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I. INTRODUCTION

Fiduciaries hold an esteemed and valuable position in the U.S. common law of trusts and agency as inherited from England. In these contexts, the duty a fiduciary owes to a beneficiary is essential to protect dependent beneficiaries from potential abuses arising from the power a fiduciary holds over the interests of the beneficiary.[1] Literally, a fiduciary is either "[o]ne who owes to another the duties of good faith, trust, confidence, and candor," or "[o]ne who must exercise a high standard of care in managing another's money or property."[2] In essence, "[t]he duty of loyalty, coupled with restitution of any gain the trustee obtains by favoring his own interest," creates the special relationship that the common law recognizes as containing the fiduciary duty owed in a fiduciary relationship.[3] Although appropriate and necessary in certain contexts, a fiduciary duty may be inapposite in other contexts, detracting from economic value or upsetting the longstanding expectations of parties to a contract.[4] This age of expanding fiduciary duties[5] demands

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1. L.S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 69.

2. BLACK'S LAW DICTIONARY 640 (7th ed. 1999).

3. Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 425 (1993).

4. Arguing that a strict fiduciary duty may not be appropriate in certain contexts does not necessarily go so far as to adopt wholesale Judge Easterbrook and Professor Fischel's view that a "fiduciary duty is not a distinctive relationship and is no different from contract law." Roberta Romano, *Comment on Easterbrook and Fischel*, Contract and Fiduciary Duty, 36 J.L. & ECON. 447, 447 (1993). Rather, this perspective merely acknowledges Easterbrook and Fischel's observation that the fiduciary duty functions as a type of gap filler in contracts as a blanket provision in areas of uncertainty:

> No contract can cover all contingencies, but often the parties can handle the major ones. . . . When one party hires the other's knowledge and expertise [e.g., trustees, managers, lawyers], there is not much they can write down. Instead of specific undertakings, the agent assumes a duty of loyalty in pursuit of the objective and a duty of care in performance.

Easterbrook & Fischel, *supra* note 3, at 426. The difference in position—the inequality—present when "one party hires the other's knowledge and expertise" justifies the existence of a

recognition of limits on the reach of fiduciary duties or relationships, particularly where the fiduciary duty might interfere with legitimate property rights or upset principles of contract law.

Fundamental principles of property and contract law govern the relationships between parties to mineral leases in the context of oil and gas law. In mineral leasing, the inequality resulting from the ownership of disparate property interests can create the opportunity to contract. But some courts have supplanted the bargaining power attendant to the unequal property interests in the relationship between the owner of the executive interest[6] and owner(s) of the

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fiduciary duty for the benefit of the dependent party and naturally reflects the intent of the parties contracting with each other. *Id.*

But inequalities also arise when different individuals own different property rights in the proverbial "bundle of sticks." One owner in the bundle of sticks might own more or better property interests than the others; these "better" interests can improve their owners' negotiating positions when entering into contracts with third parties based on their property interests. A fiduciary duty improperly imposed on the owner of these better property interests to act in the best interest of the other owners in the bundle of sticks who own inferior property interests effectually eliminates the potentially better negotiating position inherent in owning the better property interest. To that extent, a fiduciary duty is unwarranted in a regime of private property in which inequalities in the property interests held may lead parties to the negotiating table in the first place.

5. Fiduciary duties have been expanded into a number of areas:

> From its origins in the law of trusts [the fiduciary duty] has been extended to the relationships between a variety of professionals and their clients and further to the world of commerce. In that world it has been invoked in agency, partnership, and corporate relationships, and dubiously has often been said to be entailed in a large number of other contractual relationships, such as banks with borrowers or depositors, franchisors with franchisees, licensors with licensees, and distributorships.

Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 595 (1997).

6. The executive interest in a mineral estate is a property right in the bundle of sticks:

> The essence of the executive right, which may also be thought of as the executive power, is the power to grant a lease from which persons other than the lessor will enjoy royalty or other lease payments. The executive right is generally understood to include the power to grant a lease with respect to the mineral interest of another person and the executive right is a term taken to include the power to grant leases with respect to the royalty or another.

Patrick H. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop Oil and Gas Interests*, 37 NAT. RESOURCES J. 311, 315–16 (1997). Although the executive right "may also be thought of as the executive power," *id.* at 316, this semantic equivalence does not suggest that the executive right is literally a power, such as a power of appointment, as found by the Texas Supreme Court in *Pan American Petroleum Corp. v. Cain*, 355 S.W.2d 506, 510 (Tex. 1962), *overruled by* Day & Co. v. Texland Petroleum, Inc., 786 S.W.2d 667, 669 (Tex. 1990). This view of the executive right is significantly flawed because if viewed as a power of appointment, "a severed executive right appears to be a right based in contract, in the nature of a power, the duration of which is a

nonexecutive interest[7] in a mineral estate. They have found that a fiduciary obligation exists in that relationship that accrues to the benefit of the nonexecutive.[8] Holders of the executive mineral interest in mineral estates, whose executive right is a legitimate property right,[9] were not originally subject to strict fiduciary obligations[10] requiring them to subordinate their interests to those of the nonexecutive interest holder when contracting with third parties in mineral leases before these courts began imposing a fiduciary duty on them.

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matter of the parties' intent." *Day & Co.*, 786 S.W.2d at 669. Rather, the executive right is a property right and not a product of contract law:

> In fact, the executive right is a property interest subject to principles of property law when bundled with the other rights and attributes comprising the mineral estate. Once separated, however, *Cain* suggests that the executive right loses this nature, becoming subject to principles of contract and agency law. Under *Cain*, the executive right is different from all the other attributes comprising the mineral estate. We believe that this analysis is wrong.

Id.

7. The nonexecutive interest in a mineral estate is a "non-possessory, non-operating, passive interest" in the bundle of sticks constituting the mineral estate. Charles J. Meyers & Pamela A. Ray, *Perpetual Royalty and Other Non-Executive Interests in Minerals*, 29 ROCKY MTN. MIN. L. INST. 651, 653 (1983). Therefore, "[b]y definition, all non-participating royalty interests are non-executive interests" as well. *In re* Bass, 113 S.W.3d 735, 745 (Tex. 2003).

8. *See, e.g.*, *In re Bass*, 113 S.W.3d at 745 (finding that the executive interest holder indeed owed the nonexecutive interest holders a fiduciary duty—"a duty to acquire every benefit for the McGills that Bass would acquire for himself"—but that nothing indicated the necessary self-dealing to constitute breach of that duty in this case); Hlavinka v. Hancock, 116 S.W.3d 412, 417 (Tex. App. 2003) (noting the Texas Supreme Court's position that a fiduciary duty arises from "the relationship between the executive and the nonexecutive and not from the contract or deed"). Although it may not be accurate to say that a fiduciary duty arises solely from contract or a deed, *see supra* note 4, the mere existence of inequality in a relationship does not mandate the existence of a truly strict fiduciary duty. That is, whether or not a fiduciary obligation inheres between two parties may indeed arise from certain types of relationships of inequality, but "the mere existence of such a relationship does not mean that the parties to it always owe each other obligations of a fiduciary character." Deborah A. Demott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 909. Nevertheless, courts finding a fiduciary obligation between the executive and nonexecutive interest holders in the mineral estate tend to base the existence of the duty on the presence of an unequal relationship resulting from the ownership of these unequal property interests. The leading case holding that the executive interest holder owes the nonexecutive interest holder a full fiduciary obligation is still *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984). *See infra* Part V.B.

9. See *supra* note 6 for a discussion of the executive right as a property right and not as a "power" arising in contract, although the right does include the "executive power."

10. *See* Mims v. Beall, 810 S.W.2d 876, 878–79 (Tex. App. 1991) (noting that "[u]ntil the Texas Supreme Court's decision in [*Manges*], the utmost good faith standard had not been considered to create a fiduciary duty").

This Comment examines this expansion of fiduciary duties in the mineral estate in a bid at reestablishing the executive mineral interest holder's freedom of contract when leasing with third parties. First, Part II surveys the spectrum of duties of care—arising out of property and contract law—in oil and gas relationships. The duties that arise in these relationships constitute various duties of care rather than a fiduciary duty of loyalty,[11] which precludes any selfish benefit on the part of the fiduciary. Part III investigates fiduciary relationships in search of what sets them apart from other standards of care, concluding that the duty of loyalty, combined with a standard of care concerned with measuring competence in performance, creates a fiduciary obligation. Absent a duty of loyalty, the severity of which is so starkly exemplified in *Magruder v. Drury*,[12] a mere duty of care does not rise to the level of a fiduciary dury. Part IV compares the strict nature of the fiduciary obligation and its characteristic duty of loyalty with the spectrum of relationships and duties of care in oil and gas operations. Absent special facts that normally create a fiduciary relationship in other contexts, the duty of loyalty—the prohibition against any selfish benefit to the fiduciary—inherent in a fiduciary obligation does not naturally exist in these relationships.

Part V examines the applicability of a fiduciary obligation between the executive and the nonexecutive interest owners in a mineral estate, questioning the soundness of the court's reasoning in *Manges v. Guerra*,[13] the leading case holding that a fiduciary duty is proper in this relationship. The *Manges* court's lack of adequate analysis or explanation for departing from the earlier intermediary standard in favor of the unreasonably high fiduciary standard renders recent court decisions reinforcing *Manges*'s "radical departure from orthodoxy"[14] troublesome, not least because the *Manges* fiduciary

11. See *infra* Part III.A for a discussion of the duty of loyalty as the defining characteristic of a fiduciary duty.

12. 235 U.S. 106 (1914) (finding that a fiduciary violates the duty of loyalty to the beneficiary if the fiduciary benefits at all from the relationship, regardless of whether the benefit to the fiduciary occurs at the beneficiary's detriment or not, or, as in this case, even if the benefit to the fiduciary also actually *benefits* the beneficiary). See *infra* Part III.B for a discussion of the severity of *Magruder* in the fidnciary context.

13. 673 S.W.2d 180 (Tex. 1984).

14. Meyers & Ray, *supra* note 7, at 677 (discussing the Waco Court of Appeals holding in *Manges v. Guerra*, 621 S.W.2d 652 (Tex. App. 1981), which the Texas Supreme Court largely affirmed on rehearing).

duty inevitably exposes executive mineral interest holders to the fiduciary severity of *Magruder*. This Comment concludes in Part VI that the *Manges* fiduciary duty distorts a property regime in oil and gas law, in which owners of certain property rights contract for their own benefit based on those rights, and advocates for the protection of the executive's property rights through a return to a high standard of care absent a duty of loyalty to regulate the executive's behavior.

II. THE SPECTRUM OF DUTIES OF CARE IN OIL AND GAS LAW

By its very nature, oil and gas law intersects other areas of law, such as property,[15] contract,[16] and tort law.[17] But does it, or should it, cross paths with the law of trusts? Do the assorted relationships in mineral leasing implicate a fiduciary obligation, which "is most often associated with trust and trust-like relationships"?[18] Part II surveys some of the duties of care that inhere in oil and gas relationships, noting that these duties actually embody implied covenants natural

15. Ownership in mineral estates follows rules of property law:

> It is possible for a landowner to sever the title or rights to oil and gas from other rights in the land so that the oil and gas rights are owned as a distinct property interest, separate and apart from the property interest in the surface or any other property interest in the land. The owner of such an interest is considered as owning the total of all rights in and to the oil, gas, and any other mineral which were included in the grant or reservation.

1 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 15.1, at 427–28 (1987). Thus, a mineral estate is broken down into its own "bundle of sticks." For instance, both nonexecutive mineral interests and non-participating royalty interests in a mineral estate are "non-possessory interests in real property, most analogous to the unfamiliar common-law rent but close enough to easements, *profits a prendre*, and other incorporeal hereditaments to provide adequate conceptual comfort." Meyers & Ray, *supra* note 7, at 655.

16. Principles of contract law govern deeds and leases in oil and gas law. 2 KUNTZ, *supra* note 15, § 19.1, at 7–8 ("A contract to execute an oil and gas lease is generally recognized to amount to a contract to convey an interest in land and is construed as any other contract for the sale of an interest in land. The same is true with regard to a contract to assign an oil and gas lease."). Professor Kuntz examines the application of principles of contract law to oil and gas leases in great detail in Chapter 19 of his treatise. *See, e.g.*, *id.* § 19.5, at 13 ("The requirement of a writing in determining the validity of a contract for an oil and gas lease or for the assignment of an oil and gas lease involves a consideration of the statute of frauds and related statutes which require a writing and the parol evidence rule."); *see also* 3 PATRICK H. MARTIN & BRUCE H. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW § 650.2, at 642 n.8 (2003) (discussing the "arm's length" contract concept in the context of oil and gas leases) [hereinafter WILLIAMS & MEYERS].

17. Remedies in oil and gas law can stem from breach of contract or can arise in tort. *See* 5 KUNTZ, *supra* note 15, § 59.2, at 119.

18. John H. Armstrong & James M. Dion, *Fiduciary Relationships and Their Impact on Oil and Gas Operations*, 11 E. MIN. L. FOUND. § 15.01, at 15-2 (1990).

to property law. Essentially, these duties of care measure competency in performance and protect against egregious behavior in these relationships, but fall short of the duty of loyalty required in fiduciary obligations.

