A PRACTICAL APPROACH TO A UNIFORM RESOURCES JOINT VENTURE AGREEMENT[1]

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I INTRODUCTION

Joint ventures have become a predominant form of business enterprise for the exploration, development, and utilisation of natural resources. The term 'joint venture' has different connotations but in this paper, we concentrate our discussions on resources joint ventures which is differentiated from other forms by the definition that 'it is an association of persons (natural or juridical) to engage in a common undertaking to generate a product to be shared among the participants.' What basically removes this definition from the ambit of the ordinary joint venture is the fact that the association was neither organised for the purpose of a joint receipt of income nor with a view for a profit but rather to engage in a common undertaking to generate a product to be shared among the participants. The separate contributions of the participants to the cost of common activities and the separate disposition of individual shares of the common product thus characterise the resources joint venture.

The term 'resources' is also confined to the mining and petroleum upstream industry. Resources joint ventures, thus, do not cover associations created to engage in the delivery of, say, water or natural gas to buyers and end-users. While the given examples can be classified as resources, still the participants will not share the product generated (unless their objective is to use the resources themselves) but will more likely engage in creating infrastructures to bring source/supplier and consumers together. More often than not the infrastructure will be constructed to generate a profit for the participants.

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The mineral and petroleum joint venture owes its origin from the United States oil and gas lease, which is the foundation of the modern international resources industry. The petroleum upstream industry has been dominated by American capital and capability and for this reason, American oil and gas law has, to varying degrees, been persuasively received in many jurisdictions. An aspect of American oil and gas law which gained acceptance in the mineral industry as well, is that which deals with operating agreements. Joint operating agreements (JOAs), joint ventures agreements (JVAs), operating agreements, or whatever kind of operating standard or procedure you may want to call them, have existed at least since the first oil field was discovered by Colonel Drake in the 1860s. While JOAs tend to be classified as 'black letter' law subjects, they do not exist in a vacuum. A comparative study of JOAs as used in the resources industry must recognise that different legal jurisdictions invariably addressed the same physical and technological problems although in a rather diverse manner. In the U.K., the absence of comparative judicial authority concerning JOAs is attributed to the less number of players operating in the industry compared to its North American counterpart.

The new global economic order has basically widened the horizon for resources companies to new frontier areas of exploration and development. Resources companies from the U.S., U.K., Canada, Australia and South Africa, which basically are from common law countries now find themselves doing business in countries in South America, Africa and Central Asia who more often than not adhere to the civil law tradition and where many of the issues that are commonly raised between resources joint venturers are practically unheard of in their legal environment. As legal issues become more complex, it has now become imperative for host countries with civil law systems to incorporate more judicial interpretation into their statutory schemes the result of which will necessary be the adoption of common law principles into the civil law tradition. At the same time, a comparative evaluation of the individual facets of JOAs/JVAs will show that they are sufficiently similar in structure and practice to produce practical uniformity.

This paper attempts to provide a legal appraisal of the functional value and implications of resources joint venture agreements. It deals not only with the traditional comparative law perspective of operating standards in different resources jurisdictions and the civil/common law dichotomy but expands to incorporate alternative rules of contract construction. Part II will examine socio-economic events that triggered the stiff competition for risk capital which made resources companies rethink their investment strategies and host countries' governments reformulate their property, contracts, and commercial laws. Part III of the paper retraces the origin of the modern resources joint venture with a description of the U.S. oil and gas lease. This part surveys the structure and contractual provisions of the lease and the operating agreement, as exemplified by the Association of American Petroleum Landmen Model. Through the backdrop provided by the U.K. Continental Shelf Operating Standard, Part IV will highlight the similarities and distinctions between the U.K., U.S., Canadian, and Australian models. Part IV will then make an attempt to explain the tendency of distinct legal traditions to hybridise to pave the way for methods that utilise the functional aspects of both civil and common law systems. This part will briefly trace the evolution of the two legal systems and examine the unique case presented by the Mineral Code of Louisiana, the only civil law state in the predominantly common law U.S. Part V discusses the debate in the standard of conduct expected from the operator in the JVA/JOA, in our analysis, the most contentious issue if we are to achieve a practical approach to a uniform operating agreement. It is our position that more than the nature and terms of the instrument, and the intent of the parties, the relative bargaining positions of the participants will determine the standard of conduct applicable.

II A PARADIGM SHIFT IN NATURAL RESOURCES DEVELOPMENT

The past decade has seen a marked increase in privatisation and market liberalisation of natural resources reserves in developing countries. In Latin America, the energy market is reversing the nationalisation trend and opening its doors to foreign investment. The Brazilian and Venezuelan governments are aggressively developing oil and gas both onshore and offshore and inviting joint ventures.[2] Notwithstanding the present enthusiasm of Latin American governments, foreign investors still have many reservations because of the possibility that 'traditional state

[2] David K. Fagin, 'An Overview of Natural Resources Development in Latin America' in International Oil, Gas, and Mining Development in Latin America (1994) 5 *Rocky Mtn. Mineral L. Found.* 1-1, 1-13.

ownership of natural resources can potentially be restored by [simple] decree at the expense of the investors despite the existence of otherwise good contracts.'[3]

Russia's oil and natural gas fields are now meeting Northeast Asia's increasing energy demands, in part.[4] Production sharing in Russia is an extremely risky endeavour and the legal uncertainties and ever-changing political administrations and agencies can lead to financial catastrophe for foreign investors. Despite the risks involved, Russia remains an extremely attractive investment opportunity. The former Soviet Union possesses six percent of the world's oil reserves and forty percent of the world's gas reserves.[5] Considering the expanding Asian energy market's geographical proximity to Russia, it is easy to understand what attracts competing energy companies.

