Volume 56 | Issue 2 | Article 9

January 2003

Judging Made Too Easy: The Judicial Exaggeration of Exculpatory and Liability-Limiting Clauses in the Oilfield's Operator Fiduciary Cases

John Burritt McArthur

JUDGING MADE TOO EASY: THE JUDICIAL EXAGGERATION OF EXCULPATORY AND LIABILITY-LIMITING CLAUSES IN THE OILFIELD'S OPERATOR FIDUCIARY CASES

*John Burritt McArthur**

* J.D., 1984, The University of Texas Law School; M.P.A., 1984, Harvard University; M.A., Economics, 1978, University of Connecticut; B.A., 1975, Brown University.

THIS Article concerns one area where recently increased judicial deference to business interests has forced new readings onto the law without adequate explanation or, indeed, much explanation for the change at all. It is about law that judges have arbitrarily revised, not discovered. In little more than a decade, activist judges have tried to sharply reduce an oilfield operator's duty to its investors, the "nonoperators,"[1] by exaggerating the scope and impact of two clauses in the Joint Operating Agreement (JOA), the dominant American oilfield investment contract issued by the American Association of Petroleum Landmen (AAPL). One of these clauses, Article VII.A., tries to disclaim partnership status and obligations. The other, Article V.A., can become under the new readings an all-encompassing liability-limiting exculpatory clause.[2]

These new, expansive judicial readings detour from a long-traveled road. Under doctrines ranging from joint-venture and mining-partnership theories to trust-like duties and special rules for unit operators and

1. The "nonoperator" discussed in this Article is the nonoperating equity owner, the "working interest owner," who generally invests under one of the standard joint operating agreements. The term is used to distinguish this interest owner from royalty owners, net profits owners, and, of course, the operator. Williams and Meyers define the "operator" as "[a] person, natural or artificial (e.g., corporate) engaged in the business of drilling wells for oil and gas." HOWARD WILLIAMS & CHARLES MEYERS, MANUAL OF OIL AND GAS TERMS 842 (8th ed. 1991).

2. AAPL, Form 610-1977 Model Form Operating Agreement, Articles V.A., VII.A. [hereinafter 1977 JOA] (on file with the SMU Law Review). The AAPL adopted new language that expressly narrowed the operator's duty in the 1989 JOA. AAPL, Form 610-1989 Model Form Operating Agreement, Article VII.A. [hereinafter 1989 JOA]. At the same time, it expressly preserved from this narrowing perhaps the two most critical areas of operator conduct, its handling of investor money and production, and thus seems to have acknowledged that a fiduciary duty can exist in these core areas. The Article discusses this change in notes 80 and 94 *infra* and accompanying text.

operators marketing nonoperator production, many courts previously had treated operators as fiduciaries to their investors. Only in Texas were courts likely to routinely preclude fiduciary responsibility, and even there, joint ventures and mining partnerships usually received a factual analysis under which the operator sometimes was deemed a fiduciary. Academic commentary confirmed that the operator was likely to be a fiduciary to its investors in the absence of unusual factors. Until the last decade, most courts had refused to let Article VII.A.'s no-partnership disclaimer block the possibility of a fiduciary obligation to the nonoperating investors as a matter of law, or let Article V.A.'s exculpatory clause do so, either. This starting body of law is summarized in Part I.

In a reformation that began in the late 1980s and reached cruising speed in the last decade, courts in many jurisdictions inflated these two clauses to limit the operator's exposure in all its activities to acts of gross negligence or willful misconduct. These cases have lowered the operator's responsibility and shifted a large group of risks to nonoperators. In this way, they have created a zone of immunity for operators while relying on language that did not create such immunity but a few years before.

The courts have not justified this judicial about-face. Its result, however, is easy to see: substantially increased protection for the large corporations that dominate oilfield operations. Courts traditionally extend fiduciary protection because of a party's dependence. Here, perversely, they defer to the more powerful party, the operator, because of its control. Part II documents this change in the law.

Part III analyzes these changes. The new exemptions fit poorly with the language on which they rely and, taken literally, install other contradictions within the JOA. Moreover, courts rushing to protect operators have ignored the standards that ordinarily limit efforts to avoid tort liability, particularly joint efforts by competitors. Judges should no more uncritically accept efforts of large, established companies to reduce their liability by standard-form disclaimers and exculpations than they would sanction joint conduct among competitors to disavow tort responsibility in other areas of the law. It is one thing to enforce the terms of a truly bargained contract. It is another when dominant oil companies act together to avoid the duties ordinarily fixed by the common law.[3]

Part IV discusses the conflict that remains between some recent cases, most notably those imposing trustee-type duties when the operator handles nonoperator money and those making the operator an agent when it markets its investors' production, and the no-duty cases. Noting that even the most recently amended JOA leaves room for a fiduciary duty in these areas, and discussing a recent trend to preserve claims for breach of the

3. The treatment of disclaimers and exculpatory clauses does not itself determine whether, even without applying such contract barriers, courts should view the oilfield operator as a fiduciary. The author will address that issue systematically in a future article. The issue discussed here is only whether there is a justification for courts refusing to even consider that underlying issue because of these two threshold contract terms.

JOA itself from the disclaimers, it predicts that all courts (except, perhaps, the extremely business-deferential Texas Supreme Court and its counterparts on the Fifth Circuit) will end up carving out at least these major areas from the recent assault on the operator duty. The battle over these standards might even provide the impetus for a more careful articulation of the operator duty itself.

I. THE OLD REGIME: THE OPERATOR CAN BE A FIDUCIARY DESPITE DISCLAIMERS AND EXCULPATORY CLAUSES

The technical topic of the "operator/nonoperator" relationship is a vital issue in a still-vital American industry. Most drilling in the domestic United States is done via joint ventures in which an active oil company, the operator, makes the key business decisions, while investors, the nonoperators, provide most of the funds, retain certain key votes, and have a general right to monitor the project. This division of responsibilities has allowed oil and gas companies to amass very large pools of property with relatively low initial outlays, while enabling investors without similar know-how to share the risks and rewards of technologically complex drilling operations.[4]

Until the late 1980s and early 1990s, most courts regulated investment in this key industry by employing a variety of legal concepts that could make operators fiduciaries to their investors. Courts often enforced these high obligations in spite of the JOA's no-partnership disclaimer and liability-limiting exculpatory clause.[5] Mainstream academic commentators generally treated the operator as a fiduciary to its nonoperators.

A. Many Mainstream Joint-Venture Cases Grappled With the Fiduciary Question Without Letting No-Partnership or Exculpatory Clauses Derail Them

Any understanding of the changed judicial interpretation has to begin with the terms of the JOA, under which American oilfield parties traditionally have conducted oil and gas exploration and development.[6] Until

4. Joint operations also enable even the wealthiest oil companies to diffuse their risk in some of the most expensive oilfield projects, for instance deep offshore projects, and thus add predictability to their performance.

5. One recent article, which discusses little of the older tradition, claims that "it appears that ten years ago, relatively few cases dealt specifically with the AAPL Form 610 Model Form Operating Agreement." John R. Reeves & J. Matthew Thompson, *The Development of the Model Form Operating Agreement: An Interpretative Accounting*, 54 OKLA. L. REV. 211, 213 (2001). If that were the case, the early operator cases might be irrelevant to recent decisions, which would be the first to interpret the JOA. This Article shows that Reeves and Thompson's premise is incorrect; many early cases either expressly dealt with the JOA or, while not naming the specific form interpreted, dealt with language identical to JOA language.

6. The JOA traditionally has been the controlling document in American oil and gas investments. *See, e.g.*, 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

1989, the JOA had two primary clauses on the operator's overall duty. Paragraph VII.A. announced that the parties' liability was several, not joint, and that they did not intend to enter a mining or other association "or to render the parties liable as partners."[7] Article V.A. gave the operator full control of all operations on the "Contract Area," with a duty to act "in a good and workmanlike manner," but with the operator's liability at least for covered operations limited to "gross negligence or willful misconduct."[8] The JOA did not discuss in detail exactly *which* conduct was so favorably sheltered (all activity? physical operations only? dealings with third parties only?). The transition from the fiduciary world that extended well into the 1980s to today's judicial reaching out to shield operators generally occurred under the standard pre-1989 version of these two Articles, and not under the current 1989 model form.[9]

An influential Oklahoma Supreme Court case from the late 1960s typifies the traditional analysis of the internal operator/nonoperator relationship. In *Oklahoma Co. v. O'Neill*,[10] the operator, the Oklahoma

---

gas. No other instrument employed in the exploration and production business receives acceptance even approaching that accorded the A.A.P.L. paradigm."); 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) (AAPL Form 610 "has gained such general acceptance, even by major companies, that it may be considered a Standard Operating Agreement"). *See generally* ANDREW DERMAN, THE NEW AND IMPROVED 1989 JOINT OPERATING AGREEMENT: A WORKING MANUAL 1 (1991) (AAPL procedures have "been effective in establishing procedures and obligations which have resulted in the drilling of tens of thousands of wells").

7. 1977 JOA, *supra* note 2, Article VII.A.

8. *Id.* Article V.A.

9. The JOA contains a third major reduction in nonoperators' rights in Exhibit C, an accounting appendix, that essentially gives nonoperators only two years from the end of the calendar year in which a joint-account bill is received to challenge the charges in it. COUNCIL OF PETROLEUM ACCOUNTANTS SOCIETIES, ACCOUNTING PROCEDURE JOINT OPERATIONS Article I.4. (1984) [hereinafter 1984 Copas]; COUNCIL OF PETROLEUM ACCOUNTANTS SOCIETIES, ACCOUNTING PROCEDURE JOINT OPERATIONS Article I.4.A. (1995) [hereinafter 1995 Copas]. Courts generally enforce this clause. Some courts have harshly enforced this provision. *See* Calpetco 1981 v. Marshall Exploration, Inc., 989 F.2d 1408, 1414-16 (5th Cir. 1993) (holding that neither counterclaim in litigation nor two years of negotiations over audit issues were specific enough to form "claim for adjustment"); Antweil v. Keesing, 115 B.R. 299, 301, 305 (Bankr. D. N.M. 1990) (applying this Copas provision to bar claim of nonoperator who had been in divorce proceedings at time he noticed overcharges, and who had never been credited with equipment he furnished to joint account; in the court's words, "[t]he Court 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"). Courts generally agree, however, that the Copas claims bar is not intended to shield the operator from claims of fraud. *Calpetco 1981*, 989 F.2d at 1413-14; Caddo Oil Co. v. O'Brien, 908 F.2d 13, 17 (5th Cir. 1990); Exxon v. Crosby-Mississippi Resources, Ltd., 775 F. Supp. 969, 976 (S.D. Miss. 1991), *aff'd in part, rev'd in part*, 40 F.3d 1474 (5th Cir. 1995). Presumably, they would not use it to bar a claim for breach of fiduciary duty either.

This Article does not address the Copas claims limit because it does not bar tort claims as such and because there has not been a substantial broadening of the protections given the operator under this clause.

10. Oklahoma Co. v. O'Neill, 333 P.2d 534 (Okla. 1958) [hereinafter *Oklahoma Co. I*], *vacated upon discovery that Judge had succumbed to bribery*, 431 P.2d 445 (Okla. 1967) [hereinafter *Oklahoma Co. II*], *decided for plaintiff*, 440 P.2d 978 (Okla. 1968) [hereinafter *Oklahoma Co. III*].

Company, overstated lease costs and expenses; urged investors to rely on the report of an engineer whom it secretly had on commission; took royalties out of the joint property without notice; and misstated production.[11] The parties had a written operating agreement that, like the JOA, denied an intent to "create a partnership, a co-partnership or mining partnership."[12] In spite of this language, the court decided to treat the operator as a fiduciary if the plaintiffs proved three standard joint-venture elements: (1) a joint interest; (2) an express or implied agreement to share profits and losses; and (3) "acts or conduct reflecting cooperation in the project."[13]

Not only did the court give these factors priority over the no-partnership language, but it did so aggressively. The plaintiffs had almost no evidence of joint cooperation, the third fiduciary prong. Yet the Oklahoma Supreme Court let the slightest evidence satisfy that requirement. It held that one visit to the well and minor lease examination were enough.[14] These minimal acts were cooperation "under these circumstances" even though "management and operation" stayed with the Oklahoma Company.[15] The court thus treated this ordinary operating relationship as a fiduciary one in spite of no-partnership language.[16] A number of other

11. *Oklahoma Co. III*, 440 P.2d at 985.

12. The agreement stated that any rights that might arise from "any partner, co-partner, or mining partner relationship," or from entering an agreement for the operation of the property, "or from any other fact," were superseded by the rights set out in the contract. The Oklahoma Supreme Court recited these terms in its prior decision in *Oklahoma Co. I*, 333 P.2d at 542. The parties signed an operating agreement at the same time as they signed the leases, an event that was completed on June 6, 1956. *Oklahoma Co. III*, 440 P.2d at 982. The AAPL issued its first JOA in 1956, but an industry form contract had been under discussion since 1952. Young, *supra* note 6, at 199-200. While it is not clear whether the *Oklahoma Co.* agreement incorporated the terms of that first JOA, presumably those terms would have been publicly available even had the AAPL not used exactly the same terms in the first model operating agreement.

13. *See Oklahoma Co. III*, 440 P.2d at 984-85. In spite of the no-partnership disclaimer, the court was applying what it called "[t]he well recognized requirements for determining whether a business relationship between two or more persons constitutes a joint adventure." *Id.* at 984.

14. *Id.* at 985.

15. *Id.*

16. The operator tried to argue that the disclaimers had to prevail unless fraud could be proven, *id.* at 983 ("if fraud was not established then the operating agreement was controlling and there was no mining partnership, joint adventure"), and that the court had to reach the fraud issue first. The court rejected this approach. It found instead that the critical issue was the fiduciary relationship and that "a determination of these questions should be in the reverse order." *Id.* at 984. Thus, the court put the fiduciary issue before the question of fraud. In view of this priority, efforts to suggest that *Oklahoma Co. III* can be distinguished because of the claim of fraud are not persuasive. *Compare* Philip Watts, *Contingent Liability of the Passive Working Interest Investor Under Operating Agreements in Oklahoma*, 54 OKLA. B.J. 2797, 2801 (1983) ("Had there not been an element of fraud which seemed to pervade the case, the Court arguably would not have been so willing to find the element of cooperation satisfied.").

The Oklahoma Supreme Court made this decision with unusual self-consciousness because, in an earlier decision in the same case in which one of the judges had accepted a bribe, the court found the operator was not a fiduciary, relying heavily on the disclaimer, but then reversed itself. *Compare Oklahoma Co. I*, 333 P.2d at 542-43 (rejecting fiduciary duty), *with Oklahoma Co. III*, 440 P.2d 978 (Okla. 1968) (finding duty).

jurisdictions have treated operators as fiduciaries under joint-venture theories.[17]

Texas has been more restrictive than any other jurisdiction in interpreting the operator's duty, but the great majority of the Texas operator cases concerned third parties trying to hold nonoperators liable for expenses of operation, *not* disputes over the operator's internal duty to its investors. In *Rankin v. Naftalis*,[18] an early Texas Supreme Court opinion that did concern the link between the operator and its partners, the court seemingly applied a broad fiduciary approach. The parties shared one lease, and the defendant had promised to acquire an adjoining property for their joint interest, but instead leased that property for himself.[19] The trial court submitted a jury issue asking whether the parties "were jointly engaged in the business of operating the Melton lease," a question the jury answered affirmatively.[20] This finding established a joint venture and, hence, a fiduciary relationship.[21]

Though the supreme court reversed because it decided that the challenged conduct was outside the scope of the fiduciary duty—the second

17. For another early Oklahoma case that took a strong view of the operator's duty and tied it to an operating agreement, albeit without elaborating its terms, see *Britton v. Green*, 325 F.2d 377 (10th Cir. 1963). Britton allegedly failed to drill enough wells, allowed drainage, billed excessive costs, and appropriated storage tanks. *See id.* at 385. The court ruled that entering 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." *Id.* at 383. The court did not detail the terms of the agreement, but it did say that the investors had "uniform operating agreements" and that the terms designated Britton operator, with the right to purchase the oil, and the duty to manage and operate the leases for the mutual interest of all leaseholders. *Id.* at 381, 384. With so little detail, the opinion never mentioned whether there were disclaimers. Britton agreed to act for his co-tenants, making him their trustee. "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." *Id.* at 383. Whatever the terms of the *Britton* operating contract, what the court was describing was the effect of a standard JOA; and consistent application of this principle would make most operators fiduciaries.

In *Blackstock Oil Co. v. Caston*, 87 P.2d 1087 (Okla. 1939), the operator concealed good results in order to buy out its investors. *Id.* at 1088. The Oklahoma Supreme Court compared the operator relationship to other relationships that "enable[ ] the person in which confidence or trust is reposed to exert influence over the person trusting him." *Id.* at 1089. It noted that the parties had an agreement to share ownership and costs, *id.* at 1088, but beyond that the opinion gives virtually no details of the agreement's terms.

In *Schmude Oil Co. v. Omar Operating Co.*, 458 N.W.2d 659 (Mich. App. 1990), a Michigan appellate court found a fiduciary duty owed by the defendants, who had reduced the lessee's interests by secretly acquiring unleased interests after learning of a defect in the lessee's title. The court of appeals, holding that "[p]rojects for the development of oil and gas wells are joint ventures" and therefore fiduciary, agreed that this breached their fiduciary duty. *Id.* at 662, 664-67. Two other states have found a breach of fiduciary duty on quite similar facts. *See* TXO v. Hawkins Oil & Gas, Inc., 668 S.W.2d 16, 17 (Ark. 1984); Carroll v. Caldwell, 147 N.E.2d 69, 73-74 (Ill. 1957). For a number of other fiduciary cases on lease acquisition issues, see *infra* note 30.

18. 557 S.W.2d 940 (Tex. 1977).

19. Naftalis v. Rankin, 542 S.W.2d 893, 895-96 (Tex. Civ. App.—Eastland 1976), *rev'd*, 557 S.W.2d 940 (Tex. 1977). Defendant Rankin lied about the adjoining landowner's interest in leasing and even about whether he had secured the lease. *Id.* at 896-97.

20. *Id.* at 895. Rankin "admitted that the parties were jointly engaged in the production of oil from the Melton lease." *Id.* at 896.

