 37 NAT. RESOURCES J. 311 (1997). Martin ends up urging the no-fiduciary duty that he has championed in other oilfield contexts. See generally *id.*; see also *id.* at 375-405 (discussing the executive's overall duty).

arm's-length business partner whose rights are defined entirely by the written contract directly contradict settled oilfield doctrines.

The nonexecutives' dependence, the fact that they have handed the executive the *entire* management role, is more extreme than the working interest owner's loss of control.³⁸⁸ At the more general level, however, executive-rights cases are another body of law that stands as a rebuke to the joint-venture/mining-partnership cases. The executive cases link higher protection to dependency. They impose fiduciary protection because of an imbalance in the parties' relationship, *not* because of a reading of individual contract terms. This treatment places both *Manges* and other executive cases squarely in line with the more general tradition of the common law.

7. The Unit Operator Cases Impose Higher Duties Because of Nonoperator Dependence

The unit operator cases are a large set of oilfield cases in which courts tie fiduciary responsibility to nonoperators' dependence in a way that is materially indistinguishable from the ordinary operating relationship. Courts like the *Young* court have tied fiduciary protection to nonoperators' loss of control.³⁸⁹ The Oklahoma Supreme Court recently contrasted a case involving a voluntary communitization agreement, to which it held the unit fiduciary duty does not apply, to the fiduciary rule in *Young*, which it described as arising because *Young's* unit area had been "coercively unitized" by Oklahoma statute.³⁹⁰

Unitization does water down the individual owner's voice, but it is not substantially different from the basic imbalance of power in the standard operator relationship. Unit nonoperators have their votes diffused, but as a group they have as much and sometimes more control over specific operator items. There may be a loss of individual voice,³⁹¹

388. The operator cannot reduce interest owners' shares except in a limited sense with unitization or pooling (*i.e.*, by the dilution of each nonoperator's vote).

389. See *supra* notes 167-169, 175 and accompanying text.

390. Howell v. Texaco, 112 P.3d 1154, 1160-61 (Okla. 2004).

391. It is true that each unitized interest owner normally has less voting control because more interest owners are involved. The owner of a one-eighth interest, for instance, might end up with one-sixteenth, one-twentieth, or a much smaller share of a larger unit. (Or, if a nonoperator owned the same percentage of the properties being combined, it should end up with exactly the same vote in the combined property.) In the standard dilution, the pooled or unitized interest owner may find its expectations disappointed (it has a smaller vote than when it decided to invest).

Vote dilution does not mean that all investors will have less control from unitization. The effect of combining wells in a unit depends on the size of the unit and the number of voting shares. A pooled or unitized nonoperator owning large interests could end up with more voting power than a small working interest owner in a single well. Even

but not of collective voice. Much more important is the fact that the transition to a unit occurs in a setting where nonoperators already had very limited voice under the standard JOA. The overall lack of control for *both* groups of nonoperators is far more significant than any change in voting caused by unitization. In fact, courts never have made nonoperators' rights turn on how many of them share interests in a well, or which if any have a majority vote.³⁹²

Unit investors collectively tend to have the same accounting, nonconsent, and information rights as interest owners under the ordinary JOA.³⁹³ Like ordinary nonoperators, they retain control over their share of the production, the issue in dispute in *Young*.³⁹⁴ To the extent that differences exist between the unit and standard operating agreement, unit operating agreements sometimes give unit nonoperators *more* rights and, therefore, *less* need for protection. While the unit operator has the "exclusive right" to conduct operations,³⁹⁵ for instance,

when many interest owners are unitized, some large equity holders still may be able to dominate block voting, just as holders of small percentages of stock often dictate the direction of large corporations. Indeed, unitization may *expand* the stage on which their power can play.

Unit nonoperators may lose more control if unitization occurs *before* the property is developed. Here forcible unitization can push a property owner into development without its having decided whether it was ready to lease its property, one of the major rights of ownership. Yet most unit cases concern not whether development should occur, but how the operator should act during development—the costs to be billed, the price to use in paying interest owners, the obligation to prevent drainage, and the like. Most of the cases come from disputes that occurred after initial wells were drilled. For these owners, the issues that most affect their interests are how the operator conducts operations.

392. If fiduciary status turned on the dilution of nonoperating interests, operators would be fiduciaries if they had many investors, none of whom could cast controlling votes on joint-account issues, but not if they had only one or two powerful investors. Operators would benefit from a lower standard of care when treating those who owned large shares. Unscrupulous operators would have an incentive to split programs into individual wells, each with as few investors as possible. They would put the investors they most wanted to fleece into wells where those investors would have greater votes. The operator then would be able to argue for a reduced duty because the investor had "control," when in fact the operator continued to call all key shots.

393. Thus, under the API's Third Model Form Unit Operating Agreement, the nonoperators have rights to audit, art. 3.2.7; to access the unit area at reasonable times, art. 5.2.1; to receive copies of all operator reports, art. 5.2.2; to vote to remove the operator, art. 6.2; to receive records and reports, art. 7.5-7.6; and to receive all production and well records, art. 10.1.3; *see also* Accounting Procedure (Unit and Joint Lease Operations) 1.5, right to audit, *reprinted in* 7 KUNTZ, *supra* note 24, § 137.7, at 210-30 [hereinafter API Model Form].

394. *Young's* interest owners retained formal, legal rights over how their production was sold. The unit agreement let them bypass the operator and take their production in kind, rather than having it sold by the unit operator. This take-in-kind provision is described in several parts of the opinion. *See supra* note 168 and accompanying text.

395. API Model Form, *supra* note 393, art. 7.1.

as does an ordinary operator with its "full control" of operations,³⁹⁶ one standard Unit Agreement restricts that delegation by adding that the interest owners still "shall exercise overall supervision and control of all matters pertaining to Unit Operations."³⁹⁷ Ordinary JOA investors do not get this broad right.³⁹⁸

What nonoperators in ordinary and unitized properties share is a reliance upon and inability to control the operator effectively in its countless financial and operational decisions. These decisions determine the success of the joint project. The operator's power is built upon its "full control" over drilling and production and the nonoperators' practical inability to participate in or oversee physical activities and financial practices. This dependence afflicts *every* nonoperator.³⁹⁹ Nonoperators are at the mercy of the operator in ways too important for the law to ignore. The loss of control in unitization, the cited reason for giving unit operators a fiduciary duty, is real, but *that* imbalance of power also affects investors under the standard operating arrangement. The critical element is the one-sided structure of information and control between operator and nonoperator.

8. *Dependence Is the Reason Grubstake Operators Are Also Fiduciaries*

Joint-venture and mining-partnership cases requiring non-operator control in exchange for fiduciary status cannot be squared with the grubstake cases, either. If a grubstake explorer conceals or distorts reserve data to get investors, uses joint information to develop nearby property for its own account, or inflates costs and charges, the stakeowning investors are hurt in exactly the same way as if a standard joint-interest operator took the same acts. Yet the grubstake operator is

396. 1989 JOA, art. V.A.

397. API Model Form, *supra* note 393, arts. 3.1, 7.1.

398. In a related significant difference, matters upon which unit owners "shall decide and take action" include the "method of operation," drilling, recompletions, and charges that exceed an agreed amount. *Id.* §§ 3.2.1-3.2.4. Owners can participate in such detailed matters as the disposition of equipment costing more than an agreed amount of dollars. *See id.* § 3.2.5. And they enjoy a specific reservation of all rights not expressly granted in the Unit Agreement. *See id.* § 5.1. ("Working Interest Owners severally reserve to themselves all their rights, except as otherwise provided in this agreement..."). None of these pro-investor clauses can be found in the standard, unpooled, ununitized JOA.

399. Although this Article does not discuss royalty owners in detail, it logically should make no difference whether the "nonoperators" are royalty owners instead of working interest owners, or if they hold production payments instead of net profits interests—they all depend upon the operator for their economic returns. It was in this sense, for example, that the Tenth Circuit in *Young v. West Edmond Hunton Lime Unit*, 275 P.2d 304 (Okla. 1954), extended protection to "all who are interested in the oil production either as lessees or royalty owners." *Id.* at 309.

classified as a fiduciary because of its structured control, in contrast to the joint-venture and mining-partnership cases.

Courts may have been quicker to impose a fiduciary duty on the grubstake operator because its investors' vulnerability can seem so tangible. In the classic case, the operator is literally out of sight and physical reach, as in a start-of-the-last-century case in which Wyoming investors staked a prospector in an Alaska gold venture.⁴⁰⁰ Many grubstake cases contain only a very general agreement for the explorer's search. The agreement can be oral⁴⁰¹ and its primary terms may concern just the amount of money furnished and that all discoveries will inure to the parties in proportion to their contributions.⁴⁰² It is because of, not in spite of, the grubstake investors' lack of control that mining and oil and gas law have made the grubstake holder a fiduciary as a matter of law.

The inconsistency between the grubstake and joint-venture/mining-partnership cases can be comically highlighted when the exploration is successful and the parties need to develop a property. The typical grubstake is limited to the discovery of reserves. Protection can cease abruptly and arbitrarily, without any shift in the actual relationship of the parties, once a court decides that the parties have outlasted their grubstake agreement and are moving into an operational phase. Unless the relationship also fulfills the requirements of a mining partnership or joint venture, the investors may find that the grubstake fiduciary duty did not extend beyond the early acts of locating a valuable property.⁴⁰³

400. See, e.g., *Hartney v. Gosling*, 68 P.2d 1118, 1123 (Wyo. 1902).

401. See *Smaller v. Leach*, 316 P.2d 1030, 1037 (Colo. 1957).

402. See, e.g., *Hartney v. Gosling*, 68 P.2d 1118, 1123 (Wyo. 1902) (Investors staked explorer with fixed sum in Alaskan gold venture; grubstake a "common venture, wherein one party, called the 'outfitter,' supplies the 'grub,' and the other, called the 'prospector,' performs the labor, and all discoveries inure to the benefit of the parties in the proportion fixed by the agreement."). The agreements in reported grubstake cases never have detailed rights like a right to audit, access to the property site, a chance to go nonconsent, power to remove the operator, or other attributes of the standard oilfield operating relationship. These occasional controls do not sufficiently limit the areas of unsupervised operator conduct to remove the need for JOA fiduciary protection.

403. In *Gillespie v. Shufflin*, 216 P.132 (Okla. 1923), for instance, the Oklahoma Supreme Court did not require the defendant to share a substantial interest it earned on adjoining acreage when it drilled a well on their jointly owned mineral interest because it found only a grubstake relationship, and not a mining partnership. The facts were egregious. The plaintiff had suggested to the defendant that he try to get a bonus or interest from a neighboring property that would benefit from the geological information learned when they drilled their own well (something like the traditional dry hole or bottom hole contribution). The defendant went ahead and contracted for a quarter interest in the adjoining lease in return for drilling, but refused to share this interest with the plaintiff. The court admitted that, if the parties had been mining partners, the defendant's behavior

This contrast is glaring because the standard nonoperator may need more, not less, protection than investors who pay for a grubstake. In the classic grubstake case, the investors stake a set amount of money, supplies, or both, so their risk is capped. They fix their maximum liability at the start of the venture. If the explorer needs more money, it has to get a new commitment.

Investors under the standard operating agreement, in contrast, commit to a proportionate share of an unknown cost.⁴⁰⁴ Their only protection lies in the few points at which they can go nonconsent. Otherwise their fortunes lie at the mercy of the operator. If the operator is careless, skims money, or makes secret deals, nonoperators can be held responsible to pay far more than expected. Grubstake investors do not have this exposure. The typical JOA nonoperator should be afforded at least the same protections as grubstake investors.

9. The Royalty Relationship Presents a Classic Case of the Oilfield's Imposition of Higher Duties to Protect Dependent Parties

Finally, a long-established oilfield doctrine with which the joint-venture and mining-partnership cases are highly inconsistent is the

would have been "reprehensible and lacking in good faith," and he would not have been allowed to keep the full quarter-interest. *See id.* at 132. The defendant had used his equipment to drill the well, but the plaintiff paid a fixed charge per foot, and they were to share equal portions of the original lease. *See id.* at 133. But in the absence of an agreement extending to developing the [first] lease, the court found that the venture was just one "to obtain an interest in the lease," and not to "co-operate in developing the lease." *See id.* at 134. Treating the deal as "analogous" to a grubstake agreement, it found no obligation outside of securing the initial lease. *Id.*

For other examples of the limits on the grubstake fiduciary duty, see *Hartney v. Gosling*, 68 P. 1118 (Wyo. 1902) (grubstake investors not liable for later debts of gold prospector when their commitment was limited to fixed fund). *Cf.* *Austin v. Hallmark Oil Co.*, 134 P.2d 777, 782 (Ca. 1943) (finding that defendant was involved in oral grubstake agreement, not joint venture, helped the court reject defendant's duty to share interest with corporation whose affairs he promoted). Even after a grubstake agreement expires, though, a venturer may be forbidden from acquiring a separate interest if prior acquisitions failed only for technical reasons. *See Webster v. Knop*, 312 P.2d 557, 559-60 (Utah 1957) (grubstake stakeholder cannot take oil leases in own name after expiration of venture, upon learning of technical invalidity of joint leases taken within venture; court influenced by fact that defendant merely advanced money, while the plaintiffs over whom defendant leased "were the prospectors who used their knowledge to make the original location").

404. In general, the interest owner is liable for "its proportionate share of the costs of developing and operating the Contract Area." 1989 JOA, art. VII.A. While the standard JOA envisions that the parties may impose a cash limit on some aspects of operations, *see id.* art. VI.D, this generally does not apply to the initial drilling or to the major categories of approved added operations (particularly completions and subsequent wells). Thus, interest owners undertake very large, uncertain financial commitments when they invest in a standard JOA project.

royalty implied covenant doctrine. The royalty relationship is the basic building block for American oilfield operations. The royalty owner's lease provides operating oil companies, the engines of the industry's development, with the most important raw material for their production process. Although the lessee generally is not a fiduciary,⁴⁰⁵ the law gives lessees an extensive set of enhanced duties designed to protect the lessor and carry out the basic purpose of the lease. These "implied" covenants have been justified on various grounds, but in practice they remedy the imbalance of power and knowledge between the royalty owner and the lessee/operator.⁴⁰⁶

Royalty cases are divided over whether implied covenants are implied in fact, because a court assumes the duty is what the parties "must have" intended, or implied at law, to correct an imbalance in power between lessor and lessee.⁴⁰⁷ But because courts traditionally have imposed the standard covenants on all leases, the difference has mattered little. In either case, the covenant imposes a duty that protects the dependent lessor by holding the lessee, who usually is the operator, to a higher responsibility. For example, if an adjoining well drains the lease and the lessee can stem this loss with another economic well, it will have a duty to do so and to protect the mineral estate by drilling a well it might have preferred to avoid. Or if the market offers a range of prices for production from the lease, the lessee has to get the best price reasonably possible even if it otherwise might have sold the production in a different way.

In each instance, the implied covenant gives the royalty owner protection beyond that provided by the lease contract alone and provides the lessee with a greater duty to act for the interests it shares with its royalty owners. The royalty owner's dependence is perhaps clearer than in the working interest cases, because royalty owners do not even have the same rights as working interest owners to vote on decisions such as completion and subsequent wells. Commentators frequently note the inexperience and dependence of the average lessor.⁴⁰⁸

405. There are exceptions, as for instance in the *Young* unit-operator rule, but, in general, oil and gas law has used implied covenants instead of a fiduciary duty to regulate affairs between the operator and royalty owner.

406. For the implied covenants generally, see 5 WILLIAMS & MEYERS TREATISE, *supra* note 10; 5 KUNTZ, *supra* note 24, §§ 54.1–62.5.

407. Compare A.A. Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 11 TEX. L. REV. 399 (1933) (arguing factual theory), with Eugene Kuntz, *Professor Merrill's Contribution to Oil and Gas Law*, 25 OKLA. L. REV. 484 (1972) (describing and endorsing Professor Merrill's theory that covenants are imposed as a matter of law).

408. See generally Ernest Smith, *Joint Operating Agreement Jurisprudence*, 33 WASHBURN L.J. 834, 839 (1994) (lessee "almost invariably in a superior bargaining position"), 851

In essence, lessors make their vote on the operator when they pick their lessee. After that, they have no right to vote on any aspect of operations, nor do they share periodic reports and other attributes of a participatory relationship. The law tempers this dependence by imposing implied duties on the operator. Here as in every other area discussed in this section, it is added vulnerability that leads to fiduciary or at least more-than-contract protection.

B. Current Law Can Create Unexpected Liability to Third Parties

Another problem with the result-oriented joint-venture/mining-partnership jurisprudence is that it often creates unintended results. That is the risk of borrowing from one area of law to reach a desired result in another without fully addressing the underlying principles of the borrowed cases. Legal rules are no more exempt from uncertainty than other kinds of policy making.⁴⁰⁹ But the "unintended" effects of joint-venture and mining-partnership cases are foreseeable.⁴¹⁰

(implying lessors will not have experience); Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-9 (lease parties "frequently" have a "disparity in bargaining position"); accord, Gary Conine, *Speculation, Prudent Operation, and the Economics of Oil and Gas Law*, 33 WASHBURN L.J. 670, 674 (1994) (few owners of mineral rights "have the technical or financial capability of conducting, or are willing to assume the risk of, such operations"); Larry Hebert, *Louisiana Mineral Code Article 122: The Concept of Mutuality 6* (materials presented at the 45th Mineral Law Institute, LSU Law Center, Nov. 19, 1998) ("lessee is almost always in the unique position of having virtually all the knowledge and also the control regarding the matters of the lease, e.g., drilling, completing, producing, marketing, developing and exploring"); see generally John Lowe, *Developments in Nonregulatory Oil and Gas Law*, 27 INST. OIL & GAS L. & TAX'N 1-1, § 103[2], at 1-19 (1988) ("[T]he lease transaction occurs because the owner of the mineral rights generally lacks the expertise and capital to develop them, and so transfers them to an oil company, which impliedly or expressly represents that it possesses the talent and the money to develop them."); cf. Jacqueline Weaver, *Implied Covenants in Oil and Gas Law Under Federal Energy Price Regulation*, 34 VAND. L. REV. 1473, 1487 (1981) (summarizing Professor Merrill's work on implied covenants as driven by view that "the lessee/lessor relationship is by its very nature tainted with unequal bargaining power").