The 1990s have also witnessed a dramatic shift in the international economic and political order. The end of the Cold War and the emergence of new market economies in Latin America, Africa, Asia, and Eastern Europe have accelerated the pace of industrial development and spurred an onslaught of foreign investment and entrepreneurship in the developing world. This phenomenon has profoundly affected the worldwide mineral industry. Many developing countries are 'mineral economies'[6] and many others obtain an important percentage of their gross domestic product (GDP) from hard-rock mining. It has also been observed that it is not only the erosion of political and economic barriers to foreign investment that drives multinational companies (MNCs) to see the opening of new frontiers in mineral exploration and development in developing countries. Relatively restrictive taxation and burdensome mining regulation in Australia, Canada, and South Africa, as well as growing tension between the mining industry and government regulators in the United States, further

[3] Ibid 1-12.
[4] Deborah Espinosa, 'Environmental Regulation of Russia's Offshore Oil and Gas Industry and its Implications for the International Petroleum Market' (1997) *Pac. Rim L. & Policy* 647.
[5] Anthony Cioni, 'The First Pancake Always Has Lumps: Alberta Petroleum Companies, Arbitration and Arbitral Award Enforcement in the Russian Federation' (1997) 35 *Atla. L. Rev.* 726, 729.
[6] Robert E. Looney and Craig R. Knouse, 'Profiles of Third World Mineral Producers' (1987) 13 *Res. Pol.* 55, 56. Looney and Knouse list as 'mineral economies' include Indonesia, Bolivia, Togo, Tunisia, Morocco, Venezuela, Mexico, Ecuador, Liberia, Congo, Chile, Zaire, Trinidad, Jamaica, Zambia, Peru, Kuwait, Nigeria, Egypt, Algeria, Libya, Syria, Saudi Arabia, and Oman.

enable developing countries to attract western mining companies seeking more friendly operating climates.[7]

In the petroleum industry, state oil companies, enterprises that have become popular instruments of public policy as host governments assumed interests in greater control and participation in the development of their countries' petroleum resources, are active participants. Countries such as Norway will grant a petroleum license only to a consortium that includes its state oil company as a participant. In most countries, such as Indonesia, the state oil company has the exclusive right to government concessions for the exploration and development of petroleum, but the company is free to contract with foreign investors for the financing and management of the concession through production sharing agreements or risk-service contracts. In a few countries, the state oil company is either the only entity entitled to petroleum concessions and is precluded from involving other investors in its exploration and development activities, or treated just like any other company in bidding for exploration and production acreage.[8] The formation of these state-owned enterprises was a result of the assertion of national sovereignty over energy resources in combination with centralised economic planning. However, history would soon demonstrate these organisations were fatally flawed in the era of market economics.[9] The competency of administrative agencies and regulatory authorities came under increasing strain as the western world embraced the theory and practice of economic liberalisation.[10]

Developing countries' quest for foreign capital manifests itself in the form of privatisation and fiscal liberalisation.[11] Privatisation is now perceived as a universal

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[7] Mary M. Shirley, 'The What, Why, and How of Privatization: A World Bank Perspective' (1992) 60 *Fordham L. Rev.* 23, 32.

[8] Gary B. Conine, 'Mexico: Energy Development and State Oil Company' (1992) 27 *Tulsa L.J.* 625, 625.

[9] Alfred E. Kahn, 'The Economics of Regulation: Principles and Institutions' 17 (1988).

[10] Dennis C. Stickley, 'New Forces in International Energy Law: A Discussion of Political, Economic, and Environmental Forces Within the Current International Energy Market' (1993) 1 *Tulsa J. Comp. and Int'l L.* 95, 97.

[11] 'Fiscal liberalisation' refers to the array of tax incentives, import-export measures, and foreign investment deregulation that developing countries are incorporating into their new mining codes or economic policies.

panacea for under-performing economies in both developed and developing nations.[12] Governments have historically privatised state companies for three basic reasons: 1) to improve the use of public resources; 2) to improve the operating efficiency of the enterprise or industry; or 3) to increase 'dynamic efficiency,' or overall investment and innovation.[13] Many developing countries have maintained heavily subsidised state-owned mining companies. By eliminating trade-distorting subsidies and encouraging more accurate cost accounting, privatisation may improve both the allocation of public resources and the operating efficiency of mineral exploration and development. In the energy sector, governments have unwound control of strategic industries for a hosts of other reasons which include: 1) ad hoc government interventions and restrictive regulations; 2) inflation and currency devaluation; 3) producer and labour deadlocks; 4) reduction and restructure of the national debt; and 5) the disadvantage of publicly-owned companies experience in international competition by being too closely identified with a government.[14]

While the U.S. remains almost unique in allowing private ownership of minerals in place, most countries both industrialised and developing, continue to assert 'permanent sovereignty' over their natural resources. Nevertheless, as a wave of privatisation sweeps across the developing world from Argentina to Zaire, mineral concessions and state-owned mining companies are among the most important and lucrative assets transferred to the private sector. In debt-plagued Latin America, for example, countries that nationalised millions of dollars worth of mineral assets in the 1980s are now courting foreign capital by offering up their state-owned mining companies and mineral concessions to private investors. Latin American countries have sold or liquidated hundreds of firms in the last few years, including many major mining companies and properties. Important Asian mineral producers, such as India and Indonesia, also have begun to invite foreign participation in their once-exclusive state-controlled mineral sectors. In the former Soviet bloc, the collapse of the

[12] Martin J. Boodhoo, 'Some Socio-Economic Implications of Privatisation with Specific reference to Developing Countries' in *Post Privatisation and Performance: International Perspectives* (1992).
[13] Shirley, above n 6, 25-27.
[14] 'Privatisation and Control of State Owned Enterprises', Economic Development Institute of the World Bank (1991).

socialist system has opened previously state-controlled mining operations to foreign direct investment and joint venture acquisition.[15]

In addition to total divestment or 'trade sale' of state-owned industries which has been the most conventional means of privatisation,[16] developing countries have resorted to foreign investment agreements; a technique already in used in the mineral and petroleum exploration industries to attract risk capital. This type of joint venture arrangement, particularly with large MNCs, is seen as the most efficient way to access business expertise, capital, technology, and markets.[17]

Whatever the type of arrangement there might be between the MNCs and state oil companies, this has clearly brought to the fore the interface between these two kind of business enterprise in the way they allocate their rights and obligations along the lines of either a joint venture agreement or joint operating agreement model as practiced in the jurisdictions of the MNCs' countries.[18]

MNCs involvement and interest in foreign investment is based on straightforward supply and demand theory. 'Energy companies are, by definition, major producers of oil and gas…. [I]f they are to stay in the business [,] they must replace produced reserves.'[19] Energy companies believe international exploration offers the best, and possibly only, chance of replacing the world's energy reserves.[20] 'Most energy companies…are prepared to accept considerable political risk, if the potential reward is sufficiently attractive.'[21]