21. *Id.*

lease lay outside the JOA contract area[22]—it did not question the fiduciary nature of the joint development. It "recognize[d] that the relationship between the parties in the Melton lease was fiduciary in character," that their "fiduciary duties arose from the relationship of joint ownership of the mineral rights of a particular mineral lease," and that the affected conduct included "paying the production costs" and "sharing the benefits" of the lease.[23] These are standard aspects of JOA relations. The Texas Supreme Court even seemed to group the operator with other traditional fiduciaries: executors, administrators, guardians, attorneys, and partners.[24]

The *Rankin* parties had their own contract, although neither the court of appeals nor the supreme court described many of its terms.[25] The agreement was a customized operating agreement, not the standard JOA.[26] However, the supreme court filled its opinion with fiduciary language and approved the language used by the court of appeals in the face of a liability-limiting Texas statute that sounds much like the no-partnership disclaimer. The Texas statute provided that operating a property "under a joint operating agreement does not of itself establish a partnership."[27] The court agreed that simply proving a joint operating relationship would not prove a formal partnership (a relationship that is not limited to a specific venture),[28] but it held that the statute did not extin-

22. *Rankin*, 557 S.W.2d at 945.

23. *Id.* at 944. The Texas Supreme Court used traditional joint-venture language and cited other joint-venture cases of limited geographic scope. *Id.* at 944-45. It did discuss Texas cases that concern the "informal" fiduciary relationship built upon a prior confidential relationship, *id.* at 944, but it followed that observation with a discussion of traditional oilfield joint-venture cases, *id.* at 944-45. Moreover, the jury's underlying findings did not concern a prior confidential relationship, *id.* at 943, and the case therefore cannot rest on an informal duty.

24. The court mentioned these classic fiduciary capacities in noting that confidential relationships are "broader when the defendant is a fiduciary," in a sentence followed by its pronouncement discussed in text that it "recognize[d] that the relationship between the parties in the Melton lease was fiduciary in character." *Id.* at 944.

25. Early in the opinion, the court noted that each plaintiff invested through a contract that gave the operator control "of the drilling, development, operations, marketing, accounting, and the execution of division orders." *Id.* at 942. The agreements with this Article V.A.-like language identified the first lease, the Melton lease, as they described the geographic scope of the venture. When the court later held that the adjoining property fell outside the fiduciary venture, it described them as "outside of the operating agreement." *Id.* at 946.

26. Naftalis and the other interest owners tried to avoid the Texas statute discussed next on the ground that "there was no joint operating agreement between the parties." Respondents Reply to Robert E. Rankin's Application for Writ of Error at 26, Rankin v. Naftalis, 557 S.W.2d 940 (Tex. 1977) (No. B-6647). At the same time, to sooth predictable judicial concerns that every co-owned lease would become a joint venture, they argued that the fiduciary aspect of their relationship was that "the co-owners work the mine or operate the lease—that is participate in the decisions concerning operation of the mine or lease." *Id.* at 25.

27. *Rankin*, 557 S.W.2d at 945 (citing TEX. REV. CIV. STAT. ANN. Art. 6123b § 7).

28. In citing the Texas statute, the court used it to reject the plaintiffs' argument that the operating relationship created "a broader partnership arrangement." *Rankin*, 557 S.W.2d at 945. It rejected the idea that a joint operating arrangement was enough to impose liability "to operations by one of the parties on other and different lands," an area that would be "outside the scope of the fiduciary duties that were established." *Id.* at 946.

guish Rankin's duty to its investors within the area the parties intended to develop. Moreover, the agreement gave the operator sole control in strong terms, as does the JOA,[29] yet that did not block the duty. None of this language precluded the operator from being a fiduciary.

Oklahoma Co. and *Rankin*, opinions by the highest courts in two major oilfield jurisdictions, fall squarely within mainstream oil and gas law. Neither court hesitated to pronounce the operator's fiduciary duty to its investors. *Rankin* followed many opinions in Texas and elsewhere that treated the operating relationship as fiduciary, but limited the duty to share property acquisitions to leases within the venture's geographic boundaries.[30]

The court hinted that the statute's purpose was to limit liability *to third parties* by citing a commentator's claim that operating-agreement parties "[o]rdinarily . . . do not intend and should not be compelled to bear each other's liabilities." *Id.* at 946 n.6 (citation omitted).

29. *See supra* note 25.

30. For an influential case in which the Kansas Supreme Court treats the operator as a fiduciary but limits the geographic scope of its duty, see *Foley & Loomis v. Phillips*, 508 P.2d 975, 979 (Kan. 1973). "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 . . . ." *Foley*, at 979. The Kansas court defined the geographic boundaries as limited to the section where the parties first acquired leases. *Id.* at 977, 980. In a later case, *First Nat'l Bank & Trust Co. v. Sidwell Corp.*, 678 P.2d 118 (Kan. 1984), the Kansas Supreme Court affirmed a judgment making a petroleum geologist share a nearby acreage acquisition on a joint-venture theory, in spite of an operating agreement that disclaimed "any relationship of mining or other partnership as between us," *id.* at 121, because the agreement "when considered in its entirety" sustained a joint venture, *id.* at 124. Until the Great Retrenchment of recent years, joint-venture doctrines, like mining partnerships, were supple tools to increase standards of care in joint oilfield projects. The Kansas Supreme Court recently followed both cases in another property-exclusion case. *See Amoco v. Charles B. Wilson, Jr., Inc.*, 976 P.2d 941 (Kan. 1999); discussion *infra* note 126 and accompanying text.

Many of the opinions simply do not describe their governing operating agreement, much less any disclaimers in them. In one opinion, again using fiduciary duty language but drawing a geographic circle around the duty, the parties had a written contract but, as is all too common, the court did not describe its terms fully. *See* Warner v. Winn, 197 S.W.2d 338 (Tex. 1946). It did, however, cite some provisions and then note that the operating contract had "twenty-two separate paragraphs," which not only defined rights in detail but "contain[ ] the agreements usually appearing in operating contracts for the protection of both parties." *Id.* at 340.

In *Johnson v. Peckham*, 120 S.W.2d 786 (Tex. 1938), the parties had two leases "owning equal shares in the leases and sharing equally the profits and losses of the enterprise." *Id.* at 786. The opinion gave no added details of their arrangement as it affirmed the court of appeal's conclusion that one partner could not buy out the other without disclosing a pending sale to a third party. *Id.* at 787-88. In *Whatley v. Cato Oil Co.*, 115 S.W.2d 1205 (Tex. Civ. App.—Amarillo 1938, no writ), an opinion forcing the defendant to share a property with its coadventurer, the court cited only small pieces of the contract. *Id.* at 1206, 1208. (The earlier the case, the less the dominance of standard forms and the less certain what, if any, disclaimer clauses might have existed.) In *Shell v. Prestidge*, 249 F.2d 413 (5th Cir. 1957), the Fifth Circuit affirmed a joint venture between Shell and a driller to whom it had assigned its interest, retaining a royalty and certain other rights, *see id.* at 415; there is no indication whether the agreement had disclaimers in it. In *Wilcox Oil Co. v. Empire Oil of Texas*, 195 F.2d 860 (5th Cir. 1952), the trial court found a joint adventure partnership, but the court of appeals found it unnecessary to resolve the effect of this partnership because it found no agreement on the added drilling whose costs were in dispute. The opinion does not give a clue to the overall agreement or any disclaimer clauses.

In a more recent Texas case, *Fuqua v. Taylor*, 683 S.W.2d 735 (Tex. App.—Dallas 1984, writ ref'd n.r.e.), the plaintiff's rights arose from a letter option agreement, *id.* at 737, and

A number of older cases rejected fiduciary status for a given operating relationship, particularly in Texas. Most of these cases, however, involved supply companies and other vendors trying to sue the nonoperators, not just the joint account, and using a fiduciary claim to make nonoperators pay more than their committed share of the project. It is not surprising that these outside efforts to exploit a fiduciary duty foundered because they ignored the settled industry understanding that the joint account, not individual owners and their personal assets, supplies the credit for the joint operation.

A Texas Supreme Court opinion, *Ayco Development Corp. v. G.E.T. Service Co.*,[31] is one of the lead third-party cases. Four oilfield service companies sued to recover for "supplies and services."[32] Though *Ayco* did not involve a standard JOA, the governing agreement included language like the JOA's, as well as some added limiting language. The agreement limited "the Partnership's" contribution to a fixed amount just under half a million dollars. The company designated operator would drill the well "in its individual capacity," and the agreement gave the operator "control and supervision of the actual operations of every kind," language much like Article V.A.[33] A separate Drilling Contract stated that the "*Joint Venture shall have no control over the well,*" a stronger prohibition on nonoperator participation than in the JOA.[34] The contract also made the operator responsible for all costs, provided that it would indemnify nonoperators for any claims or causes of action, and included a disclaimer like Article VII.A. that the agreement did not "set up a

the court applied a *Rankin*-like geographic limit to the duty, finding a violation for letting the plaintiff share in one lease but not another.

Another oft-cited, early joint-venture case, *British Am. Oil Producing Co. v. Midway Oil Co.*, 82 P.2d 1050 (Okla. 1938), added to the irritating history of courts that do not fully explain the subject agreement. The parties had a joint development agreement that was "reduced to writing at great length," *id.* at 1050, and that "in considerable detail, sets out the mutual rights, liabilities and duties of the parties, one to the other," *id.* at 1052. But the court sketched only the most general details. So it is impossible to know what disclaimers and liability limiting language existed in it. *British American* is an early, strong statement of the essentially fiduciary nature of standard joint development arrangements, even as it also stands for the *Rankin* proposition that parties do not have to share acreage acquired outside the joint venture's boundaries.

Courts may cut off the duty to share property acquired in the area of the shared venture if the venture has terminated, *see, e.g.*, Madrid v. Norton, 596 P.2d 1108 (Wyo. 1979), although by rights they first should engage in a searching examination to make sure that the acquisition was not consummated during the joint-venture period or using joint-venture information. Presumably courts would restrict the duty to the Area of Mutual Interest, if the parties had agreed to a limited area for property-sharing in this common industry clause.

31. 616 S.W.2d 184 (Tex. 1981).

32. *Id.* at 185.

33. Brief of Appellants at 1 ex. 1, §§ 5, 9, Energy Fund of Am., Inc. v. G.E.T. Serv. Co., 610 S.W.2d 833 (Tex. Civ. App.—Fort Worth 1980) (No. 8362) [hereinafter Brief of Appellants]. The Joint Venture Agreement referred to an attached Operating Agreement as Exhibit D, but it is not referenced in the briefs and apparently is not part of the record. Brief of Appellees Halliburton Co. and Schlumberger Well Servs. at 8, Energy Fund of Am., Inc. v. G.E.T. Serv. Co., 610 S.W.2d 833 (Tex. Civ. App.—Fort Worth 1980) (No. 8362) [hereinafter Brief of Appellees].

34. Brief of Appellants, *supra* note 33, at 1 ex. 3, § 6(a).

partnership or joint venture."[35]

The service companies apparently did not plead a mining partnership.[36] The parties' use of "Joint Venture Agreement" in their contract's caption and partnership language in its text presumably made joint-venture theory irresistible to the plaintiffs.[37] Arguing *against* such a fiduciary duty, the nonoperators discounted the joint-venture label by citing authority that formal partnership designations are not conclusive, as well as a raft of Texas courts that have turned down efforts by service companies to collect on their bills from nonoperators.[38]

The trial court accepted the service company's joint liability theory. But the court of appeals reversed, and the supreme court affirmed and ordered a take nothing judgment. "[A]s a matter of law," the investors were not joint venturers.[39] Ignoring any difference between the standard JOA and the *Ayco* Joint Venture agreement,[40] the supreme court relied interchangeably on joint-venture and mining-partnership cases holding nonoperators not liable to service companies. It did not, however, provide any reasoning to explain why a fiduciary duty should not apply internally.[41]

As a practical matter, today's conservative, business-oriented Texas Supreme Court is likely to protect most operators by refusing to categorize the operator as a fiduciary in operator/nonoperator cases as well as third-party cases. *Ayco* is but one of many Texas cases finding that an operating

35. *Id.*

36. *Id.* at 24. The service companies pointed out that the nonoperators were to be involved in choosing the well site and deciding upon further development and completion; that one of them was at the well site when the well was drilled and hired his own consultant to advise him on the progress; and that one vendor's representatives spoke with him when having trouble getting paid and then received his money just two days later. Brief of Appellees, *supra* note 33, at 19-20.

37. Looking just at the labels the parties used, *Ayco* might have seemed a strong fiduciary case. The parties had a customized agreement captioned "Joint Venture Agreement" (as well as a separate "Drilling Contract)," and used the labels "joint venture" and "partnership" liberally in their contract. Brief of Appellants, *supra* note 33, at 1 exs. 1, 3. A close look at the supposed joint venture's terms, however, suggested otherwise, as the text shows.

38. *Id.* at 25-27.

39. *Ayco*, 616 S.W.2d at 186.

40. The service companies had "never disputed" the "legal point" that "a joint operating agreement does not of itself create a partnership." Brief of Appellees, *supra* note 33, at 23. But they argued that their joint-venture agreement was quite distinct, and tried to distance themselves from the nonoperators' cases because of the lack of any operating agreement. *Id.* at 24-28.

41. The court did mention that the nonoperators could not be joint venturers when their contracts left them "wholly excluded from participation in the drilling, operation, and control of the well." *Ayco*, 616 S.W.2d at 186. This conclusion most likely referred to the no control language of the Drilling Contract, but it could, of course, have encompassed the Joint Venture agreement's delegation of actual control to the Operator. The court additionally mentioned the agreement fixing the nonoperators' possible contributions as other evidence incompatible with a partnership. *Id.* After reciting that nonoperators were excluded from management, the court added: "Their contract with Energy Fund was that they would pay $154,000 for a part of the costs of drilling each well. They did that." *Id.* But it did not explain the precise mechanics through which it got from the Joint Venture Agreement to the holding as a matter of law that the parties did not have a joint venture.

relationship, often under a standard JOA, is not a fiduciary one. Like *Ayco*, though, the great majority of these cases involves *third-party* claims, not internal disputes.[42] Other Texas cases have extended the

42. As an example, the *Ayco* court cited in text eight prior Texas joint-venture or mining-partnership cases, four from the Texas Supreme Court, as support for its conclusion that no joint venture existed. Of these, five involved third parties who supplied goods or services to the joint account via a contract with the operator but were trying to reach beyond the joint account and impose full liability directly on the nonoperators. In *Youngstown Sheet & Tube Co. v. Penn*, the claim was to foreclose a materialman's lien to collect for supplies and equipment provided to the well. Youngstown Sheet & Tube Co. v. Penn, 355 S.W.2d 239, 242-43 (Tex. Civ. App.—Austin 1962), *aff'd in relevant part, modified on other grounds*, 363 S.W.2d 230 (Tex. 1962). *Rucks v. Burch*, 156 S.W.2d 975 (Tex. 1941), centered on a rented drilling rig. In *U.S. Truck Lines v. Texaco, Inc.*, 337 S.W.2d 497, 498 (Tex. Civ. App.—Eastland 1960, writ ref'd), the suit was to hold nonoperator Texaco liable for the unpaid cost of building a board road. In *Gardner v. Wesner*, 55 S.W.2d 1104, 1105 (Tex. Civ. App.—Austin 1933, writ ref'd), the service company sued to foreclose a mechanic's lien after having been hired to remove a bailer and clean an oil well. In *Root v. Tomberlin*, 36 S.W.2d 596 (Tex. Civ. App.—El Paso 1931, writ ref'd), a drilling company's partners sued after drilling a well for defendants.

A hybrid third-party case, where a court found that a partnership existed, presented unusual facts because the issue was not whether the supply company could hold nonoperators liable, but whether its lien took precedence over that of a nonoperator who had agreed to complete the well in return for securing his interest. *See* Wagner Supply Co. v. Bateman, 18 S.W.2d 1052, 1053 (Tex. 1929). Thus it was pretty obvious that this nonoperator had participated actively in the venture; he "did the labor and the work of operating the mining enterprise and making the well produce oil." *Id.* at 1055.

Two cases were internal disputes. *Munsey v. Mills & Garitty*, 115 Tex. 469, 283 S.W. 754 (1926), had to decide whether an equity owner who acquired his interest from the original landowner's daughter could disinherit the long-time operator, who at great risk and cost had developed a large field. The equity owner claimed that the original parties did not have a partnership and the operator's interest, therefore, was personal to him and did not survive his death. The court found that the relationship "clearly [was] a mining partnership." *Id.* at 758. The other case, *Luling Oil & Gas Co. v. Humble Oil & Ref. Co.*, 191 S.W.2d 716 (Tex. 1946), was a lawsuit between two owners of a lease over the right to an accounting. Although the opinion contains strong language about the burden of showing a partnership, this was dicta: "Whether the relationship of joint adventure or mining partnership existed . . . does not seem to us to be the controlling issue, since the rights of the parties are fixed by the terms of their agreement." *Id.* at 720. The court then held that the contract set out the proper time for adjusting accounts and that its timetable barred the plaintiff's claim.

The Texas Supreme Court cited eight more cases in footnote, *Ayco*, 616 S.W.2d at 186 n.1, but only one actually involved a true internal operator/nonoperator dispute. Two of the cases, *Berchelmann v. Western Co.*, 363 S.W.2d 875 (Tex. Civ. App.—El Paso 1963, writ ref'd n.r.e.), and *Misco-United Supply, Inc. v. Petroleum Corp.*, 462 F.2d 75 (5th Cir. 1972), involved the paradigmatic third-party lawsuit to recover supplies provided to the joint account. Two others involved vendors who had contracted with drilling companies, not the operators, but nonetheless were trying to fix liability on the lessee. *See* J. Robert Neal v. McElveen, 320 S.W.2d 36 (Tex. Civ. App.—Houston 1959, no writ); Shell v. Caudle, 63 F.2d 296 (5th Cir. 1933). *Price v. Wrather*, 443 S.W.2d 348 (Tex. Civ. App.—Dallas 1969, writ ref'd n.r.e.), was an internal dispute between operator and nonoperator, but not a serious claim: the plaintiff's proof of agreement was only his hazy recollection that "we made arrangements and agreements, I'm sure, but I don't remember what they are," and the court found "no mutual right of control," nor an agreement to share profits or losses. *Id.* at 351-52. And *Kahn v. Smelting Company*, 102 U.S. 641 (1880), was an odd case to cite, because it reversed a case in which the court had found no mining partnership for a new hearing, with "the parties to be at liberty to produce new proofs." *Id.* at 647.