A. Duty of Care vs. Duty of Loyalty in Mineral Leasing

The property rights involved in oil and gas law, connected to each other through contractual relationships, entail certain duties of care that the parties to the exchanges or contracts must fulfill. In general, mineral leases bring parties together in a number of common relationships: adjacent landowners, concurrent owners, lessors and lessees,[19] operating and nonoperating interest owners,[20]

19. This is not the traditional lessor-lessee relationship. Rather, in mineral leasing, the lessor is often the owner of the executive interest and thus has the power to lease to an operator, who is the lessee and who develops the minerals in the mineral estate, paying the extraction expenses and keeping the profits, subject of course to royalty interests to be paid to both the executive and nonexecutive mineral interest owners or nonparticipating royalty owners and other leasing costs.

20. The operator and nonoperators should not be confused with the executive and nonexecutive(s) in mineral leasing. The operator actually extracts the minerals while the nonoperators receive a prearranged share of the bounty known as royalty payments. This relationship usually arises in the context of pooling or unitization:

> When an oil or gas unit is formed [because unitization allows more efficient and complete extraction of the oil or gas, and enables small property owners to participate in production], one of the parties is designated "operator"; the others are "nonoperators." The operator produces the oil and gas in the unit and bills the nonoperators for costs incurred. The specific obligations and relationships of the parties are defined by an operating agreement, a lengthy contract executed before unit operations begin.

Henry J. Eyring, Comment, *The Oil and Gas Unit Operator's Duty to Nonoperating Working Interest Owners*, 1987 BYU L. REV. 1293, 1293–94.

By contrast, the executive interest holder owns the right to lease both the executive interest holder's minerals and the nonexecutive interest holder's minerals to a lessee-operator for production. In this arrangement, the nonexecutive owns a passive interest in the mineral estate. The nonexecutive mineral interest holder receives a fraction, for example one-half (depending on the constellation of ownership as between the executive and nonexecutive to the minerals in the mineral estate, here an unsevered one-half nonexecutive ownership interest in the minerals), of all lease benefits arranged by the executive in executing the lease: "½ of bonus; ½ of rentals; ½ of excess royalty; ½ of per-acre bonus payment out of oil or gas; ½ of the landowners' back-in; in short, ½ of *all* lease benefits." Meyers & Ray, *supra* note 7, at 653. In a broad sense, a nonparticipating royalty interest holder is also a nonexecutive, but the nonparticipating royalty interest does not encompass as much as a nonexecutive mineral interest; rather, nonparticipating royalty interest owners, while otherwise maintaining the characteristics of a nonexecutive in that they hold a passive interest in the mineral estate, only receive a fraction of the royalty, for example, a one-eighth royalty in the proceeds of the minerals, "and no interest in bonus, rentals, or any other benefit not classed as royalty." *Id.* In

executive and nonexecutive interest owners, and joint venturers or partners,[21] to name a few. The property rights underlying these relationships contain implied covenants expressing duties that the parties must perform for each other.

The duties arising from implied covenants or established rights of parties to a mineral lease bind the parties on a spectrum of increasingly restrictive standards—or duties of care—but not necessarily to the extent of a fiduciary duty. It is true that a duty of care must exist in a fiduciary relationship, but the mere existence of any duty of care between parties need not necessarily imply a fiduciary relationship. Without a corresponding duty of loyalty,[22] the various duties of care stop short of precluding the parties' ability to cater to self-interest in arranging their economic affairs. Absent a duty of loyalty, even the strictest duty of care on the spectrum still does not rise to the level of a fiduciary obligation.

B. As Many Duties of Care as Relationships on the Spectrum

The spectrum of duties in mineral leasing ranges from what can be termed lowest-common-denominator (LCD) duties,[23] (i.e., the least demanding duties) to an extremely severe fiduciary duty, under special circumstances. Many duties fall on the spectrum between the LCD duties and the rare fiduciary obligation in mineral leasing. These duties of care are often implied covenants attached to the property rights involved,[24] and are thus natural in this context. The fiduciary duty, however, when it exists in mineral leasing, arises because of special facts that do not deal with the property rights themselves, but rather with preexisting relationships that already

fact, the executive interest holder is rarely, if ever, also the operator: "almost without exception the parties expect . . . the landowner selling the [nonexecutive] interest and keeping the exclusive leasing right, to lease and not to drill or mine himself." *Id.*

21. These relationships are ordered, for the purpose of criticism, as found in Armstrong & Dion, *supra* note 18, at 15-1 (arguing that all of these relationships entail or are moving towards incorporating fiduciary obligations).

22. See text accompanying notes 70–79 for a discussion of the duty of loyalty as the defining characteristic of a fiduciary obligation.

23. Author's term.

24. *See, e.g.*, Meyers & Ray, *supra* note 7, at 672 (discussing the implied covenant of utmost fair dealing and diligence).

entail a duty of loyalty.[25] Otherwise, the property rights at issue alone do not seem to justify imposition of such a strict standard.

1. LCD duties

Even one of the most basic principles of oil and gas law, the rule of capture, engenders a corresponding duty in the notion of correlative rights. Adjacent landowners may exploit the oil and gas beneath their land subject to the doctrine of correlative rights, which prevents physical and economic waste in the interest of promoting efficient extraction by holding landowners to at least two basic duties: "(1) the duty to other owners not to injure the source of supply; and (2) the duty not to take an undue proportion of the oil and gas from the common pool. To violate [these] duties is to abuse one's correlative rights."[26] These represent perhaps the most basic duties in oil and gas law, or its LCD duties.

Apart from these clear minimum duties fundamental to oil and gas law, the level of duty that attaches to the other types of relationships in mineral leases is less certain. Although these relationships allow for some generalizations, the level of duty arising in any given relationship in a mineral lease may depend on the particular facts of the case.

2. The minimal duty of care between concurrent owners

The relationship between concurrent owners in oil and gas leases employs only a minimal duty, if even that. At one extreme, in Texas, "there is no duty of good faith or fair dealing in contracts generally," and cotenants have "no fiduciary or agency relationship . . . between [them] unless they create it by agreement."[27] But other courts, in some cases, have found a vague "duty of fair dealing between cotenants"[28] in oil and gas law.[29] However, unless specific

25. Ernest E. Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371, 373 (1985); *see infra* text accompanying notes 58–61.

26. Young v. Ethyl Corp., 521 F.2d 771, 775 (8th Cir. 1975) (citation omitted).

27. *In re* Fender, 12 F.3d 480, 486 (5th Cir. 1994); *cf.* Prairie Oil & Gas Co. v. Allen, 2 F.2d 566 (8th Cir. 1924) (holding that one cotenant is not barred by another cotenant's rights to exploit and sell minerals but that the nonexploiting cotenant(s) can share in the profits from the extraction after paying their share of the expenses of extracting the oil).

28. Armstrong & Dion, *supra* note 18, § 15.04[2], at 15-9.

facts heighten the standard to satisfy the demands of equity, as was the case in the few instances where courts departed from the Texas rule and found a duty between cotenants,[30] the duty between concurrent owners barely surpasses the LCD duties.

3. The "reasonably prudent operator" standard of care

The lessor-lessee relationship contains a more established duty—a higher standard than as between cotenants. The standard in this relationship stems from implied covenants attendant to the lease. Typically, the operator-lessee extracts the oil, which is burdened by a royalty interest reserved by the lessor.[31] "Both the lessee's obligations and its performance of obligations relating to drilling decisions, production operations, marketing, and government interaction have been judged by what a prudent operator would have done under the same circumstances."[32] Much of oil and gas law revolves around the reasonably prudent operator standard. The duty under this standard is not very high, however, because self-interested actions of a lessee are presumed to be in the best interest of the lessor if the lessee has acted in good faith, or as a reasonably prudent operator in the same situation would have acted.[33] This standard of care protects the lessor

29. *See, e.g.*, Howell v. Bach, 580 S.W.2d 711, 712–13 (Ky. Ct. App. 1978) (holding that select cotenants could not refuse to sign along with the rest of the cotenants with the lessee and then subsequently enter into a contract with lessee for additional royalty payments only to them); Rex Oil Ref., Inc. v. Shirvan, 443 P.2d 82, 87 (Okla. 1967) (finding that one concurrent owner could not acquire a greater interest in a preexisting production agreement to the concurrently held leasehold by obtaining an adjacent leasehold also allocated to the production area of the well to the exclusion of the other concurrent owner).

30. *See* cases cited *supra* note 29.

31. Meyers & Ray, *supra* note 7, at 653. For a discussion of the operator-lessee's obligations generally under the oil and gas lease, see Gary B. Conine, *The Prudent Operator Standard: Applications Beyond the Oil and Gas Lease*, 41 NAT. RESOURCES J. 23 (2001).

32. Conine, *supra* note 31, at 23.

33. *See, e.g.*, Stirman v. Exxon Corp., 280 F.3d 554, 565–66 (5th Cir. 2002) (noting that the "reasonably prudent operator" standard applies an implied covenant of protection against drainage, but noting that "the law is not uniform as to any implied covenant to market," with some jurisdictions applying the standard and others leaving the question unanswered); Smith v. Amoco Prod. Co., 31 P.3d 255, 272 (Kan. 2001) (finding that the standard applies for implied covenants); Browning Oil Co. v. Luecke, 38 S.W.3d 625, 641 (Tex. App. 2000) (recognizing the standard as governing generally in the implied covenants that bind the lessee and also noting that those "implied covenants, however, are subject to the express terms in the contract"—at least in Texas); Neomar Res., Inc. v. Amerada Hess Corp., 648 So. 2d 1066, 1068 (La. App. 1994) (applying Louisiana's statutory definition of the standard that "[a] mineral lessee is not under a fiduciary obligation to his lessor, but he is bound to perform the contract in good faith and to develop and operate the property leased as

by obligating the lessee to do certain things that are also in the lessee's interest; it does not preclude the lessee from serving its own self-interest in its contractual relationship with the lessor and thus does not rise to the level of a fiduciary duty.

4. The "good and workmanlike manner" standard of care vs. the "duty of fair dealing"

The operator in oil and gas law has a duty of care to those holding nonoperating interests. But because of the primacy of the operating agreement in situations giving rise to an operator-nonoperator relationship,[34] "[t]he relationship arising from a pooling order or joint operating agreement between the operator and other cost-bearing interests or between the operator and the royalty owners of other cost-bearing interests is not susceptible of being described with a single label."[35] Often the operating agreement between the parties will define the standard that the operator must fulfill toward the owners of the nonoperating interests.[36] Generally, the operator must conform to a genetic standard under the operating agreement, performing its obligations in a "good and workmanlike manner."[37] In the absence of express terms in the joint operating agreement, courts have often "den[ied] protection to the

a reasonably prudent operator for the mutual benefit of himself and his lessor," and concluding on the basis of this standard that "the lessee owes a duty to the lessor; the obligation is not reciprocal. In other words, the obligation flows from the lessee to the lessor and not vice versa"). Furthermore, since "Texas law has never recognized a fiduciary relationship between a lessee and royalty owners," HECI Exploration Co. v. Neel, 982 S.W.2d 881, 888 (Tex. 1998), this duty has not risen to the level of a fiduciary duty.

34. See *supra* note 20 for a discussion of how operators and nonoperators differ from executive interest holders and nonexecutive interest holders, and for a discussion of the primacy of the operating agreement in defining the relationship between the operator and nonoperator.

35. 2 BRUCE H. KRAMER & PATRICK H. MARTIN, THE LAW OF POOLING AND UNITIZATION § 19.04, at 19-102 to 19-103 (3d ed. 2002) [hereinafter POOLING AND UNITIZATION].

36. Eyring, *supra* note 20, at 1294–95 (noting that parties overlitigate the nature of the operator's duty to the nonoperating interest holders). Eyring proposes a standardized "two-pronged duty" for the operator: "(1) the operator is bound to observe the terms of the operating agreement, and (2) the operator must not use its position to obtain unfair advantage over the nonoperators." *Id*; *see also* POOLING AND UNITIZATION, *supra* note 35, at 19-105.

37. Conine, *supra* note 31, at 24; *see, e.g.*, Westbrook v. Watts, 268 S.W.2d 694, 697 (Tex. Civ. App. 1954) (defining "good and workmanlike manner" as "the manner in which an ordinary prudent person engaged in drilling oil wells would have performed the particular work under the same or similar circumstances").

owner of the nonoperating interest."[38] Notwithstanding this posture, as a default duty of care absent express terms in the operating agreement,

> [t]he most that can be suggested is that there appears to be developing a somewhat vaguely defined duty of fair dealing owed by the operator to the owner of a nonoperating interest. Encompassed within this duty may be certain covenant obligations, *e.g.*, a duty to protect against drainage, a duty to develop reasonably, etc., similar to those implied in an oil and gas lease.[39]

Although it is true that "[t]he duties relating to production decisions are specified in detail in the operating agreement and are rarely the subject of litigation,"[40] a more descriptive, alternative formulation of the default duty is that "[t]he operator is bound only to act with 'reasonable skill and diligence' in production decisions."[41] In essence, this default duty of care closely resembles the "reasonably prudent operator" standard of care from the lessor-lessee relationship, even though equating the two standards might indeed be misplaced.[42] Although in some senses vague, the nature of the nonoperating interest owner's dependence on the operator's good faith and skillful performance renders both the generic operating agreement's "good and workmanlike manner" standard and the default "duty of fair dealing"—or the standard of "reasonable skill and diligence"—proper. However, neither of these duties of care intimates a corresponding duty of loyalty between the operator and nonoperator that would require the operator to act only for the benefit of the nonoperator.