In the international panorama of oil and gas contracts, the evolution was already paving the way for the hybrid contracts of the 1980s which merged the characteristics

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[15] Madeline Cohen, 'A New Menu for the Hard-Rock Café: International Mining Ventures and Environmental Cooperation in developing Countries' (1996) 15 *Stan. Envtl. L. J.* 130, 147-148.
[16] Peter Holland, 'Privatisation: An Outburst of Activity' (1992) *Int'l. Fin. L. Rev.* 5-6
[17] Thomas W. Walde, 'Innovations in Petroleum and Mining Licensing: Current Issues in Finance, Energy and Resources Law '92' (Paper presented at the 10th Advanced Seminar on Petroleum, Minerals, Energy and resources Law Proceedings, Washington D.C., April, 1992) 393.
[18] While these models can be use interchangeably, for simplification this paper will refer to 'operating agreements' to the U.S. model, JOAs to the U.K. model, and the resources JVA to the Australian model.
[19] Alfred J. Boulos, 'Mutuality of Interests Between Companies and Governments – Myth or Fact?' (1990) in Energy Law '90: Changing Energy Markets – The Legal Consequences 3, 9.
[20] Ibid.
[21] Ibid 11.

of models adopted in other countries and challenged the initial classification of exploration and production contracts.[22] The relationship between the host government and the resources MNCs was best described as follows: under the law of modern concession contract, the concessionaire works essentially for itself; under the production-sharing and the risk service contract, the contractor works primarily for the government; and under the hybrid contract or the resources joint venture contract, the foreign company works in association with the state oil companies.[23]

III WHERE IT ALL STARTED: THE U.S. OIL AND GAS LEASE AND OPERATING AGREEMENTS

In the U.S., the arrangements for developing oil and gas have changed very little in the past sixty years. Landowners, including the U.S. government, still rely exclusively upon private companies for the development of oil and gas reserves. Furthermore, the emphasis upon the right to control production, development, and pricing which has characterised the development of international petroleum agreements, have been large absent. The lease remains the only commonly used type of arrangement entered into between parties.

The regulation of oil and gas in the U.S. is subject to political pressure, and this pressure has frequently come from landowners as well as from large and small oil companies;[24] that the regulatory and legislative action (or inaction) resulting from such political pressure is not part of the 'text' of the leases does not diminish its importance to the lessor.

Political pressure contributed to the ability of U.S. lessors to force modifications in their rights, but the need for change resulted in part from the failure of the original agreements. The early lease inevitably failed to address situations that arose in future years. One principal rationale for implying covenants in oil and gas lease was the inability of the parties to foresee future events, which were 'rationally left to implication…. that the further prosecution of the work should be along such lines as

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[22] Zhiguo Gao, 'International Petroleum Contracts: Current Trends and New Directions' (1994), 203-204.
[23] Ibid 204.
[24] J. Weaver, 'Unitization of Oil and Gas Field in Texas' (1986) 37-38.

would be reasonably calculated to effectuate the controlling intention of the parties as manifested in the lease, which was to make the extraction of oil and gas from the premises of mutual advantage and profit.'[25] The absence of provisions in leases and concessions to deal with such matters, and a widely held perception that the original arrangements did not adequately protect the interests of the landowner, contributed strongly to the revision of the rights of the parties to those arrangements.[26]

Under the U.S. oil and gas lease, the lease format, although it did not guarantee drilling, at least assured the landowner that his land would not be tied up indefinitely by the payment of a small annual rental. If oil was discovered, the lease does not impose upon the oil company any express contractual duty to produce from the well. Under the concession, the company could safely shut the well if it wanted to do so. The lessee in the U.S., however, risked losing the lease for lack of production at the end of the primary term, at least if the shut-in well was the initial discovery well.[27] Finally, if production was obtained, the lessor was not limited to a flat sum per ton, but received one-eight of the production or its sale price.[28]

The lessor in the U.S. had not only the benefit of the lease format, but also the more significant benefit of the U.S. courts. The most widely used printed oil and gas leases were drafted for use by oil companies and contained relatively few provisions favourable to the lessor. The courts, however, had long shown their willingness to redress egregious imbalances in contractual rights between the oil companies and their lessors. Judicial hostility to the patent unfairness of the no-term lease was the principal factor leading to its discontinuance. Judicial suggestions that the no-term lease lacked consideration brought into question its enforceability,[29] and the emergence of the implied covenants doctrine assured its demise. Indeed, the judicial doctrine that the lessee impliedly covenants to perform as a reasonably prudent

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[25] *Brewster v. Lanyon Zinc Co.*, 140 F.801, 801-811 (8th Cir. 1905).

[26] Pierce, 'Rethinking the Oil and Gas Lease' (1987) 22 *Tulsa L.J.* 445, 452-455.

[27] H. Williams, Oil and Gas Law § 632.2 (1986) (part of the H. Wiliams and C. Meyers series).

[28] Ibid § 642.

[29] *National Oil and Pipe Line Co. v. Teel*, 67 S.W. 545 (Tex. Civ. App.), 95 Tex. 586, 68 S.W. 979 (1902).

operator and to undertake the various obligations imposed by such a standard provided the lessor with his greatest protection.[30]

The lessor's position in the oil and gas lease is that of a non-performing party in a relational contract which in its ideal form involves the management of an asset where a passive party is solely dependent on the actions of the performing party due to the inability of the parties to prescribe well-defined obligations for all contingencies, subjecting the passive party to opportunistic behaviour. This relational approach to contract construction is a departure from the classical contract theory, which looks to the intent of the parties as revealed by the explicit text of the agreement. If the agreement lacks the indicia of a relational contract, open terms such as the 'good and workmanlike standard' whether express or implied, must not be applied without considering the intent of the parties gathered from a reading of the entire instrument. A contingent contract is then entered where the parties expressly provide for all, or nearly all, contingencies that might arise in the course of the transaction, the performing party's duties are well defined and the non-performing party can rely on the obligations expresses in the contract to assure fulfilment of its expectations in the transaction.[31]

The level of duty that the lessee owed the lessor was initially debated in terms of good-faith business judgment, with lessees arguing that their good faith decisions were conclusive on matters involving leasehold operations.[32] In 1899, the Supreme Court of Pennsylvania ruled:

> So long as the lessee is acting in good faith on business judgment, he is not bound to take any other party's, but may stand on his own. Every man who invests his money and labor in a business does it on the confidence he has in being able to conduct it in his own way. No court has any power to impose a different judgment on him, however erroneous it may deem this to be. Its right to interfere does not arise until it has been shown clearly that he is not acting in good faith, on his business judgment, but fraudulently, with intent to obtain a dishonest advantage over the other party to the contract.[33]

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[30] Ernest E. Smith and John S. Dzienkowski, 'A Fifty-Year Perspective on World Petroleum Arrangements' (1989) 24 *Tex. Int'l L.J.* 13, 20.