Shell v. Caudle actually vouched for a liberal interpretation of the mining-partnership doctrine. It held that the driller who was to acquire a half-interest upon completing a test well, with Shell having "management of the whole lease," nonetheless contemplated a mining partnership, *Shell v. Caudle*, 63 F.2d at 298—all this even though the court's description did not sound as if the driller, McClanahan, would have any control over operations from third-party reasoning to the internal relationship without considering the difference between the two situations. Yet the difference is critical: third-party vendors do not care about the operator's internal duties and, in those disputes, the nonoperators have no incentive to argue *for* a fiduciary relationship. For example, with one aberration, in none of the vendor cases cited by the Texas Supreme Court in *Ayco* did the operator or nonoperator try to raise, or have an incentive to make,[43] the argument that the parties *had* a fiduciary relationship.[44] The nonoperators, often at the end of an unsuccessful project, want to avoid direct liability to the vendor, so they have every incentive to deny a partnership, even if they really believe that their operator has a partner's fiduciary responsibility toward them. The vendors, on the other hand, claim a fiduciary relationship, but they do not have an incentive to prove that an internal duty survives the disclaimers between operator and nonoperator. Their only worry is to prove that *their* rights are not limited by the JOA, an agreement to which they are not a party.[45]

---

that point on. This was not the only cited case with a broad reading of mining partnerships. *State v. Harrington*, 407 S.W.2d 467 (Tex. 1966), was a suit to enforce penalties for drilling a well that violated Railroad Commission rules. The Texas Supreme Court affirmed a judgment against all interest owners, and included a finding that they were in a mining partnership even though the parties had no written agreement and the court's description did not identify any acts of control by two of the four remaining defendants, Allgood and Lutes. *Id.* at 477-78. Indeed, their main "act" seems to have been receiving progress reports. *Id.*

This leaves only one case, *Barrett v. Ferrell*, 550 S.W.2d 138 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.), that involved an internal operator/nonoperator dispute and that denied a mining partnership. But it did so relying on two cases involving other disputes: *State v. Harrington*, the penalty case, and *Gardner v. Wesner*, the third-party supply case, both discussed above. *See Barrett*, 550 S.W.2d at 143-44.

43. One might argue that in the vendor context, the operator has a perverse incentive to claim a mining partnership or joint venture in order to spread some of its liability to the nonoperators. But given that they could sue the operator under the JOA, arguing that the operator had agreed to only bill for a nonoperator's proportionate share, a finding of a mining partnership or joint venture should not help the operator, even if it gave an unexpected recovery to the vendor. Further, an operator that publicly disavowed the limits on joint-account funding in the JOA should not be surprised to find its pool of future investors drying up, or limited to very unknowledgeable investors.

44. The aberration is *Wagner Supply Co. v. Bateman*, 18 S.W.2d 1052 (Tex. 1929), the case over lien priority. Bateman acquired an interest in the lease by agreeing to finish the well, and both it and the Wagner Supply Company ended up with unpaid bills. Bateman did claim a partnership: "According to Bateman's own allegations, Roberts and his associates were a partnership . . . ." *Id.* at 1055. But Bateman, although an interest owner, was acting just as if it was a vendor. It had an unpaid bill and the partnership finding would let it enforce its claims against all participants, not just the operator.

45. In *Youngstown*, for instance, vendor Youngstown was quite happy to argue that the parties might not intend a partnership, but that this rule "has no application where creditors or other third parties are involved." Supplemental Argument on Behalf of Appellant at 20, Youngstown Sheet & Tube Co. v. Penn, 363 S.W.2d 230 (Tex. 1962) (No. A-8984). For these parties, "it is their status that is controlling and not their intention." *Id.* at 21. Youngstown said it again in its petition for rehearing: It argued that the "only thing that could possibly distinguish" its case from other mining-partnership cases was the express disclaimer, but "this contract is binding as between the parties to it, but is not binding on third parties in any way or to any extent. This is elementary." Petitioner's Motion for Rehearing at 8-9, Youngstown Sheet & Tube Co. v. Penn, 363 S.W.2d 230 (Tex. 1962) (No. A-8984).

The Texas joint-venture cases fail to support an absolute barrier to an operator's fiduciary duty to its investors in another way. Even when faced with disclaimers, these courts often looked for acts of joint participation on the assumption that such acts could override the disclaimers and make the operator a fiduciary.[46] They performed a factual analysis that would be irrelevant if Article V.A. or VII.A., or other JOA terms, bar a fiduci-

46. In *Youngstown*, discussed briefly above in notes 42 and 45, the court found for nonoperators in yet another materialman's claim. The agreement provided that "[t]he Joint Leases shall not be operated hereunder as a partnership venture, and the liability of the parties . . . shall be several and not joint or collective." 355 S.W.2d at 241. It also gave the operator "'exclusive charge, control and supervision of all operations of every kind,'" *id.*, though it allowed some control because nonoperators had to approve any expenses over $5,000. The supply company initially claimed to have booked supplies to accounts for the individual owners, that it had not even seen the operating agreement, and that it would not have sold supplies just based on the operator's credit. *Id.* at 242-43. Although the court decided this liability question as a matter of law against the vendor based upon its interpretation of the operating agreement, it did not give the disclaimer conclusive weight. Instead, it found no partnership only because there was "no other evidence sufficient to sustain a finding of partnership." *Id.* at 245. The court stressed that the agreement and the record established neither any sign of "joint operation of the leases nor mutual agency of the parties." *Id.* Had their been joint operations, the court apparently would have looked beyond the contract terms.

In *Truck Lines*, a case with a partnership disclaimer, the appellants argued that the written agreements showed, as a matter of law, that nonoperator Texaco was in a partnership arrangement. Perhaps for this reason, the court focused primarily on the contract disclaimer and the fact that it "negatives any intention to create a partnership." 337 S.W.2d at 500. However, even this was in the third-party context, as this conclusion was followed immediately by: "The contract did not authorize Richardson to create any liability *to third parties* binding on Texaco." *Id.* (emphasis added). Moreover, the court discussed facts showing that the nonoperator did not participate in the pertinent activity, negotiations for building the road. It held that "[n]either the written contract . . . nor the manner of carrying out said contract show as a matter of law that they were mining partners or joint venturers." *Id.* at 499.

In *Rucks v. Burch*, 156 S.W.2d 975 (Tex. 1941), the Texas Supreme Court focused on the lack of joint participation, *id.* at 976 ("There is absolutely no evidence that either Rucks or Middleton were to participate in the drilling operation."), but it is unclear whether it would have done so even with disclaimers, because the opinion does not cite any restrictive language. So too in *Wagner Supply Co. v. Bateman*, 18 S.W.2d 1052 (Tex. 1929), the court discussed such acts as joint operation and mutual agency, but without any discussion of disclaimer or exculpatory clauses. *Id.* at 1055-56.

In *Archer v. Bill Pearl Drilling Co.*, 655 S.W.2d 338 (Tex. App.—San Antonio 1983, writ dism'd), a drilling company tried to extend liability for drilling-pipe damage to an investor. The court reviewed the operating agreement but found determinative that the defendant had "exercised no right to participate in the control or operation of the venture." *Id.* at 344. It did not discuss any exculpatory or limiting clauses. For another fairly oft-cited case in which the court found no liability to a vendor because there was no nonoperator control or participation in management, but never indicated whether there was an operating agreement or, if so, what it was, see *Dunbar v. Olson*, 110 N.E.2d 664, 665-66 (Ill. App. Ct. 1953).

In *Bolivar v. R & H Oil and Gas Co., Inc.*, 789 F. Supp. 1374 (S.D. Miss. 1991), the estate of a Mississippi resident who died from a blowout tried to extend wrongful death liability to an investor but the court rejected that effort because of the lack of mutual control. Apparently the parties did not have any written contract. *Id.* at 1379.

Gardner v. Wesner, 55 S.W.2d 1104 (Tex. Civ. App.—Austin 1932, writ ref'd), though containing some general language about mining partnerships, decided whether net profits interests give rise to mining partnerships. *Id.* at 1106-07. The control issue was not developed in *Root v. Tomberlin*, 36 S.W.2d 596 (Tex. Civ. App.—El Paso 1931, writ ref'd) because the failure to complete a producing well meant that the contemplated operating contract never was executed. *Id.* at 601-02.

ary duty as a matter of law.[47] Just what this factual analysis means for internal operator/nonoperator cases is unclear because acts of control can be relevant to the defense of estoppel. Thus, acts of participation might be relevant to the third-party cases, but not to internal disputes. The opinions do not develop this difference, however, and analyses that look factually at acts of participation are flatly inconsistent with recent cases finding that the JOA's disclaimers and exculpatory clauses preclude fiduciary duties as a matter of law.[48]

The upshot of the joint-venture cases is that for many years operators risked being found liable as fiduciaries in states other than Texas, in spite of the JOA; and even in Texas they might be able to overcome Articles VII.A. and V.A. with appropriate proof of control over the joint operation.

It is hard to tell whether the Texas Supreme Court felt that acts of participation and the like could create a fiduciary relationship in one case where the court did not seem to look outside the contract, *Luling Oil & Gas Co. v. Humble Oil & Ref. Co.*, 191 S.W.2d 716 (Tex. 1945), because neither side seems to have cited any evidence outside the contract. The court's discussion accordingly focused just on contract terms.

In *Munsey v. Mills & Garitty*, 115 Tex. 469, 283 S.W. 754 (1926), there seems to have been little dispute that a partnership existed, just a fight over its scope. So the discussion of the operator's many acts of participation do not shed light on the larger standard.

47. Another example would be *Hamilton v. TXO*, 648 S.W.2d 316 (Tex. App.—El Paso 1982, writ ref'd n.r.e.), in which a nonoperator had tried to avoid nonconsent penalties (imposed for not having consented to well completion) by arguing that the operator had breached fiduciary duties. The parties had a standard JOA. *Id.* at 319. The court matched its facts to *Ayco*'s, which it described as a case where the nonoperators were "wholly excluded from participation in the drilling, operating and control." *Id.* at 321. It approvingly noted that Hamilton was also kept from participating because TXO "had full control of all operations." *Id.* The opinion later listed the standard exculpatory language in section 5 of the JOA, *id.* at 324; presumably section "5" would be Article V.A. of the standard JOA. The court did not discuss evidence of any efforts Hamilton had made to participate, so presumably there had been none. Though the court also considered the fact that the JOA made the parties severally liable, it listed this only after it had described the lack of any evidence of control. *Id.* ("[T]he parties were severally, not jointly, liable under Sections 5 and 22 of the J.O.A."). Had any JOA Article been dispositive, however, the court could have jettisoned its analysis of legal rights to control or acts of control.

Another case coming out in the same nonfiduciary place as *Ayco* and *Hamilton*, but following their lead only after a factual analysis is *James v. Nico Energy Corp.*, 838 F.2d 1365, 1373 (5th Cir. 1988). Alternatively, *Taylor v. GWR Operating Co.*, 820 S.W.2d 908 (Tex. App.—Houston [1st Dist.] 1991, writ denied), did not follow *Ayco* and *Hamilton* largely because the operator had initiated the lawsuit to recover unpaid costs and had itself pled a fiduciary duty. *Id.* at 911-12. Having done so, it became its own greatest barrier against getting summary judgment on the nonoperator's claims.

48. Another category of cases where the issue at stake drives the outcome are the securities cases. A joint venture can be a defense to certain securities claims, so in these instances the operator may somewhat comically trade horses and claim a joint venture to avoid securities liability. Courts concerned with preserving what look like meritorious securities claims may adopt a more stringent reading of joint-venture requirements than they do in the vendor context. As an example, see *Anderson v. Vinson Exploration, Inc.*, 832 S.W.2d 657, 663-64 (Tex. App.—El Paso 1992, writ denied), in which the court noted evidence that the operator had "ultimate control" and even cited *Ayco* and *Rankin*, yet nonetheless held that a fact issue existed on whether a joint venture existed. Thus, the interest to be protected seems to vary the judicial scrutiny.

B. Many Mining-Partnership Cases Similarly Overcame the Two JOA Clauses and Addressed the Fiduciary Issue Directly

The joint-venture cases are by no means the only cases in which courts brushed by the JOA's liability limiting clauses. The mining-partnership cases show the same pattern. This is hardly surprising because these two avenues to making operators fiduciaries are identical in most regards.[49] Courts ruling on the operator's duty cite cases from the two lines of authority interchangeably, as in the *Ayco* decision.

A number of courts have found operators to be mining partners and, therefore, fiduciaries under ordinary JOAs, without letting Article V.A. or VII.A. block them from imposing this high duty. As with the joint-venture cases, some courts treat the fiduciary question as a matter of law; others engage in a three-part factual analysis effectively indistinguishable from the three-part joint-venture analysis.[50] As with joint-venture cases, the mining-partnership opinions that ultimately hold their particular operator *not* a fiduciary often reach that conclusion only after a full three-factor analysis. In doing so, they indicate that the JOA's two liability-limiting clauses are not enough to disavow fiduciary responsibility conclusively, or, for that matter, to limit the operator's obligations in the area in dispute.

Sparks Bros. Drilling Co. v. Texas Moran Exploration[51] is a good example of this. A driller sued nonoperator Texas Moran, in addition to the operator, to recover on unpaid bills. Though the Oklahoma Supreme Court did not describe the operating agreement in much detail, it indicated that the contract provided that liability was several, not joint; that it was not to be construed as a mining partnership; and that it gave the operator "full and direct control" of operations—all terms like the JOA's.[52] The court then discussed whether the parties had a fiduciary

49. For the three-part test as applied to mining partnerships, see 2 Howard Williams & Charles Meyers, Oil and Gas Law, § 435, at 504.1-.3 (2001); 2 Eugene Kuntz, A Treatise n the Law of Oil and Gas § 19A.6, at 109-10 (1993 & Supp. 2002).

50. Many other cases, predictably, do not give details of whatever agreement applied; some seem not to have had an operating agreement. *See* Wagner Supply Co. v. Bateman, 18 S.W.2d 1052 (Tex. 1929) (driller who acquired a one-fourth "royalty interest" for completing well treated as mining partner vis-a-vis vendor, but no details of his contract; given that Bateman was a driller/investor, the odds are higher that the parties did not use a form operating agreement); Mountain Iron & Supply Co. v. Branson, 8 P.2d 407, 408 (Kan. 1932) (lead case holding defendants liable as mining partners for material and supplies, but based on oral agreement); Mud Control Labs. v. Covey, 269 P.2d 854, 857-59 (Utah 1954) (holding defendants liable for materials as mining partners after they had entered a Joint Operating Agreement, but few of its "17 pages" of terms listed; and indicating that agreement to limit liability would not be binding on third parties); Sparks v. Midland Supply Co., 339 P.2d 1056 (Okla. 1959) (holding nonoperator jointly liable as mining partner to supply company when he signed drilling contract, held joint ownership of leases, had agreement entitling him to production, and had detailed contacts with supply company; but no indication of any larger operating or other agreement or of any liability limiting clauses).

51. 829 P.2d 951 (Okla. 1991).

52. *Id.* at 952.

relationship (if so, the nonoperators would have to pay for services provided to the well)[53] without any hint that the partnership disclaimer conclusively barred liability. Ultimately, it reversed the court of appeals and found no mining partnership, but only because the facts did not show enough "cooperation" to prove the third element of a mining partnership.[54] The existence of this fiduciary duty was a fact issue,[55] not a question of law decided negatively because of a disclaimer.

Another example of the mainstream factual analysis is *Blocker Exploration Co. v. Frontier Exploration, Inc.*[56] After the operator went bankrupt, a company that performed seismic tests sued the nonoperator on a mining-partnership theory. Applying the standard three-part test, the Colorado Supreme Court extensively reviewed precedent, particularly on the "joint operations" prong.[57] The court did not list all the terms of the parties' governing agreement,[58] but it relied on a number of cases dealing with the general mining-partnership test, many of which interpreted the AAPL's ubiquitous JOA.[59] Ultimately, the court held that the nonoperator did not have enough participation to be liable as a mining partner. It did not rely either on an Article V.A.-type clause or an Article VII.A. no-partnership disclaimer. Instead, it endorsed the very factual approach that courts should determine if there was an "active role in the conduct of operations"; if not, they should determine whether the agreement creates "a right of participation in the management or control of the operation" (in which case even unexercised rights might sustain liability).[60] *Sparks*

53. For a general treatment of nonoperators' liability for services under Oklahoma law, see Watts, *supra* note 16.

54. *See Sparks*, 829 P.2d at 953-54 ("The acts of Texas Moran are not sufficient to prove cooperation in the drilling of the 1-29.").

55. *Id.* Two Justices dissented, but not because of the disclaimer; they believed the facts did establish a mining partnership. The Oklahoma Supreme Court followed *Sparks*. *See Schulte v. Apache Corp.*, 949 P.2d 291, 297 (Okla. 1995) (finding no mining partnership because no evidence of participation or intent to form partnership, without any discussion of JOA barriers in case with unidentified JOA).

56. 740 P.2d 983 (Colo. 1987).

57. *Id.* at 985-87 (citations omitted).

58. The parties entered a lease assignment that set out nonoperator Blocker's interest and cost responsibility, but in general referred to an earlier lease assignment between the operator and its predecessor, which in turn had appended an unexecuted operating agreement. *Id.* at 984.

59. As seems almost de rigeur, and is perhaps a casualty of appellate courts' penchant for sticking to high principle and ignoring tawdry factual details, far too many of the frequently cited mining partnership cases give little or no detail on the operative agreement, much less a discussion of any exculpatory or liability-limiting clauses. *See, e.g.*, Bovaird Supply Co. v. McClement, 177 N.E.2d 430, 435 (Ill. App. Ct. 1961) (finding no "actual express business partnership," and apparently no written agreement, in vendor case finding no partnership).

60. *See Blocker*, 740 P.2d at 987. In adopting this position, the Colorado Supreme Court tried to reconcile the mass of inconsistent cases about how much proof is needed to prove "cooperation." Is a legal right to participate determinative, or is actual participation required, and if the latter, are routine and fairly passive acts like reviewing leases and invoices enough to show cooperation? The court ultimately decided that such rights as receiving information, having access to the drilling site, and being consulted were not enough to show that the nonoperator "actively controlled the exploration." *Id.* at 986, 988. As these are rights quite similar to those in the JOA, they suggest that the court would

and *Blocker* illustrate the principle that Articles V.A. and VII.A. no more automatically diverted mining-partnership responsibilities in the traditional interpretation than they diverted joint-venture duties.

C. The Operator's Fiduciary Duty in Three Routine Activities—Operating Unitized Property, Handling Joint Account Funds, and Marketing Production—Ignores the Liability Limiting Clauses

Joint-venture and mining-partnership theories have been the main battleground over the operator's duty, but many courts have carved out fiduciary theories as a matter of law for selected activities. These cases, too, show that many courts do not let either Article VII.A. or V.A. derail a heightened duty.

1. Young *and the Unit Operator Theory*

A doctrine that long has generated fiduciary obligations in spite of the JOA's disclaimers and exculpatory limits is the unit-operator doctrine. A unit operator has the same general role as the ordinary operator, but generally for a larger territory. A unit is composed of small properties combined (ideally, to gain economies of scale and avoid waste) in a larger legal unit administered by a single operator.[61] "Fiduciary principles ap-

reject the view that the JOA's rights of participation suffice without some acts of participation. But the willingness to look at actual behavior also suggests that the court did not view JOA clauses as conclusive barriers to fiduciary duties.