409. For a sample of the variety of unintended consequences that can derail seemingly clear policies, see JEFFREY L. PRESSMAN & AARON WILDAVSKY, *IMPLEMENTATION: HOW GREAT EXPECTATIONS IN WASHINGTON ARE DASHED IN OAKLAND* (1984).

410. The risk is obvious. See Watts, *supra* note 63, at 2802 ("One would challenge his imagination only slightly to conceive of a case where an investor who holds a very small share of interest in a development project could be held primarily responsible for an exorbitant tort or contract claim merely because he is in a more favorable financial position than his co-investors who may be judgment-proof for such an amount."). Or consider the small investors who were held liable in *Arrow Petroleum Co. v. Ames*, 142 N.E.2d 479 (Ind. 1957) (en banc), and the creditor who barely escaped liability for picking up a small interest to satisfy a debt in *Bovaird Supply Co. v. McClement*, 177 N.E.2d 430 (Ill. App. 1961), both discussed in note 114 *supra*.

The joint-venture and mining-partnership cases take a standard suited to third-party cases but apply it in a place where it is not well-suited, the direct operator/nonoperator relationship. It makes sense that in third-party cases, courts require proof of nonoperator "control" or "cooperation." Under ordinary agency principles, courts would not hold parties liable for debts they did not actively incur, or that were not incurred by someone with actual or apparent authority for them.⁴¹¹ That is why it makes sense to deny nonoperators' liability to vendors and drillers, and to preclude a finding of a joint venture or mining partnership, unless the nonoperators meaningfully controlled the project or acted toward the vendor with apparent authority. If they did not do this, they should not be liable. When nonoperators do take those extra steps, they can become liable under ordinary agency principles.⁴¹²

As between the operator and nonoperator, in contrast, courts should hold operators to high duties of loyalty and disclosure because they are fully in charge and nonoperators have so little say. Here the principle that courts should protect the vulnerable party dictates a high internal standard. When courts stretch joint ventures or mining partnerships to operator/nonoperator disputes, they too often avoid applying the fiduciary duty through fictional determinations about nonoperator control-and-cooperation. A nonoperator's paying investment dollars and voting on participation are not "control" in the areas typically in dispute. Yet courts have solemnly treated such acts as participation and control.⁴¹³ Stretching the law this opportunistically has its price: joint ventures and mining partnerships can expose nonoperators to unlimited third-party liability that no one envisioned. This little interpretive trick of treating such limited acts as control may sometimes help nonoperators in an internal dispute, but it can bestow a bonus on third parties and unfairly penalize nonoperators in vendor cases.⁴¹⁴

General tort liability to third parties is at odds with the purpose of joint-account investments. An effective fiduciary duty that protects nonoperators should come without the third-party baggage of joint-

411. RESTATEMENT (SECOND) OF AGENCY § 159 (1958) (apparent authority).

412. See, e.g., Brimmer, *supra* note 24, at 101 (claiming that courts expanding liability to third parties in mining-partnership cases generally do so on ordinary doctrines like estoppel or waiver).

413. The classic example is *Oklahoma Co. v. O'Neil*, 440 P.2d 978 (Okla. 1968), discussed on this point in *supra* notes 62–63 and accompanying text.

414. See Boigon, *Hostile Environment*, *supra* note 3, at 5-9 (joint-venture and mining-partnership theories, at least in states other than Texas, create "substantial likelihood that a nonoperator with minimal actual involvement in operations will be held liable as a mining partner or joint venturer to third parties for acts or omissions of the operator").

venture and mining-partnership doctrine. One of the major reasons the joint-account structure is useful is that it promises a limited liability restricted to the proportionate share of the joint-account investor's commitment.⁴¹⁵ Vendors supplying goods and services to the joint account rely upon the operator's solvency and the assets of the joint account, not on the nonoperators' individual assets.⁴¹⁶

Using third-party doctrines *within* joint investment disputes can create unintended liability in another way. Many per se fiduciary duties, like that from lawyer to client or agent to principal, are one-way duties. The party promising to care for another's interests, but only it, is held to a higher standard because of the nature of its undertaking. Courts do not say, for instance, that a lawyer's fiduciary duty to the client gives the client a fiduciary obligation to the lawyer as well. Similarly, in the law of partnership a limited partner does not owe a fiduciary obligation to the general partner.⁴¹⁷ But a finding of a joint venture or mining partnership makes all venturers fiduciaries to each other, and so raises the *nonoperators'* duty to the operator, even though nothing in the relationship justifies this two-way duty.⁴¹⁸

415. Moreover, at critical points investors can cap their risk by going nonconsent. To be sure, the joint-account format still retains a sizable risk, because the nonoperators are each responsible for their proportionate share of costs. The operator might inflate bills for approved operations, or unexpected well problems may drive costs far beyond any expected range. But these risks are limited in two respects: first, nonoperators pay only their share of well costs, and second, they can go nonconsent at the completion stage, 1989 JOA, art. VI.C, and when another well is proposed, *id.* art. VI.B.

416. Though operating companies vary widely in size and solvency, many are large going concerns whose reputation and ability to pay will be known by their vendors (who should use standard business sources like Dun and Bradstreet to gauge their risk in significant projects). Vendors generally receive a lien on the joint property, which in effect makes nonoperators liable to the extent of their investment. Yet vendors often will not know who the nonoperators are, unless it is a very large project like Alaska's Prudhoe Bay field, in which the major participants are known throughout the state. Even with major oil companies, vendors do not have a reasonable expectation that they can rely on the general assets of nonoperators if they have trouble recovering against the operator and joint account unless they have some unusual, direct contact.

417. IV BROMBERG & RIBSTEIN, *supra* note 190, § 16.07(a), at 16:86 to 16:89.

418. In fact, it is far more accurate that nonoperators have no special relationship between themselves. See *Hondo Oil & Gas Co. v. Texas Crude Operator, Inc.*, 970 F.2d 1433, 1439 (5th Cir. 1992) (rejecting fiduciary duty as part of rejecting claim that operator had to charge all nonoperators the same overhead).

A finding of a joint venture can have another unfortunate effect because the status can affect rights and remedies under other laws. A joint venture can *lower* the operator's duty in some respects in states where a joint venture will negate blue sky securities liability. See *supra* note 92 and accompanying text.

C. The Lack of Principle in the Joint-Venture and Mining-Partnership Cases Appears in the Struggle over "Control" and "Cooperation"

One illustration of the poor fit between these two doctrines and the operator's basic duty is the lack of consistency over how much evidence is enough to prove a JOA nonoperator's "control" or "cooperation" and hence a joint venture or mining partnership. If predictability is among the attributes of a fair rule of law,⁴¹⁹ the courts still have work left to do on the operator cases. At one extreme, actual control or cooperation cases require some direct activity by the nonoperator.⁴²⁰ At the other extreme, some cases only require the nonoperator to possess a legal right to control, whether exercised or not.⁴²¹ In the middle lies a gray area where routine, passive activity like the receipt of information and reports (or even the right to receive such information) establishes control. The confusion is compounded when courts cite one standard but then apply another.⁴²²

419. See, e.g., Herbert Weschler, *Toward Neutral Principles of Constitutional Law*, 73 HARV. L. REV. 1 (1959).

420. See, e.g., *Oklahoma Co. v. O'Neil*, 440 P.2d 978, 984-85 (Okla. 1968) (requiring "acts or conduct reflecting cooperation in the project," but then applying minimal standard that found nonindustry investors' visit to lease and receiving falsely optimistic reports "cooperation under these circumstances" in dispute over operator's handling of property); *Dunbar v. Olson*, 110 N.E.2d 664, 666-67 (Ill. App. Ct. 1953) (reciting test as owners "have[ing] some choice and participation in control and management," and ordering judgment against them in third-party case vacated when they "never actually engaged in the management of the lease") (emphasis added)); *Archer v. Bill Pearl Drilling Co.*, 655 S.W.2d 338, 344 (Tex. App. 1983) (nonoperator in third-party suit "exercised no right to participate in the control or operation").

421. See, e.g., *Carey v. Humphries*, 107 N.W.2d 16, 30 (Neb. 1961) (requiring "equal voice in performance"); *Bolivar v. R & H Oil & Gas Co., Inc.*, 789 F. Supp. 1374, 1379 (S.D. Miss. 1991) (discussing "right of mutual control" as "not the actual exercise of control," but "the right to exercise that control"); *Parvin v. Davis Oil Co.*, 655 F.2d 901, 904 (9th Cir. 1979) (describing standard as "equal right" or "'right in some measure' to control the conduct of each other and of the enterprise," a standard the court found not met in joint-venture/securities exemption case), *cert. denied*, 445 U.S. 965 (1980); *Shell Oil Co. v. Prestridge*, 249 F.2d 413, 417 (9th Cir. 1957) (in personal injury case against lessor as well as drilling company, affirming jury's finding of joint venture and explaining that, "while equal voice and joint control of the enterprise is essential to a joint venture, one of the joint adventurers may entrust actual control of the operation to another, and it still remains a joint venture"; this test would, of course, remove any need to look at actual control as long as a nonoperator or other party retained the legal right of control); *Anderson v. Vinson Expl., Inc.*, 832 S.W.2d 657, 663-64 (Tex. App. 1992) (dispute among interest owners listing requirement as "mutual right of control or management," but finding fact issue where some evidence existed that an undefined "ultimate control" lay with operator and agreement "wholly excluded" investors from "participation in the drilling, operating and control" of the wells; court not citing language of agreement).

422. See *Ayco Dev. Corp. v. G.E.T. Serv. Co.*, 616 S.W.2d 184, 186-87 (Tex. 1981) (using "mutual right of control or management" as test in third-party case, but then discussing

The confusion over the standard of control is not the only problem. Courts send some joint-venture cases to the jury, but decide others from the bench. As a result, the cases oscillate on whether a joint venture is a question of fact or one of law. Formally, a joint venture must be proven as a matter of fact,⁴²³ with the burden of proof, naturally, on

nonoperator's visit as if actual conduct matters too); *Smith v. L.D. Burns Drilling Co.*, 852 S.W.2d 40, 41-42 (Tex. App. 1993) (affirming summary judgment for investors on third party's joint-venture claim where agreement gave operator "direct control of all operations," limited their costs, had no-partnership language, and plaintiff had not alleged that the nonoperators "actually exercis[ed] joint participation, control, or operation"); *Taylor v. GWR Operating Co.*, 820 S.W.2d 908, 911-12 (Tex. App. 1991) (citing *Ayco* on mutual control standard); *Hamilton v. Texas Oil & Gas Corp.*, 648 S.W.2d 316, 320-31 (Tex. App. 1982) (following *Ayco* in dispute over well costs); *James v. Nico Energy Corp.*, 838 F.2d 1365, 1373 (5th Cir. 1988) (citing *Ayco's* "mutual right of control" standard, but affirming summary judgment dismissing investor's joint-venture argument when his "only involvement...was limited to investment of capital" and operator "had the sole right of control in the drilling and operating of the wells"). One can perhaps reconcile these cases a little because whether nonoperators actually exercised control sounds like relevant evidence to whether they have a right to do so, but the real reading of the cases is that few courts have been precise in explaining what they mean by control.

423. *Taylor v. GWR Operating Co.*, 820 S.W.2d 908, 911-12 (Tex. App. 1991) (reversing summary judgment for operator in its dispute with investor; though fiduciary relationship was a question of law, underlying facts were for factfinder and the defendant had not disproved fiduciary relationship as a matter of law); *Anderson v. Vinson*, 832 S.W.2d, 657, 663-64 (Tex. App. 1992) (question of fact on "mutual right of control or management"); *Oklahoma Co. v. O'Neil*, 440 P.2d 978, 984-85 (Okla. 1968) (reviewing evidence and upholding trial court's finding of joint venture); *Parvin v. Davis Oil Co.*, 655 F.2d 901, 904 (9th Cir. 1979) (affirming trial court's finding of no joint venture after full review of evidence; joint venture "rests primarily on the facts of the individual case" - an observation that ignores the standardized relationships in oilfield ventures), *cert. denied*, 445 U.S. 965 (1980); *cf. Shell v. Prestridge*, 249 F.2d 413 (9th Cir. 1957) (affirming jury's finding of joint venture between lessor and drilling company in personal injury case). Then there is *Rankin v. Naftalis*, 557 S.W.2d 940, 943 (Tex. 1977), in which the jury found a joint venture but, as argued above, the supreme court discussed the relationship in terms that could find similar relationships fiduciary as a matter of law. See *supra* notes 69-70.

When an appellate court issues an opinion after trial, it has a full record before it, so it sometimes can be difficult to know whether it decided the issue as a matter of law. See *Dunbar v. Olson*, 110 N.E.2d 664, 666-67 (Ill. App. Ct. 1953) (reversing judgment for service company against nonoperators when evidence did not show that defendants had "some choice and participation in control and management"); *In re Mahan & Rowsey, Inc.*, 35 B.R. 898, 902 (Bankr. Okla. 1983) (denying summary judgment on joint-venture issue, though finding another ground to impose constructive trust as a matter of law), *aff'd on pertinent grounds*, 62 B.R. 46 (W.D. Okla. 1985), *aff'd after remand*, 817 F.2d 682, 683 (10th Cir. 1987); *Misco-United Supply, Inc. v. Petroleum Corp.*, 462 F.2d 75, 79-80 (5th Cir. 1972) (affirming submission of joint venture to jury in third-party case because "opposing inferences from contractual provisions as to the intentions of the parties regarding the creation of a joint venture will ordinarily give rise to a question of fact").

the plaintiff.⁴²⁴ Yet defining the elements of a joint venture is a question of law.⁴²⁵ Applying the law to undisputed facts is for the court, and presumably the issue presents a legal question if the only proof is an operating agreement or other guiding contract. Courts frequently have decided the joint-venture issue as a matter of law.⁴²⁶

424. In almost all states, the burden is by the civil law's traditional preponderance of the evidence. For a not-too-dated summary of joint-venture burdens of proof by state, see *Weiner v. Fleischman*, 816 P.2d 892, 898 n.3 (Cal. 1991).

425. See *Fuqua v. Taylor*, 683 S.W.2d 735, 737-38 (Tex. App. 1984) (question whether duty exists one of law for court, but underlying fact questions are for factfinder).

426. See, e.g., *Carey v. Humphries*, 107 N.W.2d 16, 30 (Neb. 1961) (affirming dismissal as a matter of law where no evidence showed joint undertaking, "equal voice in performance," or sharing profits and losses); *Johnston v. Am. Cometra, Inc.*, 837 S.W.2d 711, 716 (Tex. App. 1992) (summary judgment record established no joint venture in dispute by nonoperators over treatment of take-or-pay claims, though court found alternative basis for fiduciary duty); *Archer v. Bill Pearl Drilling Co.*, 655 S.W.2d 338, 344 (Tex. App. 1983) (agreeing in venue ruling as part of third-party lawsuit as a matter of law from agreement and other evidence that nonoperator "exercised no right to participate in the control or operation of the venture," in spite of one visit to drill site); *James v. Nico Energy Corp.*, 838 F.2d 1365, 1373 (5th Cir. 1988) (affirming summary judgment dismissing joint-venture claim where role was limited to investing capital and operator had "sole right of control in the drilling and operating"); *Bolivar v. R & H Oil & Gas Co., Inc.*, 789 F. Supp. 1374, 1382 (S.D. Miss. 1991) (finding no joint venture as a matter of law, as part of diversity/citizenship dispute in third-party wrongful death case, where nonoperator had no right of control and operating agreement gave operator "full control of all operations," *id.* at 1381 n.10; while existence of joint venture is a fact question, whether "sufficient inferences to support its existence is a question of law"); see also *Crowder v. Tri-C Resources, Inc.*, 821 S.W.2d 393, 398-99 (Tex. App. 1991) (affirming summary judgment for operator that included rejecting special relationship claim, but not directly addressing joint-venture requisites, apparently because plaintiff did not seek a constructive trust); *Smith v. L.D. Burns Drilling Co.*, 852 S.W.2d 40, 41-42 (Tex. App. 1993) (affirming summary judgment for investors on third party's joint-venture claim, but where plaintiff had not alleged actual joint operation or control).

Once again, appellate rulings issued after a jury or court trial can imply various standards. The court acts on a full record, so it is not necessarily ruling on pure questions of law, but even then the opinion may seem to use that standard. See *Ayco Dev. Corp. v. G.E.T. Serv. Co.*, 616 S.W.2d 184, 186-87 (Tex. 1981) (ordering lower court to enter take-nothing judgment, rather than remanding for trial, on third party's claims against nonoperators under "mutual right of control of management" when contract [not cited] "wholly excluded" them "from participation in the drilling, operation, and control," adding that visits to well site were not "as a matter of law" joint control, but unfortunately not explaining whether the contract language was the industry-standard "exclusive control" language in the JOA); *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316, 320-21 (Tex. App. 1982) (citing *Ayco* with approval and affirming finding of no joint venture after jury trial in dispute over well costs).

Though they do not apply multi-factor tests, cases like *Britton v. Green, Blackstock Oil Co.*, and even *Oklahoma Co. v. O'Neil* in application also would seem to make the decision one of law, not fact, see *supra* notes 42-63 and accompanying text; as, of course, should the *Reserve Oil* line of cases, see *supra* notes 122-139, 151-153 and accompanying

The same confusion dogs the mining-partnership cases. The articulated standards for joint operations run from actual control or cooperation⁴²⁷ (and taken literally, of course, "control" and

text; the *Young* unit-operator duty, *see supra* notes 166–174 and accompanying text; and the marketing-agency fiduciary duty, *see supra* notes 154–161 and accompanying text.