[31] Gary B. Conine, 'The Prudent Operator Standard: Applications Beyond the Oil and Gas Lease' (2001) 41 *Nat. Resources J.* 23, 29-31, 47.

[32] *Brewster v. Lanyon Zinc Co.*, 140 F. 801 (8th Cir. 1905); *Texas Coal and Oil Co. v. Barker*, 6 S.W. 2d 1031 (Tex. 1928).

[33] *Colgan v. Forest Oil Co.*, 45 A. 119 (Pa. 1899).

By the early decades of this century, however, a majority of oil and gas producing states have rejected the good-faith business-judgment test in favour of the reasonable prudent operator standard.[34] Judge Van Devanter in *Brewster v. Lanyon Zinc Co.*[35] provided a widely accepted rationale for choosing the prudent operator standard.

> The operations contemplated, in the event oil and gas are found in paying quantities, are not to be likened unto a business into which one puts property, money, and labor exclusively his own, the profits and losses in which are of concern only to him, and the conduct of which may be according to his own judgment, however erroneous it may be. By reason of the conditions on which the lease is granted the lessor retains at least a contingent interest in the oil and gas, to the profitable extraction of which the operations are directed. This interest in the subject of the lease, and the fact that the substantial consideration for the grant lies in the provisions for the payment of royalties in kind and money on the oil and gas extracted, make the extent to which and the diligence with which the operations are prosecuted of immediate concern to the lessor. If they do not proceed with reasonable diligence, and by reason thereof the oil and gas are diminished or exhausted through the operation of wells on adjoining lands, the lessor loses, not only royalties to which he would otherwise be entitled, but also his contingent interest in the oil and gas which thus passes into the control of others. The object of the operations being to obtain a benefit or profit for both lessor and lessee, it seems obvious, in the absence of some stipulation to that effect, that neither is made the arbiter of the extent to which or the diligence with which the operations shall proceed, and that both are bound by the standard of what is reasonable.

Arguments for imposing a still higher standard of conduct on a lessee, such as 'highest good faith' or that of a fiduciary, were not seriously pressed until several decades after the prudent operator standard had been accepted. These later cases rarely involved an attempt to supplant completely the prudent operator standard; rather they dealt with arguments that the lessee owed a higher duty to the lessor (or other royalty owners) in specific situations, such as in exercising pooling authority[36] or in marketing natural gas.[37]

A *Property Provisions of Joint Operations*

[34] Maurice Merrill, 'Covenants Implied in Oil and Gas Leases' ss 121-136 (2d ed. 1940)
[35] 140 F. 801, 814 (8th Cir. 1905). Several state courts specifically noted the *Lanyon Zinc* rationale when adopting the reasonable prudent operator standard like *Texas Pacific Coal and Oil Co. v. Barker*, 6 S.W. 2d 1031 (Tex. 1928).
[36] *Expando Production Co. v. Marshall*, 407 S.W. 2d 254 (Tex. Civ. App. 1966).
[37] *Le Cuno Oil Co. v. Smith*, 306 S.W. 2d 190 (Tex. Civ. App. 1957).

The joint operation of mineral properties has always been a significant feature of the oil and gas industry in North America. In this jurisdiction, whether oil and gas properties are pooled, unitised, or the subject of some form of concurrent ownership, the coordination necessary for joint operations has been typically achieved through the 'operating agreement.'[38] Most analytical papers dealing with the instrument have focused on the crucial question of the nature of joint operations and the resulting relationship between the participants.[39] To a large degree, the property provisions of the operating agreement resemble a random collection of property clauses common to other instruments in the industry and only peripherally important to the operating agreement itself. This view is enhanced in the operating agreement by varying and sometimes inconsistent or confusing references to the property interests affected by these provisions. Distinctions are drawn between 'leaseholds,' leases, wells, equipment, production, oil and gas rights,' rights and interests in the contract area,' and 'acreage.' These differing references to property interests have significant meanings in some contexts and no apparent purpose in others.[40]

B *Context and Characteristics of the Operating Agreement*

In simple terms, the operating agreement is a contractual arrangement between two or more parties for the joint development and operation of mineral properties.[41] Coordination is necessitated by a diversity of ownership of operating rights in the

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[38] The use of instruments referred to, as 'operating agreements' is not limited to the oil and gas industry. Instruments defining the operating rights and obligations of one party with respect to the property or assets of another have received this same denotation in the railroad, trucking, and real estate industries, in employment contracts, and in the hard minerals industry. On the subject of operating agreements in the hard minerals industry see Stott, 'Legal and Tax Consequences of Mining Joint Venture Agreements' (1973) 18 *Rocky Mtn. Min. L. Inst.* 189. In the North American petroleum industry itself, the term has been used not only in the sense discussed herein but also in referring to instruments which transfer operating rights at certain depths or in prescribed formations under federal oil and gas leases, in compliance with proscriptions on the horizontal subdivision of federal leases by assignment, see, e.g. *Rock Island Oil and Ref. Co. v. Simmons*, 73 N.M. 142, 386 P.2d 239 (1963) and to instruments governing construction and operation of processing plants, see, e.g. *Campbell v. Delta Drilling Co.*, 466 S.W. 2d 604 (Tex. Civ. App.—Tyler 1971, writ dism'd). Here we are concerned exclusively with the form of instrument used in the oil and gas industry to coordinate the development and operation of separately owned properties.