61. Unitized properties are mineral interests combined in an area that bounds a producing formation:

> 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.

6 Williams & Meyers, *supra* note 49, § 901, at 1-2. The terms are used interchangeably. *See, e.g.*, Gerard J.W. Bos & Co. v. Harkins & Co., 883 F.2d 379, 381 (5th Cir. 1989) ("[T]here is little distinction between field-wide utilization and single-unit pooling.").

Unitization generally is sought to avoid waste. It should benefit both lessor and lessee. *See generally* 4 Kuntz, *supra* note 49, at 188. Such combinations may even be "essential" to develop a property. *Id.* at 187. Even though the case for unitization often may be economically compelling, it may prove difficult to get all parties to voluntarily agree to develop their properties jointly. *See* 6 Williams & Meyers, *supra* note 49, § 910, at 85-86. Some may want to gamble that their properties are more valuable than surrounding properties and resist combination. *Id.* at 85. For this reason, states enacted compulsory unitization statutes. Williams and Meyers have recounted this history. *Id.* § 912. For the history of compulsory pooling, which 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. *Id.* § 906.

Whether unitization comes about by agreement or by operation of state law, the change leads to entry of a unit and unit operating agreement, two contracts that then control the structure of operations. Standard unit operating agreements have clauses very similar to Articles V.A. and VII.A. *See infra* note 68. Unitization causes at least two major management changes: (1) a single operator will be forced onto nonoperators who may have had no role in its selection; and (2) combining a larger group of nonoperators dilutes each nonoperator's vote.

pear 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."[62]

The lead case for treating the unit operator as a fiduciary is almost half a century old. In *Young v. West Edmond Hunton Lime Unit*,[63] a royalty owner case but one that the court announced could apply to working interests as well, royalty owners in a producing unit sued for alleged underpayment of their share of the unit's oil. Thus this was an internal dispute, not a third-party claim. The operator was delivering the oil under pre-unitization contracts, but allegedly could have found a higher price in the marketplace. In holding the operator bound to pay the highest price available, the court pointed to the nonoperators' lack of control over oil sales as a critical factor.[64] Because the law applying to the unit "afforded

---

62. 6 WILLIAMS & MEYERS, *supra* note 49, § 990, at 869-70.

63. 275 P.2d 304 (Okla. 1954), *appeal dismissed*, 345 U.S. 909 (1955). 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. Howard Williams' discussion of *Young* in his 1962 article helped bolster the case's prominence. *See* Howard Williams, *The Fiduciary Principle In the Law of Oil and Gas*, 13 INST. ON OIL & GAS L. & TAX'N 201, 264-66 (1962).

64. 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. It stressed that the unit statute deprived the plaintiffs of the right to develop their properties themselves or, seemingly, to control their production. *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 their 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 inability to market production from their original leases, the issue in dispute. *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). *Id.* (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; these properties were "productive of oil and gas," *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, when they remained able to take-in-kind the correct volumes attributable to their share of the larger area.

no voice in the organization or management of the unit or in the selection of the unit operator," the unit operator "stands in a position similar to that of a trustee."[65] As noted above, *Young* is a royalty case, but the Tenth Circuit extended the holding to working interest owners as well (to "all who are interested in the oil production either as lessees or royalty owners").[66]

Some courts have traced the unit operator's fiduciary duty to the unit statute, rather than the parties' contract.[67] Unitization statutes, however, generally are implemented by unit operating agreements, and these tend to have disclaimers and limitations just like the standard JOA.[68] Many courts have followed *Young* to make unit operators fiduciaries, in working interest and royalty cases, and they too, presumably, often applied unit agreements with such terms.[69]

A key question is 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 category of activity.

65. *Id.* at 309. Once it had decided that it would treat the operator like a trustee, the court predictably 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." *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. *Id.*

66. *Id.* at 309.

67. *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.").

68. There are standard unit operating agreements just as there are standard JOAs. The 1970 version of the American Petroleum Institute's model-form unit agreement, for instance, had language very much like the pre-1989 JOA's several liability and no-partnership language. API, 1970 Model Form Unit Agreement § 137.6, Article 14.1, *reprinted in* 7 KUNTZ, *supra* note 49, at 202. The companion API model-form Unit Operating Agreement had the JOA's good-and-workmanlike language of prudency, and a limitation of liability to gross negligence or willful misconduct, API, 1970 Unit Operating Agreement § 13.7, Articles 7.1-.2, *reprinted in* 7 KUNTZ, *supra* note 49, at 220, although the operator did have a higher duty to consult with interest owners and an at-least lukewarm duty to "keep them informed of all matters" (strong language) "which Unit Operator, in the exercise of its best judgment, considers important" (immediately watered down), *id.* The operating agreement even contained a redundant (given the unit agreement) several liability/no-partnership paragraph. *Id.* § 14.1, *reprinted in* 7 KUNTZ, *supra* note 49, at 225. The API's model-form unit agreement for field-wide units also had an Article VII.A. clone. API, Model Form of Agreement for Statutory Unitization § 12.1, *reprinted in* 7 KUNTZ, *supra* note 49, at 246. The parallel unit operating agreement had both Article V.A. and VII.A. language. *Id.*, Articles 7.1-.2, 13.1, *reprinted in* 7 KUNTZ, *supra* note 49, at 264, 268-69. There is no reason to think that such common, familiar boilerplate was not in the *Young* operating agreement as well.

69. 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. Some of the cases are ordinary working interest cases citing *Young* with approval for the rule that unit operators are fiduciaries. Here the most recent is *ENI v. Samson Investment Co.*, 977 P.2d 1086 (Okla. 1999), in which the Oklahoma Supreme Court confirmed that unit agreements give rise to fiduciary duties, but also held that the agreement "defines the limits of the duty" and did not extend to a duty to notify of acquisition of future interests. *Id.* at 1088-89. There are other cases discussing *Young*. *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 a position similar to that of a trustee"); 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 over 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); Conoco v. J.M. Huber Corp., 148 F. Supp. 1157, 1170-73 (D. Kan. 2001) (finding fiduciary duty under Oklahoma law, citing *Young* among other cases, but not extending it to duty to provide information to interest owner of "dealings with DOE and its regulations" in case over reimbursement Conoco sought for past payments to interest owners on unlawful stripper price), *aff'd*, 289 F.3d 819 (10th Cir. 2002).

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. *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*, 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. It treated *Young*, therefore, as a statutory loss-of-control case; and distinguished *Reserve Oil* as involving a narrow trustee-type duty not in issue. Citing authority that fiduciary obligations can be limited contractually, the court held that the clear alternative lien foreclosure provisions in the agreement gave the operator the right to foreclose in any manner it chose. *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 always are fiduciaries, or just believed that the duty was not as broad as alleged. *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* . . . . [The operating agreement] expressly negates such a duty.") (emphasis added); *id.* at 377 ("The *claimed* fiduciary duty does not exist.") (emphasis added). The Tenth Circuit followed *Andrau* under Wyoming law, finding no fiduciary duty, because it found "the terms of the [unidentified] agreement not expressly or impliedly giving rise to one." *Connaghan v. Maxus Exploration Co.*, 5 F.3d 1363, 1365 (10th Cir. 1993).

A number of royalty owner cases follow *Young*. *See, e.g.*, Pritchett v. Forest Oil Corp., 535 S.W.2d 708, 710 (Tex. Civ. App.—El Paso 1976, writ ref'd n.r.e.); Shutts v. Phillips Petroleum Co., 732 P.2d 1286, 1298 (Kan. 1987); Leck v. Cont'l Oil Co., 800 P.2d 224, 229 (Okla. 1989), *applied after certified question decided*, 971 F.2d 604 (10th Cir. 1992); Finley v. Marathon Oil Co., 75 F.3d 1225, 1229 (7th Cir. 1996); Roberts Ranch Co. v. Exxon, 43 F. Supp. 1252, 1263-66 (W.D. Okla. 1997); *cf.* Goodall v. Trigg Drilling Co., 944 P.2d 292, 295, 295-97 (Summers, C.J., concurring) (urging Oklahoma Supreme Court, in an overriding royalty case, to define nature of royalty relationship, and citing *Young* among other cases in urging quasi-fiduciary standard). *But see* Arco v. Farm Credit Bank, 226 F.3d 1138, 1161-63 (10th Cir. 2000) (declining to follow *Young* under Colorado law); *id.* at 1162 n.12 (citing Gary Catron, *The Operator's 'Fiduciary' Duty to Royalty and Working Interest Owners*, 64 OKLA. B.J. 2763 (1993), for the proposition that the *Young* rule is limited to Oklahoma—a narrow reading that this footnote shows is incorrect); Gerard J.W. Bos & Co. v. Harkins & Co., 883 F.2d 379, 381-82 (5th Cir. 1989) (refusing to apply *Young* under Mississippi law in suit over cancellation of take-or-pay contract where court found that unit operator's au-

One reason *Young* is so interesting is that it shows that the standard courts sometimes use to deny fiduciary responsibility in joint-venture and mining-partnership disputes, the interest owners' lack of control, actually should be a reason to find a heightened duty when dealing with the internal relations between operator and nonoperator. It makes sense, of course, when considering claims by vendors and other third parties against the joint account, to only allow liability against nonoperators if they did something to incur the expense. Ordinarily, those supplying services and equipment to an oilfield project do not rely on the nonoperators' credit. But if nonoperators have been actively involved, the outsider might reasonably have relied on their credit and assurances. In this context, it is fair to use participation and control as a test of liability.[70] In relations between investors and their operator, however, the unit-operator doctrine extends extra protection because the operator's wide range of discretionary activity gives it an unusual amount of power over the investors' interests, a power that is very hard to oversee. In the

---

thority did not include marketing production). Because standard leases do not have terms similar to Article V.A. or VII.A., this Article does not address those cases further.

Young has been cited as a general fiduciary rule, without being limited to units. *See* Teel v. Pub. Serv. Co., 767 P.2d 391, 396 & n.9 (Okla. 1985) (citing *Young* in interest owner accounting case 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 trust obligation 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).

One bold author has argued that *Young* is not really good authority for a fiduciary rule. In an exotic 1993 reading of Oklahoma law, Gary Catron argued that the outcome "may not have depended on the establishment of a fiduciary obligation." Catron, *supra* note 69, at 2765. He did not show how his reading can be reconciled with the Oklahoma Supreme Court's strong language: "The 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.

As with some other fiduciary duties, so with the *Young* doctrine, the most reluctant courts may be in Texas. *Young* has not been applied to any working interest disputes in Texas, and the Fifth Circuit rejected a royalty fiduciary duty in a unitized property under Texas law. Rutherford v. Exxon, 855 F.2d 1141, 1145 (5th Cir. 1988). In *Rutherford*, the lessors sued claiming that they had been fraudulently induced to agree to unitization by misrepresentations about the benefits of combining their properties, only to see their post-unitization 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. *Id.* at 1145-46. Though the case involved only royalty interests, *Young* claimed that the unit fiduciary rule applied to royalty and working interest relations. The Fifth Circuit seems to have rejected unitization as a source of fiduciary liability generally as far as Texas law is concerned.

70. Joint liability on this basis still could be too broad, because the only participation that should be relevant to a third party would be conduct that normally forms a basis for estoppel—joint participation on which the third party relies. Nonetheless, there is at least a rationale in third-party liability cases that participation often could be relevant.

internal setting, lack of control is a reason for finding liability, not for excusing it.

2. *The* Reserve Oil *Trust Fund Theory*

The second of the other fiduciary theories is the *Reserve Oil* trust theory, which the Tenth Circuit originated in *Reserve Oil, Inc. v. Dixon.*[71] Again the duty arose from an internal dispute. The Tenth Circuit did not identify the specific operating agreement, but the language it cited tracks the JOA.[72] The operator, Dixon, sold production belonging to Reserve Oil, an interest owner, and then used the funds to pay its operating costs and to cover the shares of other owners.[73] Reasoning that the operating agreement gave each owner title to its own production and that nothing authorized the operator to commingle their money, the Tenth Circuit held that the operator had a trust responsibility over the investor's money.[74] "[T]his 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."[75] This holding could not be correct if Article VII.A. blocked all fiduciary responsibility, or a clause like Article V.A. reduced the operator's liability for all of its acts to the implausible threshold of gross negligence or willful misconduct.

Though the court left the precise origin of this trust-like duty murky,[76] as it did the scope of the heightened responsibility, *Reserve Oil* has been cited with approval in a variety of accounting contexts. For instance, in *In re Mahan & Rowsey, Inc.*, whose guiding JOA was "substantially similar" to *Reserve Oil*'s,[77] an investor sued to recover overbillings after the operator went bankrupt. The bankruptcy court found *Reserve Oil* dispositive and that the agreement created a fiduciary relationship in the collection of well costs.[78] The district court and Tenth Circuit affirmed without sug-

---

71. 711 F.2d 951 (10th Cir. 1983).

72. For instance, the language quoted in paragraph 13 giving the Operator "the right . . . but not the obligation, to purchase such oil and gas," *id.* at 952, is a standard term in Article VI.C. of the 1977 JOA. And the agreement included an accounting procedure in Exhibit C, the standard JOA arrangement, *id.* at 953 n.3, containing language that is the JOA's standard Copas accounting form.

73. *Id.* at 952.

74. *Id.* at 952-53.

75. *Id.* at 953. The court apparently did rely on the no-partnership language in noting that it did "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." *Id.* (emphasis added). Thus it too applied the traditional understanding of what presumably was Article VII.A. (that it arose to deal with third-party claims). *See infra* notes 124-27 and accompanying text.

76. The Tenth Circuit cited none of the many prior joint-venture and mining-partnership cases. It did refer to *Young*, the lead unit operator/fiduciary case, but nothing in the opinion indicated that the properties were unitized.

77. *See In re* Mahan & Rowsey, Inc., 35 B.R. 898, 903 (W.D. Okla. 1983), *aff'd on pertinent grounds*, 62 B.R. 46 (Bankr. W.D. Okla. 1985), *aff'd after remand*, 817 F.2d 682 (10th Cir. 1987). The Tenth Circuit said that *Reserve Oil* had "an operating agreement of the type present in this case." *In re Mahan & Rowsey*, 817 F.2d at 684.

78. *In re Mahan & Rowsey*, 35 B.R. at 901-03. The bankruptcy opinion found Articles V.A. and VII.A. irrelevant in two ways: not only did it apply the trust-like theory as a

gesting that any JOA Article limited this trust duty. Other cases applying this doctrine pay just as little attention to liability-restricting clauses.[79] Even the industry seems to have conceded this fiduciary duty; the section on "custody of funds" in the 1989 JOA provides that the paragraph does not establish a fiduciary relationship toward nonoperators "for any purpose *other than to account for Non-Operators funds as herein specifically provided*."[80] This language signifies the industry's resignation, perhaps even welcome, to a fiduciary duty when the operator acts as a custodian of its nonoperators' money. In these cases, as in the unit cases, it is the operator's full control over investor affairs that creates its extra-contractual responsibility.

---

matter of law, but it held that the traditional joint-venture theory raised fact issues, ones that could not be decided on summary judgment. *Id.* at 901-02. Had either Article controlled, there would have been no fact issue about fiduciary duty, nor could the operator have labored under trust-like duties as a matter of law.

79. In *Envirogas v. Walker Energy Partners*, 641 F. Supp. 1339 (W.D.N.Y. 1986), the 1400 wells had a variety of operating agreements, none spelled out in detail, but presumably many were standard JOAs. The court found *Reserve Oil* a "useful analogy" as it concluded that it appeared likely the defending corporations would prove a fiduciary relationship, *id.* at 1345; it uttered not a word about Article V.A. or VII.A. *See also In re* Antweil, 154 B.R. 982, 985 (Bankr. D. N.M. 1993) (following *Reserve Oil* to find trustee duty). *Andrau*, which acknowledged *Reserve Oil* but did not let it override specific debt collection rights, concerned a barely identified Unit Operating Agreement. The court distinguished *Reserve Oil* because that court "was simply construing the parties' contract." 712 P.2d at 375. Given the similarity of operating terms and commonality even within unit agreements, the terms of the agreements may well have been substantially the same. The Tenth Circuit similarly distinguished *Reserve Oil* in finding that the gas-balancing obligation claimed by plaintiffs was not among the "duties outlined in the contract, nor are they duties that would naturally arise as corollaries to the obligations set forth in the agreement." Doheny v. Wexpro Co., 974 F.2d 130, 134-35 (10th Cir. 1992); *see also* Conoco v. J.M. Huber Corp., 148 F. Supp. 1157, 1170-73 (D. Kan. 2001) (finding fiduciary duty under Oklahoma law, citing *Reserve Oil* among other cases, but not extending that obligation to inform interest owner of "dealings with DOE and its regulations" in case over reimbursement Conoco sought for its past payments to interest owners based on unlawful stripper price), *aff'd*, 289 F.3d 819 (10th Cir. 2002).

Because of *Reserve Oil*'s unexplained reliance upon *Young*'s fiduciary rule for unit operators, several cases have cited its dictum that the unit operator is a fiduciary. *See* Shearn v. Ward Petroleum Corp., 808 F. Supp. 1530, 1532 (W.D. Okla. 1992); *Leck*, 800 P.2d at 228-29. If the applicable unit operating agreements or statutory terms in these cases contained clauses like Article V.A. or VII.A., the courts did not mention them.

80. 1989 JOA, *supra* note 2, Article V.D.4. (emphasis added). The paragraph applies to funds "advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Contract Area." *Id.* Commentators express approval of the duty. *See* Lynn Hendrix & Staunton 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 § 10.04[3][a], at 10-22 to -26 (1993) (making exception for fiduciary duty "to account for money or property received by the operator"); Ernest Smith, *Duties and Obligations Owed by An Operator To Nonoperators, Investors, and Other Interest Owners*, 32 Rocky Mtn. Min. L. Inst. 12-1, 12-10 to -11 (1986) [hereinafter Smith, *Duties and Obligations*] (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, Address at the Rocky Mountain Mineral Law Foundation 3-9, 3-17 (1997) [hereinafter Smith, Voluntary Agreements & Compulsory Orders]; Guy Wall, *Joint Oil and Gas Operations in Louisiana*, 53 La. L. Rev. 79, 100 (1992).