427. *See, e.g.*, *Schulte v. Apache Corp.*, 949 P.2d 291, 297 (Okla. 1995) (affirming no-partnership finding that helped reject nonoperator's claim to added acreage when the evidence failed to show "cooperation" by "active participation in the promotion, conduct or management"); *Sparks Bros. Drilling Co. v. Tex. Moran Expl. Co.*, 829 P.2d 951, 952–54 (Okla. 1991) (coming down decisively for actual participation standard and reversing finding of mining-partner liability on claim for services and materials, even though nonoperators had right to override operator's "direct control" on costs, where this right was never exercised; defining requisite cooperation as "actively joining in the promotion, conduct, or management" of project, *id.* at 953 (citation omitted); and holding that "receiving reports, questioning bills, hiring a pumper to evaluate the well in contemplation of taking over as operator, and other similar acts are things that any prudent investor would do to protect his investment" and so did not create mining partnership); *Katnig v. Johnson*, 283 P.2d 195, 196–99 (Okla. 1962) (not explaining standard applied in case where jury found no mining partnership between interest owners); *Edwards v. Hardwick*, 350 P.2d 495, 502 (Okla. 1960) (affirming trial court finding that pipe supplier who furnished pipe to be paid out of production was not in mining partnership, where it, *inter alia*, did not satisfy test of "actively joining in the promotion, conduct or management of the joint venture"); *Conley Drilling Co. v. Rogers*, 132 P.2d 959, 961 (Okla. 1943) (applying test of "cooperation," and finding evidence supported trial court's finding of mining partnership, but not describing facts on which court granted relief); *Cont'l Supply Co. v. Dickson Oil Co.*, 153 P.2d 1017, 1019–20 (Okla. 1944) (court resolving disputed evidence about nonoperator's role in purchasing material in favor of nonoperator, with plaintiff claiming it relied on nonoperator's promise to pay but other evidence showing that nonoperator had "no control" over drilling operations); *Lyons v. Stekoll*, 96 P.2d 60 (Okla. 1939) (affirming trial court's finding of mining partnership seemingly based on standard of "actions and conduct showing co-operation in project," even though operator was to be "sole judge" of expenses and to operate entire lease); *McNally v. Cochran*, 46 P.2d 955, 958–59 (Okla. 1935) (not stating test, but noting in denying mining partnership that operators had exclusive control of drilling, other parties were not consulted about labor or equipment issues or "any of the other many things necessary to be done at a new well" in claim for labor and material costs); *Anderson v. Keystone Supply Co.*, 220 P. 605, 606 (Okla. 1923) (using cooperation as test in case brought by supply company, but finding no need to define test precisely where nonoperator did nothing "in the particular work of drilling this well, or procuring the drilling of the same"); *Bovaird Supply Co. v. McClement*, 177 N.E.2d 430, 433–36 (Ill. App. Ct. 1961) (court resolving disputed evidence where nonoperating defendant met with supply company, allegedly even took part in negotiations and gave his own credit references, but other evidence suggested he never "exercised any control in the management or operation"); *Templeton v. Wolverton*, 179 S.W.2d 252, 255–57 (Tex. 1944) (reversing finding of mining partnership in third-party case to recover for services on well where contract did not suggest nonoperator would "participate in the actual development or operation of the property"; requiring "actual participation" or "agreement to participate"; and rejecting visit to well site and advancing funds as participation); *U.S. Truck Lines v. Texaco*, 337 S.W.2d 497, 500 (Tex. Civ. App. 1960) (requiring mutual agency and holding that "presence at the well, interest in the result of the drilling and knowledge" of supply contract did not establish partnership).

"cooperation" have very different implications, but often are equated in this odd corner of the law) to the less stringent formal right to control.⁴²⁸ Naturally, the mining-partnership cases also vary, like the joint-venture cases, in whether they decide the operator's status as a matter of law or

Not all cases make clear what standard of participation they apply. *See, e.g.,* Moss & Urschel v. Clark, 82 S.W.2d 1090, 1092 (Tex. Civ. App. 1935) (finding mining partnership as matter of law based upon evidence parties "were jointly operating" lease, but without explaining what evidence showed that); Robb v. Chapman, 96 P.2d 1033 (Okla. 1939) (in affirming trial court's finding of mining partnership, extending liability on claim for materials by citing with approval standard that if co-owners "work together in the drilling of the well and in the development of the lease," this can create a mining partnership, but not explaining what the "work" was (citation omitted)).

428. *See* Berchermann v. Western Co., 363 S.W.2d 875, 877 (Tex. Civ. App. 1962) (finding no mining partnership as a matter of law in vendor lawsuit where operator had "exclusive charge, management and control," but as all too usual not citing actual contract term); Mud Control Labs. v. Covey, 269 P.2d 854 (Utah 1954) (most liberal test that affirmed finding of mining partnership in vendor lawsuit to recover materials where operators had "sole right to explore and develop the land," but nonoperators retained "rights of control and protection" including withholding funds until some drilling was done; limits on well drilling; access and rights to records; consent before abandonment and on subsequent drilling if the first well succeeded; court articulating the standard that "operation or control of the activities [need not] be equal" and enough if one supplies money to be used in claim while another devotes his labor to it); Williston Oil & Gas Co. v. Phoenix Ins. Co., 271 F.2d 743, 746-47 (10th Cir. 1959) (reversing finding of mining partnership in drilling company's claim for equipment damage, where cooperation not proven in absence of testimony that defendant had any authority over equipment or rig work). In contrast, in *Mountain Iron & Supply Co. v. Branson*, 8 P.2d 407, 408-09 (Kan. 1932), a suit to recover material and supplies, the Kansas Supreme Court affirmed a finding of mining partnership among defendants even though only one of them had "active charge and management of the well," while all the rest had was knowledge of his expenditure.

Then there are easier, or at least more comprehensible cases, when there is the kind of conduct that could create apparent authority to bind the nonoperator. *See* Sparks v. Midland Supply Co., 339 P.2d 1056, 1058-60 (Okla. 1959) (nonoperator held liable for materials and services furnished credit reference, agreed to having items charged to his credit, and "co-operated in obtaining the contract" for services).

Eugene Kuntz has taken the position that the JOA does not provide "the type of control required to meet the joint operations requirement of the mining partnership." 2 KUNTZ, *supra* note 24, § 19A.6, at 110. This reading cannot explain why so many JOA cases struggle with the mining-partnership issue. (Were Kuntz correct, most would reject the claim as a matter of law.) Hendrix & Golding argue that a right to control satisfies this joint-control element, *see* Hendrix & Golding, *supra* note 10, at 10-8, but, as this Article shows, courts are more divided on this issue and rarely address it with much detail.

question of fact,⁴²⁹ although the great majority are decided (unlike the joint-venture cases) as questions of fact.⁴³⁰

There have been a number of efforts to reconcile these standards. One novel interpretation is based on a distinction between JOAs, farmout agreements, and a new category of "drilling ventures," which

429. See *Anderson v. Keystone Supply Co.*, 220 P. 605, 606 (Okla. 1923) (no mining partnership in claim brought by supply company in case decided on agreed statement of facts, thus presenting question of law on facts); *Blocker Exploration Co. v. Frontier Exploration, Inc.*, 740 P.2d 983, 987-89 (Colo. 1987) (joint operations issue generally must be decided on case-by-case issue, but summary judgment proper here where no facts to support seismic company's claim of mining partnership).

430. See, e.g., *Bovaird Supply Co. v. McClement*, 177 N.E.2d 430 (Ill. App. Ct. 1961) (issue of mining partnership in oilfield supply company's claim decided in trial to court); *Conley Drilling Co. v. Rogers*, 132 P.2d 959, 961 (Okla. 1943) (mining-partnership issue in oilfield supply case tried to court and evidence supported finding of mining partnership); *Cont'l Supply Co. v. Dickson Oil Co.*, 153 P.2d 1017, 1019-20 (Okla. 1944) (vendor case tried to court and evidence supported finding no mining partnership); *Edwards v. Hardwick*, 350 P.2d 495, 502 (Okla. 1960) (trial to court decided that mining partnership not created when pipe supplier furnished pipe to well, to be paid from production, and supplier not liable to others for supplies and services); *Katnig v. Johnson*, 283 P.2d 195, 196-99 (Okla. 1962) (jury found no mining partnership in interest owners' dispute over drilling and operating expenses); *Lyons v. Stekoll*, 96 P.2d 60, 62-63 (Okla. 1939) (trial court found mining partnership after hearing evidence in dispute among interest owners over liability for costs); *McNally v. Cochran*, 46 P.2d 955 (Okla. 1935) (reversing finding of mining partnership in case filed for labor and material claims, but on basis of full record produced in trial to court below); *Mountain Iron & Supply Co. v. Branson*, 8 P.2d 407 (Kan. 1932) (affirming trial court's finding of mining partnership in third-party case to recover for materials and supplies); *Mud Control Labs. v. Covey*, 269 P.2d 854 (Utah 1954) (affirming trial court finding of mining partnership making nonoperators liable for materials); *Robb v. Chapman*, 96 P.2d 1033 (Okla. 1939) (affirming trial court finding of mining partnership in vendor's claim for material); *Schulte v. Apache Corp.*, 949 P.2d 291 (Okla. 1995) (trial court's summary judgment dismissing mining-partnership claim reversed because of fact issues in *Schulte v. Apache Corp.*, 814 P.2d 469 (Okla. 1991), with later finding of no partnership then affirmed, see 949 P.2d at 297); *Sparks v. Midland Supply Co.*, 339 P.2d 1056 (Okla. 1959) (trial court finding liability in lawsuit for materials and services after trial); *Sparks Bros. Drilling Co. v. Tex. Moran Expl. Co.*, 829 P.2d 951 (Okla. 1991) (mining-partnership issue tried to court, with finding of partnership reversed on appeal); *Templeton v. Wolverton*, 179 S.W.2d 252, 255-57 (Tex. 1944) (reversing trial court's finding of mining partnership in third-party case, after full trial below); *U.S. Truck Lines v. Texaco*, 337 S.W.2d 497, 498-500 (Tex. Civ. App. 1960) (mining partnership finding reversed, but only after full trial below where evidence did not establish partnership and court believed that contract negated it); *Williston Oil & Gas Co. v. Phoenix Ins. Co.*, 271 F.2d 743, 746-47 (10th Cir. 1959) (liability in driller's equipment damage case tried to court; later reversed as no evidence of cooperation); *Moss & Urschel v. Clark*, 82 S.W.2d 1090, 1092 (Tex. Civ. App. 1935) (finding mining partnership as a matter of law, but only after facts developed in trial to jury).

It again can be hard to see whether some cases were decided as matters of fact or law. See *Berchelman v. Western Co.*, 363 S.W.2d 875, 876 (Tex. Civ. App. 1962) (trial court withdrew case from jury, but opinion not clear on how much factual record was before court; and court of appeals viewed evidence and duty "to be a question of law").

the author proposes as the only relationship that is truly fiduciary.⁴³¹ Others believe that the standard may vary depending upon whether the issue is third-party liability or an operator's duty to its investors. This is because disclaimers may not be effective against outsiders, but might be enforced internally,⁴³² so that operators might have less responsibility to their own investing partners than to third-party vendors. Of the two leading jurisdictions, Texas courts are more stringent than Oklahoma courts, so it could be argued that while Texas requires a right of mutual control (or actual joint control), Oklahoma courts only need minimal signs of cooperation, a standard easier to satisfy from the terms of the JOA.⁴³³

431. Gary Conine sponsored this novel interpretation of the operator cases. He argues that the cases and their readings of cooperation and control can be reconciled if put into three categories: farmouts, JOAs, and drilling ventures. His drilling venture is a farmout arrangement where the farmor retains at least part of the working interest (not just a reversionary interest) and usually, though not always, shares some of the costs. *See Conine, supra* note 30, at 8-10. He discusses three kinds of drilling ventures. In one, the parties share costs proportionately but the farmee handles the drilling. In a second, the farmor runs the drilling, but both split the costs. In the third, the farmor's costs are fixed. *See id.* at 8-11.

Conine believes that courts do not treat ordinary farmouts or the JOA as creating joint ventures or mining partnerships. Instead, his analysis is that they generally refuse to treat the JOA as a joint venture or mining partnership because of the "deciding factor...the absence of joint operations." *Id.* at 8-25. Farmouts fail for this reason and may not satisfy other elements as well. *See supra* notes 30, 119. In contrast, Conine thinks that courts quite readily treat drilling ventures as fiduciary relations even "where there has been no joint operation beyond the financial contribution required by the transaction." *See Conine, supra* note 30, at 8-27. "Factors accepted by courts as evidence of joint operation involve much less control by the nonoperating party under the drilling venture than under the other two instruments." *See id.* at 8-29. Even minimal "prudent investment" activity like receiving reports is enough when a drilling venture is involved. *See id.* at 8-29 to 8-32.

The natural question for Conine is why farmouts or joint operating investors should have to satisfy more stringent tests than those in drilling ventures. What legitimate policy supports this distinction? Conine offers none. The paradox is deepened because Conine endorses an extraordinarily liberal construction of joint operations. He claims that it is "long established" that "the contribution of funds itself implies a degree of participation in operations." *See id.* at 8-34. "One often overlooked feature of joint operations is that they can be inferred from the mere fact that the parties share the expense of operations." *See id.* at 8-35. Conine cannot be correct that the joint operations test is this easily met, or virtually every JOA case would automatically have joint operations. Because Conine professes to believe that courts apply such a loose test, however, it is even harder to understand why he claims that the JOA does not create a joint venture or mining partnership. This is particularly so when Conine understands that the contribution can be in cash, property, or services, *see id.* at 8-35, a test the JOA investor and the farmor easily satisfy. It is because of this liberal reading of contributions that Conine believes a drilling venture always satisfies the joint operations prong (because all parties contribute cash or services). *See id.* For the argument that Conine has not sufficiently justified his theory, *see infra* note 436.

432. *See Fiske, supra* note 22, at 235-36.

433. At least, this standard is easy to satisfy if one takes things like the mere receipt of nonoperator information as sufficient involvement, as in *Oklahoma Co. v O'Neil*.

The Colorado Supreme Court in *Blocker Exploration Co. v. Frontier Exploration, Inc.*,⁴³⁴ a mining-partnership case, tried to bridge the gap between the conduct cases and the formal control cases. It held that joint operations can be proven when a co-owner takes "an active role in the conduct of operations," or, in the absence of such control, if the parties' agreement "gave the co-owners a right of participation in the management or control of the operation."⁴³⁵ This test would resolve the conflict between the actual-control and the right-of-control cases by realigning those two standards in a two-step hierarchy. But *Blocker's* effort to impose order on the current clutter ignores the fact that the cases are all over the map on just what showing they require to meet the management or control prong of both joint-venture and mining-partnership tests. Further, it ignores the larger conflict with the normal, sensible equitable principle that the law endows people in positions of control with higher responsibility to protect those dependent upon them. There is no reason to increase one party's duty because the other person has *more* control and is actually active in a venture.

In fact, none of these efforts successfully reconcile the cases. The "drilling venture" theory finds no real support in the cases or, for that matter, in policy.⁴³⁶ The division between third-party and internal

434. 709 P.2d 39 (Colo. App. 1985), *aff'd in part, rev'd in part*, 740 P.2d 983 (Colo. 1987).

435. *Blocker*, 740 P.2d at 987. The Colorado Supreme Court affirmed summary judgment for the nonoperator in the face of a seismic company's attempt to establish a mining partnership when the nonoperator had the right to receive reports, have access to the site, and be consulted; the court held that this did not rise "to the level of active participation in control or management."

436. Gary Conine's effort to separate JOAs from drilling ventures is unsatisfying. He admits that JOA parties "can be classified potentially as partners" as well as "mere cotenants." Conine, *supra* note 30, at 8-37. Here, as in Conine's drilling venture, the parties "expressly agree to advance funds to cover development costs" and so display a commitment to joint cooperation. *See id.* Conine does not view JOA cash contributions as a sign of joint operations because he thinks a contribution of funds among cotenants may be "no more than a way to encourage one party to do what it is already authorized to do on its own as a matter of law...." *Id.* at 8-38. Yet, if a small retained working interest will convert an ordinary farmout agreement to a drilling venture, why won't a cash payment do this with JOA ventures? Investors in both have similar "control" by shared interest and cost exposure—indeed, it is retaining an interest like a JOA investor's that persuades Conine to transform a farmout into a drilling venture.

Conine's position on farmouts is no more persuasive. Apparently all it takes to push a farmout into a drilling venture, with totally different legal consequences, is retention of a small working interest by the farmor. *See id.* at 8-36. Conine is right that courts do not treat the ordinary farmout as a fiduciary relation, *see supra* notes 30, 119, but he gives no reason why technical changes in the timing of interest acquisition should so dramatically vary the operator's duty.

Conine's failure to offer a plausible reason for exalting his drilling ventures above other standard oilfield investment structures is not the only problem. An equal weakness is

disputes cannot explain the cases. If it did, the courts would be able to limit the fiduciary dispute to third-party cases, an odd result when the JOA contains disclaimers in article VII.A to *exclude* third-party liability.⁴³⁷ The continued debate over the proper standard in disputes between operator and nonoperator and the number of cases decided as disputes of fact suggest that a distinction between internal and third-party cases does not plausibly explain the cases to date.

Theories that separate the cases by jurisdiction are little more persuasive. While Texas courts have been more restrictive than Oklahoma courts and the Tenth Circuit, both jurisdictions apply the same general tests for joint ventures and mining partnerships, so their areas of agreement often are more significant than their disagreements.⁴³⁸

The "either/or" test of *Blocker* (either actual control or a right to control) is also a great oversimplification. If *Blocker* were correct, cases finding no actual control should then evaluate the right of control in the JOA and discuss both actual conduct and legal rights of control; but very few cases use such careful analysis.