[39] Boigon, 'Liabilities and Relationships of Co-Owners Under Agreements for Joint Development of Oil and Gas Properties (1986) 37 *Inst. on Oil and Gas L. and Tax'n* 8-1.

[40] *Warner v. Winn*, 191 S.W. 2d 747 (Tex. Civ. App. – San Antonio 1945).

[41] McCollam, 'A Selective Comparison of Contractual Operating Problems under Federal Offshore and Onshore Oil and Gas Leases (1978) 29 *Inst. on Oil and Gas L. and Tax'n* 229, 233.

area to be developed. This diversity of ownership, and the consequent need for joint efforts, can arise in any of three contexts.[42]

The first exists where multiple parties have acquired joint ownership of operating rights in a single tract or lease of sufficient size, configuration, and location to permit drilling and production activities under applicable conservation regulations but desire to conduct joint operations for practical or legal reasons.[43] In some states the rules on concurrent ownership preclude any single co-owner from extracting minerals without the consent of the others, unless accomplished to protect or preserve the joint estate.[44] The operating agreement may serve as the vehicle for obtaining this consent and simultaneously set the terms under which operations will be conducted. By contrast, the rule on joint ownership applied in the majority of states permits any co-owner to extract minerals without the consent of the other owners, provided the producing party accounts to the other co-owners for their proportionate share of production after deducting reasonable costs of development, production, and marketing. The operating party is able to recover his costs from production if operations are successful, but the other owners are not personally liable for any expenses incurred.[45] As a consequence, all risks are borne by the operating party, who is entitled in the long term to only a portion of production. Although the execution of an operating agreement to obtain co-owner consent to operations is not essential under the majority rule, the use of the agreement is of considerable benefit to the operating party by reducing his individual risk in the venture to a level commensurate with his potential gain by committing the other co-owner to personally bear a portion of costs.[46]

In the second context, there exists separate ownership of adjoining tracts or leases of such size and configuration that it is necessary to combine, or pool, the tract in order for some or all parties to participate in a well.[47] Alternatively, the geologic

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[42] Gary B. Conine, 'Property Provisions of the Operating Agreement-Interpretation, Validity, and Enforceability' (1988) 19 *Tex. Tech. L. Rev.* 1263, 1268.
[43] Ibid 1268-1269.
[44] *Gulf Ref. Co. v. Carroll*, 145 La. 299, 82 So. 277 (1919).
[45] *Cox v. Davidson*, 397 S.W. 2d 200 (Tex. 1965).
[46] Hill v. Field, 384 F.2d 289 (10th Cir. 3967).
[47] Conine, 'Property Provisions of the Operating Agreement' above n 41, 1270.

features of the tracts may be of such a nature that the parties desire to explore their separately owned properties together in order to disperse the risks of the operation.

The third context arises where a fieldwide unit is established covering multiple tracts or leases to conduct gas recycling, water flood, or other secondary or tertiary recovery operations requiring coordinated operations throughout the field.[48] In each of these scenarios, pooling or unitisation essentially entails an arrangement whereby the owners of the tracts are to share production derived from any location within the unit. This may be accomplished by voluntary agreement or by compulsory order of a state conservation commission.[49]

The operating agreement establishes parameters for the conduct of operations within a prescribed geographic area and provides the mechanism by which costs and production are shared among parties to the agreement. The typical operating agreement will include provisions addressing or accomplishing the following:[50]

- Designation of the geographic area which is the subject of the instrument, variously referred to as the ‘contract area’ or ‘unit area’;[51]
- Appointment of a single party as ‘operator’ who is entrusted with management and control of drilling, development, and production activities, subject to varying degrees of control by the ‘non-operators’ or an elected management committee;[52]
- Prescription of a formula or formulas by which all costs of operations will be borne, and all production shared, by each participant;[53]
- Specification of initial joint operations approved by all parties and procedures for determining participation in operations proposed from time to time in the future;[54]

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[48] Ibid.
[49] Ibid.
[50] A summary of operating agreement provisions also appears in *Home-Stake Prod. Co. v. Tri-State Pipe Co.*, 197 Kan. 163, 415 P.2d 377, 382 (1966).
[51] AAPL Form 610-1982, Art. I.D.
[52] Ibid Arts. V.A., VII.D.3, VII.F., VII.E., X., VII.G., and VI.C.
[53] Ibid Arts. III.B., IV.
[54] Ibid Art. VI.

- Procedures for collecting and securing payments due the operator for joint operations;[55]
- Prohibitions on the abandonment of a well or surrender of a lease without the consent of all parties;[56] and
- Limitations on assignments, acquisitions, and partitions by the parties.[57]

As with the oil and gas lease, there is no 'standard operating agreement.' Specific provisions vary to allow for the peculiar needs of the parties to the instrument and special concerns inherent in the immediate transaction. Nevertheless, there is considerable similarity in the basic provisions of most operating agreements. This results in large part from the development of model forms of the instrument, which have received widespread acceptance in the industry. Over time, these model forms have contributed greatly to the simplification of negotiations, the standardisation of technical terms and, to a more limited degree, consistency in legal interpretations. In 1956, the American Association of Petroleum Landmen published the first version of its model form operating agreement, designated AAPL Form 610, which is generally perceived to be the most popular form in current use. The popularity of the AAPL Form 610 has been used as the basis for this study.[58]

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[55] Ibid Arts. VII. B. and C.
[56] Ibid Arts. VIII.A. and VI.E.
[57] Ibid Art. VII. B to F.
[58] Conine, 'Property Provisions of the Operating Agreement' above n 41, 1274. AAPL Form 610-1956 was prepared for joint operation of private lands and was the result of four years of study and drafting by a committee composed of representatives from twenty-seven petroleum companies. Forms from seventeen companies were used to develop the model instrument after consultation with operating divisions of the participating companies. The form was modified in 1977 and 1982 and is presently undergoing further revision. The Rocky Mountain Oil and Gas Association published a competing joint operating agreement for private land in 1958 as its Form 3 (hereinafter referred to as RM Form 3). The Canadian counterpart is the operating procedure form of the Canadian Association of Petroleum Landmen. Prior to RM Form 3, the Rocky Mountain Oil and Gas Association issued its operating agreement Form 1 (undivided interest) and its operating agreement Form 2 (divided interests) in 1953 and 1954, respectively, which were designed for units on unproven tracts comprised in part of federal states. These forms were developed by the Association's Public Lands Committee, which began formal work on the project in 1953. Under the undivided form (used primarily for small units), shares in costs and production are proportioned among the working interest owners on the basis of the leased acreage contributed by each to the unit area. In contrast, the divided form (used primarily for small units), shares in costs and production are proportioned among the working interest owners on the basis of the leased acreage contributed by each to the unit area. In contrast, the divided form (normally used for larger areas) makes the distribution among participation areas on the basis of the broader criteria more indicative of the quantity of production obtainable from each such area and divides costs and production among working interest owners within such areas on the basis of acreage contributed to the participation area. There is no standard form for proven areas since terms for such units are heavily negotiated and a complex formula is required to allocate costs and production. Similarly, no model form agreement for offshore operations has yet been devised.