3. *The Operator as Marketing Fiduciary*

A last fiduciary theory disregarding the JOA's two liability shields was launched in the early 1990s by a Texas court of appeals. In *Johnston v. American Cometra, Inc.*,[81] the parties had a 1977 JOA. The operator was a successor to the original operator and apparently did not own an interest in the well.[82] The working interest owners sued when the operator failed to pursue a claim for breach of a take-or-pay gas purchase contract. The nonoperators argued that American Cometra's hiring to "operate and manage a well for Appellants" made the company their agent and, therefore, a fiduciary.[83] In response, the operator's brief set out in detail arguments based on both Article V.A. and VII.A., as well as the claim that Texas law treats the operating tie as "strictly contractual."[84] The same argument was raised in an amicus brief later filed in the Texas Supreme Court by the Texas Mid-Continent Oil & Gas Association.[85]

The trial court granted summary judgment for the operator. In reversing and remanding, the court of appeals held that if the operator sold gas on behalf of the nonoperators, it owed "all those duties owed by an agent to its principal."[86] The idea that an operator marketing production assumes heightened responsibility over its nonoperators' affairs is a familiar one, because it also reflects the substantive effect of *Young*. The *Johnston* operator cited a long line of cases holding that "no fiduciary relationship exists between the operator and the non-operators."[87] Those cases, however, addressed "the relationship between the operator and third parties" and were "not dispositive of the duty issues raised by appellants' pleadings."[88] That limited purpose was not germane to this internal dispute. Pointing to Article VII.A. and to the delegation of control to the operator, the court claimed that the "intention of the JOA is to delegate operational and managerial control to the operator with the intent of shielding the non-operators from liability."[89]

---

81. 837 S.W.2d 711 (Tex. App.—Austin 1992, writ denied).

82. Appellants' Brief at 2, 31, Johnston v. Am. Cometra, Inc., 837 S.W.2d 711 (Tex. App.—Austin 1992, writ denied) (No. 03-90-00249-CV) [hereinafter Appellants' Brief, *Johnston v. Cometra*]. This presumably was why the nonoperators agreed that "[b]y admission of all parties, they are not joint venturers." *Id.* at 32.

83. *Id.* at 32-34.

84. *See* Appellee's Brief at 11, 14-16, Johnston v. Am. Cometra, Inc., 837 S.W.2d 711 (Tex. App.—Austin 1992, writ denied) (No. 03-90-00249-CV) (the Article V.A. argument); *id.* at 23 (the Article VII.A. argument); *id.* at 12-13, 18, 23-24 (the Texas law section).

85. Amicus Curiae Brief of Tex. Mid-Continent Oil & Gas Ass'n, Johnston v. Am. Cometra, Inc. (Tex. 1993) (No. D-3092).

86. *See Johnston*, 837 S.W.2d at 716.

87. *Id.* at 715.

88. *Id.* at 715-16.

89. *Id.* at 716. The court cited Ernest Smith's well-known 1986 article on the operator's duty as authority for its conclusion. *Id.* (citing Smith, *Duties and Obligations*, *supra* note 80). Moreover, even if there was no fiduciary duty, American Cometra's failure to protect its nonoperators' rights could violate its duty as a reasonably prudent operator and its duties as agent. *Id.*

Johnston recently has been read to apparently give rise to a duty only to perform in a workmanlike manner, like any operator, Reeves & Thompson, *supra* note 5, at 229, but

Though one way to read *Johnston* is that the operator is not an overall fiduciary, but just an agent in one particular activity, marketing production, this reading is not sufficient to explain the opinion. For Article VII.A. in the 1977 JOA provided that the agreement did not form a partnership or association and, in addition, that each party would be "liable only for its proportionate share of the costs of developing and operating the Contract Area."[90] If this language applied between the parties, as well as to third-party liability, it should have blocked any fiduciary or agency liability of American Cometra for failing to make a take-or-pay claim. Moreover, Article V.A. limited American Cometra's liability to "gross negligence or willful misconduct." This conflicted with the court of appeals' conclusion (ironically, drawn from the same paragraph) that American Cometra could have been liable if it merely failed to act with reasonable prudence in not making the claim. The court simply did not apply the exculpatory and disclaimer language to the internal marketing dispute between this operator and its nonoperators.

A year later, in *Arco v. Long Trusts*,[91] another Texas court of appeals faced a JOA of the same vintage[92] and agreed that "an agency relationship does arise when an operator is selling gas belonging to a nonoperator."[93] A variety of prominent commentators, as well as several other courts, have endorsed this agency marketing duty without any suggestion that the JOA's two liability-limiting paragraphs should cut it off, and the 1989 JOA expressly leaves room for the operator to have this fiduciary responsibility over revenues received from selling the nonoperators' production.[94]

---

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.

90. 1977 JOA, *supra* note 2, Article VII.A.

91. 860 S.W.2d 439 (Tex. App.—Texarkana 1993, writ denied).

92. The language the court did cite from its JOA, the take-in-kind paragraph VI.C., *id.* at 442-43, is in the 1977 and 1982 JOAs.

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

94. On commentators' views, see Smith, *Duties and Obligations*, *supra* note 80, at 12-43; Margaret Sullivan, *Negotiating Joint Operating Agreements*, 23 TEX. STATE BAR SECTION REPORT, OIL, GAS & MIN. L. 3, 5, 9 (1998); Smith, Voluntary Agreements & Compulsory Orders, *supra* note 80, at 3-16 to -17.

Both *Johnston* and *Long Trusts* cited work by Ernest Smith on the operator's duty when marketing production. *See, e.g.*, *Johnston*, 837 S.W.2d at 714-15 (citing Ernest Smith, *Gas Marketing by Co-Owners: Disproportionate Sales, Gas Imbalances and Lessors' Claims to Royalty*, 39 BAYLOR L. REV. 365, 370 (1987), for proposition that operator may act as agent in selling nonoperators' gas); *Long Trusts*, 860 S.W.2d at 445 (same). In a subsequent case, the court did not give any details of the operating agreement. *See* Jonalstem, Ltd. v. Corpus Christi Nat'l Bank, 923 S.W.2d 701, 705 (Tex. App.—Corpus Christi 1996, writ denied) (finding that operator's "act of selling for the other appellants . . . made him their agent," citing *Johnston*, 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). A still later Texas case 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 any fiduciary duty to the plaintiffs. Holloway v. Arco, 970 S.W.2d 641, 643 (Tex. App.—Tyler 1998, no pet.). In *Holloway*, the agreement presumably was a standard JOA; the contract had the JOA's pre-1989

D. Major Academic Commentators Used to Assume that the Operator's Fiduciary Status, Though Perhaps a Fact Issue, Would Not Be Derailed by Boilerplate JOA Terms

The traditional JOA-fiduciary rule is encapsulated as well in lead articles by some of the industry's best-known commentators. In 1962, in an early, detailed review of the operator 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."[95] He predicted that "[i]t appears a safe prognosis to declare that to an increasing extent we may expect fiduciary principles to be applied to various relationships involving interests in oil and gas."[96] When Williams discussed the "per cent" or "participating" working interest, he claimed that the relationship "has been said to be one of trust and confidence amounting to a voluntary trust,"[97] and that "co-owners' groups" with a promoter as operator "may be described in appropriate cases as a partnership, limited partnership, mining partnership, or as a joint venture."[98] In this way, Williams put the traditional operator/interest owner case in a fiduciary category.[99]

"best price obtainable" language, which the court cited as it held that operator Arco might have breached this contract duty. *Id.* at 642. But *Holloway* also did not rely on Articles V.A. or VII.A. in agreeing that no fiduciary duty existed on these 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 Litig., 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 on wells that happen to turn up natural gas and another lesser duty on wells that strike oil. The opinion states that counsel for defending oil companies 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 this fiduciary duty, see *supra* note 80 and accompanying text.

95. Williams, *supra* note 63, at 274. Williams predicted that:

> Wherever the owner of an interest in oil and gas has a *power* with respect to another person's interest in oil and gas, the courts are quick to imply a *duty* in connection with the exercise of such power. Power begets responsibilities and duties. A fiduciary principle becomes applicable.

Id. Williams' early article focused heavily on the lessor/lessee relationship, *id.* at 215-31, and executive/nonexecutive issues, *id.* at 239-52, both of which Williams found governed by something less than a full fiduciary duty.

96. *Id.* at 274-75.

97. *Id.* at 237.

98. *Id.* at 272.

99. Williams did observe that the traditional no-partnership disclaimer "might be viewed as negating a fiduciary relationship between or among the parties," *id.*, but by noting that its purpose was to avoid joint tort liability and by not giving it extended discussion, he suggested that it should not be a major factor in fiduciary analysis. Disclaimers did not claim significant space in his pages.

Writing almost a quarter century after Howard Williams, 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.[100]

Given the prevalence of JOAs, had Professor Smith believed that the JOA's disclaimer and exculpatory Articles are "other factors" that justify a lower standard, he most likely would have rewritten his article to claim that "One can, I think, safely start with the assumption that the operator is excused by the standard JOA, unless in the presence of unusual language or, perhaps, control by the nonoperator. But ordinarily, the operator will not be a fiduciary." The *absence* of a standard JOA then would be one "other factor," albeit a somewhat unusual one, that raises, instead of lowers, the operator's duties. Professor Smith did argue that the operator's duty generally should be decided on a case-by-case basis.[101] He did not suggest, however, that the industry's boilerplate disclaimers already decide the issue across most cases and preclude a fiduciary duty.

A third commentator on the operator's duty, Howard Boigon, agreed in the same period that in almost every state the standard JOA satisfies the requirements of a joint-venture and its fiduciary trappings. "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."[102]

---

100. Smith, *Duties and Obligations*, *supra* note 80, at 12-14 (emphasis added); *see also id.* at 12-5. Smith's full 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 is "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 Martin, *The Joint Operating Agreement - An Unsettled Relationship?*, SWLF SPECIAL INST. 98, 115 n.39 (1997). Smith's view that oilfield parties should be able to disclaim fiduciary duties and his preference for a nuanced factual standard is pronounced 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, 372-75 (1985) (urging standard that "should vary with the nature and purpose of the transaction").

101.
> A court in interpreting an operator's duties should not lose sight of [such] customs and usages .... [T]he appropriate 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.*

Smith, *Duties and Obligations*, *supra* note 80, at 12-14 (emphasis added).

102. Howard L. Boigon, *The Joint Operating Agreement in a Hostile Environment*, 38 INST. ON OIL & GAS. L. & TAX'N 5-1, at 5-5 (1987) [hereinafter Boignon, *Hostile Environment*]; Howard L. Boigon, *Liabilities and Relationships of Co-Owners under Agreements*

These authors could not have treated the operator relationship, which in American law is tantamount to a JOA relationship in the vast majority of oilfield projects, as generally fiduciary if they thought the JOA's standard terms block such a duty. If they meant that the operator owes non-operating investors a fiduciary duty unless they use the omnipresent JOA, they would have said so. These major reviews of operator jurisprudence agreed with dominant case law that the JOA and its terms do *not* prevent operators from having a fiduciary duty toward their working interest investors.

---

for Joint Development of Oil and Gas Properties, 37 INST. OIL & GAS L. & TAX'N 8-1, 8-20 (1986) [hereinafter Boigon, *Liabilities and Relationships*] ("[T]he 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."); *id.* at 8-17 ("In fact, apart from such disclaimers, the typical joint operating agreement appears to contain all the requisite indicia of mining partnerships or joint ventures."). Boigon did qualify his opinion with the caveat "in states other than Texas." Boigon, *Liabilities and Relationships*, *supra*, at 8-20. While it is true that Texas does not have the depth of fiduciary case law of, say, Oklahoma, it has not fully rejected the three-part joint-venture or mining-partnership tests. *See, e.g.*, Rankin v. Naftalis, 557 S.W.2d 940 (Tex. 1977). For others reaching roughly the same conclusions, see Christopher Lane & Catherine Boggs, *Duties of Operator or Manager to its Joint Venturers*, 29 ROCKY MTN. MIN. L. INST. 199, (1983):

> The problem . . . that [joint operating] relationships pose is that as soon as any element of control or voice in operational decisions is shared, all the characteristics of the joint venture or mining partnership are present: (1) joint ownership; (2) co-operation/joint operation; and (3) agreement to share profits and losses. Absent a contractual provision to the contrary, it is highly likely that a court would hold that a joint venture or mining partnership exists.

Id. at 209.

> 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.

Id. at 238-39. *See also* DERMAN, *supra* note 6, at 41, 71-72 (operator may be a mining partner if mutual control exists); *id.* 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"); *id.* at 78-83 (discussing disclaimer cases); Keefe, *supra* note 6, at 18-12 & n.34 (courts "generally will impute fiduciary duty . . . unless the agreement specifically provides otherwise" and "some debate" arises over enforceability of disclaimers).

The most frequently cited article on mining partnerships, by Terry Fiske, did not come out clearly in favor of disclaimers. *See* Terry Noble Fiske, *Mining Partnership*, 26 INST. ON OIL & GAS L. & TAX'N 187, 235-36. Fiske 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. *Id.* at 235. Disclaimers or express limitations "probably are of limited value" toward third parties, but "should have greater significance" between the parties. *Id.* at 235-36.

As shown, some of these articles did mention disclaimers, but they assumed that there is a live fiduciary duty in most operator cases, an unfounded opinion if standard paragraphs in the vast majority of operating agreements disclaim or limit such duties. At most, the question of disclaimers was an unsettled one that might affect individual cases, but not exculpate operators as a body. This treatment of the issue belongs to the industry's age of innocence, before the drive to disclaim all tort liability reached its full strength.

II. SOME COURTS APPLYING THE SAME JOA LANGUAGE IN THIS TORT-REFORM ERA HAVE LOWERED THE OPERATOR'S DUTY OF CARE

In recent years, particularly since the early 1990s, some courts have shifted to a much more restrictive reading of the same JOA terms that courts had not treated as a per se barrier to fiduciary liability in earlier years. They have done so using Articles VII.A. and V.A., independently or in combination, but without acknowledging their change from past interpretations. Commentators reflect this more conservative trend. Moreover, in 1989, the AAPL amended the JOA to more expressly disclaim tort liabilities, although it left room for a fiduciary duty in the areas of handling funds and marketing production.

An oft-cited, early example of the revisionist approach is *Tenneco v. Bogert*,[103] a 1986 opinion in which an Oklahoma federal district court rejected efforts to force the operator to drill an additional well when it knew of a draining well. In a way it was a silly dispute. *Both* sides had the right to propose a new well; the operating agreement did not allocate this responsibility exclusively to the operator.

The parties almost certainly had a standard JOA, yet the court did not treat their contract as barring any possible fiduciary duty. Though the court did not identify the operating agreement, it cited no-partnership language identical to that in Article VII.A[104] and a "section 5" that contained JOA Article V.A. language.[105] Oddly, considering its ultimate holding, the court even called the overall relationship a fiduciary one ("the present joint operating agreement may be seen to create a joint venture with attendant fiduciary duties").[106] Nonetheless, the case then became what can be called a "fiduciary-but" case as the court used other parts of the contract to limit the obligation. Arguing that the term "fiduciary" is "bandied-about without precision," the court found the "existence and extent" of the duties defined (and so limited) by the JOA.[107] Though Tenneco was suing over the operator's failure to drill an additional well, the agreement only required the operator to drill a first test well. *Any* party could move to drill other wells,[108] but because the agreement did not require the operator to drill additional wells, failing to do so could not be actionable.[109] The additional well was outside the contractual field,

103. 630 F. Supp. 961 (W.D. Okla. 1986).

104. *Id.* at 963 ("The liability of the parties shall be several, not joint or collective. . . . It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render them liable as partners.").

105. *Id.* at 966 (citing section 5 of the agreement, which stated that the "Operator . . . shall conduct all operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties . . . except as such may result from gross negligence or from breach of the provisions of this agreement."). This language about "breach of the provisions of this agreement" was in the 1956 JOA. *See infra* note 137.

106. *Bogert*, 630 F. Supp. at 966-67.

107. *Id.*

108. *Id.* at 969.

109. *Id.*

which bounded the operator's fiduciary responsibility.[110]

Bogert was not clear on whether the parties had disclaimed their fiduciary duty, or merely limited it to an area where the court felt the contract dictated the outcome.[111] Moreover, it is one of those mischievous cases in which the court almost certainly found the substantive argument so unappealing (the court finding it ridiculous that one party with a right to drill a well could sue another party with an equal right to drill) that it wasn't concerned about articulating precisely why the duty did not exist. Such is the danger of dictum. But *Bogert* is an early outpost for the most conservative readings of the JOA.

A number of courts in the years following *Bogert* have held that the JOA precludes any fiduciary duty, be it for an activity within the contract's terms or not.[112] Many use Article VII.A. They preempt the typical

110. Parts of the opinion, like the discussion of Article V and of the existence of detailed contract obligations, *see Bogert*, 630 F. Supp. at 966, sound as if the overall duty was extinguished; 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, *id.* at 967, as if the court merely narrowed the duty. The court also found that the operating agreement did not support claims that the operator should have shared information that would have let the nonoperator take corrective action. *Id.* at 967-68.

111. On the immediate question of whether the plaintiff could force the operator to drill an additional well, the court refused to find that the operator breached any duty by not drilling a well when any party could propose drilling an offset well. *See id.* at 968-69.

One subsequent case using *Bogert* to limit fiduciary duties is *True Oil Co. v. Sinclair Oil Corp.*, 771 P.2d 781 (Wyo. 1989). The Wyoming Supreme Court found that the parties had a fiduciary relationship, *id.* at 793, and even that the evidence supported the trial court's finding of a joint venture, *id.* at 797, but "the rights and duties of the parties are controlled by their agreement," *id.* at 793. It then aggressively ignored most of nonoperator Sinclair Oil's evidence and held that the correct reading of the agreements required reversal of the trial court's judgment for Sinclair on certain cost issues. *Id.* at 794-95.

An early case to which many of the "fiduciary-but" cases return is *Frankfort Oil Co. v. Snakard*, 279 F.2d 436 (10th Cir. 1960), *cert. denied*, 364 U.S. 920 (1960). *See, e.g.*, *Bogert*, 630 F. Supp. at 969. Here, as in *Bogert*, one claim was that an operator should have drilled a well when either side could do so, and neither had an obligation to do so. *Frankfort Oil*, 279 F.2d at 439-42. The court discussed fiduciary standards in reference to the operator's alleged failure to disclose information. It used very strong language, holding that the "common undertaking" was "fiduciary in character and required the utmost good faith on the part of both parties." *Id.* at 443. Nonetheless, the "extent and effect of such relationship is determined by the written agreements," and the court found no "contractual obligation" to disclose the information allegedly concealed. *Id.*

Other courts find no fiduciary breach because the conduct alleged did not breach any JOA term or "duties that would naturally arise as corollaries to the obligations set forth in the agreement." Doheny v. Wexpro Co., 974 F.2d 130, 135 (10th Cir. 1992); *accord* Davis v. TXO Prod. Corp., 929 F.2d at 1515, 1519 (10th Cir. 1991); Andrau v. Mich. Wis. Pipe Line Co., 712 P.2d 372 (Wyo. 1986) (discussed *supra* note 69).