It certainly can be said that when courts have wanted to protect nonoperators, they have been willing to find "control" from the slightest

that he never shows that courts directly or even implicitly group cases the way he does. It is a sign of his theory's explanatory failure that he has to stretch some of the best-known fiduciary cases beyond all recognition. Consider, for instance, his effort to appropriate two of the best-known fiduciary cases, *Oklahoma Co. v. O'Neil*, 440 P. 2d 978 (Okla. 1968), and *Mud Control Laboratories v. Covey*, 269 P.2d 843 (Utah 1954), as purported drilling ventures. See Conine, *supra* note 30, at 8-33 to 8-34, 8-43 to 8-44. The *Mud Control* opinion actually turns on the language of the operating agreement and applied a very minimal test of "control" to that agreement, with no hint that any farmer relation was involved. See *supra* note 113; see also *Mud Control*, 269 P.2d at 857-59. In *Oklahoma Co. v. O'Neil*, which concerned an arrangement to purchase leases "as a group," 440 P.2d at 984, not even unusual clairvoyance could divine that the court really relied on what Conine calls a drilling venture rather than ordinary joint-venture analysis, which is what the court said. See *id.* at 983-85; see generally *supra* notes 59-63.

437. See *supra* notes 302-305 and accompanying text.

438. In Texas, one of the supposedly restrictive actual "control" states, the *Rankin v. Naftalis* supreme court affirmed the trial court's submission of the joint-venture issue in language that does not track either category precisely but would seem to encompass the loose cooperation jurisdictions: "Do you find [the parties] were jointly engaged in the business of operating the Melton lease, sharing income and expenses...?" 542 S.W.2d at 895. Conversely, in Oklahoma, supposedly a cooperation state and source of the liberal *Oklahoma Co. v. O'Neil* opinion, the supreme court at times has required much more than such minimal acts as receiving reports. For instance, in *Schulte v. Apache Corp.*, 949 P.2d 291, 297 (Okla. 1995), a mining-partnership case, the Oklahoma Supreme Court was willing to overlook even false promises and the fact that plaintiffs had been forcibly pooled because they had not "participated in the promotion, conduct or management of Apache's business," a much more stringent test.

of contacts.⁴³⁹ In contrast, when courts want to apply a rigorous test of actual control, it is hard to deny that most nonoperators cannot meet that test.⁴⁴⁰ Yet courts in the same jurisdictions, in cases not involving third parties, have come to very different conclusions on what conduct is enough to sustain a joint venture.

The urge to force some structure onto the operator cases is understandable, but the most sophisticated commentators have understood that the cases are not yet consistent. That is why Howard Williams long ago called the joint venture an “adjectiv[al]” concept used to justify imposing a constructive trust⁴⁴¹ and similarly found a “wide variance” in the joint operation definitions for mining partnerships.⁴⁴² Terry Fiske’s review of mining partnerships agreed that the best explanation for the concept is as an ex post category that courts use to protect interests they find deserving, a “hook” on which they hang the “hat of judicial relief.”⁴⁴³ When one considers the gap between this body of law and the other common-law and oilfield doctrines discussed here, it clearly is time for courts to clarify the principles that they are in fact applying in the operator fiduciary cases.

D. The Failure to Ground the Duty Has Left It Vulnerable to the JOA’s Boilerplate Disclaimers

One final problem with current law, a problem that extends beyond the joint-venture and mining-partnership cases, is the ease with which some courts let the parties disclaim the operator’s duties. As discussed in Part VI, the liability-limiting cases owe their lineage to the tort-reform era, with its pronounced corporate push to limit business liability as far as possible. But had courts clearly identified the areas where the operator is a fiduciary, and been upfront about the basis for the duty, it is almost inconceivable that even overworked courts could have issued an opinion like *Stine v. Marathon*, a case treating the entire fiduciary issue as a simple matter of reading the contract.⁴⁴⁴

The fiduciary duty has survived and put down roots for such activities as acquiring acreage, handling funds, and marketing production—but has not extended to the operator’s physical activities.

439. *Oklahoma Co. v. O’Neil*, 440 P.2d 978 (Okla. 1968), discussed *supra* notes 59–63, is the classic example of minimal requirements.

440. See Lansdown, *supra* note 172, at 13–24; Martin, *supra* note 27, at 107–09.

441. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437.1, at 524; Williams, *The Fiduciary Principle*, *supra* note 10, at 262.

442. See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 435, at 504.2.

443. See, e.g., Fiske, *supra* note 22, at 90–91.

444. For *Stine*, see *supra* notes 320–323 and accompanying text.

Acknowledging the operator's unrestrained power in the areas where it has a strong separate interest, and thus tying it to the same reference points of control and dependence that underlie other fiduciary duties, will equip courts with the information needed to determine where the disclaimers and exculpation should apply. Here too, oilfield law will benefit from clarification and restatement.

VIII. ARGUMENTS AGAINST A FIDUCIARY DUTY DO NOT JUSTIFY TREATING OPERATORS DIFFERENTLY THAN OTHER AGENTS AND TRUSTEES

A number of arguments have been raised against making the operator a fiduciary. These arguments do not justify a per se rule of no fiduciary duty.

Perhaps the dominant objection is that punitive damages would cripple the oilpatch.⁴⁴⁵ Yet many professional services carry heightened responsibility. Far from crippling these services, they often command high premiums in the marketplace. A second common argument is that operators no longer would be able to charge fairly for their services. This complaint exaggerates the stringency of fiduciary obligations. Some say that an absolute duty would oversimplify much more complex oilfield relations. Yet the emerging duty already takes many variations into account. As no doubt has been true from time immemorial, oil companies and the like-minded tend to see imposition of any tort duty as an interference with their freedom of contract. Yet this is an extremist argument whose logical conclusion is the extinction of all tort responsibilities—producing an atomistic world in which no one has any social obligations and the law merely enforces private bargains. Finally, oil companies almost certainly will point to existing tort doctrines and deny the need for added regulation. Existing tort doctrines, however, have not been sufficient to remove the temptations created by the operator's special position of trust and confidence.

A. The U.S. Supreme Court Has Sharply Limited Punitive Damage Awards

The purported injustice of punitive damages is a cornerstone of the tort reform movement. When considering oilfield issues, business-

445. It is absolutely correct that "[p]unitive damages lie at the heart of the controversy about the civil justice system and have been the focus of reform efforts at both state and local levels of government." ERIK MOLLER ET AL., PUNITIVE DAMAGES IN FINANCIAL INJURY JURY VERDICTS xiii (1997).

oriented discussions talk darkly of the "astronomical liability" that supposedly would flow from the duty and the "chilling effect" on the oilpatch.⁴⁴⁶

The tort reform movement has littered the national landscape with the myth that juries frequently enter huge, enforceable punitive damage awards.⁴⁴⁷ For oil companies whose self-interest is to minimize their duties, it is all too easy to exaggerate the risks that fiduciary liability really poses.

In reality, there are many barriers to the award of punitive damages. It is true that exposure to punitive damages creates an added risk. Were that not the case, they would not serve any deterrent purpose. But such damages are not easy to get.

A first barrier is that an oil company only has to pay punitive damages if a jury finds that it acted with gross recklessness or willful indifference. Second, an increasingly aggressive U.S. Supreme Court has reinterpreted the due process clause in recent years to impose rigorous limitations on the amount a jury can award as punishment, with the

446. Eyring, *supra* note 130, at 1310. Even some sophisticated authors have taken the view that a fiduciary duty "arguably" would turn the operator into a "virtual insurer" of the success of the venture. See Lane & Boggs, *supra* note 11, at 216. Though less strongly phrased, this is the same message of those who claim fiduciaries could not take any "separate benefit" from the nonoperators. See *infra* Part VIII.B. A similar emphasis on punitive damages is part of a larger cultural view, one propagated by many business concerns and Republican politicians, that the jury system is out of control and unfairly damaging American business. Two of the major articulations of these views were the Republican National Committee's CONTRACT WITH AMERICA (1994) and Vice-President Dan Quayle's report, PRESIDENT'S COUNCIL ON COMPETITIVENESS, AGENDA FOR CIVIL JUSTICE REFORM IN AMERICA (1991); popular culture versions include PETER W. HUBER, LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES (1988) and WALTER OLSON, THE LITIGATION EXPLOSION (1991). For an example of this tort-reform perspective from a familiar oilfield commentator, see Martin, *supra* note 27, at 99-100 (opining that "stakes then become quite high" because of punitive damages at outset of article on fiduciary duty, and some pages later trying to paint the fiduciary cases as among the "extraordinary steps the courts have taken in the post-World War II era to expand tort liability to dig into as many deep pockets as possible so that no personal injury go [sic] uncompensated," *id.* at 114; consider also Martin's accusation that "[o]ne suspects" fiduciary claims are made "to raise the pressure in high-profile business litigation," *id.* at 122, and in "hardball tactics" to suggest to factfinders that a party is "in bad faith or is morally depraved" — all this a typical tort-reform characterization that demeans the ethical standards that govern lawyers and are supposed to prevent this kind of conduct).

Some sophisticated industry observers also seem troubled that fiduciary responsibility might overturn the industry ship of state. See, e.g., Smith, *Fiduciary Implications of Executive Right*, *supra* note 27, esp. at 399 (in article generally arguing that fiduciary duty improperly requires executive to subordinate its interests to nonexecutive, mentioning "potentially crippling liability" if executive not protected from fiduciary standard).

447. See, e.g., HUBER, *supra* note 446, at 115-32; OLSON, *supra* note 446, at 280-89.

result that judges now have extraordinary discretion to lower punitive-damage awards.⁴⁴⁸ The very success enjoyed by large corporations in their tort-reform crusade to restrict awards of punitive damages substantially reduces the risk of runaway awards.⁴⁴⁹ Third, a look at the punitive damages awarded in some of the oilfield cases, even those with egregious facts, suggests that juries are not the runaway trains of popular Republican culture.⁴⁵⁰ This is in line with evidence that large

448. In *BMW of North America v. Gore*, 517 U.S. 559 (1996), the Supreme Court held that considerations of due process—of giving the defendant fair notice of the sanction that could apply to its conduct—required courts to use three “guideposts” in determining whether an award is excessive: (1) the “reprehensibility” of the conduct, *id.* at 575–80; (2) the ratio between the harm inflicted and the punitive damages, *id.* at 580–83; and (3) comparable civil and criminal penalties, *id.* at 583–85. In *Cooper Industries v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001), the court redefined the punitive award as an “expression of [the jury’s] moral condemnation,” rather than a traditional fact finding, and used this rhetorical sleight of hand to justify allowing courts of appeals to engage in de novo review of the award. *See id.* at 432–41. Most recently, the Court has even suggested that, in cases with sizable compensatory damages, a 1:1 ratio between punitive and actual damages may be all the judicial market will bear. *State Farm Mut. Auto. Ins. v. Campbell*, 538 U.S. 408, 424–25 (2003).

449. Even by the time of *BMW v. Gore*, roughly half of all states had imposed statutory limits on punitive damages. *See BMW v. Gore*, 517 U.S. 607, 614–19 (Ginsburg, J., dissenting) (Appendix listing states that imposed caps on punitive damages, states that allocated a portion of punitive damages to state agencies, and states that bifurcated liability and punitive damage trials). Four more states had capped punitive damages by 2001. *Cooper Industries*, 532 U.S. at 433 n. 6. For a recent example of the significant downward effect these new rules can have on a jury’s punitive damage award, even in cases of highly deliberate and outrageous fraud, see *Cass v. Stephens*, 156 S.W.3d 38, 77 (Tex. App. 2004) (reducing jury award of \$2.5 million on each claim, against each defendant, to \$300,000 against each defendant).

450. One example is *Manges v. Guerra*, the executive rights fiduciary case. Even though executive Manges could hardly have done more to siphon off profits from the property, the jury only awarded half a million dollars in punitive damages, on top of actual damages of \$382,608. In *Texas Oil & Gas Corp. v. Hagen*, the well-known royalty bench trial in which the judge determined that Texas Oil and Gas Corp. (TXO) used an affiliate as a “sham” to avoid paying royalties on the good price it received for gas from the royalty owner’s property, the court only awarded \$300,000 in punitive damages on top of \$1,075,030.02 in actuals. *Tex. Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24, 27 (Tex. Civ. App. 1984), *aff’d in part and rev’d in part*, No. C-3768, 31 S. Ct. J. 140, 1987 WL 47847 (Tex. 1987) (affirming holding that lessee TXO had to disgorge profits made by reselling through affiliated company, but reversing on existence of tort claims (and so of right to punitive damages)), *vacated after settlement*, 760 S.W.2d 960 (Tex. 1988). While one could argue that the risk in punitive damages lies primarily in jury cases, not bench trials, the fact that the judge awarded punitive damages is a reminder that the remedy does have its proper uses, and, of course, had this been a jury trial and the award much higher, the judge could have pared it back.

The rare case with very high punitive damages often deserves them. *Texas Oil & Gas Corp. v. Alliance Resources Corp.*, 509 U.S. 44 (1993), a prime example, involves, fittingly, recidivist TXO and its royalty operations. The evidence showed that TXO took out a more-than-1000-acre lease on what it expected to be a very lucrative tract. It offered very favorable royalty terms, but almost immediately embarked upon an intricate, highly

deliberate campaign, including securing and recording a frivolous deed and then filing an equally frivolous declaratory judgment lawsuit, to trick a lessee into believing that its title was defective and so to steal the mineral interest for itself. (The facts are described by the West Virginia Supreme Court in *Texas Oil & Gas Corp. v. Alliance Resources Corp.*, 419 S.E.2d 870, 875-77 (W. Va. 1992), and then by the U.S. Supreme Court in 509 U.S. at 447-51.) The record contained evidence that TXO engaged in similar conduct in other states. See 419 S.E.2d at 881-82. The jury awarded \$19,000 in actual damages and \$10 million in punitives, a decision that both supreme courts affirmed. Though this was 526 times the actual damages, it was not much more than the \$5 to \$8.3 million that the royalty owners estimated their interest would have been worth, based on TXO's valuation of the property. See 509 U.S. at 462. Moreover, the amount was miniscule compared to TXO's \$2.2 to \$2.5 billion estimated net worth. It should not have been a surprise when the U.S. Supreme Court affirmed the award "in light of the amount of money potentially at stake, the bad faith of petitioner, the fact that the scheme employed in this case was part of a larger pattern of fraud, trickery and deceit, and petitioner's wealth..." *Id.*

A much more recent, huge oilfield punitive damage award, again in the royalty setting, is the \$3.42 billion jury award against Exxon, and in favor of the State of Alabama, on an \$87.8 million actual damage award for what the evidence showed and the jury and trial court obviously believed was a long-running, highly intentional effort to underpay royalties to the State of Alabama. See *State of Alabama v. Exxon*, 2001 WL 1116835 (Ala. Cir. Ct. May 3, 2001), *rev'd for improper admission of privileged document*, 859 So. 2d 1096 (Ala. 2002). The Alabama Supreme Court reversed and remanded after deciding that the trial judge had committed reversible error by admitting a particular privileged document (the judge had found the privilege waived), but the trial court's decision outlines a very deliberate scheme to avoid royalties that Exxon knew were due. See *Alabama v. Exxon*, 2001 WL 1116835, slip op. at 2-7. Moreover, the punitive damages were at most 2 to 1 times the expected gain under the state's evidence, *id.* at 10; 10 to 1 under Exxon's evidence, *id.* at 10-11. Finally, the amount was a mere 1.15% of Exxon's market value when the verdict was rendered, and less than 5% of its net worth. *Id.* at 13. As the court noted:

The difficulty of bringing Exxon to justice is apparent from these figures.

An ordinary royalty owner would have no chance of doing so if a punitive award were limited to a low multiple of the compensatory damages. The cost of litigating a claim against Exxon supports imposing high punitive damages to encourage litigant to persevere to the end.

Id. at 14-15. With a record showing an "egregious, intentional fraud by which [Exxon] sought to deprive Alabama of hundreds of millions of dollars, probably well over a billion dollars, of royalties due and payable," *id.* at 15, the punitive damages do not seem outrageous at all. Yet many of the most public opponents of punitive damages seem untroubled by this kind of entrenched fraudulent conduct. They simply assume that large verdicts are runaway verdicts without explaining how they propose to deter this kind of corrosively destructive behavior.

On remand, the jury found \$103.9 million in compensatory damages (including interest) and agreed on an even higher punitive damage award of \$11.8 billion. The trial judge remitted the punitive damages to \$3.5 billion, Post-Judgment Order, *State of Alabama v. Exxon*, Case No. 99-2368, at 60 (filed Mar. 29, 2004), an amount slightly above the first jury's award. The opinion is replete with evidence of fraud, with the court stating it "is thoroughly convinced, as was the jury, that Exxon intentionally and deliberately took action, from the moment the leases were signed, to commit fraud upon the State." *Id.* at 19; see generally *id.* at 19-29. The opinion includes findings that Exxon intentionally "gamed" the discovery process, *id.* at 48-49, and that

punitive awards are rare to begin with, and often end up reversed or substantially lessened.⁴⁵¹

Exxon knowingly and calculatingly set out to deprive a State with which it had voluntarily contracted of what all agree were ultimately to be hundreds of millions of dollars in royalties that Exxon knew it owed, and to conceal the fact of its underpayment from "inexperienced regulatory staff and processes" that it thought would never detect it.

Id. at 49. All this from the most profitable corporation in the United States. Sordid facts like these never disturb the mythological world inhabited by advocates of tort reform, but this is exactly the kind of improper and outrageous behavior that warrants severe financial deterrence.