The nature of the relationship between the parties to the operating agreement (and between these and third parties) has not been clearly resolved. Possible theories imposing a fiduciary relationship include agency, trust, cotenancy, and partnership. However, two basic theories appear to be evolving.

Despite the disclaimer in most operating agreements that a partnership relationship is not intended,[59] most jurisdictions which have addressed the issue have concluded that the instrument creates either a mining partnership[60] or joint venture[61] under which the usual rules of fiduciary duty and joint and several liability control.

Conine made the observation that neither characterisation of the operating agreement as a form of joint venture or as a simple cotenancy is likely to control the result in any single dispute between the parties to the agreement since the usual legal consequences of either relationship are severely altered by contractual provisions of the agreement pertaining specifically to the dispute.[62] He concluded that a detailed

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Yet another form is the Model Form of Unit Operating Agreement of the American Petroleum Institute (hereinafter referred to as the API Form), originally published in 1957 and designed to facilitate secondary recovery operations in oil and condensate reservoirs where primary development is essentially complete. The API form was prepared by the subcommittee on Unit Operations of the API Executive Committee on Drilling and Production Practice, Division of production. Another API Form is the Model Form of Unit Operating Agreement for Statutory Unitisation, prepared for use in states with compulsory unitisation laws.

[59] AAPL Form 610-1982 Art. VII.A.

[60] *Mud Control Labs. v. Covey*, 2 Utah 2d 85, 269 P.2d 854, 859 (1954). The mining partnership originated with hard rock mining operations but has been applied to oil and gas operations. This partnership arises when there: (1) concurrent ownership of a mineral interest; (2) joint operation of the property; and (3) an express or implied agreement between the co-owners for the sharing of profits and losses. Texas courts have added resultant requirements of community interest and mutual agency. The element of joint operation is not obviated by designation of one co-owner as 'operator' of the venture. The involvement of 'non-operators' to the extent of furnishing labour, equipment, supplies, or advice is sufficient to fulfil the requirement of joint operations. Similarly, because the mining partnership is a relation imposed by law, disavowal of the intent to create a partnership is inconsequential. As with any partnership, the members of the mining partnership are fiduciaries to each other and the operator may bind the parties to contracts and obligations within the scope of the venture.

[61] *Oklahoma Co. v. O'Neil*, 440 P.2d 978 (Okla. 1968). Although there is no precise universal definition of a joint venture, there seems to be general concurrence that it exists in the presence of the following factors intended by the parties: (1) a contribution by the parties of money, property, effort, knowledge, skill or other asset to a common undertaking; (2) a joint interest in the subject matter of the venture; (3) a right of mutual control or management of the enterprise; (4) expectation of profit; (5) a right to participate in the profits; and (6) most usually, limitation of the objective to a single undertaking or ad hoc enterprise.

[62] Conine, 'Property Provisions of the Operating Agreement' above n 41, 1277.

analysis of any single operating agreement is likely to reveal that the instrument is intended as something more than a simple cotenancy and less than a joint venture.[63]

C *The Operator Under the Operating Agreement*

One might have assumed that the good faith business judgment rule would have played as important a role in the operating agreement cases as in the early cases dealing with the oil and gas lease. The disparity in bargaining position that frequently characterised the early lessee-lessor negotiations is rarely present. Non-operators are never marginal farmers and ranchers and are rarely lacking either in financial resources or in formal education. The parties to an operating agreement are usually either oil or gas companies or experienced investors. Non-operators normally have access to geological data relating to the contract area prior to signing the operating agreement. By industry custom they are furnished an Authority for Expenditure (AFE) that is prepared by the party to be designated as operator and specifies the proposed initial well's location, depth, and estimated cost.[64] Agreement to the AFE, which can be evaluated by the parties' in-house geologists, engineers and accountants or outside consultants, precedes agreement to the joint operating agreement.[65] Non-operators should be able to bargain from an information and economic base that is not widely dissimilar from that of the operator. Such factors would suggest that in the absence of special circumstances, non-operators can include special self-protective clauses in the operating agreement and only need an implied standard that protects them from outright fraud. Such protection would be amply provided by a standard of simple good faith.

In fact, the good-faith standard has rarely been urged or argued as applicable to an operator. The standard of utmost fair dealing, beset by conceptual and practical uncertainties,[66] has played no role whatsoever. Discussions of the duty owed by an operator to non-operators have centred on the existence of a global, all encompassing standard at the opposite end of the duty spectrum from simple good faith business

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[63] Ibid.
[64] Ernest E. Smith and Jacqueline L. Weaver, Texas Law of Oil and Gas, s 17.1(B), (Butterworths 1989 and 1993 Update)
[65] *Vicioso v. Watson*, 325 F. Supp. 1071 (C.D. Calif. 1971).
[66] Joshua Morse and Jamie Ross, 'New Remedies for Executive Duty Breaches: The Courts Should Throw J.R. Ewing Out of the Oil Patch' (1988) 40 *Ala. L. Rev.* 187.

judgment. Both academic commentary[67] and cases[68] have focused on whether the level of conduct required of the operator is that of a fiduciary. One possible reason why the good faith standard has had such little influence in discussions over the duty owed by an operator to non-operators is the indirect influence of decisions involving executive and non-executive relationships, where a relatively high standard of conduct has been imposed upon a party with exclusive managerial power.[69] A more probable explanation for the use of the fiduciary standard lies in the context in which the operating agreement participants' relationship has been litigated.[70]