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38. 2 WILLIAMS & MEYERS, *supra* note 16, § 420.2, at 366.2.

39. *Id.* at 366.3. But 2 WILLIAMS & MEYERS also notes the possibility that, absent an express provision in the operating agreement, "the owner of a nonoperating interest has no protection apart from the terms of his contract with the operator . . . since informed parties, dealing at arms length, may be expected to include the provision if such be their intent." *Id.* at 366.2–366.3.

40. Eyring, *supra* note 20, at 1295.

41. *Id.* at 1295 n.10.

42. *See, e.g.*, Conine, *supra* note 31, at 25 (arguing that adopting the reasoning behind the reasonably prudent operator standard of oil and gas leases insufficiently explains the good and workmanlike standard of the joint operating agreements, because the oil and gas leases have room for implied covenants arising out of property law, whereas the operating agreements rest on contract law).

5. The duty of "utmost fair dealing"

A little higher on the spectrum of duties in oil and gas law comes the duty between the owner of the executive interest and the owner of the nonexecutive interest, which can include, but is not limited to, a royalty interest[43] in the mineral estate. "Both the executive and non-executive interest owners possess part of the bundle of rights that, when taken together, represent fee title to the mineral estate."[44] Significantly, then, the executive right is a property right; it is "an ordinary incident of the mineral estate."[45] It is true that the "essence" of the executive right is the "power" to execute leases for both the executive and nonexecutive interest holders.[46] But this does not mean that, when severed from the mineral estate, the executive right becomes subject to contract and agency law because of any analogy to a power of appointment.[47] Rather, "[a]lthough the executive right is similar to a power, it is not a product of contract, but rather a creature of property rights."[48] Owning this property right, however, enables the executive interest holder to contract with third parties to extract the minerals in the mineral estate. Specifically, the owner of the executive right "has the exclusive right to execute leases on the land,"[49] whereas the holder of the nonexecutive interest owns a "passive interest," merely retaining a right either to a fraction of all lease benefits on leases entered into by the executive interest holder, in the case of the holder of the nonexecutive mineral interest, or to royalties from production alone, in the case of the holder of a nonparticipating royalty interest.[50]

Because the executive and nonexecutive interests are bound together in the "bundle of rights" appurtenant to the mineral estate,

43. Meyers & Ray, *supra* note 7, at 653–54.

44. Armstrong & Dion, *supra* note 18, § 15.04[5], at 15-15.

45. Meyers & Ray, *supra* note 7, at 656.

46. Martin, *supra* note 6, at 315–16. See also *supra* note 6 for a discussion of why the executive right is governed by property law rather than contract or agency law.

47. *See* Pan Am. Petroleum Corp. v. Cain, 355 S.W.2d 506, 510 (Tex. 1962) (holding that the executive right was not a real property interest but was similar to a power of appointment and thus could not be passed to heirs at death), *overruled by* Day & Co. v. Texland Petroleum, Inc., 786 S.W.2d 667, 669 (Tex. 1990) (unequivocally defining the executive interest as a property right, subject to principles of property law, even when severed from other attributes of the mineral estate).

48. *Day & Co.*, 786 S.W.2d at 669.

49. 2 WILLIAMS & MEYERS, *supra* note 16, § 339.1, at 204.

50. Meyers & Ray, *supra* note 7, at 653.

and particularly since the nonexecutive interest holder depends on the executive interest holder for any benefit from the mineral estate, oil and gas law does "not leave the royalty owner completely at the mercy of the holder of the exclusive-leasing privilege."[51] On the contrary, courts have found a range of standards to define the duty between the executive interest owner and the nonexecutive interest owner. This standard can extend from "good faith" and "ordinary care" in some courts to a full fiduciary obligation in others.[52] But the standard of "utmost fair dealing" is an intermediary between these two extremes: "This standard of conduct is said to fall between an unrealistically high fiduciary duty and an inadequately low standard of ordinary care and good faith."[53] As such, it "denote[s] the standard of conduct required [of the executive interest owner] to satisfy the various implied covenants"[54] that attach to these property rights. And, not surprisingly, utmost fair dealing may in practice also "come[] down to an ordinary, prudent landowner test,"[55]

51. Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 573 (1948).

52. Phillip E. Norvell, *Pitfalls in Developing Lands Burdened by Non-Participating Royalty: Calculating the Royalty Share and Coexisting with the Duty owed to the Non-Participating Royalty Owner by the Executive Interest*, 48 ARK. L. REV. 933, 974 n.96 (1995) ("Differing opinions have been expressed over the years as to what standard of care could be imposed on the executive to adequately protect the non-executive interest. Suggestions have included the no duty rule; ordinary care and good faith standard; the utmost fair dealing standard; and the fiduciary duty."). Professor Williams clearly shows here the ambiguity inherent in defining this standard:

> Judicial opinions differ as to the nature of the duty which exists in this situation. They have expressed the duty in a variety of language: "Utmost fair dealing"; "utmost fair dealing and diligence"; "an implied covenant . . . [to] protect" the royalty interest; "good faith in the performance of a duty . . . [to be discharged] with prudence and good faith and with ordinary care and diligence"; and "utmost good faith." In other cases some sort of duty has been recognized but its nature has not been specified. A leading writer on the subject endorses the duty of "utmost fair dealing" as the appropriate standard of conduct to govern the exercise of the executive right.

Howard R. Williams, *The Fiduciary Principle in the Law of Oil and Gas*, 13 INST. ON OIL & GAS L. & TAX'N 201, 242 (1962) (alterations and omissions in original). *See infra* Part IV.B.

53. Williams, *supra* note 52, at 242.

54. Jones, *supra* note 51, at 574 (emphasis omitted).

55. WILLIAMS & MEYERS, *supra* note 16, § 339.2, at 212; Norvell, *supra* note 52, at 973–74 ("The evolution of [the standard of care that the executive owes the nonexecutive interest holder] has not been uniform or without controversy. The prevailing standards have been the traditional 'utmost fair dealing' standard, sometimes referred to as the 'prudent landowner' standard, and the 'fiduciary' srandard originating in the 1985 [sic] Texas case of *Manges v. Guerra*.").

considering that standard's general usefulness in oil and gas leases.[56] But this duty of care does not imply a duty of loyalty that prevents the executive from seeking selfish benefit from the ownership of this property interest in contracting with third parties in mineral leases. It would seem, then, that because of the absence of a duty of loyalty, the duty of utmost fair dealing still falls short of a fiduciary duty.[57]

6. A full fiduciary duty under special facts

Oil and gas law does not necessarily exclude fiduciary obligations. The same relationships that create a fiduciary duty elsewhere, such as where "an express trust is created, [where] close family members turn over the management of their affairs to the member having special business expertise, or [where] a partnership is formed,"[58] also give rise to such a duty in oil and gas law. Therefore, when parties enter into a joint venture or partnership to pursue a mineral lease, they must fulfill the fiduciary obligations that naturally inhere in such a relationship.[59] These enterprises embody the highest standard of the duty between participants in oil and gas leasing—a full fiduciary obligation—because an oil and gas joint venture is still a joint venture in the traditional sense and retains the fiduciary obligation owed in any partnership.[60] And the terms of the

56. *See* Conine, *supra* note 31, at 24.

57. *But see* Parts V.B.1.a–V.B.2.c (discussing *Manges v. Guerra* and its progeny, which equate "utmost fair dealing" with a fiduciary obligation); Joshua M. Morse III & Jaimie A. Ross, *New Remedies for Executive Duty Breaches: The Courts Should Throw J.R. Ewing Out of the Oil Patch*, 40 ALA. L. REV. 187, 219–20 (1988) ("The emerging 'fiduciary duty rule' holds that executives owe nonexecutives traditional fiduciary duties. This school of thought defines the standard of duty as the utmost good faith of a fiduciary."); Armstrong & Dion, *supra* note 18, § 15.04[5], at 15-15 to 15-16 (reasoning that because the "executive . . . controls the fate of the nonexecutive interest," the standard of "utmost good faith" is essentially a euphemism for "fiduciary duty").

58. Smith, *supra* note 25, at 373.

59. *See, e.g.*, UNIFORM PARTNERSHIP ACT § 21 (1997). Every state except Louisiana has adopted the Uniform Partnership Act (UPA) and its definition of the partners' duty to each other:

> Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

Id.; *cf.* UNIFORM LIMITED LIABILITY COMPANY ACT § 409(a) (1996).

60. *See* WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP § 188, at 298 (3d ed. 2001) ("One of the most significant aspects of the partnership relation is its fiduciary character."). For confirmation that this principle remains consistent in oil and gas law as well,

agreement between the parties reveal the requisite intent for them to stand as joint venturers or partners with each other.[61] These relationships introduce the fiduciary obligation into oil and gas law, creating the strictest standard on the spectrum of duties that govern the various relations—many of which are outside the scope of this investigation—involved in mineral leases. This is the strictest standard on the spectrum of duties because no other duty prevents the obligor from seeking selfish benefit within the scope of the duty. The other standards on the spectrum are duties of care which regulate the level of performance owed, whereas the fiduciary obligation entails both such a duty of care and a duty of loyalty. Thus, although fiduciary duties might exist in some oil and gas leases, they stem from a preexisting relationship of trust or confidence[62] rather than from the nature of implied covenants attendant to property rights.

III. THE SEVERITY OF FIDUCIARY OBLIGATIONS

Many relationships in various legal contexts create a fiduciary obligation between the parties in order to prevent self-dealing. The fiduciary obligation serves a vital function, particularly in relationships of dependence:

> A fiduciary relationship exists when one person places trust and confidence in another who, as a result, gains influence and superiority over the other. . . . The fiduciary is prohibited from seeking a selfish benefit during the relationship. When the fiduciary relationship does not arise as a matter of law, it must be proved by clear and convincing evidence.[63]

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see *Palmer v. Fuqua*, 641 F.2d 1146, 1155 (5th Cir. 1981) (finding that a partnership agreement to acquire and explore oil and gas leases as lessee-operators gave rise to the same fiduciary obligation as between partners in any partnership, thus justifying imposition of a constructive trust) and *Rankin v. Naftalis*, 557 S.W.2d 940, 944 (Tex. 1977) ("While we recognize that the relationship between the parties in the Melton lease was fiduciary in character, the fiduciary duties extended only to dealings within the scope of the underlying relationship of the parties: joint venturers for the development of a particular oil and gas lease.").

61. Carroll v. Caldwell, 147 N.E.2d 69, 74 (Ill. 1957) ("[T]he relationship is a matter of intent, as between the parties, and arises only where they intended to so associate themselves, such intention being determined in accordance with the ordinary rules governing the interpretation and construction of contracts.").

62. *See* Smith, *supra* note 25, at 373.

63. Kurtz v. Solomon, 656 N.E.2d 184, 190–91 (1995) (citations omitted).

Certain relationships justify an obligation to act solely in the interest of another, while others do not. This Part compares strict fiduciary duties in other areas of the law with the duties of care in various oil and gas relationships. Part III.A briefly discusses the fiduciary duty in agency law, finding that its focus is to prevent an agent from serving its own interest in its agency capacity. Indeed, the duty of loyalty is the defining characteristic of fiduciary duties. Part III.B addresses the fiduciary principle in trust law, observing similarly that it emphasizes protecting trust beneficiaries by preventing the trustee from profiting from the trustee position. A duty of loyalty, such as that owed to the trust beneficiary by the trustee, makes one a fiduciary. This duty of loyalty exposes the fiduciary to extremely strict prohibitions on seeking selfish benefit out of the subject matter of the fiduciary obligation, regardless of whether such behavior harms or benefits the beneficiary of the fiduciary duty. The U.S. Supreme Court has illustrated in *Magruder v. Drury*[64] the severity of a fiduciary's duty of loyalty by holding that a fiduciary breaches this duty even if the self-interested action actually benefits the beneficiary.

A. The Fiduciary in Agency Law

In typical agency relationships, such as that between joint venturers and partners in oil and gas projects, a fiduciary obligation represents a strict, and proper,[65] standard indeed. Significantly, the fiduciary owes both a duty of care and a duty of loyalty to the beneficiary.[66] "The duty of care addresses only the minimum level of required performance by an agent [or other fiduciary]."[67] In other words, the duty of care will vary with the context, depending on the skill level of the agent or service provider and on the responsibilities of the agent or the service being provided. It is true that the duty of

64. 235 U.S. 106 (1914). See *infra* Part III.B for a discussion of the strictures of the *Magruder* principle.

65. The strict standard is proper in agency law because those involved have consented to be bound and it prevents abuse of the dependent party by the party with greater knowledge, access to information, or skill. By contrast, a strict fiduciary duty would not be proper in a situation where there is no justification for precluding one party from pursuing self-interest in the free market and where the parties have not consented to be in a fiduciary relationship with each other.

66. Brudney, *supra* note 5, at 599.

67. *Id.* at 599 n.12.

loyalty[68] also has a number of manifestations based on context.[69] But "[f]rom its origins in the law of trusts and its invocation in agency relationships, the fiduciary obligation of loyalty has entailed the exclusive benefit principle and a kind of prophylactic prohibition on self-dealing."[70] Thus, "between the fiduciary's interest and the beneficiary's interest the fiduciary is to serve *only* the latter."[71] This exclusive benefit principle, or the duty of loyalty that a fiduciary owes the beneficiary, is the common thread uniting these variations of the duty of loyalty in the fiduciary duty and is a constitutive principle in the fiduciary obligation.