One final oilfield example, albeit one in a setting more remote from the ordinary operator dispute, is the \$5 billion punitive damage award that an Alaskan jury added to \$287 million in compensatory damages for the Exxon Valdez oil spill. The Ninth Circuit remanded the case for reconsideration in light of more stringent U.S. Supreme Court caselaw; the trial judge found that the jury's instructions already incorporated this law in substance and, in addition, that there was no need to reduce the punitives, but, because the Ninth Circuit already had held that the punitives were excessive (see *In re Exxon Valdez*, 270 F.3d 1215, 1238-47 (9th Cir. 2001)), the judge lopped \$1 billion off the punitives while urging the plaintiffs to appeal his decision to do that if Exxon did not settle, see *In re Exxon Valdez*, 236 F. Supp. 2d 1043, 1068-69 & n.88 (D. Alaska 2002). The trial-court decision included an impassioned argument from a judge, not jury, on why the punitive damages were needed, including a discussion of the need for a very substantial fine to change Exxon's behavior. See *id.* at 1063-65.

The Ninth Circuit remanded the *Exxon Valdez* case after the U.S. Supreme Court issued the punitive damages decision in *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003), but on remand the trial court largely reiterated its prior opinion, with the sole material difference being that this time it only remitted \$500 million instead of \$1 billion. *In re Exxon Valdez*, 296 F. Supp. 2d 1071, 1110-11 (D. Alaska 2004).

451. For general discussions of this punitive damage issue, see Stephen Daniels & Joanne Martin, *Myth and Reality in Punitive Damages*, 75 MINN. L. REV. 1 (1990); Marc Galanter & David Luban, *Poetic Justice: Punitive Damages and Legal Pluralism*, 42 AM. U. L. REV. 1393 (1993); Marc Galanter, *News from Nowhere: The Debased Debate on Civil Justice*, 71 DENVER L. REV. 77 (1993).

The Rand Corporation has compiled a large database of jury verdicts from jurisdictions covering roughly one-fourth of the U.S. population and has been studying trends in punitive damages for the last two decades. From 1985 to 1994, plaintiffs won punitive damages in only four percent of cases overall, although in 14 percent of "financial injury cases." MOLLER ET AL., *supra* note 445, at 9-10, the category into which oil and gas cases most likely would fall. These percentages vastly overstate the risk of a large punitive award, because they do not include cases that settle, a percentage that Rand researchers have elsewhere computed as over 95 percent of all cases. See BABARA MEIERHOEFER, COURT-ANNEXED ARBITRATION IN TEN DISTRICT COURTS 49 (Federal Judicial Center 1990) (median percentage of cases tried in ten federal courts with arbitration programs in mid-1980s was just 2%); Marc Galanter, *The Life and Times of the Big Six; or, The Federal Courts Since the Good Old Days*, 1988 WIS. L. REV. 921, 947-48 (test group of federal cases in which 11% of cases went to trial in 1960, but only 4.4% by 1986); see also Marc Galanter, *The Regulatory Function of the Civil Jury*, in VERDICT: ASSESSING THE CIVIL JURY SYSTEM, 61, 63 & tbls. 3-1, 3-2 (Robert E. Litan ed., 1993) ("Overall, [jury trials] take place in less than 1 percent of cases terminated in state courts and in 2 percent of terminations of federal courts."). Using those figures, punitive damages would be awarded in less than 1 percent of all financial cases.

It may be telling that the amount of punitive damages is rarely the real issue on appeal in the operator cases, even in cases involving tort awards. Instead, the focus generally is on the scope of the fiduciary duty—where it applies and whether it creates liability for a particular failure to disclose or failure to act in the nonoperators' interest. When punitive damages have been awarded, the conduct often makes quite clear that some deterrent beyond actual damages is indeed needed.⁴⁵²

Finally, the risk that a tort duty would impose a crippling blow must be discounted by the fact that so many joint operations already wear fiduciary clothing. This existing fiduciary liability has not deterred oilfield operations. Many investments are real, not just tax, partnerships; many are joint ventures and mining partnerships; many involve handling investor funds, marketing their production, or unit operations; and a number occur in an atmosphere of established trust and confidence that would satisfy the indicia of an informal fiduciary duty. Every investment made in a corporate form, with the operator a corporate officer and the investors shareholders, imposes such a duty. Surely most oil and gas investments are already sheltered under one of these umbrellas.⁴⁵³ Adopting a firmer basis for the duty would impose added costs only in the areas where the duty does not yet apply, or

(And, while punitive damages still may be increasing the size of settlement payments in some cases that do not reach trial, most lawyers know that settlement negotiations ordinarily focus on actual damages, not punitive or statutorily enhanced damages.)

On the other hand, the amount of punitive damages awarded has been increasing...and it is the risk of a crippling award that has driven the tort-reform debate. Punitive damages averaged 53% of all damages awarded in financial injury cases. MOLLER ET AL., *supra* note 445, at 26 and tbl. 3.5. The mean punitive award had more than doubled, averaging \$7,619,931 in the 1990–1994 period. *Id.* Finally, the median ratio of punitive to compensatory damages was 1.4:1. *Id.*

452. See *supra* note 450.

453. Operators may protest that, if courts generally do treat them as fiduciaries, then there cannot be much cost to leaving things as they are, for those who approve of this duty. The problem with this argument is several-fold. One is that the failure to acknowledge this duty clearly produces wasteful litigation, increases uncertainty, and results in some operators who should be held to high standards being protected for conduct that would violate any fiduciary standard. The price is almost certainly higher, though, in unlitigated cases. The larger sphere of contract law lies in the many informal arrangements that never reach the courts. For the classic article on the informal web of understanding and practices that surround everyday business practices, see Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963). It is in this informal arena that the gravitational pull of uniform rules is likely to impart its deepest influence. And here operators gain undesirable leverage if they can ignore or negotiate away claims that they would have to treat more seriously were they subject to a fiduciary standard. The cost of using the wrong duty is almost certainly greatest in the bottom-of-the-iceberg cases that never reach the courts.

where courts currently deviate from the mainstream and do not honor existing fiduciary doctrines.

Nothing is easier than to assert that putting a company's future into a jury's hands would be "crippling."⁴⁵⁴ But there is no showing that the many people who labor under fiduciary responsibilities—for instance, lawyers, trustees, joint venturers, partners, and corporate officers—have been dissuaded by their potential exposure to punitive damages. Ironically, the opposite may be true. Fiduciary positions tend to be highly paid, in part because they carry higher responsibilities, and accordingly are in great demand. Finally confirming this duty for the portions of the operator's relationships where its interests diverge from its equity investors' would not have a severe effect on the industry.

B. A Fiduciary Duty Does Not Prevent Operators from Collecting Fees for Their Services

Another reason the courts at times have been slow to impose fiduciary responsibility more widely upon the operator may be the fear that it would disrupt long-standing forms of operator profit. Operators traditionally collect contractually defined fees for their services, in addition to the revenue from their share of the joint property. Some critics claim that operators could not collect such fees, maximize the value of their own share in the property, or take any "separate benefit" if they become fiduciaries.⁴⁵⁵ Like any straw-man argument, this one

454. It is unfortunate that there is not more empirical data on punitive damages in the oil cases themselves, an oilfield analogy to Rand's general work. The only way to estimate perfectly the impact of extending punitive damages to operators would be to have accurate data on the number of tort cases with punitive damages pled and the number of awards made by the jury. The cases then would have to be discounted for the egregiousness of the conduct. All this would have to be compared to the number of operators who violate fiduciary standards and the egregiousness of their behavior.

455. It is common oilfield rhetoric to discuss the fiduciary operator as if it had to subordinate its interests and eschew *any* separate benefit without regard to the parties' power to agree to different standards. See, e.g., Lane & Boggs, *supra* note 11, at 211 ("In matters of loyalty, disclosure, prohibitions against self-dealing, and acquisitions of benefits which should flow to the joint operation, the manager will be held to the highest standard."); Lansdown, *supra* note 172, at 13-23 (standard on fiduciary "extremely high"); 13-25 (treating obligation as one that would require operator to "subordinate its interests" and involves "major restraints"); Martin, *supra* note 27, at 116 (fiduciary is a person having duty "to act primarily for another's benefit" (citation omitted)); Martin, *supra* note 387, at 406 (urging, in executive rights context, nonfiduciary standard because "few landowners or other persons in the oil and gas industry intend to assume fiduciary duties to the persons with whom they deal"); Smith, *Duties and Obligations*, *supra* note 24, at 12-22 to 12-23 (fiduciary duty, unlike utmost good faith, could prevent operator from using company's own facilities and requires subordination of interest to nonoperators); Eyring, *supra* note 130, at 1298 ("A true fiduciary is required to subordinate his own interests to those of his

trivializes the real issue. Fiduciaries can limit and narrow many of their duties by contract. What they cannot do is collect hidden profits or otherwise fail to disclose material facts about their job.

A main root of this accusation lies, ironically, in the rhetorical success of America's most famous fiduciary case, *Meinhard v. Salmon*.⁴⁵⁶ Many oilfield fiduciary cases cite this aged New York decision.⁴⁵⁷

coadventurers." (citation omitted)). Even an article like Howard Williams' well-known 1962 summary, which began with several pages from straight trust law, see Williams, *The Fiduciary Principle*, *supra* note 10, at 202-06, including the trust rule that even fair self-dealing is voidable, see *id.* at 204, suggests a stronger duty than is actually at issue in the ordinary operator case.

What these descriptions omit is the extent to which a variety of standardized forms of separate operator profitmaking and self-dealing, often through affiliates, is perfectly allowable as long as the terms are disclosed and accepted in advance. It is in the area of disclosure that the fiduciary duty's deepest significance lies. It is correct that a fiduciary "may not profit at the expense of the party to whom he owes the duty," see Hendrix & Golding, *supra* note 10, at 10-6; it is not true that a fiduciary oilfield operator cannot charge a fee for services that it makes to the joint account, and even a profit if agreed upon. Lane & Boggs note that "self-dealing," by which they mean transactions where the operator deals on its own behalf with the venture, is prohibited and will be "presumed invalid" or even fraudulent if the operator benefits, unless there was some prior agreement. Lane & Boggs, *supra* note 11, at 214-15.

Disclosure and knowing agreement are the key. Most disputes are characterized by the absence of these factors. Lansdown does admit that the results of a fiduciary duty should not be "so egregious" given such customs as operators using their own facilities. See Lansdown, *supra* note 172, at 13-30.

Conversely, in an illustration of assuming one's conclusions, one author has used the fact that the operator allegedly is *not* required to subordinate its own interests as proof that it therefore cannot be a fiduciary or trustee. See Eyring, *supra* note 130, at 1299. This author urges instead a standard that would hold the operator to the JOA terms and to not "us[ing] their position to gain an unfair advantage." See *id.* at 1312. Yet this standard does not resolve the conflicts because fights over the fiduciary issue are also fights over what is "unfair."

456. 164 N.E. 545 (Ct. App. 1928).

457. Consider, for instance, the major Texas oil and gas cases citing *Meinhard v. Salmon* with seeming approval. See *Smith v. Bolin*, 271 S.W.2d 93, 96 (Tex. 1954) (citing Cardozo's two strongest expressions of the duty, the "punctilio of an honor the most sensitive" and "thought of self was to be renounced, however hard the abnegation" in case over duration of duty); *Peckham v. Johnson*, 120 S.W.2d 786, 788 (Tex. 1938) (quoting *Meinhard* and applying it with approval to stop one venturer from concealing offer for joint property); *Omohundro v. Matthews*, 317 S.W.2d 771, 779 (Tex. Civ. App. 1958) (citing *Meinhard* and including lengthy quotation from *Smith v. Bolin's* discussion of *Meinhard* with approval in another dispute over duration of duty), *aff'd*, 341 S.W.2d 401, 408 (Tex. 1960) (referencing *Smith v. Bolin's* cite to "the leading case" of *Meinhard*); *Whatley v. Cato Oil Co., Inc.*, 115 S.W.2d 1205, 1209 (Tex. Civ. App. 1938) (including *Meinhard* among authorities justifying requiring operator to share leases with joint adventurer). The Texas Supreme Court cited *Smith v. Bolin's* discussion of *Meinhard* in the important oil and gas partnership case of *Huffington v. Upchurch*, 532 S.W.2d 576, 579 (Tex. 1976). For another use of *Meinhard* to beef up a strong fiduciary ruling in an operator case, see *Texas Oil & Gas Corp. v. Hawkins Oil &*

Benjamin Cardozo decided *Meinhard* while Chief Judge of the New York Court of Appeals. His prose continues to cast a strong spell 75 years later. Ironically, Cardozo's bold language, though intended to raise a joint venturer's level of care, so exaggerated the duty that it seems to have made many courts wary of imposing it.

The *Meinhard* defendant was the active partner in a New York hotel. He never told his partner about an offer he had received to develop a much larger hotel on the same site after their lease expired.⁴⁵⁸

Gas, Inc., 668 S.W.2d 16, 17 (Ark. 1984) (applying *Meinhard* to prevent operator who learned of break in title from leasing property for itself).

It is symptomatic of *Meinhard's* continuing influence that even today major treatises begin their discussion of partnership fiduciary duties with Cardozo's opinion. See IV BROMBERG & RIBSTEIN, *supra* note 190, § 16.07(a)(2), at 16-89 to 16-90. *Meinhard* is also the perfunctory first cite in *Williams & Meyers'* list of authorities to support the proposition that "[t]he most important characteristic of a joint venture is that a fiduciary relationship of trust and confidence arises therefrom." See 2 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 437.1, at 519. Given the wide use of Cardozo's opinion, it is little surprise that so many critiques of the duty rely on *Meinhard v. Salmon* for their overly stringent definition of the duty. See Eyring, *supra* note 130, at 1298 n.29.

On the other hand, not every citation to an opinion is proof of a case's continuing vitality in the true sense of actually affecting case outcomes. *Meinhard* is a convenient string cite when the court wants to present an appearance of thoughtfulness and certainty, even if it has no intention of holding the operator to a high duty on the facts before it. See, e.g., *Rankin v. Naftalis*, 557 S.W.2d 940, 943 (Tex. 1977) (including *Meinhard* in string cite before sharply limiting operator's punctilio to only the immediate area of the venture); *Winn v. Warner*, 197 S.W.2d 338, 341 (Tex. 1946). Another good example is the famous Oklahoma Supreme Court opinion in *British American Oil Producing Co. v. Midway Oil Co.*, 82 P.2d 1049 (1938), discussed *supra* notes 73, 233 and accompanying text. The *British American* court indulged in an extended analysis of *Meinhard*, which the plaintiffs understandably cited. See 82 P.2d at 1053-54. But when the court decided to limit the duty to the venture's geographic area, it appropriated a less often cited section of Cardozo's rhetoric, his rhetorical flourish that "[l]ittle profit will come from a dissection of the precedents," see *id.* at 1054, to decide the case without further using *Meinhard*. Cardozo used the freedom from precedent to strengthen the fiduciary duty; the *British American* court, to narrow it.

Cases directly citing *Meinhard* are not the full measure of its influence. As its authority radiates from Cardozo's opinion and infuses opinions like *Smith v. Bolin* and *Johnson v. Peckham*, later cases that cite those authorities without citing *Meinhard* nonetheless are driven by Cardozo's seed.

458. The defendant was Walter Salmon. Hard though it is to resist the temptation to note that Salmon turned out to be a slippery fellow, Cardozo saved Salmon from that fate by preserving the speculative possibility that he acted in good faith: "Very likely he assumed in all good faith that with the approaching end of the venture he might ignore his co-adventurer and take the extension for himself." *Meinhard*, 164 N.E. at 548.

Salmon built and operated the Hotel Bristol on Forty-Second Street in New York. To raise money, he entered a joint venture with Meinhard. Meinhard was purely an investor; his only role was to provide funds, a limited role equally common in the oil and gas industry. *Id.* at 546. Salmon and Meinhard agreed to share profits and losses, as do many operators and investors. Salmon had full power to manage the hotel, just as

Cardozo transformed the fairly dull facts of this real estate falling out into a common-law classic. He held the "co-adventurers" to fiduciary duties "akin to those of partners" and found that Salmon's acquisition of the new lease for his own account violated this duty. Salmon was liable even if he acted in good faith.⁴⁵⁹

Salmon's objection that, as the active partner, he had created all the wealth and therefore should get special treatment has a familiar ring. It echoes the operator who objects that it provided the skill and labor and, accordingly, is entitled to appropriate special benefits like dry hole payments, acreage bought up around the well, volume discounts, profit paid to affiliates, a good price it does not want to share, and so on.⁴⁶⁰

Cardozo forced Salmon to share the new lease despite such objections. As a co-adventurer, Salmon "had put himself in a position in which thought of self was to be renounced, however hard the abnegation...for him and those like him, the rule of undivided loyalty is *relentless and supreme*."⁴⁶¹

"Thought of self was to be renounced...abnegation...The rule of undivided loyalty is *relentless and supreme*," to say nothing of the famous if little understood "punctilio of an honor the most sensitive"

operators have exclusive rights over oilfield operations; Meinhard had nothing to do with its maintenance. *See id.*

Near the end of Meinhard and Salmon's apparently peaceful 20-year lease, the owner of an adjoining property approached Salmon and proposed to lease the Hotel Bristol, as well as several adjoining properties; tear down the existing buildings; and replace them with a \$3 million hotel. The reconstruction was expected to produce a big increase in rent and profits. *Id.* Salmon entered the new lease quickly but secretly. *Id.* He did not tell Meinhard. When Meinhard discovered Salmon's new deal, he sued, claiming that he had a right to share the profits from the new venture. Ironically, had the original lease had just a few more years to run, it would have expired after the Great Crash of 1929, which put a prompt end to the hotel boom of the Twenties.

459. Cardozo held the "co-adventurers" to fiduciary duties even assuming that Salmon might have acted in good faith. In words that have defined the duty ever since, he held:

We have no thoughts to hold that Salmon was guilty of a conscious purpose to defraud. Very likely he assumed in all good faith that with the approaching end of the venture he might ignore his co-adventurer and take the extension for himself. He had given the enterprise time and labor as well as money. He had made it a success. Meinhard, who had given money, but neither time nor labor, had already been richly paid. There might seem to be something grasping in his insistence upon more. Such recriminations are not unusual when co-adventurers fall out. They are not without their force if conduct is to be judged by the common standards of competitors.