The issues in this litigation are markedly different from those of the early oil and gas lease cases involving the lessee's standard of conduct. The reasonable operator standard was established in disputes over whether the lessee was under an affirmative duty to undertake drilling. Lessors successfully argued that a reasonable prudent operator would necessarily take certain types of action: to drill an initial test well within a reasonable period of time,[71] to drill offset wells to protect against drainage to neighbouring tracts,[72] to drill additional developmental wells once oil had been discovered in commercial quantities.[73] One established, the reasonable standard was applied in evaluating other types of conduct by the lessee, such as marketing,[74] and in assessing whether the lessee had used proper techniques in its physical acts of drilling and producing.[75]

The relationship between the operator and non-operators and the standard derived from that relationship are now being established in two types of cases that differ both from the early lessor-lessee cases and from each other. The first type of case does not directly involve the standard owed by the operator; rather it involves the

[67] Boigon, above n 38, 8-12 to 8-13; Ernest E. Smith, 'Duties and Obligations Owed by an Operator to Non-operators, Investors and Other Interest Owners' (1986) 32 *Rocky Mtn. Min. L. Inst.* 12-1, 12-9 to 12-11; Henry J. Eyring, 'Note, the Oil and gas Unit Operator's Duty to Non-operating Working Interest Owners' (1987) 1987 *B.Y.U.L. Rev.* 1293.
[68] *Vicioso v. Watson*, 325 F. Supp. 1071 (C.D. Calif. 1971); *Blocker Exploration v. Frontier Exploration, Inc.*, 740 P.2d 983 (Colo. 1987); and *Berchelmann v. Western Co.*, 363 S.W.2d 875 (Tex. Civ. App. 1962).
[69] Ernest Smith, 'Joint Operating Agreement Jurisprudence' (1994) 33 *Washburn L. J.* 834, 841.
[70] Ibid.
[71] *Consumers' Gas Trust Co. v. Littler*, 70 N.E. 363 (Ind. 1904).
[72] *Blair v. Clear Creek Oil Co.*, 230 S.W. 286 (Ark. 1921).
[73] *Brewster v. Lanyon Zinc Co.*, 140 F. 801 (8th Cir. 1905); *Waggoner Estate v. Sigler Oil Co.*, 19 S.W.2d 27 (Tex. 1929).
[74] *Bristol v. Colorado Oil and Gas Corp.*, 225 F.2d 894 (10th Cir. 1955).
[75] *Empire Oil and Refining Co. v. Hoyt*, 112 F.2d 356 (6th Cir. 1940).

parties' basic relationship. These are suits by third parties, typically suppliers or their contract creditors, who are attempting to hold non-operators liable for debts incurred by the operator.[76] Since the plaintiff has not contracted directly with the non-operators, the plaintiff almost invariably relies on a joint-venture theory or on a theory of a mining partnership, near kin to a joint venture. Joint venturers are jointly and severally liable and each venturer can be held liable for any other venturer's debt incurred in connection with the venture.[77] This theory allows a creditor to go after the operating agreement participants who have the deepest pockets. Not surprisingly, it is frequently invoked when the operator is insolvent or in bankruptcy.[78] Tort claimants who have been injured by the enterprise's operations have used a similar theory in suits against non-operators.[79]

Third-party creditors (as opposed to tort claimants) have had limited success in establishing that the non-operators are in a joint venture or mining partnership with the operator. Some courts are clearly influenced by the fact that the creditors negotiated with the operator and relied on its credit in furnishing material and providing services.[80] They are unlikely to have relied upon the relationship created by the operating agreement because almost all operating agreements contain an express disclaimer of an intent to create a partnership or joint liability.[81]

However, in these jurisdictions if the non-operators have bargained for additional input into management and incorporated such rights into the operating agreement, the creditors' claims may well succeed. For example, parties adopting the common practice in offshore and international operations of setting up a management

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[76] *Blocker Exploration v. Frontier Exploration, Inc.*, 740 P.2d 983 (Colo. 1987); *Smith v. L.D. Burns Drilling Co.*, 852 S.W.2d 40 (Tex. App. 1993); *Berchelmann v. Western Co.*, 363 S.W.2d 875 (Tex. Civ. App. 1962).
[77] *Truly v. Austin*, 744 S.W.2d 934, 937 (Tex. 1988).
[78] *Blocker Exploration v. Frontier Exploration, Inc.*, 740 P.2d 983 (Colo. 1987).
[79] *Shell Oil Co. v. Prestidge*, 249 F.2d 413 (9th Cir. 1957).
[80] *Berchelmann v. Western Co.*, 363 S.W.2d 875 (Tex. Civ. App. 1962). If a non-operator has failed to pay its proportionate share of the creditor's bill, the creditor should be subrogated to the operator's claim against the non-operator.
[81] Article VII.A of the 1977, 1982 and 1989 versions of the A.A.P.L. Model Form Operating Agreement states: 'The liability of the parties shall be several, not joint or collective. …It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners…' The 1989 version of the model form also specifies that the parties do not intend to create a joint venture or agency.

committee to oversee and advise the operator[82] may well risk joint liability for all debts incurred by the operator. Moreover, in some jurisdictions, especially those were 'mutual control' does not require all participants to have equal rights of management,[83] the standard operating agreement may be viewed as providing sufficient incidents of control in the non-operators to justify a joint-venture finding. Article V.B.1 of the widely used 1982 Model Form Operating Agreement authorises the non-operators to remove and replace the operator in specified situations. Article VI.B.2 allows non-operators to propose additional drilling within the Contract Area. Article VII.D requires unanimous consent of all participants to drill, deepen, test, rework or plug back certain wells. Article VII.D.3 prohibits the operator from undertaking any project not previously authorised if it involves an expenditure in excess of a stipulated amount. Article X imposes an upper limit on settlements that the operator can enter into; if the amount required for settlement exceeds this amount, all participants must be involved in handling the claim. As one influential commentator[84] has pointed out, the fact that these managerial rights in non-operators are limited relative to the operator's broad powers does not distinguish the JOA from other types of joint ventures, where the venturers entrust full operational control to one of the participants.