112. There are other courts that use the several liability or no-partnership language as grounds to reject a joint venture or mining partnership. *See Doheny*, 974 F.2d at 134-35 (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. LL&E, 717 F. Supp. 717, 722 (D. Colo. 1989) (listing Article VII.A., 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); 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"); Prentice v. Amax Petroleum Corp., 220 So.2d 783, 787 (La. Ct. App. 1969) (rejecting claim to

factual analysis by looking solely to this prophylactic Article. These cases typically ignore Article VII.A.'s limited purpose of foreclosing third-party claims, and ignore the need to provide a basis for thinking that Article VII.A. should apply between operator and nonoperator.

A second set of revisionist cases relies on Article V.A.'s liability-limiting language. A characteristic graduate of this school is *Caddo Oil Co. v. O'Brien*, a 1990 Fifth Circuit opinion in a dispute over certain unpaid well costs.[113] The court rejected the nonoperator's breach of fiduciary duty claim without any case citation or discussion of purpose. It simply presumed that Article V.A.'s exculpation applies to all operator conduct. "Under the terms of the Operating Agreement, the Operator is liable 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.—Austin 1962) (citing, inter alia, separate liability and no-partnership clause (as well as lack of joint operation) in sustaining summary judgment that no partnership was created and nonoperators were not liable on vendor claim), *aff'd in relevant part, modified on other grounds*, 363 S.W.2d 230 (Tex. 1962); U.S. Truck Lines v. Texaco, Inc., 337 S.W.2d 497, 498-500 (Tex. Civ. App.—Eastland 1960, writ ref'd) (citing no-partnership and several liability clauses in an opinion that reviewed facts but also held that the agreement itself "negatives" intention to form partnership and thus sparing nonoperator Texaco from liability to road builder); Smith v. L.D. Burns Drilling Co., 852 S.W.2d 40, 41-42 (Tex. App.—Waco 1993, writ denied) (citing 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); *cf.* Adobe Res. Corp. v. Newmont Oil Co., 838 S.W.2d 831, 836 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (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"); 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). *But see* Davidson v. Enstar, 860 F.2d 167 (5th Cir. 1988) (affirming summary judgment holding defendants immune under LHWCA because of joint venture, in spite of no-partnership clause, *reversing on rehearing* its prior decision in 848 F.2d 574, 577-78 (5th Cir. 1988) and affirming trial court by following Bertrand v. Forest Oil Corp., 441 F.2d 809 (5th Cir. 1971)).

In another oft-cited Texas Supreme Court opinion, *Luling Oil & Gas Co. v. Humble Oil & Ref. Co.*, 191 S.W.2d 716 (Tex. 1946), 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 seemed to explain the holding by noting that the contract did not authorize either side to create binding third-party liability for the other. *Id.* So it is not clear whether the contract had an express disclaimer, or just did not create authority for one partner to bind another and the court was holding that a party needed express authority to create liability for another.

Ironically (given the initial purpose of Article VII.A.), some courts have gone further and suggested that the parties may be free to extinguish the operator's liability within their venture, but not to third parties. *See, e.g.*, *Misco-United*, 462 F.2d at 80. If that is so, the no-partnership and several liability clauses may not be effective in their original intent. Naturally, parties cannot extinguish their liabilities to third parties simply because they say so. Were that the case, partners could evade general common-law duties by contracting them away. *See, e.g.*, Mud Control Labs. v. Covey, 269 P.2d 854, 859 (Utah 1954) (if parties could contract away third-party liability, they would "by private agreement between themselves, obtain the advantages of limited partnership without complying with the statutory requirements"). But these courts have not offered a justification for distorting an article aimed at confirming that the operator cannot expose its partners to direct third-party liability by using it to reduce the operator's own duty to these interest owners. The result is an oilfield Catch-22: where the article is intended to prevent liability (external liability), it will not work, but where it was not intended to limit liability (internal duties), it will do so.

113. Caddo Oil Co. v. O'Brien, 908 F.2d 13 (5th Cir. 1990).

the Owners only in cases of the Operator's willful misconduct."[114] The Fifth Circuit cited no authority for this conclusion: no cases, no reference to prior interpretations of the Article, no discussion of the clause's intent—nothing.

In an equally indiscriminate exculpatory opinion two years later, *Stine v. Marathon Oil Co.*,[115] the Fifth Circuit interpreted Article V.A. under Texas law to preclude claims over an alleged failure to drill in a timely manner, refusal to share information, overcharges, and interference with a gas purchase agreement. It refused to confine Article V.A.'s exculpation to "physical acts by the operator within the geographic limits of the contract area."[116] Instead, the court extended it to "administrative and accounting duties"; indeed, to "any acts done under the authority of the JOA 'as operator.'"[117]

Stine had a fairly extended discussion before reaching its draconian holding. But in general, the discussion considered only whether Article V.A. should extend to contract as well as tort violations. The court did not explain *why* it rejected the nonoperators' position that Article V.A. covers just operational matters. Though pretending to give Article V.A. a narrow reading because exculpatory clauses are to be read narrowly, the court in fact gave the broadest reading possible to the terms "*any acts done under the authority of the JOA 'as Operator.'*"[118] Citing primarily two commentators and two very recent opinions,[119] it ignored the large

---

114. *Id.* at 17. In *Grace-Cajun Oil Co. v. Damson Oil Corp.*, 897 F.2d 1364, 1366 (5th Cir. 1990), a trial court had assumed that Article V.A. applies to the operator's filing of a well status determination application necessary to secure a higher federal regulated gas price, but it found the operator grossly negligent in not filing the application. *Id.* The Fifth Circuit did not decide the scope of the clause because it found that by assuming to sell the nonoperators' gas in its gas purchase agreement, defendant Damson assumed responsibility for filing the application. *Id.* at 1366-67.

115. 976 F.2d 254, 259-61 (5th Cir. 1992).

116. *Id.* at 259.

117. *Id.* at 260. 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." Smith, Voluntary Agreements & Compulsory Orders, *supra* note 80, at 3-7. *Stine* clearly is at the "outer limits" of exculpation. Hendrix & Golding, *supra* note 80, at 10-30.

The Article V.A. opinions almost always focus on the Article's gross-negligence language. Patrick Martin has argued that other language in Article V.A. on the operator's "full control" should itself negate the third element of joint ventures and mining partnerships (the participation or cooperation prong). *See* Martin, *supra* note 100, at 109. He cites *Hamilton v. TXO*, 648 S.W.2d 316 (Tex. App.—El Paso 1982, writ ref'd n.r.e.), in which the court cited the operator's "full control" under the JOA in denying a joint venture, *id.* at 321, and *Humble Oil*, where the court did note the lack of authority for either party to create third-party liability, 191 S.W.2d at 722, though the latter seemed to rely primarily on the contract's fixing the time for payment in its accounting dispute, *id.* at 721, as examples of courts using the operator's high control to negate a joint venture. 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.

118. *Stine*, 976 F.2d at 261 (emphasis added).

119. The court cited an article in which Ernest Smith urged applying Article V.A. to contract duties and Andrew Derman's JOA book (*see* DERMAN, *supra* note 6) in which he

body of cases containing the traditional analysis. Readers would have no idea that the court was reversing settled JOA interpretations.

A number of other opinions adopted restrictive readings of Article V.A. in the 1990s. They generally employed brusque, conclusory discussions, mainly citing or referencing the language of the paragraph without grappling with the purpose of the Article or the conflict with precedent.[120]

A new militancy about limiting business liability has shown up in academic commentary as well. With increasing frequency, authors have urged courts to abandon even the possibility of fiduciary responsibility.[121]

---

seemed to endorse a broad reading, *Caddo*, and *Grace-Cajun Oil*. *Stine*, 976 F.2d at 260-61. In an interesting disregard for precedent, the court arbitrarily treated the issue as if its first judicial consideration occurred in 1990, and the many prior cases could be disregarded. Offering no explanation for the prior holdings and not even acknowledging their existence, the court certainly disregarded them.

120. *See, e.g.*, Dime Box Petroleum Corp. v. LL&E, 938 F.2d 1144, 1147-48 (10th Cir. 1991) (citing Article V.A. as evidence that "parties contracted for a standard to measure operator's conduct which is different than that applicable to a fiduciary"); Caddo Oil Co. v. O'Brien, 908 F.2d 13, 17 (5th Cir. 1990) (glib opinion rejecting fiduciary argument in accounting claim by citing language close to Article V.A.'s (operator liable only "in cases of the Operator's willful misconduct"), with no elaboration or case discussion); Archer v. Grynberg, 738 F. Supp. 449, 452-53 (N.D. Utah 1990) (holding in farmout case that Article V.A. "will normally prevail" over general law of fiduciaries, and rejecting fiduciary duty in dispute over operator's alleged failure to develop); *Bogert*, 630 F. Supp. at 966-69 (citing Article V.A. as well as provisions seemingly governing information and drilling issues, in holding that parties limited fiduciary duty by contract); *see also* Huggs, Inc. v. LPC Energy, Inc., 889 F.2d 649, 652-53 (5th Cir. 1989) (though operator failed to pay delay rentals, 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).

In a contrasting case, *Grace-Cajun Oil*, an interest owner succeeded in holding an operator liable for its losses from the operator's failure to file an NGPA well determination, in spite of a clause like Article V.A. (the operator was not liable as operator except for "such as may result from gross negligence" or breach of the contract provisions), by treating the operator's entering a gas purchase agreement as separately creating "responsibility for tasks necessary to its performance of that agreement." Grace-Cajun Oil Co. v. Damson Oil Corp., 897 F.2d 1364, 1366-67 (5th Cir. 1990). The trial court had found the operator grossly negligent, *id.* at 1367, but the appellate court did not reach this issue because its decision removed the gross-negligence barrier.

121. *See, e.g.*, Hendrix & Golding, *supra* note 80, § 10.04[2][a], at 10-15 to -18 (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); Martin, *supra* note 100 (arguing that courts should treat the JOA as a purely contractual relationship and enforce disclaimers, and claiming that this is the emerging standard). The change perhaps can best be seen in articles like 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 (1995), which treats the operating agreement as not establishing a fiduciary tie, as if everyone knows that the disclaimers will be enforced without any acknowledgement that this is a sharply disputed position. *Id.* at 13-9, 13-24 to -29 (fiduciary duty does not exist because of disclaimers or can be sharply narrowed by agreement); *see also* 2 KUNTZ, *supra* note 49, § 19.6(c) (discussing JOA as an entirely contractual relationship).

For an additional example of the cramped perspective that is gaining currency, see another article by Scott Lansdown, *The Dozen Most Significant Cases Concerning Operating Agreements*, 23 TEX. STATE BAR SECTION REPORT, OIL, GAS & MIN. L. 17 (1999). Of

Some commentators seem to feel that parties can contract away the operator's tort liability, at least *inter se*, whenever the operator wants; indeed, whenever the industry wants to put a disclaimer in the JOA. Two authors have even begun testing the extremist position that the JOA may not satisfy *any* of the three joint-venture or mining-partnership requirements.[122]

III. THESE COURTS HAVE NOT JUSTIFIED THEIR SHIFT IN JUDICIAL INTERPRETATION

The new cases ignore their abandonment of traditional joint-venture and mining-partnership cases like *Oklahoma Co.* and even of the generally broad, factual analysis of cases like *Rankin*. The new treatment of the disclaimers and exclusions is flatly inconsistent with the unit operator, trustee-of-funds, and marketing-agent cases; it also does not fit with the room that the 1989 JOA has left for a fiduciary duty in handling funds and marketing production. Moreover, this late protuberance on the body of oil and gas law produces many new problems. The language relied on itself harbors interpretive problems ignored by these courts, and the rigid protection for operators opens up new inconsistencies in the JOA. Finally, these courts have forgotten the skeptical eye that courts normally bring to efforts to disavow tort liability and to anticompetitive efforts by

Lansdown's even-dozen "significant" cases, not one of the key cases identified in this article, neither *Rankin v. Naftalis*, 557 S.W.2d 940 (Tex. 1977), nor *Oklahoma Co. v. O'Neil*, 440 P.2d 978 (Okla. 1968), or *Britton v. Green*, 325 F.2d 377 (10th Cir. 1963), for joint ventures; *Reserve Oil, Inc. v. Dixon*, 711 F.2d 951 (10th Cir. 1983), for the trustee-type duty; *Young v. West Edmond Hunton Lime Unit*, 275 P.2d 304 (Okla. 1954), *appeal dismissed*, 345 U.S. 909 (1955), for unit operators; or *Johnston v. American Cometra, Inc.*, 837 S.W.2d 711 (Tex. App.—Austin 1992, writ denied), for marketing cases, makes an appearance. Instead, fully six of Lansdown's twelve cases are essentially disclaimer or no fiduciary cases: *Hamilton v. TXO*, 648 S.W.2d 316 (Tex. App.—El Paso 1982, writ ref'd n.r.e.) (standard JOA no fiduciary duty), *Bogert* (a key case for using the JOA as a shield against fiduciary responsibility), *True Oil v. Sinclair Oil Corp.*, 771 P.2d 781 (Wyo. 1989) (using JOA terms to limit fiduciary obligation), *Dime Box* (holding that disclaimer had narrowed modified fiduciary obligation), *Exxon v. Crosby-Mississippi Resources, Ltd.*, 775 F. Supp. 969 (S.D. Miss. 1991) (treating Copas two-year claims limitations period as creating "conclusive presumption of correctness" to block claims more than two years old), *aff'd in part, rev'd in part*, 40 F.3d 1474 (5th Cir. 1995), and *Stine* (giving broadest reading to Article V.A.'s limit of operator's liability to gross negligence or willful misconduct, holding that it reaches all acts done under JOA authority). A seventh case, *TexStar North America, Inc. v. Ladd Petroleum Corp.*, 809 S.W.2d 672 (Tex. App.—Corpus Christi 1991, writ denied), 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 extra-contractual 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 in the revisionism of recent years.

122. Patrick Martin has argued that, notwithstanding the many courts finding to the contrary, the standard arrangement may not satisfy *any* of the joint-venture elements. *See* Martin, *supra* note 100, at 104-11. Gary Conine has launched a unique reading that what the courts really have been 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* Gary Conine, *Joint Ventures in Oil and Gas Contracts*, 47 INST. ON OIL & GAS L. & TAX'N 8-1, 8-20 to -22 (1996).

an industry's dominant firms to collectively limit their liability to those doing business with them.

A. The Unit, Trustee, and Marketing Cases Contradict the Recent ProBusiness Trend, As Do All Joint-Venture and Mining-Partnership Cases that Treat Fiduciary Status as a Fact Issue

These recent cases are flatly inconsistent with the much longer, earlier precedent. Many unit agreements have language endowing the operator with primary control, limiting its liability for activity in the Contract Area to gross negligence or willful misconduct, and disclaiming partnerships. If that language had an absolutist effect, *Young*'s unit rule could not survive. If Article V.A. or VII.A. functioned as cases like *Stine* suggest, they also would prevent the operator handling trust funds and the operator marketing nonoperator production from being a fiduciary in those activities.[123]

Cases like *Stine* would revolutionize oilfield joint-venture and mining-partnership analysis as well. Were they correct, the dozens of cases scrutinizing the record for acts of "control" or "participation" would have been wasting their time on an irrelevant inquiry because a handful of contract words determine the outcome anyway. There would be no need to reach three-part tests; no matter how much participation and control the nonoperators enjoyed in a well, the relationship could not be a fiduciary one.

B. Neither Article VII.A. Nor V.A. Should Preclude a Fiduciary Rule

It is no accident that courts once held that the JOA's standard terms do not impede treating the operator as a fiduciary. Courts that ignored these clauses when grappling with the fiduciary question did not do so inadvertently. Neither clause should govern the operator's general duty to its investing partners in traditional JOAs.

1. *Article VII.A. Originated to Protect NonOperators from Direct Liability to Vendors and Others Dealing with the Operator*

This Article already has discussed the substantial body of law tracing Article VII.A.'s no-partnership language back to the problem of limiting the nonoperator's duty *to third parties*. The intent of Article VII.A. was to prevent supply companies or others *outside the joint venture* from using the theory that investors have a partner's unlimited liability to gain direct and unlimited recovery against them. Courts explained that Article

123. Two recent authors have noted, with at least implicit criticism, that cases like *Young*, *Reserve Oil*, and *Hawkins* "appear[ ] to disregard the specific language of 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 5, at 220. In claiming that courts "disregard the specific language," they ignore the purpose of the language, which the courts honored.

VII.A.'s purpose was not to limit the operator's obligation *to its nonoperating investors.*

For instance, even the Fifth Circuit, home of *Caddo* and *Stine*, has written that 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.*"[124] In *Johnston*, the marketing-agent case, the Texas court of appeals agreed that no-partnership clauses apply to third parties and "are not dispositive of the duty issues raised" between operator and nonoperator.[125] More recently, the Kansas Supreme Court treated the JOA's no-partnership language as of no effect, with even broader reasoning as it required an operator to share property acquired in the unit area with nonoperators. In *Amoco v. Charles B. Wilson, Jr., Inc.*, 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 non-operator to deal with each other in a fair and equitable manner.[126]

In the mainstream period, commentators agreed that Article VII.A. was designed to limit liability to third parties. Howard Williams, for instance, wrote years ago that the Article's goal "is to avoid liability by one

124. *See* Norman v. Apache Corp., 19 F.3d 1017, 1024 (5th Cir. 1994) (emphasis added) (citing *Johnston*, 837 S.W.2d at 715-16). The *Norman* court went on to hold, however, that neither would the "mere existence" of a JOA prove a joint venture, citing *Rankin* of all cases, but not addressing in detail the issue because the nonoperators had not claimed a joint venture. *Id.* at 1024. They instead tried to argue, without success, that they could prove an "informal" fiduciary relationship, which, under Texas law, sometimes arises from long-standing relationships of trust and confidence. *Id.* at 1025-26.

125. *Johnston*, 837 S.W.2d at 715; *see supra* notes 81-90 and accompanying text; *see also* Lavy v. Pitts, 29 S.W.3d 353, 358 (Tex. App.—Eastland 2000, pet. denied) (citing *Johnston*'s interpretation that AAPL intended to shield nonoperators from third parties). In *Reserve Oil*, in which the court enforced a trustee-type fiduciary duty, the Tenth Circuit cited Article VII.A., but claimed that what it disavowed is "a general agency relationship *as to third parties.*" *Id.* at 953 (emphasis added).

The mere fact of having precedent to cite does not, of course, prove that a court is right or wrong, though it is powerful evidence in a system built upon precedent. It might be possible that a judge carelessly announced a doctrine; others cited it because it is already on the books; and no court ever looked at the merits. Parties might even try to raise policy objections one way or the other, but if the initial pronouncement was clear, courts might forever more hide behind the shield of precedent. The assumption of precedential reasoning is that the early opinions while a doctrine is being hammered out are *reasoned* opinions that do grapple with opposing substantive arguments, and that courts will revise or even overrule doctrines if those reasons are invalidated by changes in social facts, theoretical understandings, or any other permissible factors. The many fiduciary findings reached in earlier years without mentioning Article VII.A. or V.A. as a barrier is a strong piece of evidence that courts understood that those Articles do not apply in the broad manner with which some courts recently have extended it.