Id. at 548.

460. As an example, see Denver oilman Marvin Davis's argument that he earned discounts because of the volume of his business, discussed in McArthur, *Twelve-Step Program*, *supra* note 132, at 1504 n.157.

461. *Meinhard*, 164 N.E. at 548 (citations omitted; emphasis added).

and “[u]ncompromising rigidity”⁴⁶²—Cardozo was carried away by his own words. The trouble is that they are not a true description of the fiduciary’s duties. Every agent, every trustee, every fiduciary can within quite broad limits contract for profits it does not share with its charges. Banks and trustees, for instance, collect high fees for managing trusts; lawyers can get rich charging high fees while serving as fiduciaries to their clients; partners and joint venturers (and operators) ordinarily charge a management fee that benefits them even if the venture loses money. Compensation is, again within broad limits, a matter of bargain and exchange. Had Salmon insisted that the property rights would revert to him alone at the end of the venture, or that he would keep the value of all improvements, and had Meinhard still entered the agreement, Salmon could have done exactly what he did without liability

The critical difference, of course, is full disclosure. Meinhard would have known the limits of his partnership at the outset. If he did not like them, he did not have to invest. Alternatively, Salmon might have found he needed Meinhard’s funds so badly that he had to share the opportunity and would have agreed to do so in writing. Either way, full disclosure would have led to revelation of both sides’ true preferences. It would have removed improper self-dealing and both sides would have understood their bargain.

Language like Cardozo’s can be read to mean that operators cannot take any profit not shared with nonoperators.⁴⁶³ But the duty

462. *Id.* at 546–48 (citations omitted).

463. Cardozo’s rhetoric swelled and swelled. With the fiduciary duty in place, he broadly forbid many ordinary forms of hard bargaining and competition:

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of finest loyalty. Many forms of conduct permissible in the workaday world for those acting at arms length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exception. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by a judgment of this court.

Meinhard, 164 N.E. at 546 (citations omitted). Little things like precedent were quickly swept aside by this animating principle:

Little profit will come from a dissection of the precedents. None precisely similar is cited in the briefs of counsel. What is similar in many, or so it seems to us, is the animating principle

. . . .

[T]he standard of loyalty for those in trust relations is without the fixed divisions of a graduated scale....Equity refuses to confine within the

really just forces them to spell out how they intend to make their money. It limits them to what the market can bear. In a word, disclosure, disclosure, disclosure. Operators can profit from separate charges. The difference is that they must give full notice of their earnings and secure agreement. They cannot make separate profits secretly.⁴⁶⁴

C. A Fiduciary Standard Would Not Oversimplify Complex Oilfield Relations

Another criticism is that a fiduciary duty oversimplifies a complex industry by imposing just one standard of conduct. Courts should be free to vary the duty with the type of conduct at issue and the relationship of the parties in each case. Thus Ernest Smith, one of the most sophisticated industry commentators, has urged a factually varied standard:

A court in interpreting an operator's duties should not lose sight of [such] customs and usages....[T]he appropriate

bounds of classified transactions its precept of a loyalty that is undivided and unselfish. Certain at least it is that a "man obtaining his locus standi, and his opportunity for making such arrangements, by the position he occupies as a partner, is bound by his obligation to his copartners in such dealings not to separate his interest from theirs, but, if he acquires any benefit, to communicate it to them." Certain it is also that there may be no abuse of special opportunities growing out of a special trust as manager or agent....It is no answer for the fiduciary to say "that he was not bound to risk his money as he did, or to go into the enterprise at all...."

Id. at 547-48 (citations omitted).

464. Lawyers are a little different, of course, because they are bound by professional standards whose violation can mean disbarment. Under these codes, lawyer compensation must be "not...unreasonable." MODEL RULES OF PROFESSIONAL RESPONSIBILITY 1.5(a) (2002), reprinted in THOMAS MORGAN & RONALD ROTUNDA, 2003 SELECTED STANDARDS ON PROFESSIONAL RESPONSIBILITY 21 (2003). The truth is that these rules are precatory but have little bite. Lawyers are among the highest-paid professionals and there is no shortage of people who seek to enter this lucrative profession. A rule that "reasonable" compensation is that paid to one of the best-paid professions in the country is a rule that is all bark but no bite.

A related objection is that a fiduciary duty would hold operators to an unreasonably high standard. Yet a high level of discretion and limited duties in the circle of professional life fits many professionals. Thus, even if the operator is a fiduciary, its daily drilling decisions still can be tested under the reasonable prudent operator standard. What it cannot do is profit at the expense of its charges. Smith, *Duties and Obligations*, *supra* note 24, at 12-29. Smith notes that even a trustee's standard of care ordinarily is not more than that of an "ordinarily prudent person engaged in similar business affairs." *See id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 174 (1959)). Even trustees can modify their fiduciary duties to some extent. *See* Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-14 to 3-15 (citation omitted).

standard applicable to the operator may range from strict compliance with contractual obligations to observance of strict fiduciary duties, *depending upon the language of the operating agreement and the context of the dispute*.⁴⁶⁵

Behind this objection is a feeling that the varietals of finely aged oilpatch wine should not be fit into just one fiduciary barrel. Operators play many roles. They usually are investors as well as operators. Unlike many fiduciaries, they often hire third parties to conduct physical operations. And they traditionally have their own trade secrets, like their geologic approaches, that they are entitled to keep from everyone, including investors.

Unfortunately, circumstantial tests do not provide clarity, certainty, or fairness in this setting.⁴⁶⁶ Who could advise a nonoperator, or an operator, as to what standard would apply to their case under this standard? The "context of the dispute" is too broad a factual assessment to guide courts. Evidence of this can be found in the inconsistency within mining-partnership and joint-venture cases, and the abandon with which some courts have turned limited disclaimers and exculpatory clauses into absolute contract barriers to liability.

If a higher duty is going to be based on the operator's control and nonoperators' structured dependence, the duty should be imposed clearly – and the areas where it applies should be clear – at the front end of the bargain. That way it can serve as an effective deterrent. Precisely

465. Smith, *Duties and Obligations*, *supra* note 24, at 12-57 (emphasis added); *see also id.* at 12-13 (claiming "obvious difficulties in attempting to apply a single concept and a uniform standard of conduct to the thousands of situations and dozens of jurisdictions where operating agreements are in use"). One effect of fact-variant duties is to give courts, and juries, many more opportunities to reject fiduciary obligations. Thus it is no surprise to find one author, in an article whose primary theme is that the operator is not a fiduciary, also arguing that if courts ignore contract disclaimers, they still should turn to "the realities of the relationship between the parties," including the "specificity" of their contract, any trust and confidence, and "the potential for overreaching by a party in a dominant or special position." *See* Martin, *supra* note 27, at 117. This begs the question if the point of most fiduciary cases is that the operator is in a "dominant or special" position by the nature of its undertaking and rights. For an opposing view, *see* Wall, *supra* note 151, at 100 (duties that varied with sophistication of parties "cause far too much uncertainty regarding the operator's duties").

466. Adoption of such a standard will have another predictable effect in this day and age: It will help oil companies defeat class actions even if that is the only procedure in which certain behavior can ever be challenged by interest owners. The central factor in most class-action certifications is the predominance of common questions. *See* John Burritt McArthur, *The Class Action Tool in Oilfield Litigation*, 45 KAN. L. REV. 1 (1996). If the duty varied by the individual relationship between operator and nonoperator, or perhaps even by each of the operator's joint ventures, it would sharply narrow the class of disputes eligible for this often most efficient form of adjudication.

because someone is entrusted with another's interests but cannot be efficiently monitored, the law imposes a higher standard, and higher penalties, if the agent or trustee strays from its responsibility.

As shown above, the structure of control and nonoperator dependence is characteristic of relations that the law carves out as "technical" fiduciary relationships, relationships where social policy requires higher standards as a matter of law regardless of the sophistication of the parties and the circumstances of their relationship.⁴⁶⁷ Among the fiduciaries defined as a matter of law are attorneys, agents, trustees, receivers, executors and administrators, partners, corporate officers, and brokers.

It is also worth noting that, given the way the oilfield fiduciary duty has developed, courts already have adjusted the operator's liability to oilfield realities. Thus, the operator generally is not a fiduciary in its physical operations, but is held to that standard when acquiring property within the JOA (but perhaps not outside), handling funds, and marketing production. If the operator is to be held to a higher standard in its initial pitch to investors or when disclosing information about the ongoing investment, the application of those fiduciary responsibilities lies in the future, but they still can fit within the practicalities of the industry.

D. The Freedom of Contract Argument: Parties Should Be Free to Do What They Want

Those worried about protecting business discretion insist that the fiduciary issue must be viewed through the lens of contract law alone. Courts must respect whatever contracts the parties enter.⁴⁶⁸ This is

467. See, e.g., *Consol. Gas & Equip. Co. v. Thompson*, 405 S.W.2d 333, 336-37 (Tex. 1966); *Blue Bell, Inc. v. Peat Marwick*, 715 S.W.2d 408, 416 (Tex. App. 1986); RESTATEMENT (SECOND) OF AGENCY §§ 13 (agent), 14A & cmt. a (partner), 14B & cmt. a (trustee), 14F & cmts. a-c (receivers, guardians, executors, and administrators), 14N & cmt. a (attorneys, brokers, factors, collection agencies, and selling agencies) (1958).

468. See, e.g., 2 KUNTZ, *supra* note 24, § 19A.6(c), at 108-10 (discussing JOA as contract relation only, one that is "not intended to create any relation between the operator and nonoperators nor among nonoperators that is beyond the contractual relation," and relying heavily on disclaimers as support for this view; arguing JOA "standing alone" should not create mining partnership or joint venture); see also *id.* § 19A.6, at 64 (Supp. 2002) (reiterating that relation of JOA parties should be governed by contract terms unless parties had ongoing relation, and that key issue is finality of contract rather than state law on JOA relationships, *i.e.*, whether contract will stand *uber alles*); *Catron*, *supra* note 23, at 2764 ("Parties are free to create their own contractual arrangements....A mere contract does not give rise to a fiduciary relationship between businessmen." (citations omitted)); *Hendrix & Golding*, *supra* note 10, § 10.04[2][a], at 10-15 to 10-19 (urging view that courts enforce "objective intent" of contract, claiming that equitable fiduciary principle is inconsistent

the archetypal claim that contract law is supreme over all other bodies of common law.

The direct enforcement of contract intent is a powerful rule of law, but it creates only some of the principles with which the law regulates parties who do business with each other. To assert that nonoperators' rights should be limited to their contract is to assert that contract law preempts all other bodies of law, including the law of fiduciary obligations.⁴⁶⁹ It ignores the general rules that intervene in

with detailed JOA and thus that fiduciary duty, if any, "must arise concurrently with or separately from the joint operating agreement" – apparently from some outside fact that can trump the contract), 10-26 (claiming that "emerging rule" is that even if duty exists, it will be "almost invariably controlled" by contract terms); Lansdown, *supra* note 172, at 13-24 to 13-29 (giving heavy weight to intent and disclaimers in argument against full fiduciary duty); Martin, *supra* note 27, at 114 (complaining of fiduciary liability when parties "have expressly negated such a relationship"), 117-18 (urging that contract "defines the scope of the relationship" and limits it to good and workmanlike activity, with no liability except for gross negligence); 121-22 (not any "compelling reason" courts should not enforce negotiated standard); Smith, *Duties and Obligations*, *supra* note 24, at 12-14 (One problem with joint-venture theory is that it is "not clear that the parties...understand or expect that their relationship will be treated as a joint venture..."; Smith contends in a contract-oriented way that the operating agreement's language is "[p]robably the single most important factor which may modify the operator's fiduciary obligation," *id.* at 12-15); Eyring, *supra* note 130, at 1299 (rejecting fiduciary duty in part because operator "does not intend to subordinate its own interests").

This literature may have been heavily influenced by the primacy of lessor and executive rights litigation, which flowered long before the heavy litigation of operator/nonoperator cases. See Smith, *Duties and Obligations*, *supra* note 24, at 12-4 (lease disputes and executive cases were contested areas before operator/nonoperator cases became common). Courts view the lessor/lessee relationship through the prism of contract law, with extra duties supplied by implied covenants. See generally 5 WILLIAMS & MEYERS TREATISE, *supra* note 10. While there is some dispute about the executive's duty, see *supra* Part VII.A.6, many courts and the most influential academic commentators have urged a contract-based, less-than-fiduciary standard of utmost good faith for the executive. In doing so, they have claimed that it best fits the intent of the parties. See, e.g., Jones, *supra* note 174, at 573-75.

469. Consider this position:

In focusing on the label to be attached to the relationship, it seems that much of the discussion seems to miss an essential point, namely is there a duty at all....One must first find whether a contract imposes a duty upon another party....

Martin, *supra* note 27, at 117 (citation omitted). This is an assertion that if a contract exists, courts must let it define all of the duties to the nonoperators. This reasoning has been used by courts in some states, including Texas, to refuse a general tort duty of good faith in every contract, but no state has used it to refuse fiduciary obligations merely because a party has a contract (as does almost every lawyer with its client, many agents with their principals, most brokers, trustees). The view that the contract is all is, of course, the favored perspective of businessmen who want as little liability as possible. But with a fiduciary standard, "[n]o longer may parties enter into such relationships with the insouciant

contract affairs when courts or legislatures judge that the public interest requires some control over free bargaining. It is now long-established that such interventions generally do not violate the Constitution's contract clause or takings clause.⁴⁷⁰

Even private bargains contain a social element. The scope and extent of the area left open for contracting go a long way to establishing the nature of a society, including the closeness or separateness of its members. One general rule may be that parties should be free to negotiate any agreement they wish, but another is that one who assumes to act for another dons a higher level of care. It is because the law will force the agent, the trustee, the lawyer—and in many instances the operator—to hew to a high standard of conduct that those legal relationships have become such reliable ways of structuring certain legal arrangements.

Those trying to limit the operator to strict contract duties often betray another belief that seems to track this effort: most operating agreements are between large companies, and they ought to be free to do whatever they want.⁴⁷¹ Yet the real basis for heightened responsibility in such areas as handling funds and marketing production is that the operator's discretionary decisions in these areas are very hard for anyone to supervise. At the same time, its incentive to profit off the joint account is at its highest. While a ChevronTexaco may decide not to cheat an ExxonMobil because they are in numerous joint investments around the world, on the other hand, why not if the cheating is subtle and not immediately detectable? Moreover, if an operator is going to treat its industry partners with utmost scrupulousness (or if they are going to be reluctant to bring tort lawsuits because of their many other joint ventures), there would not be any significant expansion of risk by

attitude that business world concepts will exonerate their conduct." Lane & Boggs, *supra* note 11, at 239.

470. For the firm establishment of the right of public regulation, see ROBERT McCLOSKEY, *THE AMERICAN SUPREME COURT* 91-120 (1994).

471. See Lansdown, *supra* note 172, at 13-44 to 13-45 (explaining lack of operator litigation on presumed fact that industry parties observed common ethical standards, at least until recently); Martin, *supra* note 27, at 116, 121 (using Exxon and Chevron as examples of parties entering JOAs and claiming JOAs are "most often entered into by sophisticated companies and business people"); Moore, *supra* note 3, at 15-2 to 15-4 (using "industry novices" and "newcomers" as reason for changes to JOA in 1982 and erosion of industry customs); Smith, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-9 ("The disparity in bargaining position that has frequently characterized lessor-lessee negotiations is rarely present between parties to an operating agreement."); Smith, *Joint Operating Agreement*, *supra* note 408, at 840. My friend Mark Wawro, who has extensive oilfield experience representing such large companies, also insists that there needs to be an industry-company exception to any fiduciary duty.

making the operator a fiduciary to industry as well as nonindustry partners.

In other areas of the law, joint venturers or partners do not escape fiduciary liability just because they happen to be large companies. That this claim is advanced for industry companies is another example of the way in which the oilfield expects an exception from American law for its affairs.

E. Other Torts and Contract Protections Are Not Sufficient to Deter Wrongdoing

One possible argument is that existing tort and semi-tort standards provide sufficient deterrence.⁴⁷² Operators who commit fraud risk punitive damages, their conduct at times can fall under the securities laws, and good-faith duties may apply. Yet these protections are less effective than fiduciary protection.

Claims of fraud do not always fit well when overlaid on the standard oilwell investment. Legal fraud is not what the man in the street thinks of as fraud, because proving actionable fraud requires proof of a "material" misrepresentation or omission and a "reasonable" reliance. In general, the operator must have intended the victim to rely on the falsehood, and the victim must have done so. The nonoperator plaintiff must show that the fraud took control over its behavior. The loose requirement that such reliance must have been "reasonable" creates another chance for conservative courts to prevent legitimate fraud claims from getting to the jury.⁴⁷³

472. See, e.g., Martin, *supra* note 27, at 122 (prudent operator or good faith standard enough to deter strategic operator behavior).

473. The reasonable reliance requirement puts an odd premium on finding the gullible, or increasing one's sales pitch until the sincerity of hard selling overcomes the average level of skepticism. The premium has been enhanced by such cases as *Gilbert v. Nixon*, 429 F.2d 348, 357-58 (10th Cir. 1970), in which the Tenth Circuit held that "small" price gouging, like keeping secret volume discounts, was not sufficiently "material" to an oil and gas investment to support a claim of securities fraud.