In essence, although the fiduciary obligation encompasses both a duty of care and a duty of loyalty, "[t]he distinguishing obligation of a fiduciary is the obligation of loyalty."[72] If it can be said that a duty of loyalty exists prohibiting selfish benefit of any kind, then a fiduciary duty exists no matter what level of duty of care attaches (though a duty of care must indeed attach). The duty of care will then measure the fiduciary's competence according to the fiduciary's skill or the skill level that the fiduciary has intimated in offering services to the beneficiary, which will in turn depend on the context of the particular relationship. A fiduciary, then, is someone who is subject to such a duty of loyalty: one "is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to

68. RESTATEMENT (SECOND) OF AGENCY § 387 (1958) ("Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency.").

69. *See, e.g.*, *id.* §§ 388–400 (duty to account for profits arising out of employment (§ 388); duty not to act as adverse party without principal's consent (§ 389); duty to deal fairly with principal when acting as adverse party with principal's consent (§ 390); duty not to act for adverse party without principal's consent (§ 391); duty to act with fairness to both when acting for adverse party with principal's consent (§ 392); duty not to compete with principal as to subject matter of agency (§ 393); duty not to act for one with conflicting interests with principal (§ 394); duty not to use or disclose confidential information (§ 395); duty not to confuse or appear to own principal's things (§ 398)).

70. Brudney, *supra* note 5, at 601.

71. *Id.*

72. Bristol & W. Bldg. Soc'y v. Mothew, [1998] Ch. 1, 18 (C.A.), 1996 WL 1092374, at *18 ("The principal is entitled to the single-minded loyalty of his fiduciary. . . . The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity. Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough."); *cf.* Brudney, *supra* note 5, at 599 (noting that, in the fiduciary context of publicly held corporations, the "emphasis on loyalty reflects substantial doubt that the 'care' obligation entails a useful norm of behavior").

them that he is a fiduciary."[73] Thus, fiduciaries are, to name a few, "executors and administrators of estates, guardians, trustees and directors of corporations as well as agents. All of these owe similar duties of loyalty to their beneficiaries."[74] They also all owe varying duties of care to their beneficiaries, but their duty of loyalty is what makes them fiduciaries in the first place.

The duty of loyalty, and the fiduciary duty as a whole, flows from the consent of the parties set forth in a contract or agreement of some kind.[75] Existence of a fiduciary duty of loyalty severely restricts the party to whom the obligation accrues.[76] This is because the obligation of fiduciaries "is to act only in the interest of their beneficiaries and to forego personal advantage aside from compensation in the exercise of their tasks."[77] Justice Cardozo poignantly expressed the strictness of the obligation:

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[78]

Both vague and eloquent, the standard of the "punctilio of an honor the most sensitive" might not constitute a very clear standard for this duty of loyalty. By way of clarification, the fiduciary has "put himself in a position in which thought of self [is] to be renounced, however hard the abnegation."[79] This principle highlights the severity of the duty of loyalty in fiduciary obligations: the fiduciary duty of loyalty forbids selfish benefit of any kind.

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73. *Bristol & W. Bldg. Soc'y*, [1998] Ch. 1, 18 (C.A.), 1996 WL 1092374, at *18.

74. GREGORY, *supra* note 60, § 4, at 13.

75. RESTATEMENT (SECOND) OF AGENCY § 1 (1958) ("Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.").

76. See *supra* text accompanying notes 68–72 for a discussion of the "exclusive benefit principle" that renders the fiduciary duty so restrictive.

77. GREGORY, *supra* note 60, § 4, at 13.

78. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

79. *Id.* at 548.

B. The Fiduciary in Trust Law

The incompatibility of seeking "selfish benefit" with a trustee's responsibilities in efficiently administering a trust renders the fiduciary principle central to trust law as well. In fact, it is through analogy to the law of trusts and the role of a trustee in relation to the trust property that courts have expanded the fiduciary concept from trustees to the various other relationships in agency and other areas of law.[80] "A trust . . . is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons . . . ."[81] In trust law, "the fiduciary is under a duty not to profit at the expense of the other and not to enter into competition with the other without the latter's consent,"[82] since such promotion of self-interest would threaten the purpose of the trust, which the trustee must always further. In fact, for this very reason, "[u]nder traditional trust law, self-dealing not only is prohibited, but also constitutes a per se violation of the fiduciary duty."[83] In other words, in trust law, even good faith will not excuse selfish benefit or its subset of self-dealing.

The trust relationship by its very nature warrants such a severely high standard precluding self-dealing. The trust case of *Magruder v. Drury*[84] illustrates the rigidity of the "well settled rule that a trustee can make no profit out of his trust,"[85] presciently speaking to the applicability of this strict fiduciary standard in other contexts where parties have not affirmatively consented to stand in such a relationship, such as oil and gas leases. In *Magruder*, one of the trustees to a testamentary trust, Drury, partly owned a real estate firm. The firm loaned money in exchange for promissory notes and

80. Sealy, *supra* note 1, at 72 (noting that the word "fiduciary" not only "is still sometimes used in an indefinite and descriptive sense, so that it embraces all trust-like [sic] situations *including* the trust itself," but also "in reference to those situations which are in *some* respects trustlike but are not, strictly speaking, trusts").

81. RESTATEMENT (THIRD) OF TRUSTS § 2 (2003).

82. *Id.* § 2 cmt. b.

83. Smith, *supra* note 25, at 377.

84. 235 U.S. 106 (1914).

85. *Id.* at 119.

charged a one or two percent commission on the notes.[86] Drury bought some of the mortgages from the firm with money from the trust in exchange for the notes, paying the face value of the mortgages plus accrued interest. Because of this arrangement, Drury, in his capacity as trustee, did not have to pay any of the commissions on the notes, since Drury's firm had already collected commissions on the mortgages. None of these notes defaulted and no disadvantages accrued to the trust; rather, the auditor below had found that

> the relation of the firm of Arms & Drury to [the] trustees[] benefited the estate, by enabling the trustees at all times to make immediate re-investment of its funds, without loss of income, and by enabling the trustees to at all times readily procure re-investments without payment of brokerage,[87]

and by sparing the trust from having to shop around for suitable mortgages.

The auditor supported the trustees in finding that the transactions "cost the estate not a penny more than if the transactions had been with some other firm or individual."[88] The auditor rejected the plaintiff's claim that since Drury's firm initially charged commission on the mortgage purchasers and he earned a share of the commission from the transactions, Drury should pay the profit to the estate.[89] The Supreme Court rejected the auditor's opinion based on the trustee's fiduciary duty to the trust: "The rule in such cases springs from [a trustee's] duty to protect the interests of the estate, and not to permit his personal interest to in any wise conflict with his duty in that respect."[90] As a matter of principle,

86. *Id.* at 118–19 (quoting auditor's report in the record to describe the facts relating to this part of the suit).

87. *Id.* at 119.

88. *Id.* at 118.

89. *Id.* at 119. The auditor felt that granting the plaintiff's claim would create a windfall for the estate:

> The objection narrows itself to a claim that Drury, by reason of his position as trustee, should, in addition to the benefit of his valuable services, commercial knowledge, and business acumen, make the estate a gift of profits on his individual moneys, to which the estate is in no wise entitled, and to which it could not make a semblance of reasonable claim had the trustees been other than Drury, or the agents of the estate been other than [the firm] Arms and Drury.

Id.

90. *Id.*

because of the sensitive nature of the dependent relationship between beneficiaries and trustees, trust law prohibits this kind of self-dealing:

> It makes no difference that the estate was not a loser in the transaction or that the commission was no more than the services were reasonably worth. It is the relation of the trustee to the estate which prevents his dealing in such way as to make a personal profit for himself. . . . While no wrong was intended, and none was in fact done to the estate, we think nevertheless that upon the principles governing the duty of a trustee, the contention that this profit could not be taken by Mr. Drury owing to his relation to the estate, should have been sustained.[91]

Therefore, as the Supreme Court expressed in *Magruder*, the nature of the trust relationship in general justifies such stricture in *Magruder*'s holding.[92] Drury, the fiduciary, had to subordinate his freedom of contract to obtain the best terms possible to the fiduciary prohibition on selfish benefit. *Magruder*'s striking example of the restrictive implications of a fiduciary obligation in the trust context informs the question of whether fiduciary principles may appropriately abridge the freedom of contract in mineral leasing in a similar way.

IV. TOWARDS A FULL FIDUCIARY OBLIGATION IN OIL AND GAS OPERATIONS

Part IV evaluates the duties in oil and gas law against the high fiduciary standard. Part IV.A distinguishes fiduciary relationships from oil and gas relationships but notes confusion in the courts about whether fiduciary duties apply to the latter, as well as some academic enthusiasm for applying fiduciary duties to these relationships. In truth, some relationships in oil and gas law may indeed warrant imposition of a fiduciary duty, such as when an express trust already exists between parties.[93] But Part IV.B

91. *Id.* at 120.

92. The holding was strict indeed, because Drury's actions in *Magruder* actually *benefited* the beneficiary of the trustee's fiduciary duty, but since the scheme served the fiduciary's self-interest at the same time, the Court found that Drury had breached his fiduciary duty.

93. *See generally* Smith, *supra* note 25, at 373 (noting that the fiduciary obligation is clearly warranted in oil and gas leases "[i]f an express trust is created, if close family members turn over the management of their affairs to the member having special business expertise, or if

concludes that imposition of a fiduciary obligation in oil and gas operations absent special facts essentially reverses the property regime in the mineral estate. A fiduciary duty binding the executive for the benefit of the nonexecutive elevates the nonexecutive mineral interest over the executive interest by requiring the executive to seek only the nonexecutive's benefit when executing a mineral lease with a third party. Thus, the fiduciary duty in this context also turns contract law on its head by depriving the executive interest holder of the freedom of contract to serve self-interest in negotiating the best lease terms possible, as long as those terms do not intentionally harm the nonexecutive's interest.

A. The Fiduciary Duty in Oil and Gas Law

1. Reassuring a middle ground

Although, as discussed above,[94] various relationships between parties exist in oil and gas law, many of these merely appertain to either property or contractual rights. Oil and gas leases involve businesspeople or others trying to profit through beneficially contracting with the property rights they own. For example, owning the executive interest allows the holder to lease the mineral estate to a lessee-operator; in doing so, the executive's freedom of contract justifies seeking the best lease terms possible, subject to the utmost fair dealing duty of care in respect to the passive interests of the nonexecutive mineral interest holder. In this sense, then, the relationships in oil and gas law do not resemble dependence relationships in other contexts, in which fiduciary duties protect the dependant party.[95] In agency relationships,[96] stockholders or clients are dependent on the greater access to information and levels of skill

a partnership is formed," because "it would be totally unacceptable to permit the person entrusted with managerial responsibilities to act in his own selfish interest and ignore the interests of the other parties").

94. See *supra* Part II for a discussion of the spectrum of relationships and corresponding duties in oil and gas operations.

95. *See, e.g.*, Marathon Oil Co. v. Moye, 893 S.W.2d 585, 591 (Tex. App. 1994) ("A mere contractual relationship reserving a nonparticipatory royalty interest will not create a fiduciary relationship between the parties. The fact that a royalty interest owner is dependent upon the executive interest holder to manage the mineral estate in good faith does not of itself create a special relationship of trust and confidence.").

96. See *supra* Part III.A for a discussion of the fiduciary relationship in agency law.

or knowledge of those on the board of directors or professional service providers respectively. In trust law,[97] the trust beneficiary is dependent upon the trustee's loyal and careful management of the trust property. But expanding the various duties of care arising under mineral leases to the level of a fiduciary obligation—the severity of which is poignantly expressed by the *Magruder* case—may adversely affect the parties' contractual prerogatives.

Duties in the oil and gas context mostly fall on a spectrum[98] according to the given circumstances of each lease. Even though these duties, such as the "duty of fair dealing owed by the operator to the owner of a nonoperating interest," are sometimes "somewhat vaguely defined,"[99] some leading commentators on the subject note that they have not reached the level of fiduciary obligations. For example, "there is no fiduciary relationship arising automatically as between the owner of an operating interest and the owner of a nonoperating interest in the same premises, but the former may owe to the latter a duty of fair dealing, the scope of which remains undefined."[100]

As to the relationship between the owners of the executive and nonexecutive interests in mineral estates, "the executive will not be bound to a standard of selfless conduct, such as that imposed on trustees or guardians,"[101] or in other words, to a fiduciary standard of conduct. Rather, the executive "may exercise the executive right with the same self-interest in mind as if there were no outstanding royalty or nonexecutive mineral interest," meaning that "[i]f the conduct of the executive satisfies the ordinary, prudent landowner standard, the fact that the nonexecutive owner has been harmed is not actionable under this view."[102] The formulations of standards for the duties of care in oil and gas law would render the *Magruder* holding—potentially disastrous for the executive interest owner—irrelevant for

97. See *supra* Part III.B for a discussion of the fiduciary relationship in its context of origin, the law of trusts.

98. See *supra* Part II for a discussion of the spectrum of duties arising in the various relationships of oil and gas operations.

99. 2 WILLIAMS & MEYERS, *supra* note 16, § 420.2, at 366.3.

100. *Id.* at 366.6.

101. *Id.* at 212–13.