126. Amoco v. Charles B. Wilson, Jr., Inc., 976 P.2d 941, 954 (Kan. 1999). For a critical, industry-oriented review of *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).

participant for the torts or contracts of other participants."[127]

Finally, the more expansive interpretation of Article VII.A. disregards the hornbook law, set out in many cases and authorities, that a mining partnership is an intention-defeating doctrine. Mining partnerships are supposed to impose fiduciary duties regardless of the parties' intentions, if their arrangement otherwise satisfies the requisites of mining-partnership law. It is old precedent that the mining-partnership doctrine is "intention-defeating"[128] and that, on its face, a partnership disclaimer, while "of value as indicating intention, is not legally controlling."[129]

---

127. Williams, *supra* note 63, at 272. Williams admitted that the language "*might* be viewed as negating a fiduciary relation between or among the parties," *id.* (emphasis added), but in general, he predicted that courts increasingly would impose fiduciary duties where one owner had power "in respect to" another's property, *cf. id.* at 273. Though the current Williams and Meyers treatise notes that Article VII.A.'s goal is to avoid third-party liability, it observes 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., traditional third-party claims—but it "may deprive the investor of rights against the operator" on a fiduciary claim. *See* 2 WILLIAMS & MEYERS, *supra* note 49, § 435.2, at 514.

There are other authorities that address this issue. *See* Boigon, *Hostile Environment*, *supra* note 102, at 5-10 to -11 (prior version of Article VII.A. would not bar third-party claims, and inconclusive inter se because it "says nothing" about joint venture or agency and does not specifically deny fiduciary rights and responsibilities); Hendrix & Golding, *supra* note 80, at 10-12 ("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 102, at 230 (no-partnership language was developed to limit liability to creditors and third persons, but ironically "it appears to be uniformly recognized that the clause will be essentially ineffective to that end"); *id.* at 236 ("[D]oubtful 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 80, at 12-7 (discussing delegation of power to operator and Article VII.A. as intending to shield nonoperators from liability); Watts, *supra* note 16, at 2798 (stating "reason for a disclaimer is quite clear" and then discussing third-party liability).

In a quite nuanced treatment, Christopher Lane and Catherine Boggs argued that parties might be able to limit fiduciary liability among themselves, "but not to waive that liability *in toto*." Lane & Boggs, *supra* note 102, at 228. They urged parties to specifically authorize actions that might otherwise violate a fiduciary duty, as well as to try to define a less-than-fiduciary standard. *Id.* at 236.

Defeating third-party liability also seems to be the point of such statutes as the old Texas Article 6132(b), which stated that a JOA "does not of itself establish a partnership." In *Rankin*, the Texas Supreme Court held that this Texas statute providing that mere "operation" of a property under a JOA "does not of itself establish a partnership" precludes a *general* partnership relationship, but never suggested that the statute could undermine the jury's finding of a joint venture within the geographic area of the joint project. *Compare* 557 S.W.2d at 945-46 (the supreme court's discussion of this statute), *with* 542 S.W.2d at 895 (the jury's finding). As *Rankin* shows, this language may disclaim a general partnership duty but not the limited obligations of a mining partner or joint venturer. The similar language in the Louisiana Code is a little stronger: "[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 2000).

128. Lee Jones, *Mining Partnerships in Texas*, 12 TEX. L. REV. 410, 410, 414 (1934).

129. Lee Jones, *Problems Presented by Joint Ownership of Oil, Gas and Other Minerals*, 32 TEX. L. REV. 697, 717 (1954) (disclaimer of partnership, while "of value as indicating intention, is not legally controlling," and will not avoid partnership duties when they have been assumed); Clarence Brimmer, *Mining Partnerships*, 15 ROCKY MTN. MIN. L. INST. 85, 92 (1969) (disclaimer of partnership not effective to prevent mining partnership if its elements otherwise met by acts and conduct). *See generally* 2 KUNTZ, *supra* note 49, § 19A.7(b), at 112 (mining-partnership duty imposed by law and does not require specific intent to form arrangement); 2 WILLIAMS & MEYERS, *supra* note 49, § 435.1, at 248.1 (min-

2. *Article V.A. Uses Terms that Apply to Physical Operations on the Wellsite*

The language of Article V.A. suggests that courts had good reason for not letting that Article diminish the operator's overall duty of care to its investors. Article V.A. gives the operator "full control *of all operations*," makes it perform its duties 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 misconduct."[130]

This language is well-suited to making the operator act with reasonable prudence but not as a guarantor in operational matters (e.g., drilling wells, fishing pipe from the hole, etc.). At least in such activity, it does suggest that "all parties seem to have assumed the risk of loss arising from bad judgment or honest error by the operator."[131] Article V.A. does not sound designed to go further, however, and regulate the overall operator/nonoperator relationship. "Losses sustained" or "liabilities incurred" is not language one would choose to reduce the operator's duty. The term "losses sustained" sounds like damages to the joint property—a drilling accident, for instance; the term "liabilities incurred" sounds like contract obligations the operator incurred for the joint account. In 1989, in a change that underscores this meaning of Article V.A., the AAPL inserted an independent contractor clause, which holds that the operator shall not hold itself out as the nonoperators' agent when dealing with third parties.[132] Some commentators, too, have noted the seeming fit be-

---

ing 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").

130. 1989 JOA, *supra* note 2, Article V.A. (emphasis added). Somewhat amusingly, two experienced industry hands have claimed that the gross negligence and willful misconduct limitations make legal action rare because "the terms are undefinable and virtually impossible to prove in a court of law." JOHN JOLLY & JIM BUCK, JOINT INTEREST ACCOUNTING: PETROLEUM INDUSTRY PRACTICE 49 (1988). This is an exaggeration, but one probably close to the effect intended by Article V.A.'s more convinced proponents.

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 102, at 5-26. Hendrix and Golding find a "dearth of case law" interpreting what the exculpatory provisions really mean, but they believe gross negligence can be summed up as requiring "extreme carelessness or recklessness or a conscious disregard for the rights of others." Hendrix & Golding, *supra* note 80, at 10-34 to -35. Splitting the legal hairs, they find "willful misconduct" a more stringent standard. *Id.* at 10-36. It will be a rare jury that doesn't treat both of these as very deferential toward the operator.

131. *See* Boigon, *Hostile Environment*, *supra* note 102, at 5-15. An example of this core use of Article V.A. in matters of physical operations is *Transcon. Gas Pipe Line Corp. v. Mr. Charlie*, 294 F. Supp. 1025, 1031 (E.D. La. 1968), *aff'd in part and rev'd in part on other grounds*, 424 F.2d 684 (5th Cir. 1970), *cert. denied*, 400 U.S. 832 (1970), a Louisiana case that applied the operator's limited negligence liability to split the damages to an underwater pipeline among the owners in their proportionate shares. The court reached this conclusion in spite of finding the operator clearly negligent in siting the offshore drilling platform; the parties nonetheless had agreed to share all liabilities to third parties.

132. *See* 1989 JOA, *supra* note 2, Article V.A. ("Operator shall not be deemed, or hold itself out as, the agent of the Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third party."). Patrick Martin opposes the limited reading of Article V.A. He urges that its independent contractor lan-

tween Article V.A. and the requisites of physical operations on the joint account site.[133]

Limiting the operator's liability for drilling operations may be palatable because most operators have the same strong incentive as the nonoperators to do well in physical operations.[134] Operators also benefit from safe, efficient, trouble-free physical operations. But in internal matters, like the handling of funds, sale of production, use of affiliates, and acquisition of surrounding properties, the operator can profit by cheating its investors, so the rationale for deference does not exist.

The business-protecting readings of Article V.A. introduce anomalies into the overall relationship of the parties interested in the well. If the Article does apply to everything the operator does, then operators have no more obligation to their investors than drilling contractors and service companies have to the joint account.[135] The investment relation might as well be a venture among strangers. Indeed, the operator's obligation will be *less* unless the supply contract duplicates the gross-negligence, willful-misconduct limitation. It is implausible that the operator is no closer to its investors than a drilling company is to the joint venture, and perhaps even more distant.

---

guage "mak[es] clear that the disclaimer of partnership is not limited to the operator's relations with third parties." Martin, *supra* note 100, at 111. But this language seems much more concerned with 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, a hurdle that neither the actual-participation nor legal-right-to-control courts have applied, but one that seems designed to disqualify the standard operating arrangement with its centralization of active power in the operator as a matter of law in every case, regardless of acts of joint participation or control.

133. *See* Lane & Boggs, *supra* note 102, at 223-25 (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 80, at 3-10 (language of Article V.A., with limits to "Contract Area" and its "good and workmanlike" standard, "seems more appropriate to physical activity than to billings, purchasing and administrative decision making"; usual reason for exculpatory clause is to avoid liability for catastrophic damage, not breaches of contract).

134. Some operators do not share this incentive fully. If an operator decides to build its company around high-volume operations, on the theory that the law of averages will produce handsome returns for it as long as its investors pick up most of the cost of the wells, it may outstrip its ability to monitor but fare well if it has even a few barnburner wells. The great majority of investors in these poorly managed wells will lose money. Put another way, even a reckless operator who can raise funds to drill dozens of wells a year largely at the expense of others is likely to get rich if even a few wells really come in. The author has discussed operators like these in John Burritt McArthur, *Coming of Age: Initiating the Oilfield into Performance Disclosure*, 50 SMU L. REV. 663 (1997).

135. A drilling contract routinely requires performance in a "good and workmanlike manner." 2 KUNTZ, *supra* note 49, at § 19A.5, at 98-100. This linguistic parallelism is another sign that Article V.A. was aimed only at 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. *Id.* at 104 (courts will look at 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).

Not only that, but reading Article V.A. to reduce the operator's overall responsibility conflicts with other plain words in Article V.A. and other articles. Article V requires management in a "good and workmanlike" manner—the reasonable prudence standard—and, since 1989, all parties are supposed to act "in good faith in their dealings with each other with respect to activities hereunder."[136] A careless operator is not prudent, even if its actions are not grossly negligent or willful misconduct. But if the operator is never liable for less than extreme conduct, then, presumably, it can fall well below the workmanlike standard as long as it does not hurt its investors intentionally or with gross recklessness and still not be liable even for a run-of-the-mill breach of contract.[137] Aggressive readings of Article V.A. would strip the operator of the duty that for decades has defined its basic obligation.

The new definition also inserts an odd duality into the common venture. The operator has to act with reasonable prudence toward all its royalty owners,[138] but is free to act negligently as far as its working-interest owners are concerned.[139] Even though the operator can commit nonoperators to far greater financial exposure than royalty owners, nonetheless it would owe them less fidelity. No commentator or court has yet suggested why working-interest owners should be relegated to second-class citizenship when they have such vital interests at stake.[140]

---

136. The drafters of the 1989 JOA lodged this language in Article VII.A. 1989 JOA, *supra* note 2, Article VII.A.

137. Ernest Smith has suggested that Article V.A. should encompass and shield violations that would amount to a breach of contract. He bases his argument 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 80, at 12-30 to -31. The Fifth Circuit cited Smith with approval in *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?

138. *See generally* 5 WILLIAMS & MEYERS, *supra* note 49, § 806.

139. Hendrix and Golding have predicted that courts will treat the conflict between the reasonable prudent operator standard and the disclaimer by lowering the operator's standard of care. *See* Hendrix & Golding, *supra* note 80, at 10-33 to -34. It is one sign of the wild rush to protect operators that courts and commentators might suggest jettisoning a 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.

140. Some might argue that the lesser sophistication of royalty owners justifies their getting more protection. And it certainly should be undisputed that royalty owners are on average less wise in the ways of the business than the average working interest owner. *See* Ernest Smith, *Joint Operating Agreement Jurisprudence*, 33 WASHBURN L.J. 834, 839 (1994) (lessee is "almost invariably in a superior bargaining position"); *id.* 851 (implying lessors will not have experience); 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"); John Lowe, *Developments in Nonregulatory Oil and Gas Law*, 27 INST. ON OIL & GAS L. & TAX'N 1-1, 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 follows:

C. The Recent Trend Ignores Barriers the Law Ordinarily Erects to Tort Disclaimers and Joint AntiCompetitive Behavior by Competitors

Issues surrounding disclaimers of tort liability and antitrust concerns have become more central to the operator-duty issue today because, in 1989, the AAPL adopted a new JOA that clearly intends to extinguish the operator's internal fiduciary duty in most areas and not just deal with third-party issues. The new Article VII.A. includes the condition that: "*In their relations with each other under this agreement*, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own respective self-interest . . . ."[141] The large oil companies whose representatives sat on the drafting committee clearly intend to avoid internal fiduciary responsibility.[142]

One telling aspect of the restrictive JOA cases is their resolute discussion of the fiduciary duty as an issue *sui generis*, without any acknowledgement that the law casts a skeptical eye on the disclaimer of tort duties and has standards governing such efforts. In fact, the law generally disfavors blanket abandonment of tortious responsibility. In Texas, for instance, disclaimers of negligence generally have to be conspicuous and carefully spell out the behavior covered. One recent treatment of Texas standards 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 immunized acts.[143] 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 en-

"the lessee/lessor relationship is by its very nature tainted with unequal bargaining power").

The critical factor here, however, is not subjective ability, but the dependence fostered by the operator's dominant role in the venture. While working interest owners have some voting rights not shared by royalty owners, and get some information under standard investment practices that royalty owners do not get, they too rely on the operator to make the major decisions that will determine how the venture fares. Moreover, their financial exposure, which is not limited to an acreage contribution, is far greater than the average royalty owner's, so in some ways they have far more at stake.

The use of Article V.A. to define the operator's tort duty internally can create a subtle, implicit conflict *across* the JOA as well. The reading assumes that even though the parties dealt expressly with the scope of tort liability in Article VII.A. (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.

141. 1989 JOA, *supra* note 2, Article VII.A. (emphasis added).

142. The JOA has been an offspring of the largest oilfield companies from its inception. The initial 1956 form was written by representatives of all but one of 28 invited "larger oil companies." Young, *supra* note 6, at 199. Significantly, the one unnamed company refused to participate because "of a belief that such a joint effort might have adverse antitrust implications." *Id.*

143. Dick Watt et al., *A Litigation Perspective: Selected Thoughts on the Express Negligence Doctrine, Exculpatory Clauses, and Indemnity in Joint Operating Agreements*, 26 Oil Gas & Energy Res. L. 14, 23 (State Bar of Texas 2001).

forced in four states that lack anti-indemnity statutes (Colorado, Montana, Oklahoma, and Utah) and two states that exclude operating agreements from such statutes (Texas and Louisiana), but that New Mexico and Wyoming, two other major oilfield jurisdictions, would not enforce them.[144]

This Article does not address this intricate statutory area. It is worth noting, however, that none of the trend-setting disclaimer cases even mentions the policy issues that surround efforts to disclaim or severely limit tort liability. This omission is a sign of their unseemly haste to limit the operator's responsibility.

The other barrier ignored by the new cases is the antitrust ban on anticompetitive restrictions among competitors, including competitors acting via joint ventures and trade associations. Antitrust litigation has been conspicuously absent from the exploration and production sector of the industry. There are famous antitrust cases at other levels of the industry, like the case dissolving Standard Oil Company in 1911 and the benchmark merger case involving El Paso Natural Gas Company and Northwest Natural Pipeline Company.[145] By and large, however, the activities of finding and producing oil and gas are notable for the small amount of antitrust litigation.[146] Some of this exemption is due to the fact that natu-

144. Robert C. Bledsoe, *The Operating Agreement: Matters Not Covered or Inadequately Covered*, 47 ROCKY MTN. MIN. L. INST. 15-1, 15-4 to -18 (2001).

145. These two landmark cases are *Standard Oil v. United States*, 221 U.S. 1 (1911) and *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

146. One sign of the absence of antitrust litigation is the lack of significant law-review writing on oil and gas antitrust issues. In one of the rare treatments of these issues, the main focus was large pipeline and manufacturing joint ventures and joint bidding issues. Arthur Thad Smith, *Antitrust Aspects of Joint Operations*, 16 ROCKY MTN. MIN. L. INST. 311 (1971). This author treated joint operating agreements briefly, but seemingly only from the standpoint of whether the agreement reduced competition *among* the parties—not the problem of the industry agreeing on a standard form for all its operations. Smith dismissed JOA issues as not raising serious antitrust problems. He discounted the risk of exposure here because he felt that amendments to insert a take-in-kind right removed the basis for finding joint marketing or pooling of profits. *Id.* at 339-40. Smith claimed in addition that such joint ventures were "absolutely necessary in the interests of conservation," thus discerning a procompetitive justification. *Id.* at 340-41. His conclusion: "Where a joint venture enables parties to accomplish something together which no one party could achieve separately, the risk of antitrust exposure should be at a minimum." *Id.* at 344.

Another survey almost a decade later noted the surprisingly small amount of litigation over exploration and production. It too focused heavily on joint ventures and joint bidding. William Burke & Rufus Oliver, *Current Antitrust Developments in Oil and Gas Exploration and Production*, 30 INST. ON OIL & GAS L. & TAX'N 271, 272-73 (1979). They attributed the lack of antitrust litigation to the large number of participants in E&P (making antitrust abuse less likely to be profitable, to the extent that a larger number of firms makes the industry competitive), and the fairly heavy regulation and preemption under state law. *Id.* When these authors discussed their antitrust concerns about joint operating agreements, they too focused on the removal of competition within a single joint venture. *Id.* at 292 ("By suspending operation of the rule of capture, joint operating agreements eliminate the competition that would otherwise occur among participating tract owners . . . ."). The authors predicted that the JOA's effect on price was too indirect to fall under the per-se rule against price fixing. *Id.* at 293-94. The article did cite a Justice Department lawsuit in 1947 that challenged unit operation of certain pools. *See id.* at 293 (citation omitted). That case was dismissed, apparently after the government failed to pursue discovery. *Id.* at 293 n.51. *See generally* 6 WILLIAMS & MEYERS, *supra* note 49, § 911. For a history of ral gas prices were regulated from 1954 until their phased-in deregulation under the Natural Gas Policy Act of 1978. Regulated rates and activity generally are sheltered from direct antitrust challenge.[147] Another reason is that the large number of independent oil companies reduces concentration in many relevant markets. Nonetheless, joint acts by oil companies to reduce their legal exposure raise serious antitrust concerns.