Or, to show the difference between the stringency of proof of fraud and the relative clarity of a fiduciary duty, consider the operator who says that actual cost is what he pays at the time of purchase. He uses this interpretation to justify keeping discounts or credits received at year's end. The investor thinks that "actual cost" is what the operator paid after tabulating its costs and subtracting any discounts or special deals. The operator responds that operators often keep discounts and it did not agree to sacrifice this custom. It claims that "everybody" knows that operators can get discounts and that the investor should have raised the point if it did not agree. The hapless investor responds that it never imagined that the operator would keep any secret profits for itself. The operator says it never lied. And on and on. Faced with this confusion, courts may continue to find these terms immaterial, or that there was no "representation" or "omission" that was sufficiently

When an oilfield project is assembled, it is the point of maximum enthusiasm. Nonoperators generally will not negotiate special accounting terms or question the accuracy of the operator's oral representations. Industry companies assume that they will receive "standard industry" treatment; and nonindustry partners usually lack knowledge, place their faith in the operator, and do not question the ins and outs of well accounting or the treatment of geologic data. Nothing suggests to them that their operator will favor itself over their interests.⁴⁷⁴ Indeed, a key goal of an effective oil-company sales pitch is to create an environment of trust that nurtures such beliefs.

Securities fraud claims have their own weaknesses. One is that even though Congress defined fractional undivided interests in oil and gas and other mineral rights as securities, and though there is a well-established body of law treating standard nonoperating interests as securities,⁴⁷⁵ courts can exempt many small oil and gas investments from

specific to be actionable. This operator defense would not arise if the operator had the fiduciary's broad duty of disclosure.

No-fraud holdings in this situation are fanciful. It would virtually always be material for investors to know that the operator has a secret way of making profits that will cover some, if not all, of its costs, even on wells that produce no oil or gas. This hidden self-dealing cushions the operator's risk. It gives it a reason to drill wells that are near certain to lose money for the other interest owners, but may make profits for the operator because its costs are cushioned by secret floats. It adds insult to injury if the operator not only pockets profits on drilling to casing point, thus setting itself up to make money on dry holes, but keeps getting discounts or other benefits from completion and production. In these cases, it could complete and produce a well just because the process of spending more money generates more profits for it. If the operator backs in to well expenditures at casing point, as in a standard third-for-quarter deal, it still has an incentive to complete and produce wells that lose money for investors, as long as whatever revenue is produced plus the secret profits more than cover the operator's cost and the "opportunity cost" of whatever it thinks it could make if it put its time and money in some other investment. Or operators could complete uneconomic wells, when their costs are at least minimized, in order to produce inflated "success ratios" based on well completions that can be used to lure the next generation of investors.

Courts holding that concealing secret deals is not fraud, because investors were not smart enough to ask about such deals (and so, presumptively, did not rely on any misrepresentations), demonstrate why common sense should be a necessary antidote to legal formalism.

474. Presumably nonoperators would negotiate a different deal if they imagined that their operator intended to make his profits by cheating on accounting or in other areas, but such suspicions are far from the mind of the average investor at the moment of commitment. After all, the normal reason for investing is the belief that the operator knows how to discover reserves and is sharing the risks of the aptly named "joint adventure."

475. One lead securities case was an oilfield case addressing the definition of a "security," the wartime case of *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). For other concurring authority, see, for example, *Parvin v. Davis Oil Co.*, 524 F.2d 112, 115-16 (9th Cir. 1975) (undivided interests "securities" under Act, but exempt from registration requirements under private offering exemption); *Nor-Tex Agencies, Inc. v. Jones*, 482 F.2d

registration requirements.⁴⁷⁶ Alternatively, the securities may be exempt as joint ventures.⁴⁷⁷ Moreover, the applicability of securities requirements often has been more honored in the breach, not only with operators failing to file necessary registration forms,⁴⁷⁸ but with plaintiffs bringing substantive claims far less frequently than the number of oilfield investment disputes would suggest.⁴⁷⁹

Worse, from the perspective of effective regulation, the securities laws have been substantially weakened by tort-reform impulses in the last decade. In the mid-1990s, business interests prevailed in a lobbying

1093, 1097-99 (5th Cir. 1973) (finding fractional interests securities under literal language of Securities Act and under investment contract test), *cert. denied*, 415 U.S. 977 (1974); *Gilbert v. Nixon*, 429 F.2d 348, 354 (10th Cir. 1970) (fractional interests in oil and gas leases treated as securities); *Woodward v. Wright*, 266 F.2d 108, 111-14 (10th Cir. 1959) (same). *But see* Ballard & Cordell Corp. v. Zoller & Danneberg, 544 F.2d 1059, 1063-65 (10th Cir. 1976) (sale of company's entire 50% lease interest not "fractional" interest in oil and gas lease, and not "investment contract" where buyer would not be relying on seller's effort for buyer's profits).

476. For a discussion of the exemption for small issues, see LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 301-07 (1995); for the private-offering exemption, see *id.* at 307-21.

477. See *supra* note 92 and accompanying text.

478. A telling though dated example of just how little the industry observed registration requirements came in the mid-1970s, when the Oklahoma Securities Commission conducted a broad ranging survey of 1171 oil and gas operators who had sold 67,083 prospects over a 25-year period, all involving fractional oil and gas interests. It is generally accepted that these interests do fall under securities regulation. Bruce Day, *Securities Regulation of the Sale of Fractional Interests in Oil and Gas Leases: Is There an Answer for the Small Producer?*, reprinted in THE PETROLEUM EXPLORATIONIST'S GUIDE TO TITLES, LEASES & CONTRACTS 213, 215 (Lewis G. Mosburg, Jr. ed. 1984). The Commission found that only 44 operators had used a schedule D filing, 121 tried to comply with the small offering exemption, 29 registered in the states where they sold interests, 66 relied on the private offering exemption, and only 16 had been subject to enforcement. *Id.* at 223.

It seems no exaggeration to conclude that, at least until the early 1980s, "[i]t appears that the independent oil and gas industry has in practice, at least insofar as it was represented by these responses, almost completely ignored the registration requirements, and exemptions therefrom, of both federal and state securities laws." *Id.* at 224. "The industry has apparently operated in substantial violation of the law for 35 years with no significant enforcement action being maintained until the 1975-1976 onslaught of Schedule D abuses." *Id.* at 225.

479. One reason for the paucity of oilfield securities litigation is that a number of investments fall outside of registration requirements. See *supra* notes 476-477 and accompanying text. A registration violation can bring death-penalty sanctions because the transaction may be rescinded. See, e.g., *Parvin v. Davis Oil*, 655 F.2d 901, 904 (9th Cir. 1979) (rescinding investment under California securities law), *cert. denied*, 445 U.S. 965 (1980). But in the absence of a registration violation, the other likely claim, a securities fraud claim under rule 10b-5, faces today's heightened scienter requirement, see *infra* note 480, yet unlike a fraud or fiduciary duty cause of action, does not support punitive damages. So a plaintiff who cannot come under the registration requirements may decide that the effort needed to prove a violation is not worth the expected return.

campaign to weaken securities protection by making it harder to prove civil lawsuits and secured an increase in the burden of proving intent for the archetypal securities fraud claim.⁴⁸⁰ After the resulting climate proved hospitable to fraud as it nurtured such deceptions as Enron, Global Crossing, and Worldcom's gross misstatements, Congress has begun tightening up, including an extension of the securities limitations period, but the troublesome intent requirement and a mid-1990s Supreme Court decision terminating aider-and-abettor liability remain major barriers against securities claims.⁴⁸¹

The duty of good faith will not protect investors in the biggest oilfield states. Most major producing states have rejected such an independent tort cause of action for "ordinary" contract cases.⁴⁸² The tort duty of good faith generally has been limited to insurance contracts.⁴⁸³ A contract-like duty of good faith, like the one in the 1989 JOA, may help nonoperators before a jury, but the standard does not give clear signals

480. Private Securities Litigation Reform Act of 1995, Public Law 104-67, H.R. 1058, 104th Cong., 1st Sess. (Dec. 22, 1995). The Act cut back the 1934 Securities Act by requiring that any action based upon a misleading statement or omission has to plead the facts with Rule 9(b) particularity and, in addition, that proof of state of mind "shall," for each act, "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Id.* § 101(B) (emphasis added). The Act even stays discovery if a motion to dismiss is filed challenging the pleading's adequacy under this standard. *Id.* § 101(B)(3). In other words, Congress went out of its way to give special comfort to those accused of securities-law violations.

481. The Court ended aider-and-abettor liability in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 175-78 (1994).

482. See *Texstar N. Am. v. Ladd Petroleum*, 809 S.W.2d 672, 676-77 (Tex. App. 1991) (applying general Texas rule of no contract duty of good faith to standard JOA); *Taylor v. GWR Operating Co.*, 820 S.W.2d 908, 912 (Tex. App. 1991) (reversing for trial on fiduciary duty, but affirming summary judgment on cause of action for duty of good faith; parties "in a [JOA] do not generally owe each other the duty of utmost good faith and fair dealing"); *Adobe Resources Corp. v. Newmont Oil Co.*, 838 S.W.2d 831, 836 (Tex. App. 1992) (Texas court noting that Louisiana has not imposed duty of good faith outside insurance context); see also cases cited in note 360 *supra*.

Texas courts also rejected efforts to find a basis for liability in the Deceptive Trade Practices Act (DTPA). See, e.g., *Hamilton v. Texas Oil & Gas Corp.*, 648 S.W.2d 316, 321-22 (Tex. App. 1982) (nonoperator not "consumer" who acquired "services" from operator and could not sue operator under DTPA); *C&C Partners v. Sun Exploration & Prod.*, 783 S.W.2d 707, 713 (Tex. App. 1989) (following *Hamilton*); *Anderson v. Vinson Exploration, Inc.*, 832 S.W.2d 657, 665 (Tex. App. 1992) (following *Hamilton* and *C&C Partners*).

Oklahoma generally has limited the tort duty of good faith to insurance cases, see *Rogers v. Tecumseh Bank*, 756 P.2d 1223, 1225-27 (Okla. 1988), although it may recognize the duty when a party acts to destroy another's contract benefits, see *Davis v. TXO Prod. Corp.*, 929 F.2d 1515, 1519 (1991). New Mexico allows a tort duty of good faith in cases of "malicious" breach of contract. See *Romero v. Mervyn's*, 784 P.2d 992, 997-1002 (N.M. 1989).

483. See generally *supra* notes 359-360 and accompanying text.

about disclosure. When the operator is a fiduciary, it has a duty to disclose; when it is not, juries may end up struggling with little guidance on how much information a good-faith operator can conceal if not asked about it,⁴⁸⁴ or courts may permit obviously dishonest conduct as a matter of law.

Partnership law will not fill this gap because most oil ventures are not formal partnerships and, indeed, disclaim this status. Even before the current disavowal of fiduciary duties, the JOA disclaimed any intent to create a partnership.⁴⁸⁵ While this language may not block joint ventures or mining partnerships, it seems sufficient to preclude ordinary partnership liability.

Informal duties of trust and confidence are one last route to fiduciary protection, but courts have set the requirements for proving such relationships deliberately high. The need for long-standing prior relations and much more than subjective trust can weed out even the most meritorious claims—and encourages courts to do so on summary judgment.⁴⁸⁶ Nonoperators therefore will not be protected under this standard in their initial investments; yet this may be the time when they

484. One industry-oriented author has argued that good faith is even less constricting than the industry gross negligence test. See Lansdown, *supra* note 172, at 13-22 (“bad faith is generally deemed to place a heavier burden on a party claiming a breach of duty,” requiring “element of wrongdoing or improper motive” (citation omitted)); see also Hendrix & Golding, *supra* note 10, § 10.04[3][b][iv], at 10-36 to 10-37 (interpreting bad faith as the “most difficult possible standard to breach”). These readings seem erroneous because they assume that good faith must be a subjective test, so that the operator can come in and get off by persuading the jury that it was pure of heart. In other areas, for instance the executive’s duty to exercise good faith in pooling, courts have used objective tests. The reasonably prudent operator standard is an objective test, and there is no warrant for replacing it with a subjective standard that would be toothless.

For Lansdown’s argument that any duty of good faith would be even more vulnerable to the JOA disclaimers, see Lansdown, *supra* note 172, at 13-37 (arguing that exculpatory clauses do “not encourage notion that the parties were placing a great deal of trust in the operator,” and if the standard is an objective one, many relationships seem to lack the necessary trust).

485. 1977 JOA, art. VII.A.

486. A good example of how harshly the prior-relationship rule can work is the Texas Supreme Court’s opinion in *Consolidated Gas & Equipment Co. v. Thompson*, 405 S.W.2d 333 (Tex. 1966). The plaintiffs were a father and son; the defendant, a corporation, offered no testimony to support its position. The plaintiffs said that they had an oral agreement with the defendant’s president that they would find leases for it, the defendant would drill on the properties, and the plaintiffs would earn royalty interests. They said the agreement was not in writing because when they suggested getting an attorney to document the agreement, the defendant’s president said that he would have the papers prepared, and then advanced a variety of excuses for not having yet documented the arrangement. *Id.* at 335. The court refused to find a constructive trust that would remove the agreement from the Statute of Frauds because the parties did not have a prior fiduciary relationship. See *id.* at 336-37.

are least protected against fraud and sharp dealing (e.g., investors who sign up for additional wells presumably are more likely to have made their peace with the operator). The informal fiduciary duty is not a viable protection in most oil and gas investments.

In short, unless there is an affirmative duty on the operator to disclose information and to not arrange secret financial deals, many ongoing abuses will go unpunished. Not just unpunished: a number of schemes will be less likely to ever be discovered. Those claims that are discovered and pursued will not cost operators enough to deter others from continuing to run their business the old way. If the operator gets caught but is not exposed to at least the threat of punitive damages, its liability will be limited to refunding the pickings it took from those investors who were lucky enough to discover the fraudulent dealings. Further, the operator can settle with those plaintiffs but still keep a good part of the profits extracted from the joint account. That is why the fiduciary duty is so significant for policing fair dealings in oilfield joint investments.

IX. FIVE RESTATEMENTS OF THE OPERATOR'S FIDUCIARY DUTY

This complex body of law suggests five possible standards of fiduciary duty. The operator's control and nonoperators' dependence have frequently sustained a fiduciary duty. Yet long-standing acceptance of article V.A's exculpations, at least in physical operations, and article VII.A's express disclaimer make it unlikely that courts will impose an across-the-board fiduciary duty. The most likely development is that courts will apply this heightened standard in at least three areas closest to traditional fiduciary responsibilities: (1) handling funds, (2) marketing production, and (3) acquiring property. The common factor linking these separately developed duties is that, when viewed against the larger backdrop of the operator's control and investor dependence, they represent major areas where the operator's interests diverge from its investors'. All that is lacking is final articulation of this duty. The other area of divergent interests, the disclosure of project facts, both before the investment and during it, fits logically within this duty, but only time will tell whether courts will bring this activity into the fiduciary sphere.

Other possible but less well-supported standards range from a simple duty of good faith or a case-by-case determination to the lowest standard, no fiduciary duty at all. The no-fiduciary duty is the most extreme position, and it flies in the face of years of precedent. It would require abandonment of long-established doctrines ranging from *Rankin* and *Foley & Loomis v. Phillips* to *Oklahoma Co. v. O'Neil* and the unit

operator case in *Young*, and from the *Reserve Oil* trust cases to the operator marketing cases. This possibility cannot be wholly discounted given the corrosive effects of the tort "reform" movement ("reform" being a euphemism for "abolition"). Nothing in the litigated cases, however, suggests that the limited contract liability allowed under the JOA is incentive enough to make operators faithful stewards of nonoperator interests.

A. The Operator Almost Certainly Will Not Be a Per Se Fiduciary to Nonoperators

The strongest fiduciary duty would be a per se duty covering the entire relationship, in the same way that a trustee, an agent, or for that matter a lawyer is a fiduciary to his or her charge. Such a rule would acknowledge fully the structured dependence of the nonoperator in the standard joint-account relationship, and the operator's control of almost all decisions affecting the health of the venture.

Nonetheless, such an absolute standard is not likely to prevail. Courts often trim fiduciary arrangements to fit historical circumstances and, to some extent, the parties' definition of the relationship. Their doing so makes such a global fiduciary duty perhaps just as unlikely as holdings that there is no duty at all. Imposing an across-the-board duty would mean disregarding article V.A's decades-old limitation of liability even for physical operations.⁴⁸⁷ In this area, operators generally do share the same incentive to find the most reserves at the least cost. At least in regard to physical operations, operators have financial incentives to act as diligently for nonoperators as well as for themselves, and there is less reason for a heightened standard of care.

No jurisdiction defines the operator as a fiduciary as a matter of law in all circumstances. There is no sign that the law will end up in that position. Nor do the principles that have sustained some fiduciary duties justify extending the duty to the physical aspects of the operator's activity, where the parties do indeed generally share the same interests.⁴⁸⁸

487. Article V.A still might retain some residual meaning, as the JOA could be read to mean that the operator is a fiduciary to its interest owners, but if the joint account lost a claim to third parties, the operator could not be directly liable for more than its proportionate shares unless it acted with gross negligence or willful misconduct. But this would reduce fairly sharply the protection that article V.A currently extends to the operator.

488. It is an exaggeration to say that all operators share the incentives of the joint account in their physical activities. It is expensive to conduct quality oil and gas operations. A company set up as a Ponzi scheme can make a conscious decision to create just the

B. The Emerging Standard of Operator as Fiduciary in Handling Joint-Account Funds, Marketing Production, and Acquiring Property

The operator should be treated as a fiduciary when it performs traditional fiduciary roles. These fiduciary roles include (1) the acquisition of property for the joint-account, (2) exercise of trust responsibility over expenditure of funds on the investment, and (3) marketing the nonoperators' production.

The fiduciary obligation to share property acquisitions in the joint-account area is one of the oldest oilpatch rules. It produced a strong statement of fiduciary claims even in Texas and has been acknowledged in *Rankin v. Naftalis*,⁴⁸⁹ *Foley & Loomis v. Phillips*,⁴⁹⁰ *British American Oil Producing Co. v. Midway Oil Co.*,⁴⁹¹ and numerous other cases.⁴⁹² The belief that the operator is a fiduciary when spending its partners' money has found widespread acceptance since its articulation in *Reserve Oil*.⁴⁹³ Even the latest JOA leaves room for it.⁴⁹⁴ The marketing duty, which is

vener of competent activity, without spending the money needed to make a diligent effort to recover oil and gas, because it expects to earn money by milking new investors while propping up the cheapest operations possible. This was the modus operandi of a number of the ventures mentioned in note 276 *supra*. Such companies could rationally decide to run a volume shop, figuring that if they attracted enough investors who paid the operator's well costs, perhaps on the traditional "third-for-quarter" basis, even sloppy operations can discover a lot of oil and gas over the long run. Thus, the operator might well make money even if no one else did.