102. *Id.* at 213. See *supra* Part II.B.5 for a discussion of how the utmost fair dealing standard of care between the executive and the nonexecutive in the mineral estate can also be boiled down to the ordinary, prudent landowner standard of care owed between parties to a mineral lease.

these parties. But despite these reassuring statements, courts have not uniformly followed this lead; indeed, some courts have expanded these duties into a fiduciary obligation.

2. Expanding into a higher realm

The apparent expansion by courts of some of the standards of care in the various relationships of mineral leasing into fiduciary obligations has led other commentators to observe that fiduciary obligations belong in certain areas of oil and gas law. "While the courts struggle with the distinction between 'good faith' and 'fiduciary duty,' it may well be that there is none. The courts appear to be ensnared in a hopeless exercise in semantics."[103] For example, even though "[a]s a general rule the relationship between cotenants does not involve fiduciary principles,"[104] some courts have found behavior between cotenants sufficient to constitute a breach of fiduciary dury.[105] And as between the operator and the owner of a nonoperating interest, "appropriate facts"[106] may lead to a fiduciary relationship, most notably in unitization.[107] Finally, because "the holder of the executive interest possesses the exclusive right to lease

103. Armstrong & Dion, *supra* note 18, § 15.04[3], at 15-12. This observation may reveal that these commentators, or the courts, or both, do not fully appreciate what makes a fiduciary duty a fiduciary duty in the first place: the duty of loyalty, coupled, admittedly, with a duty of care. Or it might imply that in finding fiduciary duties in these relationships, the courts are misusing the term "fiduciary" to mean something less than a true fiduciary, that is, to refer to someone who is not truly prohibited from seeking selfish benefit out of the position, as is a true fiduciary. See *supra* text accompanying notes 70–79 for a discussion of the duty of loyalty, or the "exclusive benefit principle," as the defining characterisric of a fiduciary obligation. *See also supra* Part III.B (discussing *Magruder v. Drury*, 235 U.S. 106 (1914)).

104. Armstrong & Dion, *supra* note 18, § 15.04[2], at 15-7.

105. *See, e.g.*, Howell v. Bach, 580 S.W.2d 711, 712–13 (Ky. 1978); Rex Oil Ref., Inc. v. Shirvan, 443 P.2d 82, 88–89 (Okla. 1967); Neilson v. Hase, 314 S.W.2d 219, 221 (Ark. 1958) ("[J]oint tenants and [copartners] stand in such confidential relations in regard to one another's interest, that one of them is not permitted in equity to acquire an interest in the property hostile to that of the other."); Pure Oil Co. v. Byrnes, 57 N.E.2d 356, 361 (Ill. 1944) (finding a breach of fiduciary duty between tenants in common but noting that normally "[a] fiduciary relationship [does] not arise merely from the fact that appellant and appellee were tenants in common"; rather, "[t]he question whether there is a fiduciary relation between such parties, so that confidence is reposed by one in the other, will depend upon all the facts and circumstances of the particular case").

106. Armstrong & Dion, *supra* note 18, § 15.04[4], at 15-13.

107. *See, e.g.*, Young v. W. Edmond Hunton Lime Unit, 275 P.2d 304, 309 (Okla. 1954) ("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.").

and, consequently, controls the fate of the nonexecutive interest,"[108] the executive "stands in a position of superiority to the non-executive"[109] and "[o]ur courts require that the executive's rights be exercised to the benefit of the non-executive interest."[110] Thus, these assertions seem to indicate that these oil and gas relationships contain a fiduciary duty after all. But, in truth, commentators justifying a fiduciary obligation in these oil and gas relationships must perform some semantic shifting of their own.

B. An Unreasonably High Standard for Oil and Gas Relationships

Closer examination reveals two weaknesses in these observations of a fiduciary duty in oil and gas relationships. First, even in oil and gas relationships that do not naturally contain a fiduciary obligation, special facts or circumstances can create such a duty.[111] In many of the situations in which courts found a fiduciary obligation arising out of oil and gas leases, special circumstances, such as the presence of a literal fiduciary relationship, imposed the fiduciary duty rather than the nature of the oil and gas relationships alone. That is, even though a fiduciary relationship does not naturally exist in a given oil and gas relationship—for example, between the executive and nonexecutive interest holder—"[i]f an express trust is created, if close family members turn over the management of their affairs to the member having special business expertise, or if a partnership is formed,"[112] then these relationships will introduce a fiduciary obligation into the oil and gas relationship by their own virtue. The fiduciary relationship will then stem from those traditional trust and agency relationships, not from an inequality arising from the ownership of disparate property interests.

Second, statements that various oil and gas relationships create fiduciary obligations seem to stem from an exceptionally loose understanding of what it means to be a fiduciary. Interesting intellectual gymnastics facilitate this redefinition of the meaning of fiduciary. Literally defined, fiduciary means "[o]f or pertaining to a

108. Armstrong & Dion, *supra* note 18, § 15.04[5], at 15-15 to 15-16.

109. *Id.* at 15-16.

110. *Id.*

111. *See* Smith, *supra* note 25, at 373.

112. *Id.*

trustee; pertaining to or of the nature of a trusteeship."[113] This is the kernel of the definition of fiduciary. Neither the *Oxford English Dictionary* nor *Black's Law Dictionary* strays from the connotation of trustee in the definition of "fiduciary"—an admittedly high standard. True, "an executor, guardian, agent, or corporate officer or director is a fiduciary," and the duty of care varies between all of these relationships,[114] but the characteristic unifying all of these as fiduciaries is that fiduciaries all owe their beneficiaries a duty of loyalry, which precludes acting in the fiduciary's self-interest with regards to the subject matter of the fiduciary relationship.[115] "All of these owe similar duties of loyalty to their beneficiaries. Their obligation is to act only in the interest of their beneficiaries *and to forego personal advantage aside from compensation in the exercise of their tasks.*"[116] Thus, fundamental to the obligation of a fiduciary, whether trustee or otherwise, is the prohibition on "selfish benefit"[117] at the expense of or in competition with the benefit of the other parry.

However, to find that each of the relationships in oil and gas law also contains a "fiduciary" obligation, Armstrong and Dion simply equate the fiduciary dury with any of the lower level duties of care—such as the duty of good faith or the other duties along the spectrum[118]—inherent in those relationships by loosely redefining fiduciary. First, "[t]he judicial fiction of 'correlative rights' imposes a fiduciary duty on each party taking oil and gas from a common reservoir to act in good faith and with due regard to the interests of the others."[119] In noting that even the LCD duties[120] of oil and gas law associated with the doctrine of correlative rights impose a fiduciary duty, Armstrong and Dion use an extremely lax—perhaps even brand-new—definition of fiduciary duty: "good faith" and "due regard."

113. 4 OXFORD ENGLISH DICTIONARY 191 (1978).

114. RESTATEMENT (THIRD) OF TRUSTS, introductory nt. (2003).

115. See *supra* text accompanying notes 70–79 for a discussion of the duty of loyalty as the defining characteristic of fiduciary relationships.

116. GREGORY, *supra* note 60, § 4, at 13 (emphasis added).

117. Kurtz v. Solomon, 656 N.E.2d 184, 191 (Ill. App. Ct. 1995).

118. *See supra* Part II.B.

119. Armstrong & Dion, *supra* note 18, § 15.04[1], at 15-7.

120. *See supra* text accompanying notes 26–29.

In the context of duties in cotenancy, "[w]hen it can be said that there exists a duty of fair dealing between cotenants, a violation of that duty will support an action for breach of the fiduciary relationship."[121] But a mere duty of care, such as the duty of fair dealing, does not preclude consideration of one's own best interest and thus cannot equal a fiduciary duty.[122] Finding a fiduciary duty between the lessor and the lessee proves more difficult for this type of intellectual gymnastics because "[t]he lessee has a substantial interest that must be taken into account, and it would not be required to subordinate its own interest to the interest of the lessor."[123] In fact, at least one court has found it impossible to find a fiduciary duty between the lessor and lessee.[124] To overcome this obstacle to identifying a fiduciary obligation between lessee and lessor, these commentators simply accuse courts of an "exercise in semantics"[125] by failing to recognize a supposed lack of distinction between "good faith" and "fiduciary duty." However, mere good faith and the stringent fiduciary duty are on different ends of the spectrum of duties of care in oil and gas relationships.[126]

Finally, in finding a fiduciary duty between the executive and the nonexecutive, Armstrong and Dion admit to redefining "fiduciary relationship" for the relationships in oil and gas law. The standard of "utmost fair dealing" in the executive-nonexecutive relationship "is a fiduciary relationship falling within the definition adopted for this [analysis]"[127] even though that would oblige the executive to subordinate its interest to that of the nonexecutive.[128] This is an untenable assertion when considering the property rights involved in these relationships and how those property rights affect the negotiating positions of the parties to these relationships with third parties. On the other hand, the authoritative treatise *Williams and*

121. Armstrong & Dion, *supra* note 18, § 15.04[2], at 15-9.

122. See *supra* Parts III.A and III.B for a discussion of the prohibition on the fiduciary from receiving selfish benefit out of the fiduciary relationship, or the duty of loyalty, as the core of the fiduciary duty.

123. Vela v. Pennzoil Producing Co., 723 S.W.2d 199, 206 (Tex. App. 1986).

124. *Id.* (holding that a "lessee is not a fiduciary and that such a standard is entirely too strict").

125. Armstrong & Dion, *supra* note 18, § 15.04[3], at 15-12.

126. See *supra* Part II for a discussion of the spectrum of duties of care in oil and gas relationships.

127. Armstrong & Dion, *supra* note 18, § 15.04[5], at 15-16.

128. *Id.* § 15.04[5], at 15-15 to 15-16.

Meyers Oil and Gas Law correctly asserts that the "utmost fair dealing" duty of care that the executive interest holder owes to the nonexecutive "fall[s] between [the] unrealistically high fiduciary duty and an inadequately low standard of ordinary care and good faith."[129] This is so because the utmost fair dealing standard is a duty of care, not a duty of loyalty; neither does it necessitate a duty of loyalty for proper performance. The same is true with regard to the other oil and gas relationships discussed by Armstrong and Dion and surveyed above.[130] Instead of containing fiduciary duties, these relationships fall on a spectrum on which the duties of care involved constitute a range of duties that more or less resemble the reasonably prudent operator standard rather than such a strict fiduciary obligation.

V. THE DEBATED ROLE OF THE EXECUTIVE RIGHT OWNER AS A FIDUCIARY

Part V examines the applicability of a fiduciary obligation between the executive and the nonexecutive interest owner(s) in the mineral estate. Part V.A discusses the intent of parties in severing the mineral estate into an executive right in fee and nonexecutive mineral interests. It is highly unlikely that the parties to such a severance intend the executive to be bound by a fiduciary obligation. Part V.B analyzes the rule proceeding from *Manges v. Guerra*[131] and its progeny that a fiduciary obligation indeed binds the executive interest holder. Lack of adequate explanation or reasoning in establishing this rule complicates analysis of why the court imposed a fiduciary duty on the executive. Part V.C, however, critically evaluates the appropriateness of such a fiduciary obligation in this context. This device upsets the property regime entered into by the parties and interferes with the executive interest holder's freedom of contract in dealing with third parties. Subjecting the executive to an unduly high fiduciary duty gives the nonexecutive control over the actions of the executive. Furthermore, *Manges* opens the door to the strictures of *Magruder* for owners of the executive right, signaling

129. 2 WILLIAMS & MEYERS, *supra* note 16, § 339.2, at 212.

130. See *supra* Part II.B for a discussion of the spectrum of duties of care in oil and gas relationships, which follows the same order of treatment as the relationships in which Armstrong and Dion find fiduciary obligations.

131. 673 S.W.2d 180 (Tex. 1984).

that this expansion truly has occurred to the executive's detriment. Part V.D distinguishes the relationship of the executive and nonexecutive mineral interests from a fiduciary obligation, appealing for protection of the executive's property rights through an intermediary standard of care that allows the executive the appropriate freedom of contract.

A. The Intent of the Parties in Severing the Executive and Nonexecutive Interests

When in 1965 the court in *Uzee v. Bollinger* concluded that "Louisiana has rejected the doctrine of implied agency and fiduciary relationship as between the owner of royalty interest and the owner of the right to lease the land for mineral purposes,"[132] it protected the owner of the right to lease—the holder of the executive right—from a complete elimination of the benefits associated with owning the executive interest in a mineral estate. In *Gardner v. Boagni*, the court affirmed this conclusion by finding that after complying with the provisions of the partition agreement by securing not less than a one-eighth royalty for the nonparticipating royalty owners, "the executive was at liberty to negotiate, for his own benefit and his co-owners, for any additional bonuses, rentals, etc., whether he accepted them in the form of cash, overriding royalty or oil payments."[133] These holdings, although extreme in finding that the executive owes no duty at all to the nonexecutive, more closely approximate the intent of the parties in severing the executive interest from the mineral estate than does imposition of a fiduciary obligation that significantly restricts the executive's freedom of contract in negotiating leases with third parties.

The owner of a mineral estate in fee simple can, for consideration, convey interests in that mineral estate and retain the executive right.[134] After severance in this manner, both a nonparticipating royalty interest and nonexecutive mineral interest—which also encompass a non-participating royalty interest in addition to a fraction of all lease benefits that the executor obtains in negotiating the lease—constitute passive interests in the mineral

132. 178 So. 2d 508, 512 (La. Ct. App. 1965).

133. 209 So. 2d 11, 15 (La. 1968).