The rules governing joint conduct—when competitors act together—derive from section one of the Sherman Act and analogous state provisions. The JOA is an example of joint conduct because it was drafted by representatives of some of the largest oil companies, all direct competitors of each other. Section one prohibits agreements in restraint of trade.[148] Some categories of agreement, like those that (1) fix, maintain, or stabilize prices; (2) divide markets; or (3) boycott competitors, are "per se" illegal. If the plaintiff has enough evidence to prove any of these agreements, it is entitled to present its damage claim to the jury. For instance, if a group of producers sat down and agreed (orally or in writing) on the price they would charge investors for serving as operator, or at least a price floor below which they would not fall, their agreement would be per se illegal.[149] It would be no defense that the price was written into

---

unitization beginning with oilman Henry Doherty's 1924 proposal and the resulting antitrust issues, see ROBERT HARDWICKE, ANTITRUST LAWS ET AL. V. UNIT OPERATION OF OIL OR GAS POOLS (rev. ed. 1961). Burke and Oliver predicted that any JOA anticompetitive impact upon prices would be slight, while the agreements often promote competition by bringing new production to market, and so should survive rule-of-reason tests. Burke & Oliver, *supra*, at 295. The authors claimed that state regulation should at least help tip the balance toward legality, *id.* at 296, and that provisions to take-in-kind should help skirt antitrust liability. The article ended with a discussion of monopoly issues within given fields. *Id.* at 299-310.

In a sign of how far detailed antitrust considerations are from the consciousness of even very good oil and gas lawyers, neither article discussed the problem of having an industry's largest players combine to fix terms that limit liability and otherwise disadvantage customers (here, the nonoperating investors).

147. Regulation can preclude antitrust challenges in several ways. Courts can find antitrust claims preempted when faced with a detailed regulatory scheme over the same subject matter. The "state-action" doctrine protects behavior that follows "clearly articulated" and actively supervised state policies. *See, e.g.*, Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980); Cantor v. Detroit Edison Co., 428 U.S. 579 (1976). Or, were a plaintiff to challenge particular prices that had been set in ratemaking proceedings, it could find its case dismissed under the filed-rate doctrine. The lead filed-rate case is *Keogh v. Chicago & Northwest Railway*, 260 U.S. 156 (1922), a railroad case. For an example of the filed rate doctrine in the oilfield context, see *Arkla v. Hall*, 453 U.S. 571 (1981), which rejected producer's attempt to claim higher price that exceeded filed rate. And courts may defer to the "primary jurisdiction" of a regulatory agency if needed to preserve a complex regulatory scheme. *See* II SECTION OF ANTITRUST LAW, AMERICAN BAR ASSOCIATION, ANTITRUST LAW DEVELOPMENTS 1128-31 (4th ed. 1997) [hereinafter ANTITRUST LAW DEVELOPMENTS].

148. In its familiarly broad language, section one prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade." 15 U.S.C. § 1 (1997).

149. Price fixing is illegal even if it is accomplished indirectly. In a case involving the oil and gas industry, if not the E&P level, major oil companies agreed among themselves to buy surplus gasoline from competing independent refiners in order to prevent price "depressions." The Supreme Court agreed that this price manipulation accomplished indirectly by manipulating supplies nonetheless is per se illegal. United States v. Socony-

a standard-form contract that also had efficiency justifications. If parties to the JOA divided markets between them, it would be just as unlawful.[150] And a group of competitors cannot refuse to deal with another except on certain terms or refuse to deal with certain companies.[151]

The first hurdle faced by an antitrust claim over the JOA is proving agreement. For the large oil companies directly involved in drafting the JOA, there may be evidence that they agreed with competitors to use its terms. But many of today's operators did not participate in drafting the JOA, and there can be sharp disagreements on what they "agree" to do when they use the JOA. In the absence of direct agreement, such a case would have to be proven by circumstantial evidence, which under today's standards generally requires evidence that "tends to exclude the possibility of independent action."[152] Each defendant, of course, will claim that it is purely in its self-interest to use the JOA. Moreover, though it is hard to see what the drafters of the JOA thought they were doing if not agreeing on settled industry standards, including reducing a risk all operators share, it is only fair to point out that there is no public evidentiary record even on that.[153] Showing agreement is the first evidentiary hurdle for a

---

Vacuum Oil Co., 310 U.S. 150 (1940). That the Court issued this ruling when the country still had not fully emerged from the Depression, and in the aftermath of industry provisions under the National Industrial Recovery Act in the early New Deal that rested on the desirability of joint industry cooperation to stabilize markets, shows the Court's strong commitment to the rule against price fixing. For other lead cases, see *United States v. Addyston Pipe & Steel Co.*, 175 U.S. 211 (1899) and *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927). Later courts have nibbled at the edges of the per se rule by identifying special areas where agreements with an effect on price may get rule-of-reason treatment. *See, e.g.*, NCAA v. Bd. of Regents, 468 U.S. 85 (1984) (treating limit on number of televised football games as horizontal price fixing but nonetheless applying rule of reason); Broad. Music, Inc. v. CBS, 441 U.S. 1 (1979) (analyzing blanket licensing for users of copyright music under rule of reason). Regardless, there is no serious doubt of the general rule's continuing vitality.

150. *See generally* Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); United States v. Topco Assocs., Inc., 405 U.S. 596 (1972).

151. *See generally* Klors, Inc. v. Broadway-Hale Stores, 359 U.S. 207 (1959). Suggestions that the Court might have backed away from this per-se rule were quashed on the unusual facts in *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411 (1990), in which the Court accepted a per-se ban against lawyers representing indigents who tried to increase their fee by refusing new appointments until they were better paid.

152. This language, drawn from the vertical price-fixing case of *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 768 (1984), received a boost when the Supreme Court used it as a broader standard in the predatory-price conspiracy case of *Matsushita Elec. Indus. Co. v. Zenith*, 475 U.S. 574, 588 (1986), and has spawned a cottage industry of finding "plus factors" sufficient to allow a jury to decide that defendants' behavior was joint and not independent. For a survey of this law, see I ANTITRUST LAW DEVELOPMENTS, *supra* note 147, at 8-14.

153. The prediscovery evidence of agreement is not as strong as, say, in *Hartford Fire Insurance Co. v. California*, 509 U.S. 764 (1993), the trade-industry case in which insurers fought to impose terms through standard form contracts. Certain insurers, their trade group, and foreign re-insurers brought direct pressure to change the terms in standardized commercial general liability policies by refusing to deal with companies using older forms. The main changes sought were to alter commercial general liability (CGL) insurance polices in an existing 1984 standard form promulgated by the Insurance Services Office, Inc. (ISO), a trade association providing "support services" for the CGL industry. The changes would (1) eliminate "occurrence" insurance (for undiscovered conditions that occurred in the policy period); (2) impose retroactively a limit on when claims under "claims-

section-one claim.

The second major issue facing an antitrust claim is whether an agreement, even if proven, violates the antitrust laws. The JOA is not as naked a restraint of trade as direct price-fixing or market allocation and, for that reason, is most likely to be tested under the rule of reason. Joint action by competitors that has multiple purposes, including the pursuit of increased efficiencies, and that does not facially fix prices, divide markets, or boycott companies, generally is judged under this standard.[154] For instance, when firms enter joint ventures, courts generally use the rule of reason.[155] In such cases, the jury weighs the pro- and anticompetitive effects of the challenged behavior in a relevant geographic and product market.[156]

The oil and gas industry is not exempt from antitrust scrutiny just because it acts through trade groups or industry associations. Other diverse trade groups have been exposed to potential antitrust liability even though they acted through trade associations, for instance: (1) garment manufacturers that attempted to boycott retailers who copied their "original creation" clothing and sold lower-priced versions; (2) the American Medical Association in its efforts to prevent physicians from working at a nonprofit health provider run for government employees; (3) a county bar association trying to set minimum fees for its members; and (4) insurers who imposed restrictive terms via form contracts developed by an industry trade group.[157] Antitrust scrutiny will attach even if the standards have a strong, legitimate purpose that is unrelated to anticompeti-

made" policies could be filed, thus excluding the risk of undiscovered claims from before a policy's date; (3) eliminate certain pollution coverage; and (4) cap legal defense costs as part of the total policy coverage. *Hartford Fire Ins.*, 509 U.S. at 772-73. The largest American re-insurer enlisted its trade group to agree to use forms with the last three changes, and it and another major insurance company hired a reinsurance broker to announce at an ISO meeting that reinsurers would not reinsure using the 1984 ISO form. *Id.* at 774-75. Defendants took steps to pressure London reinsurers to reject the 1984 ISO CGL forms as well. *Id.* This activity bears similarity to the drafting process for the JOA in that here too major industry companies agreed on a standard form to be used by the entire industry; it differs (at least on the known evidence) in the absence of direct efforts to boycott those who do not use the form.

154. The Supreme Court adopted the rule-of-reason test in an effort to find some balance for section one's nominal prohibition on *every* "contract, combination, . . . or conspiracy in restraint of trade" in *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918).

155. *See, e.g.*, United States v. Penn-Olin Chem., 378 U.S. 158 (1964).

156. The test involves a broad and very factual analysis. *See* Chi. Bd. of Trade v. United States, 246 U.S. 231, 238 (1918):

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be obtained, are all relevant facts.

157. For the cases, see *Fashion Originators' Guild v. FTC*, 312 U.S. 457 (1941); *United States v. American Medical Ass'n*, 317 U.S. 519 (1942); *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975); and *Hartford Fire Ins.*

tive goals.[158]

The JOA is likely to receive rule-of-reason treatment. There is little doubt that having standard JOAs is efficient. This standard-form contract saves transactions costs by avoiding individual negotiation for every venture and has produced settled interpretations and expectations of the core investment form. Yet there is no showing that reading Article V.A. and VII.A. to extinguish the operator's fiduciary duty is necessary to achieve these efficiencies. The purpose and effect of these Articles, as most recently interpreted, is to limit the operators' exposure and thus improve their economic position across a wide swath of industry investments, all at the expense of the nonoperators doing business with them. This joint, industry-wide effort to exclude liability that otherwise could arise under state law is suspect under the rule of reason.[159] The oil and gas industry thrived in decades of vigorous exploration without giving operators an absolute shield against fiduciary liability. It is hardly plausible that the recently expanded protection is needed to bring the JOA into existence or to secure its benefits.

Oil companies, like any businesses seeing a chance to minimize their exposure, will claim that they never would engage in joint investments unless protected from fiduciary liability. They will speak darkly of runaway juries, as befits American businesses' basic distrust of a jury-based system of justice.[160] But these are cries immemorial of business seeking to avoid regulation. The same claims that regulation would destroy initiative appeared almost a century ago against workers compensation, in the 1930s against the Social Security Act and virtually every form of New Deal regulation, and crop up today against reform of accounting stan-

---

158. For an example of the irrelevance of the purity of motive for an anticompetitive agreement, see the Ivy League's agreement on uniform financial-aid standards, an agreement tested under the rule of reason. United States v. Brown Univ., 5 F.3d 658 (3d Cir. 1993). In order to limit competition based on aid packages, Ivy League schools had agreed to offer only need-based (not merit-based) financial aid; adopted a common formula to determine need; and affected schools met to agree on the "family contribution" for students they had each admitted. *Id.* at 662. The schools "understood that failing to comply with the Overlap Agreement would result in retaliatory sanctions," as indeed happened when Princeton began awarding small merit scholarships in 1986. *Id.* at 663.

Other industry-level activities have been struck down as violating section one, sometimes under a per se rule and sometimes using the rule-of-reason. *See FTC v. Trial Lawyers Ass'n*, 493 U.S. at 435-36; FTC v. Ind. Fed. of Dentists, 476 U.S. 447, 463 (1986) (dentists' agreement to withhold X-rays from insurers, who would use them to evaluate claims, violated section one but not under per-se rule); Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 349 (1982) (agreement among physicians on maximum rates charged to specific health insurers illegal under per se rule); Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 683-84, 693-96 (1978) (agreement by group of engineers to refuse to negotiate client fees until the client selected an engineer invalidated under abbreviated rule of reason); *Goldfarb*, 421 U.S. at 788 (1975) (county bar association's minimum fee schedule violated section one, although with suggestion that rules adopted by professions receive lighter scrutiny).

159. The same issues arise with the Copas claims limitations, discussed *supra* note 9.

160. For the suggestion that at least one supreme court, the business-oriented Texas Supreme Court, shares the distrust of juries and will strain to decide fact issues as a matter of law when doing so might protect business interests, see Phil Hardberger, *Juries Under Siege*, 30 St. Mary's L.J. 1 (1998).

dards. That such objections are knee-jerk business objections does not prove that they are incorrect (or correct), but, as with all ideological myths, it does suggest that courts and legislators should approach them with skepticism.

The robust health of the industry under old JOA interpretations shows that the efficiency justifications for the new restrictive JOA readings are wildly exaggerated. There is little reason to vary from the rule that a generation ago Howard Williams correctly, albeit overoptimistically, predicted would come to regulate this industry:

> Whenever the owner of an interest in oil and gas has a *power* with respect to another person's interest in oil and gas, the courts are quick to imply a *duty* in connection with the exercise of such power. Power begets responsibilities and duties. A fiduciary principle becomes applicable.[161]

IV. LIMITS ON THE DAMAGE DONE

Those seeking to negate a fiduciary duty have not entirely carried the day. The *Reserve Oil* trust duty for handling nonoperator money, the *Johnston* agency duty for marketing production, the unit responsibility in jurisdictions that follow *Young*, and most likely the heightened duty that even cases like *Rankin* recognize within the joint-account area for property acquisitions all are likely to survive. As already noted, even the 1989 JOA went out of its way to leave open the possibility of fiduciary responsibility tracking *Reserve Oil* and *Johnston*. These cases conflict with the absolutism of cases like *Stine*, but courts are almost certain to continue to carve out such areas of special responsibility.[162]

Recently, courts have suggested new ways to reject the extremism of the *Stine* approach. One pioneering Texas court of appeals limited Article V.A. to physical operations in *Abraxas Petroleum Corp. v. Hornburg*.[163] The case was another internal, joint-account dispute. The working interest owners, who had not paid the most recent bills, sued a fairly newly installed operator whose term had been marked by sharp increases in costs and a disastrous performance that ended with its plugging three of four wells.[164] The nonoperators did not file a fiduciary claim, but alleged

---

161. Williams, *supra* note 63, at 274.

162. Some commentators argue that courts should vary the operator's duty depending upon the operator's particular activity. *See* Robert Bledsoe, *supra* note 144, at 15-6 to -7 (arguing in part 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"); *see also* Melanie Bell, *The Evolution of the Onshore Model Form Operating Agreement*, 26 TEX. STATE BAR SECTION REPORT, OIL, GAS & ENERGY RES. L. 4, 32, 40-41 & n.67 (noting that several authors have suggested "different levels of liability for different Operator functions," including fiduciary duties for marketing production and handling funds).

163. 20 S.W.3d 741 (Tex. App.—El Paso 2000, no pet.).

164. *Id.* at 747-48. The transformation was so severe that within two years of the operator's taking over, production fell from 1,000 barrels per month to just thirty barrels.

negligence, gross negligence, willful misconduct, breach of contract, and waste. Abraxas argued that a jury finding that it breached the JOA by sending an improper AFE was defective because the jury had not found it acted with gross negligence or willful misconduct.[165] That is, this contract claim was blocked by Article V.A. The interest owners denied this and contended that the clause "applies only to causes of action arising from lease operations."[166]

The court of appeals agreed that Article V.A. does not apply to breaches of the JOA itself. It reasoned that the Article is limited to drilling operations, i.e., not by cause of action, but by type of activity. Article V.A. is "an article which 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."[167] Last year another Texas court of appeals followed *Abraxas* and considered a dispute over well charges in spite of Article V.A.'s effort to limit claims to gross negligence or willful misconduct.[168] According to the same logic, not only breach of contract claims, but also breach of fiduciary claims for violating duties to interest owners should not be affected by Article V.A. unless, of course, the alleged violation concerns physical drilling itself.

Because *Stine* and many of the strong disclaimer cases generally ignore contrary authority, the clash between those cases and the trust and marketing cases has not been fully resolved. With the even more restrictive 1989 JOA paying obeisance to these special duties, however, only truly extremist courts will hold that there is no fiduciary duty even in these two core areas. The law appears to be moving toward a standard that would protect nonoperators in areas where the operator's interest diverges from theirs, as courts have done with royalty owners.[169] The ultimate contours of the operator's fiduciary duty is likely to cover disputes over handling joint account funds, marketing production, acquiring acreage, and using joint account information. In these types of disputes the operator and nonoperator have such conflicting interests that deference is not warranted and higher responsibility is needed.

---

165. *Id.* at 758-59.

166. *Id.* at 759.

167. *Id.*

168. Cone v. Fagadau Energy Corp., 68 S.W.3d 147, 154-55 (Tex. App.—Eastland 2001, pet. denied). The unhappy nonoperator actually pled a variety of causes of action, including one for breach of fiduciary duty. *See id.* at 147. 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" that were "in the nature of an accounting." *Id.* at 155. So there is no direct holding on what effect Article V.A. might have on breach of fiduciary claims.

169. *See generally* 5 WILLIAMS & MEYERS, *supra* note 49, § 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.").

V. AMERICAN COURTS SHOULD NOT JETTISON INVESTOR PROTECTION CAVALIERLY

The substantive debate over the correct level of behavior, no doubt, will rage on. Major producers, with their concentrated resources and stakes, are likely to dominate the debate through their legions of lawyers and lobbyists.[170] But power is not a substitute for reason, nor is it a reason to vary from well-settled interpretations. Recent decisions do not reconcile their narrow linguistic readings with the older tradition in which the operator could be held a fiduciary to its investors. Under traditional rules, the activities of trustees and agents, such as acquiring property in an area of joint interest, disclosing information, handling partners' money, and selling their production, were regulated by the high standards of behavior that courts denominate fiduciary. It is irrational to reduce this duty because of concerns that only arise when third parties try to extend unlimited liability to nonoperating investors. The restrictive courts need to take a new, reasoned look at these issues and ask whether they really should continue to deviate from the older, mainstream interpretation.

As far as blanket exculpations and disclaimers go, courts should adopt the traditionally restrictive approach to tort exclusions and, in addition, consider the antitrust problems raised by joint industry efforts to improve their bargaining position. State legislatures should also consider statutorily barring efforts to remove the industry from the ordinary application of fiduciary principles; they should legislate to prevent the JOA from limiting the operator's tort liability to its partners. At a minimum, state legislatures should protect the areas where the operator can most readily profit from its investors: handling funds, marketing production, acquiring property, and concealing information on its performance.

---

170. Recent capture theory has come from economists and been one of the impetuses for deregulation. *See* Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); George Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971). For earlier models from political science, see MURRAY EDELMAN, THE SYMBOLIC USES OF POLITICS 24 nn.1-5, 56 (1985), which provides a list of five major post-War studies of administrative behavior that support an "instrumental" theory of agencies "as economic and political instruments of the parties they regulate and benefit, not of a reified 'society,' 'general will,' or 'public interest.'"