489. See *supra* notes 64-72 and accompanying text.

490. See *supra* note 73.

491. See *supra* note 73.

492. For *Foley* and these other cases, see *supra* note 73; accord, *DERMAN*, *supra* note 3, at 73-75; *Boigon*, *Hostile Environment*, *supra* note 3, at 5-12 to 5-16; *Hendrix & Golding*, *supra* note 10, § 10.04[3][a], at 10-22 to 10-26 (making exception to general dismissal of fiduciary duties for "property dealings within the contract area that have not been disclosed"). But see *Wall*, *supra* note 151, at 104 (arguing that parties can acquire property without sharing absent fiduciary duty or AMI provision).

One reason that courts have been willing to limit the geographic scope of the operator's duty undoubtedly is the existence of the AMI clause, a standard clause defining the area within which the parties must share mutually acquired interests. For discussion of AMI clauses, see 2 *KUNTZ*, *supra* note 24, § 19A.4, at 87-93; *DERMAN*, *supra* note 3, at 158-61 (sample language). The parties also routinely share acreage and cash contributions earned by their joint operation, another sign of an intent to limit the sharing to the Contract Area. See generally *id.* at 100-03. Strict interpretations of the AMI rule, though, conflict with another longstanding rule, namely, that the operator cannot take a separate benefit if based on information paid for by the joint account, compare generally *Smith*, *Duties and Obligations*, *supra* note 24, at 12-56 to 12-57; see also *Smith*, *Voluntary Agreements & Compulsory Orders*, *supra* note 151, at 3-19 (operator cannot "use venture information or opportunities for its personal benefit"). Mining partnerships also are projects limited in geographic scope. See *Fiske*, *supra* note 22, at 218-19.

493. See *supra* note 139 and accompanying text.

494. See *supra* note 152 and accompanying text.

quite similar to the heightened duty-to-market that courts have imposed as an implied covenant on the operator when it acts for its royalty owners, is a more recent development, but it has received a positive response from commentators as well as courts and it too fits into the latest JOA.⁴⁹⁵

As this duty develops, courts will have to define its limits more clearly than they have to date. There are obvious areas that require clarification. Part V.A. already has discussed the problems with Rankin's limiting the fiduciary duty to share property acquisitions to the joint-account area alone, in a case in which the operator may have used joint-account information and even promised that he would share outside acquisitions with the investors.⁴⁹⁶ As courts become more accustomed to discuss these portions of the operator's role in fiduciary terms, they also should become comfortable extending this application to obvious abuses of confidential information even outside the JOA's geographic area.

In the expenditure of investor funds, the fiduciary duty will have little bite unless the operator is held to an actual-cost basis and has to disclose each source of profit. To the extent that the operator makes a profit or fee for its services, it should have to describe its profit structure fully in advance. Such a standard tracks the principle already embodied in COPAS, that the operator is neither to "gain nor lose" from its position as manager of the project.⁴⁹⁷ The many provisions that detail the appropriate funding for equipment, overhead, and other areas are all efforts to enforce this basic principle.⁴⁹⁸

The clarification of this duty would have prevented some of the unfortunate decisions of the past. For instance, it would have prevented LL&E from misrepresenting that it was taking equipment out of inventory in *Dime Box Petroleum v. L.L.&E.*⁴⁹⁹ It would have forced True Oil's Dave True to bill Sinclair Petroleum his actual cost, just as he promised.⁵⁰⁰

A full articulation has perhaps been delayed in part because *Reserve Oil* is such an extreme case—an operator using one investor's money to pay the debts of other investors. It is not the operator using one investor's money to pay another's debts, but the operator profiteering off all its investors, where this duty will most often be needed.

495. See *supra* notes 154–161 and accompanying text.

496. See *supra* notes 65, 75 and accompanying text.

497. See *supra* notes 257, 357 and accompanying text.

498. See McArthur, *Twelve-Step Program*, *supra* note 132, at 1456–58.

499. See *supra* notes 141–150 and accompanying text.

500. See *supra* note 258 and accompanying text.

In marketing activities, the operator will have to make an effort to get the best price reasonably possible and to avoid affiliate and other arrangements designed to yield a separate profit. In this area, the standard of behavior should track the operator's duty-to-market obligations toward its royalty owners.⁵⁰¹ Thus far, however, the JOA is less detailed in its discussion of the standards for marketing production than the average lease. The standard JOA does not provide proceeds or market-value pricing or any specific pricing term, while the lease at least generally does. The JOA's COPAS accounting provisions include no terms for revenue audits to complement the pages on cost accounting; and courts have not imposed the duty to market that they have used to flesh out the operator's duty to royalty owners. The mature development of this fiduciary duty should produce a convergence of royalty and working interest marketing standards.

Courts have yet to link these separate duties together, but in combination they already impose heightened standards in most areas where the operator has an incentive contrary to its investors'. Courts are already protecting the nonoperator's dependence, albeit with different doctrines.

It is always a great advance in the law, increasing its efficiency and consistency in application, when the fog clears from the common law's slow and isolated refinement of a new principle and a mass of unrelated cases finally stand revealed as a single principle. A well-known example of this kind of systematization is Fuller and Purdue's classic article showing that American courts long had protected a reliance interest in contract cases, even though the strictures of contract law sometimes made them reluctant to admit it.⁵⁰² The proposed fiduciary standard will remove uncertainty and inconsistency in the oilfield operator cases by finally recognizing that a single interest is being protected: the nonoperator's dependence and vulnerability to the operator.

This process would have to deal with the one major area of divergent interest where courts have not generally imposed fiduciary burdens. This is the operator's representations about its success and performance, both past and present. The operator has an incentive to overstate its success in order to find and keep investors.⁵⁰³ If courts link

501. See generally 5 WILLIAMS & MEYERS TREATISE, *supra* note 10, § 853 (discussing duty-to-market implied covenant); 5 KUNTZ, *supra* note 24, § 60.

502. Lon Fuller & William Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L. REV. 52, 373 (1936).

503. See *supra* notes 273-281 and accompanying text.

all other duties as needed to keep the operator motivated toward serving the joint interest, they will impose a duty of full disclosure as well.

If courts were accustomed to thinking about the operator as a fiduciary in areas of divergent interest, they would require the operator to make full disclosure of all material facts about the investment. This disclosure would include the operator's past track record—including completion ratios and economic performance—and accurate economic information for all current activities. In the absence of such a duty, operators may be able to avoid liability for fraudulent omissions and continue to provide investors with false information. This Article has reviewed a variety of examples showing why this protection is needed.⁵⁰⁴

American courts will clear up a lot of the confusion in oil and gas law if they begin imposing a single, distinct fiduciary duty on the operator in these core areas. No longer would they need to grapple with the intricacies of joint-venture and mining-partnership law, with their wrong-headed requirement of control to extend extra protection. The *Young* unit rule could be discarded—courts could avoid the risk that *Young* might be applied to physical operations. In areas covered by the fiduciary duty, like the marketing production at stake in *Young*, the unit operator would be held a fiduciary in common with other operators. Nor would courts need to justify *Reserve Oil* or *Johnston* as separate, isolated duties. The *Reserve Oil* and *Johnston* fiduciary duties could finally become part of a single larger responsibility with clear demarcations. At the same time, physical operations would retain their traditional limited exposure.

The major barriers to this standard duty are the exculpatory clause in JOA article V.A and the limitations of liability in article VII.A. Yet the careful language in article V.D.4 (stating that the operator shall not be a fiduciary other than in the custody of funds) and its definition that leaves open both funds paid to the operator by its investors and proceeds of production seem clearly sufficient to exempt at least these fiduciary responsibilities from both articles V.A and VII.A.

The court's equitable powers are not defined by the JOA. Application of a uniform fiduciary standard for the operator's handling of investor money and protection of joint revenues should be extended to other areas, such as property acquisitions and disclosure. It is in these areas, too, that nonoperator dependence requires protection. The erosion and limitation of the exculpatory clauses in recent cases like *Abraxas Petroleum Corp. v. Hornburg*,⁵⁰⁵ and the disregard of these barriers in the

504. See *supra* notes 273–281 and accompanying text.

505. See *supra* notes 336–340 and accompanying text.

Reserve Oil and marketing fiduciary cases, indicates that courts already have the tools to craft this fiduciary duty without being blocked by current JOA provisions.

C. A Contract Duty of Good Faith

The 1989 JOA has a duty of good faith. But given the limit of liability in article V.A, it is not at all clear whether this is a meaningful responsibility. How can the courts pretend to effectively regulate operators, if operators can defeat claims just because they only acted with negligence instead of gross negligence, or admittedly committed misconduct, but not gross misconduct? Moreover, the pre-1989 JOAs, the majority of JOAs in effect today, do not have this language and most courts will not imply a duty of good faith in them. This duty will not be an effective barrier to operator misconduct. The JOA's good-faith duty is so undefined that it does not impose a clear standard even in such areas as handling funds, marketing production, and acquiring acreage.

D. Courts Might Decide the Duty Case by Case

It is a good bet that oil companies will find case-by-case adjudication a very attractive proposition because even if they do not succeed in extinguishing the duty entirely, case-by-case adjudication means that they have a chance to avoid fiduciary obligations in every case, and are more likely to avoid class actions. In their support they can cite one of the most respected authorities, Ernest Smith, who has suggested a very fact specific analysis.⁵⁰⁶

But case-by-case standards are much less effective protection for nonoperators. Operators with superior resources will benefit from their comparative advantage in what may be very costly litigation over what the parties actually intended, and the amorphousness of such standards will give judges leeway to decide at least many of these cases for either side. In addition, case-by-case standards all but ensure that one of the most effective ways of maintaining proper behavior with large operators, for instance major oil companies, will be unavailable. That is because case-by-case standards tend to defeat the commonality required to certify the most frequent class action, the common-question class action.⁵⁰⁷ Even the gradual emergence of duties in particular substantive areas, like handling funds and marketing production, is a testament that

506. See *supra* note 465 and accompanying text.

507. For this key requirement, see McArthur, *Class Action Tool*, *supra* note 466, at 126-28.

case-by-case adjudication is too amorphous to effectively control operator excess.

E. The Minimal Standard: No Fiduciary Duty

Given the variety of settings in which courts have made the operator a fiduciary, a rule that the operator/nonoperator tie is purely contractual and no fiduciary duty exists at all is as unlikely as a finding that the operator is a fiduciary in all aspects of its work, including physical operations. Only the most extreme disclaimer/exculpatory cases reduce this close, intimate relationship to essentially a contract among strangers. Part VI has reviewed the reasons why this view should not prevail in the long run: The JOA's article V.A is not equipped to govern all aspects of the operator's role, and article VII.A originally was directed toward third-party liability.

In addition, a number of the fiduciary doctrines—the trust duty for handling funds, the marketing agency, the unit-operator rule—disregard these limiting clauses entirely. The 1989 JOA leaves room for fiduciary responsibility in handling funds and revenue, even as it tries to exclude complete fiduciary responsibility.

Beyond this, the most conservative of the liability-limiting cases, such as *Tenneco v. Bogert* and *Stine v. Marathon*,⁵⁰⁸ have never explained why the operator, who has responsibilities like trustees and agents, should avoid the heavier obligations of other fiduciaries.

A system of precedent does not disregard generations of common-law protections simply because some judges may have a political preference for tort-reform simplifications, in which the only ties that bind are contract ties. The no-duty rule would require a far greater radicalization of American law than seems likely, even if such radicalization no doubt will remain a goal of the oil industry for years to come.

X. THE CASES ARE RIPE FOR RESTATEMENT

There is no reason for the law to deny dependent nonoperators the level of protection offered to joint venturers and mining partners simply because nonoperators failed to persuade courts that they also "participate" or "control" operations. Nonoperators should not have to prove a factual relation of trust and confidence to defend their interests, when their right to fiduciary protection should stem from the structure

508. See *supra* notes 310–313, 320–323 and accompanying text.

of their investment. Similarly, there is no reason why most courts should hold that *all* nonoperators in unitized agreements deserve fiduciary protection; operators marketing production or handling nonoperator funds labor under this duty; predevelopment grubstake operators labor under similar standards—but other nonoperators, with virtually identical agreements, have only contract rights unless they make the additional showing that they are joint venturers or mining partners.

To some extent, the disorder in the operator jurisprudence may be part of the price for our common-law system. It is difficult to imagine the same uncertainty if American oil and gas law had begun with a written code. The experience should confirm the views of those, be they Realists from the thirties or critical legal studies doyens of recent years,⁵⁰⁹ who believe that common-law courts have so much freedom to choose among interpretive techniques and to redefine the facts that judges “make” the law without effective constraint.

Yet these differences are not required or justified by common-law adjudication. If it is unclear why the operator cases have stayed so remote from other fiduciary cases, the shortcomings in current doctrine are obvious. The cases rely on special rules and hypertechnical categorization. The oil and gas lawyer does not ask broadly whether the operator is an agent, a fiduciary, or a trustee, but rather must narrowly determine whether one of the industry’s special relationships applies, *i.e.*, whether a case fits into a joint-venture or mining-partnership rubric, whether the property is unitized, whether it holds executive rights, etc. The court then robotically applies the appropriate characterization to the level of duty (fiduciary or nonfiduciary) mandated by industry

509. For a flavor of the “cls” movement, see ROBERTO UNGER, *THE CRITICAL LEGAL STUDIES MOVEMENT* (1986). For examples of Realist criticism, see FRED RODELL, *WOE UNTO YOU LAWYERS!* (1939); JEROME FRANK, *COURTS ON TRIAL: MYTH AND REALITY IN AMERICAN JUSTICE* (1949). For a longer discussion, see MORTON HOROWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870–1960*, at 169–212 (1992).

A good oilfield example of the unknowable contingency of case-based adjudication is the anti-royalty owner positions on take-or-pay buyouts and settlement pass-throughs that initially were established in cases in which the federal government would have been the royalty recipient. See McArthur, *The Mutual Benefit Implied Covenant*, *supra* note 172, at 830–61. Individual royalty owners in later-decided cases found themselves confronted by precedent apparently establishing that producers did not have to share any settlements. Whether the outcome would have been the same had a clearly cheated private royalty owner been the first plaintiff is a significant, but unanswerable, question.

Of course, the power courts retain to define the facts of a case also let them deviate from precedent. Thus an arbitrary outcome may be pulled back by a silly classification or, on rarer occasion, by reconsideration en banc or a court’s pulling out one of those trump cards like “changed circumstances.” Unfortunately, only a few jurisdictions had the insight to buck the tide of the royalty take-or-pay cases.

precedent. Over time, existing law has become too focused on fitting cases into narrow categories without discussing the reasons why.⁵¹⁰

The current inconsistency is destructive because parties have a right to have their cases decided under clearly articulated principles. As Herbert Weschler wrote nearly 50 years ago, "reasoned elaboration"—the ability to see the reasons for a decision and for opinions to be reasoned, not arbitrary, and therefore predictable—is a necessary condition for a government of laws.⁵¹¹

It is time to make the law consistent by acknowledging the underlying principle that operators function as agents, handle property responsibilities as critical as any trustee's, and need to be forced to act for the benefit of their charges. A natural progression should have led courts to agree by now that operators are fiduciaries as a matter of law in many areas⁵¹² when so many of the operator's duties are like those of agents and trustees. Operators act for other parties in a wide range of activity and manage property for outside beneficiaries as well as themselves. By contract structure, by the inherent demands of their role, to some extent by selective expertise, operators play the determinative role in joint operations. Courts already would have made operators per se fiduciaries in most of their activities under mainstream legal principles if they interpreted oil and gas law under general agency and trust principles.

In trying to pigeonhole new cases into existing cubbyholes and then tease the right result from precedent, courts have ignored the

510. "Lawyers and judges seek to classify joint operating agreements so that they can then say what rules of law apply to the parties." Martin, *supra* note 27, at 102. Martin likes this categorical application because a number of courts have put the operator cases into a category called "disclaimer." In a way, any system of precedent is a system of categories, with disputes over whether a new case falls into any prior category or is "close enough" to fit into it and, if not, whether it is close enough that prior opinions "solve the case" anyway. The strength of a precedential system is that it promotes economy of decision making for courts and predictability and reliability for those governed. The weakness, and it is a weakness apparent in the operator cases, is that it is too easy for the categories to become tautological and end up being applied without analyzing *why* a category should be imposed.

511. See generally Weschler, *supra* note 419.

512. It is an interesting question in the philosophy of law to ask how courts have managed to carve out an oilfield jurisprudence that excepts operators from equity's fiduciary principles. One answer might be that the caselaw is still young and finding its way. Courts seem to have reached issues about the basic standard for royalties and executive rights before they got to the core operator/nonoperator question. See Smith, *Duties and Obligations*, *supra* note 24, at 12-4. Yet the operator cases run back to the turn of the last century and there are dozens of them. They in turn have roots in a law of mining that was being actively litigated over a century ago. Another possible explanation for oilfield exceptionalism is that operating companies have the resources to out-litigate working interest (and royalty) owners.

reasons underlying common-law fiduciary rules. The *structure* of the standard operator relationship, both the operator's assumption of high duties and the built-in dependence of nonoperators, should make operators as responsible as agents, and in such core activities as handling joint money and property as duty-bound as trustees.

The principles driving these cases are the operator's superior control and their nonoperators' dependence, as magnified in the areas of divergent interests. The operator should bear fiduciary obligations when it acquires acreage, handles nonoperators' investment funds or production proceeds, and markets production. Ultimately it should bear a fiduciary's duty of full economic disclosure. In its physical operations, it should continue to be protected by the article V.A disclaimers.