134. Meyers & Ray, *supra* note 7, at 652.

estate.[135] But regardless of whether the fee owner conveyed a nonparticipating royalty interest or the broader nonexecutive mineral interest, "no one can deny that the grantor [in either case] intended to retain forever the exclusive right to lease."[136] But, significantly, "it is unlikely that the parties contemplated a trust relationship"[137] in this transaction, or even a trust-like relationship at all for that matter. If the grantor intended to retain the executive right as *trustee* or *quasi-trustee* for the nonexecutive interest holder—that is, if the grantor intended to be subject to a fiduciary obligation, including the duty of loyalty—then, rationally, the grantor would have also provided for trustee compensation to the holder of the executive right as part of the conveyance. However, the executive is not paid for being the executive in the executive-nonexecutive relationship.[138] This small caveat alone is crushing to those who wish to impose fiduciary obligations on the executive interest holder merely because "[n]onexecutives are subservient to executives," in the sense that "they cannot explore or lease the minerals, and they cannot protect themselves by having their interests partitioned by the courts."[139] Ignoring the intent of the parties in severing the executive and nonexecutive interests, it might be possible to look at the unequal relationship that results, have sympathy on the nonexecutive, and think that equity demands imposition of a fiduciary duty.[140] But, as shown, it is highly unlikely that the grantor intended to function as a fiduciary for the nonexecutive in conveying the nonexecutive interest

135. *Id.* at 653. In fact, the nonexecutive mineral interest developed out of the self-interest of the non-participating royalty interest holder:

> Chronologically, the perpetual, non-participating royalty interest appears to have emerged first; the non-executive mineral interest somewhat later. We suspect that the reason for the creation of the non-executive mineral interest instead of a royalty interest may well lie in the solid, sensible self-interest of the non-executive: not only does he pick up lease bonus and rental, he is protected from wrongdoing such as disguising excess landowner royalty (e.g., 3/16) as a "bonus" payable out of production (e.g., $2,500 an acre payable out of 1/16 of production).

Id. at 654–55.

136. *Id.* at 654.

137. *Id.* at 667.

138. *Id.*

139. Morse & Ross, *supra* note 57, at 226.

140. *Id.* at 213.

and retaining the executive interest.[141] And one must consent to be a fiduciary because of the severe nature of the fiduciary duty of loyalty.[142] Therefore, the intent of the grantor in creating the executive and nonexecutive interests weighs against the existence of a fiduciary duty to the benefit of the nonexecutive.

Understanding that the grantor intends to retain the exclusive right to lease for extraction of the minerals in the estate, including the undivided fraction of those minerals now owned by the nonexecutive, also illuminates the nonexecutive's intention in the transaction. Presumably, the nonexecutive knows at the time of the transaction what interest has been conveyed and what consequences result. First, "partition is unavailable, not because the interest is non-possessory, but because the parties did not intend to permit partition."[143] Second, the nonexecutive "cannot enter and drill, because he agreed with [the grantor] to be a passive receiver of lease benefits."[144] Finally, the transaction neither suspends alienability of either interest, nor unduly fetters alienability.[145] Furthermore, the nonexecutive is aware that the executive is not being paid to function as a trustee of the mineral interests. It is true that the interest the nonexecutive holds as a result of the conveyance is subject to potential abuse by the holder of the executive right.[146] But absent an "unrealistically high fiduciary duty,"[147] the intermediate utmost-fair-

141. Furthermore, "[t]here is much solicitude for the rights of owners of non-executive interests, but concern for them may diminish if one thinks of them as absentee owners speculating on mineral development." Martin, *supra* note 6, at 317.

142. *See supra* text accompanying notes 75–77.

143. Meyers & Ray, *supra* note 7, at 655.

144. *Id.*

145. *Id.* This fact immunizes the executive and nonexecutive property rights from violation of the rule against perpetuities. *See id.* at 656–63.

146. *See id.* at 664–66 (providing examples of ways that the executive can abuse the executive right to the detriment of the nonexecutive/nonparticipating royalty owner). Only nonexecutives with nonfixed fractional royalties or defeasible term royalties are really subject to harm from actions of the executive meant to benefit the executive. *Id.* at 664–65. That is, if the nonexecutive or the nonparticipating royalty interest is both a fixed fraction and of infinite duration, then "no action of the executive can harm the royalty owner without also harming the executive." *Id.* at 664. But if the nonexecutive or royalty interest is for a defeasible term, the executive has the opportunity and incentive to wait until the end of that term to execute a lease because if the lease is unencumbered by the additional costs of the nonexecutive or nonparticipating royalty interests, then more of the lease benefits go to the executive and the executive is more likely to find a lessee who might not have been willing to lease if it meant paying that extra royalty. *Id.* at 665–66.

147. 2 WILLIAMS & MEYERS, *supra* note 16, § 339.2, at 212.

dealing standard of care protects the nonexecutive by requiring the executive to perform in the same manner as a reasonably prudent landowner[148] unencumbered by the nonexecutive interest would. This standard prevents the executive from harming the nonexecutive but does not deprive the executive of the freedom of contract to seek for herself the best terms possible in the lease.

Despite these intentions of the parties in this conveyance, courts have occasionally imposed fiduciary duties on the holder of the executive right. Some commentators have applauded this action, finding that it is socially just because of the nonexecutive's lack of control over the terms of third-party leases that the executive arranges.[149] But it is not just or fair to the holder of the executive right to be deemed a fiduciary if that is not the grantor's intent at the creation of that right. Contrary to the holdings in *Manges v. Guerra* and its progeny,[150] imposing a fiduciary obligation on the executive against the intent of the conveyance of the executive right both subordinates the executive right to the nonexecutive right as a property interest and deprives the executive of the freedom of contract to negotiate in her own self-interest for a lease with the greatest benefit to her as long as it does not harm the nonexecutive's interest.

B. The Executive as Fiduciary for the Nonexecutive?

1. Revisiting Manges*: Opening the door to* Magruder

a. The standard of "utmost fair dealing" vs. fiduciary duty. The common element in fiduciary duties in various contexts is the duty of loyalty, or the prohibition on self-dealing or profiting from the fiduciary position. That prohibition may render fiduciary obligations inappropriate for oil and gas relationships unless some more traditional fiduciary arrangement, such as a joint venture or

148. Norvell, *supra* note 52, at 973.

149. *See, e.g.*, Armstrong & Dion, *supra* note 18; Morse & Ross, *supra* note 57; W. Randolph Elliott, *The Executive Right*, 42 TEX. L. REV. 865 (1964); Eugene Kuntz, *The Rule Against Perpetuities and Mineral Interests*, 8 OKLA. L. REV. 183, 188–99 (1955); Mack Keith McCollum, Note, Manges v. Guerra: *The Executive Right Holder Undergoes Close Scrutiny*, 38 BAYLOR L. REV. 189 (1986).

150. Morse & Ross, *supra* note 57, at 225 ("Commentators now view *Manges* as the preeminent case imposing a fiduciary obligation on executives.").

partnership, exists alongside the oil and gas relationships[151] governed by property principles and their attendant implied covenants. But like the commentators who needed to perform a certain degree of intellectual gymnastics[152] in order to elevate the duties inherent in these implied covenants to the level of a fiduciary obligation, courts imposing a fiduciary obligation on the executive interest holder for the benefit of the nonexecutive interest resort to "a radical departure from orthodoxy"[153] in their conception of the nature of the executive interest—and in their definition of what it means to be a fiduciary. That is, in the relationship between the executive and the nonexecutive interest holder in the mineral estate, courts have explicitly elevated the duty of utmost good faith or utmost fair dealing naturally associated with the executive's right to lease[154] to a fiduciary duty. Specifically, twenty years ago, in the 1984 Texas case of *Manges v. Guerra* (*Manges II*),[155] "the standard of 'utmost good faith' . . . was specifically equated with fiduciary obligations."[156] The Texas Supreme Court reaffirmed this posture again in 2003.[157] Furthermore, since "[o]ther states frequently look to Texas decisions

151. Often, these fiduciary obligations stem from special circumstances arising under mineral leases. *See supra* Part II.B.6.

152. *See supra* text accompanying notes 113–129.

153. Meyers & Ray, *supra* note 7, at 677 (discussing the appellate court decision in *Manges v. Guerra*, which the Texas Supreme Court largely affirmed on rehearing).

154. *See supra* text accompanying notes 44–55.

155. 673 S.W.2d 180 (Tex. 1984). The Texas Supreme Court heard the *Manges* case in 1983 and issued a decision at that time, 26 Tex. Sup. Ct. J. 430 (June 8, 1983) (opinion withdrawn), but then reheard the case a year later and decided the marter differently. The second opinion is the official decision, since the first one was withdrawn at the time the second one was issued. Thus, this Comment distinguishes between these two decisions as *Manges I* and *Manges II*, where *Manges II* is the second, and official, decision.

156. Smith, *supra* note 25, at 378.

157. *In re* Bass, 113 S.W.3d 735 (Tex. 2003) (discussed *infra* Part V.B.2.b); *see also* Hlavinka v. Hancock, 116 S.W.3d 412 (Tex. App. 2003) (discussed *infra* Part V.B.2.c); Laredo Med. Group v. Lightner, 2003 WL 45689, at *5 (Tex. App. 2003) (reaffirming *Manges II* in a completely different context—that of a doctor's action against a medical group—stating that "in *Manges*, the court recognized that a holder of executive rights to a mineral estate owes a fiduciary duty to the non-executive interest. That is not the situation here.").

However, "[t]he *Manges* fiduciary rule for executive rights holders . . . has found dissenters, even within the Texas lower courts, some of whom simply refused to follow *Manges*. These courts even include a court in the same jurisdiction that decided *Manges*." John Burritt McArthur, *Coming of Age: Initiating the Oilfield into Performance Disclosure*, 50 SMU L. REV. 663, 735 n.214 (1997).

when confronted with a new or unsettled issue of oil and gas law,"[158] and since "[f]ew states . . . have developed a significant body of case law dealing with the issue,"[159] this holding may continue to erode the executive's position on a wider scale.

b. The facts: self-dealing to the detriment of the nonexecutives. Because *Manges II* concerned self-dealing[160] by Manges, the holder of the executive interest, the case was particularly subject to the trust analogy, which the court seemed to employ in finding Manges liable for a breach of fiduciary obligation. Specifically, as the executive right holder, Manges had executed a lease to himself on the grounds that another pending lawsuit brought against him by the plaintiffs, the owners of an undivided nonparticipating interest in the mineral fee, encumbered the lease and prevented him from leasing to a third party.[161] As nonparticipating mineral fee owners, the plaintiffs were entitled to royalties, a portion of the bonus, and a percentage of production.[162] The terms of Manges's lease to himself "recited a total bonus of $5 for the 26,000 acres it covered, provided for a ten-year primary term, a one-eighth royalty, and a $2 per acre delay rental."[163] Manges's lease was a prime example of self-dealing—which, as *Magruder* points out, a true fiduciary may never do, even if no harm results to the beneficiaries.[164] As affirmed by the Texas Supreme Court, the trial court found, in contrast to the terms that Manges had provided in the lease to himself, "that the entire ranch, rather than just one portion of it, could have been leased to a third party for a $35 per acre bonus, a one-sixth royalty, and a $5 per acre delay rental."[165] Thus, Manges's self-dealing behavior was more egregious than merely benefiting himself as the executive without gaining any corresponding benefit for the nonexecutives; rather, Manges

158. Smith, *supra* note 25, at 375 n.13.

159. *Id.* at 375. Indeed, "[c]ommentators now view *Manges* as the preeminent case imposing a fiduciary obligation on executives." Morse & Ross, *supra* note 57, at 225.

160. *Manges II*, 673 S.W.2d at 182.

161. *Id.*

162. *Id.* at 181 ("The deed provided that Manges was not to lease the Guerras' mineral interest for less than a one-eighth royalty; also, it expressly provided that the Guerras were to participate 'in all bonuses, rentals, royalties, overriding royalties and payments out of production.'").

163. Smith, *supra* note 25, at 376 (footnote omitted).

164. *See supra* text accompanying notes 84–91.

165. Smith, *supra* note 25, at 378.

benefited himself to the detriment of the nonexecutives because they did not receive the same pecuniary return they would have if Manges had executed an arm's length third-party lease. Based on this self-dealing, the court in *Manges II* found that Manges, as the executive interest holder, had breached his fiduciary dury to the nonexecutives.[166] But holding an executive to a *fiduciary duty* constituted a novel approach.

c. The orthodox approach in Manges I*: Rejecting a fiduciary duty.* Originally, Texas had always found that the utmost fair dealing standard of care applied to the conduct of the holder of the executive right with regards to the holder of the nonexecutive mineral interest.[167] In fact, the first time that the Texas Supreme Court heard *Manges v. Guerra* (*Manges I*),[168] the court applied an orthodox expression of the utmost fair dealing standard—"[t]he same degree of diligence and discretion on the part of the owners of the leasing rights as would be expected of the ordinary, prudent landowner in the exercise of the leasing power inherent in the mineral fee if no royalty or executive mineral interest were outstanding."[169] Significantly, in *Manges I*, "the court took significant steps toward carving out a definable middle ground between good faith conduct and a fiduciary standard."[170] In doing so, the Texas Supreme Court overturned the Waco Court of Civil Appeals, which had not only affirmed the trial court's decision, but also had taken the further step of "remov[ing] Manges as the executive on analogy to the removal of a trustee for breach of fiduciary duty."[171] This appellate court holding had radical implications for both property and contract law: "In effect, the court of appeals undid the bargain made by the parties and conferred upon them the status of concurrent owners, a relationship . . . those parties never contemplated."[172] Thus, this holding neither respected the property rights involved (changing

166. *Manges II*, 673 S.W.2d at 182.

167. Schlittler v. Smith, 101 S.W.2d 543, 545 (Tex. 1937) (endorsing the "utmost fair dealing" standard).

168. 26 Tex. Sup. Ct. J. 430 (June 8, 1983) (opinion withdrawn). See *supra* note 155 for an explanation of the relationship between *Manges I* and *Manges II*.

169. *Manges I*, 26 Tex. Sup. Ct. J. at 432.

170. Smith, *supra* note 25, at 377 (discussing the original opinion in *Manges I*).

171. Meyers & Ray, *supra* note 7, at 677 (applauding the original opinion in *Manges I*).

172. *Id.*

them into something they were not, i.e., from an executive and nonexecutive mineral interest to a concurrent ownership interest in the minerals) nor respected the contract between the two, which specified that the Guerras held nonexecutive interests and that Manges held the executive right.

The Texas Supreme Court still awarded damages in *Manges I* for Manges's breach of the duty of utmost fair dealing. As the executive interest holder, Manges had leased to himself as the lessee/operator[173] for terms significantly less beneficial to the nonexecutive interest holders than he would have obtained had he been dealing with third parties.[174] Thus damages were an appropriate remedy, despite the prerogatives of the executive right.[175] But the court reversed the award of exemplary damages as inappropriate in this context.[176] And finally, "[i]n reversing the cancellation of the executive right, on which the court was unanimous, the court sustained the basic bargain the parties made, namely that the non-executive has no executive rights and is not a cotenant."[177] Essentially, the court in *Manges I* recognized that a fiduciary duty's restriction of the fiduciary's own pecuniary interest was inconsistent with the executive's property rights. "Thus, the court was prepared to allow the holder of the executive right, unlike a true fiduciary, to justify self-dealing by showing that the nonparticipating interest owners were not harmed by the transaction."[178] This rational decision left the executive the opportunity to seek profit from owning the executive right, as was the likely intent of the parties in creating the right,[179] in the mineral estate as long as the action did not harm those severed from this right.

173. Upon creation of the executive right, the parties (particularly the grantor) generally intend that the holder of the executive right lease to a third-party operator and not serve as the operator himself. *Id.* at 653.

174. *Id.* at 677.

175. *Id.* at 678 ("If a total stranger to the title trespassed on the land and produced from it, the appropriate remedy for both the executive and the non-executive would be the value of the minerals produced, less reasonable expenses if the trespass was made in good faith.").

176. *Id.* at 677.

177. *Id.*

178. Smith, *supra* note 25, at 377 (footnote omitted).

179. See *supra* Part V.A for a discussion of the intent of the parties in severing the mineral estate into the executive and nonexecutive mineral interests.

d. The radical departure in Manges II*: Imposing a fiduciary duty.* A year later the Texas Supreme Court withdrew its initial opinion in *Manges I* and, on rehearing, "[t]he 'intermediacy' of the [utmost good faith] standard virtually disappeared"[180] as the court equated the utmost fair dealing standard with a fiduciary duty, "imposing fiduciary responsibilities upon the executive right holder."[181] The court in *Manges II* justified the existence of a fiduciary obligation in this relationship by reevaluating "the source of the executive's duty, basing it upon the relationship of the parties and not upon the express or implied provisions of the instrument creating the relationship,"[182] as was the case under the more orthodox contract approach taken in *Manges I*.[183] In other words, the court in *Manges II* found that the nature of the relationship between the executive and the nonexecutive created the fiduciary duty, not the contract which created the executive right in the first place.

But the court in *Manges II* never explained why it held the executive to a fiduciary duty. The court seemed to rely implicitly on an analogy to trust law and the trustee's relationship of trust and confidence with the beneficiary,[184] although it never actually expressed this analogy—or any other reason to impose such a strict duty on the executive—in the opinion. True, the court equated *Schlittler*'s "utmost fair dealing" standard of care with a fiduciary duty,[185] but it nowhere explained why it departed from *Schlittler*'s own definition of the utmost fair dealing standard of care. For the *Schlittler* court, the utmost fair dealing standard meant "that *self-interest on the part of the [executive]* may be trusted to protect the [nonparticipating royalty interest owner] . . . . [T]here should be the utmost fair dealing on the part of the [executive]."[186] The standard as formulated in *Schlittler* simply cannot be a fiduciary duty because it trusts in the self-interest[187] of the executive to protect the

180. Smith, *supra* note 25, at 378.

181. *Id.* at 375.

182. *Id.* at 378.

183. Meyers & Ray, *supra* note 7, at 677.

184. Manges v. Guerra [*Manges II*], 673 S.W.2d 180, 183 (Tex. 1984).

185. *Id.*

186. Schlittler v. Smith, 101 S.W.2d 543, 545 (Tex. 1937) (emphasis added).

187. See *supra* text accompanying notes 70–79 for a discussion of the duty of loyalty, which prohibits the fiduciary from pursuing its own self-interest, as the defining characteristic of a fiduciary obligation.

nonexecutive, subject to performing the executive duties with utmost fair dealing. In *Manges II*, the court jumped from the *Schlittler* posture to a fiduciary duty without any explanatory analysis:[188] "The duty of utmost good faith owed by an executive has been settled since *Schlittler v. Smith*. . . . The fiduciary duty arises from the relationship of the parties and not from the contract."[189] Thus, from one sentence to the next, the *Manges II* court merely replaced the appellation "utmost good faith" with "fiduciary duty"[190] with no explanation. But these terms are not interchangeable in this way, unless "fiduciary" has no special meaning tied specifically to a duty of loyalty.

Ironically, then, even though the *Manges II* court claimed to be applying the *Schlittler* utmost fair dealing standard, the *Manges II* rule—that the holder of the executive interest owes the nonexecutive a fiduciary obligation—runs contrary to the nature of the *Schlittler* standard. Whereas *Schlittler* relied on the executive's own self-interest in applying the utmost fair dealing standard, the *Manges II* decision *prohibited* the self-interest of the executive through the imposition of the fiduciary duty. Because the *Manges II* court found that the fiduciary duty arose from the nature of the relationship between the executive and nonexecutive (presumably because the nonexecutive depends on the executive to realize any income from their property interest), rather than from the contract that created these interests, it upheld the trial court's exemplary damages award.[191] However, the *Manges II* court reversed the appellate court's removal of Manges as the executive based on the nonexecutive's decision to pursue damages rather than rescind the contract.[192] This new posture in *Manges II* "considerably altered traditional Texas executive duties."[193] That is, "[h]eld to a fiduciary duty, the executive cannot act in his own interest, disregarding the

188. Indeed, as a general matter, "[t]he cases which have found the trust relationship to exist have done so without a thorough analysis of the nature of that relationship." Meyers & Ray, *supra* note 7, at 668.

189. *Manges II*, 673 S.W.2d at 183 (citation omitted).

190. *Id.*

191. *Id.* at 184 ("Recovery against a breaching fiduciary is not limited to an accounting of profits received by the fiduciary, but can also include exemplary damages. This is in contrast to a suit for breach of contract, which will not support a judgment for exemplary damages even if the agreement is maliciously breached.") (citations omitted).

192. *Id.*

193. Morse & Ross, *supra* note 57, at 223.

interest of the nonexecutive," which "departs from the early Texas rule that executives could act for self interest."[194] But in finding that the executive interest holder owes a fiduciary duty to the nonexecutive, it seems that the *Manges II* court misunderstood either the *Schlittler* "utmost fair dealing" standard of care or the meaning of "fiduciary," or both. At any rate, the court should have at least explained why it redefined the "utmost fair dealing" standard of care in this manner, particularly since this radical departure from precedent, pursued to its logical extreme, exposes executives to *Magruder*'s fiduciary severity.

2. Manges II as unfortunate precedent: Abuse of the executive's (property) rights

a. Dependence as grounds for affirming Manges II *in* Dearing, Inc. v. Spiller.[195] Subsequent decisions have confirmed the trust analogy in the relationship between the executive and nonexecutive interests in the mineral estate. In *Dearing, Inc. v. Spiller*, the court examined *Manges II*, affirming that "the Texas Supreme Court's decision in [*Manges II*] used the terminology of 'utmost good faith' and specifically equated that standard with a fiduciary obligation."[196] Moreover, the court emphasized policy reasons justifying the *Manges II* court's imposition of a fiduciary standard: "Because the non-participating royalty owner must depend upon the mineral fee owner for the enjoyment of his interests, the courts have implied a covenant of the utmost fair dealing in the exercise of the executive rights to lease or develop the minerals."[197] The *Manges II* court had found that on these grounds the executive's duty hailed from the nonexecutive's relationship of dependence with the executive rather than from the contract and the implied covenants themselves. Interestingly, *Dearing* retains the appellations utmost good faith and utmost fair dealing as defined in *Manges II* as entailing a fiduciary duty.

But rightly understood, the standard of utmost fair dealing is only a duty of care, and constitutes an intermediary position between an unrealistically high fiduciary standard and a mere good faith duty

194. *Id.* at 224.

195. 824 S.W.2d 728, 732 (Tex. App. 1992).

196. *Id.* at 732 (citations omitted).

197. *Id.*

of care, which would ostensibly not provide enough protection to the nonexecutive.[198] If viewing the holder of the nonexecutive mineral interest as somehow disadvantaged, then such a holding might seem to stand for protection of the nonexecutive against "abuse of executive rights."[199] But when viewed in light of the parties' intentions at the time the executive right was created,[200] it stands instead for an abuse of the *executive's* rights. The existence of a fiduciary duty binding the executive means that the executive, who previously had the freedom to contract in her own self-interest when leasing to develop as long as the terms did not harm the nonexecutive's interests, must subordinate her superior property interest to that of the nonexecutive and seek only the nonexecutive's interest in executing leases. *Dearing* was not an isolated holding prolonging the aberration of *Manges II*: two Texas cases decided in 2003 reinforce the fiduciary obligation that the executive interest holder has owed the nonexecutive interest holder in a mineral estate since *Manges II* identified that duty for the first time in 1984.

b. Reaffirming Manges II *twenty years later in* In re Bass.[201] In *In re Bass*, the nonparticipating royalty interest holders claimed that Bass, the executive interest holder in the mineral estate, had violated the fiduciary relationship set out in *Manges II*.[202] The Texas Supreme Court first observed that "[b]y definition, all non-participating royalty intetests are non-executive interests."[203] Then, the court expressly reaffirmed that *Manges II* "creat[ed] a fiduciary duty between executive and non-executive interest holders in mineral deeds."[204] But although the court referred to a fiduciary duty, the absolute prohibition on selfish benefit[205] that inheres in the fiduciary

198. See *supra* Part II.B.5 for a discussion of the "utmost fair dealing" duty of care that the executive owes the nonexecutive.

199. *See* Lloyd Lochridge, *Abuse of Executive Rights*, 36 INST. ON OIL & GAS L. & TAX'N 2-1, § 2.02[2][c], at 2-16 to 2-17 (1985).

200. *See supra* Part V.A.

201. 113 S.W.3d 735 (Tex. 2003).

202. *Id.* at 744.

203. *Id.* at 745.

204. *Id.* (distinguishing *Manges II* by noting that "no evidence of self-dealing exists here").

205. See *supra* Part III.B for a discussion of *Magruder v. Drury*, which stands for the principle that the fiduciary duty of loyalty means that a fiduciary cannot seek selfish benefit

duty of loyalty is missing from the court's reasoning. "Because *Manges* held that the executive owes the non-executive a fiduciary duty, the [nonparticipating royalty interest holders] correctly state that Bass owes them a duty to acquire every benefit for the [nonparticipating royalty interest holders] that Bass would acquire for himself."[206] This language does not connote a fiduciary duty rightly understood because the executive can still seek selfish benefit as long as he also obtains the same benefit for the nonexecutives; rather, this is a formulation of *Schlittler*'s original utmost fair dealing standard, which relied on the executive's self-interest, precluding any self-interest that might come at the detriment of the nonexecutive.[207] In the end, however, the *In re Bass* court found that Bass had not breached any fiduciary obligation because the court found that no oil and gas lease existed at all: "Because Bass has not acquired any benefits for himself, through executing a lease, no duty has been breached."[208]

The *In re Bass* court did not take notice of the detrimental effects of imposing a fiduciary duty on the executive. Binding the executive interest holder, who owns a superior property right in the proverbial bundle of sticks, to such a fiduciary obligation removes much of the benefit of owning the executive right, namely, to negotiate the best lease terms possible for herself with third parties in developing the mineral estate. The court should at least have addressed this aspect of imposing a fiduciary duty, since the fiduciary duty essentially subordinates the executive to the nonexecutive in obtaining leases, a consequence likely not intended by the parties in creating the executive right.[209] In addressing this reversal of the property regime in the mineral estate, the court should have provided a justification

from the relationship regardless of whether such action harms or benefits the beneficiary of the duty.

206. *In re Bass*, 113 S.W.3d at 745. The *Manges II* court also defined the "fiduciary duty" that the executive owes the nonexecutive in these terms. 673 S.W.2d 180, 183 (Tex. 1984).

207. See *supra* text accompanying notes 185–190 for a discussion of the "utmost fair dealing" standard as expressed in *Schlittler v. Smith*, 101 S.W.2d 543, 545 (Tex. 1937), and how *Manges II* failed to apply the *Schlittler* standard rightly understood. By contrast, the true fiduciary may not seek self benefit out of the subject matter of the relationship even if it obtains the same benefit for the beneficiary as held in *Magruder v. Drury*. See *supra* text accompanying notes 84–92 for a discussion of the extent of the fiduciary duty of loyalty.

208. *In re Bass*, 113 S.W.3d at 745.

209. See *supra* Part V.A for a discussion of the intention of the parties in creating executive and nonexecutive rights.

for such a posture. But *In re Bass* merely followed the precedent set in *Manges II*. The *Manges II* court, for its part, did not seem cognizant of the implications of its holding for the property interest held by the executive.

c. Examining Manges II *and its progeny in* Hlavinka v. Hancock.[210] A Texas appellate court also followed *Manges II* in a 2003 decision without considering the effect of such a fiduciary duty on the property rights of the executive interest holder. In *Hlavinka v. Hancock*, the nonexecutive mineral interest owners sued the executive interest holders for breach of the *Manges II* fiduciary duty.[211] The jury found against the executive interest owners.[212] On appeal, the court noted that the *Manges II* court had expanded the traditional duty of utmost good faith between executive and nonexecutive interest holders to a full fiduciary obligation "arising from the relationship between the executive and the non-executive and not from the contract or deed."[213] This obligation, the court further noted, "requires the holder of the executive right to acquire for the non-executive 'every benefit that he exacts for himself,'"[214] a proposition that exposes the executive to *Magruder*'s fiduciary severity. Finally, the *Hlavinka* court addressed the *Manges II* progeny, observing that "[c]ases interpreting the *Manges* decision have concluded that . . . a fiduciary relationship exists between the executive and the non-executive mineral interest owner."[215] Despite reaffirming and applying the *Manges II* duty, the court was able to find that the executive had not breached this duty on appeal. Both *In re Bass* and *Hlavinka* show that *Manges II* is still potent twenty years after it turned the duty of utmost good faith into a fiduciary obligation; both cases also show that this duty exposes executives to the strictures of *Magruder*. The fiduciary duty also distorts the property regime in the mineral estate by subordinating the executive to the nonexecutive.

210. 116 S.W.3d 412 (Tex. App. 2003).
211. *Id.* at 416.
212. *Id.*
213. *Id.* at 417.
214. *Id.* (quoting *Manges II*, 673 S.W.2d 180, 183 (Tex. 1984)).
215. *Id.* at 417 n.3.

C. Abuse of the Executive's Rights

Not all courts have followed *Manges II*'s lead. Some have tried to narrow its holding; others have refuted it. Representing the former, a Texas appellate court in *Pickens v. Hope*[216] returned to the duty of utmost good faith as based on the duty of an ordinary and prudent landowner instead of following *Manges II*. The court did this in the interest of the executive interest owner's economic rights:

> Matters of cash bonus, primary term, delay rentals and special provisions are matters of trading, and as long as the executive acts in good faith and with reasonable regard for the interests of the non-participating royalty owner, his judgment in leasing or refusing to lease is not subject to question, and his refusal to lease, absent arbitrariness, connivance or deliberate action calculated to deprive the non-executive of his royalty interest, will not constitute a breach of duty owed the owner of the non-participating royalty. The duty to develop known minerals by the executive depends upon economics.[217]

This retreat from *Manges II* shields the executive from *Magruder*'s strict prohibition on deriving personal benefits from the relationship. Also, following *Pickens*, a Texas appellate court in *Marathon Oil Co. v. Moye* narrowed *Manges II* by finding that if a fiduciary duty exists between the two, it is because of a *preexisting* relationship of trust and confidence:

> A mere contractual relationship reserving a nonparticipatory royalty interest will not create a fiduciary relationship between the parties. The fact that a royalty interest owner is dependent upon the executive interest holder to manage the mineral estate in good faith does not of itself create a special relationship of trust and confidence. Unless the lease document itself creates a legally binding trust, or unless a relationship of trust and confidence necessarily results from the lessor-lessee relationship, the standard of conduct of the lessee cannot be appropriately categorized as fiduciary. However, when the executive and nonexecutive are cotenants in the mineral estate ***and there is a relationship of trust and confidence***, a fiduciary relationship exists between the executive and nonexecutive interest holders.[218]

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216. 764 S.W.2d 256 (Tex. App. 1988).

217. *Id.* at 269.

218. 893 S.W.2d 585, 591 (Tex. App. 1994) (emphasis added) (citations omitted).

Finally, in *Shelton v. Exxon Corp.*, a federal court in Texas seemed to refute *Manges II* by stating that "one of the economic and legal justifications for the alienation of the executive rights is the resultant power of the executive right holder to disregard the wishes of the non-executive."[219] These holdings all shore up executives from sliding down the slippery slope that leads to *Magruder* by indicating that what is at stake are the executive's property rights, which should allow the executive to contract with third parties for the best (economic) deal available, subject only to the utmost fair dealing standard with regard to the nonexecutive interest holders.

Although these decisions shore up the *Manges II* fiduciary duty against *Magruder*'s severity, the current trend does not seem to be moving away from binding the executive with "fiduciary" language. The more recent cases of *Laredo*, *In re Bass*, and *Hlavinka* testify to *Manges*'s continued vitality in the new millennium. Furthermore, positive reception of this fiduciary obligation in academic literature has reinforced its misplaced existence. As noted above,[220] courts should return to the utmost fair dealing standard properly understood[221]—that is, as expressed in *Schlittler v. Smith*[222]—in dealing with holders of executive rights.

D. Protecting the Executive's Rights

Because a fiduciary obligation leads in the end to the *Magruder* principle in the oil and gas context because of the strict nature of the fiduciary duty of loyalty, this duty contradicts the nature of the relationship between the executive and the nonexecutive interest holder and actually harms the executive's property right. "To apply the strict fiduciary standard applicable to trustees or agents [to holders of the executive right] would do violence to the intention of the parties and to the accepted trust and agency concepts."[223] The relationship between the executive and the nonexecutive is not analogous to an agency relationship. "It does not seem to be contemplated by the parties that the royalty owner shall have that

219. 719 F. Supp. 537, 544 (S.D. Tex. 1989).

220. See *supra* Part II.B.5 for a discussion of the appropriate standard of care that the executive owes nonexecutives: the intermediary "utmost fair dealing" standard.

221. See *supra* Part V.B.1.d for a discussion of the *Schlittler* standard rightly understood to rely on the executive's self-interest rather than preclude it, as in *Manges II*.

222. 101 S.W.2d 543, 545 (Tex. 1937).

223. Jones, *supra* note 51, at 573.

degree of control over the owner of the executive right which usually characterizes a principal-agency relation."[224] Moreover, the executive-nonexecutive relationship is not a trustee-beneficiary relationship: "Where is the trust property? The owner of the executive right does not have legal title to any property belonging to the royalty owner . . . ."[225] The relationship between the executive and the nonexecutive interest holder, rather than being fiduciary in character, arises from property rights:

> [A] royalty owner has no power to lease, not because he has given authority to another as his agent to exercise that power for him, but *because he does not own and never did or will own, a property interest that is capable of being leased.* Even if he could revoke the power to lease of the owner of the executive right, which he apparently cannot do, he still would not own a property interest that could be leased by him. . . . The legal title to the incorporeal royalty interest and all the usual powers and privileges incident to that interest is [sic] completely vested in the royalty owner.[226]

Therefore, contract principles govern when the respective owners deliberate about their interests: "[T]he courts may impose duties upon the owner of the executive right under the ordinary principles of contract law without recourse to duties flowing from any relationship concept."[227] However, imposing a fiduciary obligation on the holder of the executive right—absent a contractual provision in which the executive consents to act as the nonexecutive's fiduciary—frustrates the intention of the parties in creating that right.[228] The holder of the executive right expects to be able to enter into leases with third parties at the best terms possible for herself. Because of the dury of loyalty contained in the fiduciary duty, which is the threshold for the existence of a fiduciary duty,[229] the executive can no longer seek selfish benefit when subject to a fiduciary duty,

224. *Id.* at 573 n.17 (quoting a paper prepared and presented to the Wichita County Bar Association by A.W. Walker, Jr., Dec. 14, 1946).

225. *Id.* at 574 n.17.

226. *Id.* (emphasis added).

227. *Id.* at 574 n.18 (quoting Moore v. City of Beaumont, 195 S.W.2d 968 (Tex. Civ. App. 1946)).

228. See *supra* Part V.A for a discussion of the parties' intentions in severing a mineral estate.

229. See *supra* text accompanying notes 68–79 for a discussion of the importance of the duty of loyalty in constituting the fiduciary duty.

but rather must put the interests of the nonexecutive first. But such a limitation on the executive's freedom of contract is unnecessary in light of the utmost fair dealing standard rightly understood,[230] which allows the executive to pursue her own self-interest in executing leases with third parties, as long as the terms do not harm the nonexecutive's interest.

It is true that all fiduciary duties limit the freedom of the fiduciary. To that extent, there is nothing wrong with such a limitation if the party acting as a fiduciary has consented to play this role. In such a case, the fiduciary elevates the interests of the beneficiary over any personal interests according to the duty of loyalty that characterizes a fiduciary duty.[231] It is also true that fiduciary duties exist to protect the interests of parties who have entered into a relationship of dependency with a party with superior knowledge, access to information, or skill.[232] To that extent, a fiduciary duty often is proper in numerous contexts where parties enter into joint ventures or partnerships to exploit an opportunity.[233] But the executive is not in a joint venture or partnership with the nonexecutive. The executive owns a distinct property interest in fee that has been severed from the mineral estate. The benefit of that property interest is to execute leases with third parties to develop the minerals in the mineral estate. As long as the executive does not collude with lessees or operators in order to extinguish or otherwise harm the nonexecutive's interest,[234] and as long as the executive behaves as a reasonably prudent landowner unencumbered by a nonexecutive interest,[235] the executive complies with the appropriate standard of care: utmost fair dealing. Of course, nonexecutive interest holders who own defeasible interests will need

230. See *supra* Part V.B.1.d for a discussion of the "utmost fair dealing" standard as correctly applied by *Schlittler v. Smith*, 101 S.W.2d 543, 545 (Tex. 1937).

231. *See supra* text accompanying notes 68–79.

232. Morse & Ross, *supra* note 57, at 213 (stating that "fiduciary relationships exist where in confidence one gives another dominance over the interest"); *see supra* text accompanying notes 68–79.

233. *See* Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

234. *See* Meyers & Ray, *supra* note 7, at 666–79 (discussing cases, including *Manges I*, in which the executive violated the duty of utmost fair dealing through either fraud or collusion with lessees); *see also* Shelton v. Exxon Corp., 921 F.2d 595, 600 (5th Cir. 1991) ("Abuse may occur if the holder of executive rights manipulates lease terms so that benefits usually shared by all mineral owners inure solely to the benefit of the executive.").

235. 2 WILLIAMS & MEYERS, *supra* note 16, § 339.2, at 212.

to be wary because along with the executive's freedom of contract comes some possibility of wrongdoing:

> [A]ny time a defeasible term royalty or non-executive mineral interest expires for lack of drilling and production, the non-executive owner is likely to scrutinize the conduct of the executive, the lessee, and any successor-operator for any unusual behavior which would permit an inference that a purpose existed to destroy the non-executive interest.[236]

But that does not mean that the executive is or should be subjected to a fiduciary duty to seek *only* the benefit of the nonexecutive interest holder. Rather, it means the executive owes the nonexecutive a duty of care absent a fiduciary duty of loyalty. This respects the intent of the parties at the time the interests were severed. It also protects the nonexecutive while allowing the executive to own a superior property right and to use it with the freedom of contract to obtain the best lease terms possible.

VI. CONCLUSION

Allowing a fiduciary standard to govern the executive's conduct towards the nonexecutive interest holder turns the property rights regime on its head. This happens as a result of the executive owner's duty of loyalty, under a fiduciary standard, to subordinate self-interest to the interests of the nonexecutive. The executive's "duty of loyalty will require him to exclude all considerations of self-interest in making decisions affecting the [nonexecutive interest]."[237] Specifically, the executive "impermissibly profit[s] at the expense of the [nonexecutive]" if the executive, in employing the executive right to lease the mineral estate to third parties for production, "chooses any benefit, such as a larger bonus or production payment at the expense of a smaller lease royalty,"[238] as the product of the contract negotiations.

In other words, the executive no longer benefits from the freedom of contract that should attach to the superior executive property interest. In this sense, the executive's interest becomes a burden, subjecting the executive to the duties of a trustee, with the

236. Meyers & Ray, *supra* note 7, at 674.

237. Smith, *supra* note 25, at 387 (footnote omitted).

238. *Id.*

penalties of *Magruder* lurking below the surface for any benefit that the executive power could bring to the negotiating table. Therefore, expanding the duty of care the executive owes to the nonexecutive "should be discouraged in most circumstances because of the many ramifications that flow from the labeling of a commercial relationship as a fiduciary relationship."[239] On the other hand, the duty of utmost fair dealing, as an intermediary standard between good faith and the fiduciary obligation, exhibits a desirable flexibility in contracting and rightly maintains the benefit in owning an executive interest in the first place.

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239. 2 WILLIAMS & MEYERS, *supra* note 16, § 420.2, at 366.4.