This second type of case involves disputes between the parties to the operating agreement. These cases fall into two general categories. In the first the operator is suing non-operators for debts which it is owed, and the non operators deny liability on the ground that the operator violated a fiduciary duty. The alleged breach may be in matters such as failing to divulge pertinent information concerning drilling and development[85] or in conducting operations in an inappropriate manner.[86] Alternatively, the non-operators, the non-operators may concede liability, but insist that the parties' mutual fiduciary duties preclude the operator from collecting the debt

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[82] For a thorough discussion of a Model Form International Agreement – 1990, prepared as a suggested guide by the Association of International Petroleum Negotiators and the American Corporate Counsel Association, see Andrew B. Derman, 'International Oil and Gas Joint Ventures: A Discussion with Associated Form Agreements' 89-192, A.B.A. Sec. On Nat. Resources, Energy and Envt'l. L. Monograph Series No. 16 (1992).
[83] *Vicioso v. Watson*, 325 F. Supp. 1071 (C.D. Calif. 1971).
[84] Boigon, above n 38, 8-12 to 8-13.
[85] *Oklahoma Co. v. O'Neill*, 440 P.2d 978 (Okla. 1968).
[86] *Hamilton v. Texas Oil and Gas Corp.*, 648 S.W.2d 316 (Tex. App. 1982).

in the manner chosen.[87] The second category consists of cases in which the non-operators are attempting to share in some benefit obtained by the operator, such as profits from a refining operation,[88] leases acquired within the area covered by the operating agreement[89] or within the same prospect,[90] or the purchase price stipulated in a gas purchase contract.[91] These cases may also involve claims that the operator should have taken some action that would have benefited the non-operators.[92]

In both types of suits the plaintiffs commonly attempt a global characterisation of the nature of the relationship between the operator and non-operator. Although arguments for a fiduciary duty based upon agency,[93] trust,[94] and cotenancy[95] have been advanced, all of these theories pose conceptual and factual problems in their application.

Agency provides a clear example of these problems. Some international JOAs that give broad authority to a management committee may be subject to an agency analysis, but not standard domestic onshore operating agreements where most agreements are either one of the AAPL Model Form Operating Agreements or are based on one of the model forms. The 1989 form specifically disavows the existence of a principal-agent relationship,[96] and none of the forms provides for the degree of control that a principal is entitled to assert over his agent. The limited managerial rights given non-operators relate primarily to decisions affecting a non-operator's individual interest, such as disposition of its own share of production or withholding consent to additional drilling operations. Non-operators have no right to direct the operator in contracting or in the way it conducts drilling or producing operations. Under the traditional forms, the non-operators cannot revoke the appointment of the

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[87] *Andrau v. Michigan Wisconsin Pipe Line Co*., 712 P.2d 372 (Wyo. 1986).
[88] *Crosby-Mississippi Resources, Ltd. V. Sage Petroleum U.S., Inc*., 767 F.2d 534 (5th Cir. 1985).
[89] *Texas Oil and Gas Corp. v. Hawkins Oil and Gas Co*., 668 S.W.2d 16 (Ark. 1984).
[90] *Kaye v. Smitherman*, 225 F.2d 583 (10th Cir. 1955).
[91] *Andrau v. Michigan Wisconsin Pipe Line Co*., 712 P.2d 372 (Wyo. 1986).
[92] *Johnston v. American Cometra, Inc*., 836 S.W.2d 711 (Tex. App. 1992).
[93] *Britton v. Green*, 325 F.2d 377 (10th Cir. 1963)
[94] Smith, 'Duties and Obligations Owed by an Operator' above n 66, 12-1, 12-9 to 12-11.
[95] Ibid 12-11 to 12-12.
[96] Article VI.A. states: 'In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor not subject to the control or direction of the Non-Operators except as to the type of operation to be undertaken in accordance with the selection procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the Non-Operators with authority to bind them to any obligation or liability assumed or incurred by operator as to any third party.

operator without cause. The decision-making regime established by the standard operating agreement is inconsistent with a theory that views the operator as subject to non-operator control. There are equally serious problems with trust analyses and claims of confidential relationship based upon cotenancy.[97] Hence, arguments for a fiduciary obligation are most commonly predicated upon the existence of a joint venture.

Although non-operators appear to have been more successful in asserting a joint venture theory than third-party creditors, even in this context there is no widespread acceptance of the joint-venture theory as a global characterisation of the operating agreement/JOA relationship. Some courts have simply applied the same reasoning to suits between non-operators and operators as in suits brought by third-party creditors and have rejected the joint venture theory on the ground that the provisions of the standard operating agreement negate mutual rights of control.[98]

D *Alternative Approaches*

The joint venture concept has been so frequently urged as the correct characterisation of the participants' overall relationship that it has tended to obscure the judicial approach to the operator's standard of duty that appears to be evolving. Courts have focused on individual fact patterns or specific operating agreement provisions and applied a standard appropriate to the situation or determined by agreement. This standard has varied from a strict fiduciary standard[99] to merely a requirement that the operator not engage in grossly negligent conduct.[100] Even in cases where the courts have concluded or tacitly assumed the existence of a joint venture, the operator has often been held to a standard established by the express language in the operating agreement, rather than a general standard applicable to all operators in all situations. Whether the standard remains constant for the parties in all aspects of their relationship or whether it varies with the specific activity involved depends primarily upon the language used in their agreement.

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[97] Smith, 'Duties and Obligations Owed by an Operator' above n 66, 12-7 to 12-12.
[98] Compare the reasoning in *Hamilton v. Texas Oil and Gas Corp.*, 648 S.W.2d 316 (Tex. App. 1982), with that in *Berchelmann v. Western Co*., 363 S.W.2d 875 (Tex. Civ. App. 1962).
[99] *Schmude Oil Co. v. Omar Operating Co*., 458 N.W.2d 659 (Mich. Ct. App. 1990).
[100] *Stine v. Marathon Oil Co*., 976 F.2d 254 (5th Cir. 1992).

1 *The Contractual Standard*

If the parties to the operating agreement contractually agree to a general standard applicable in all situations, the level of conduct required of an operator may vary from operating agreement to operating agreement, but will not vary with different activities or circumstances conducted under any specific agreement. Article V.A. of the 1977, 1982 and 1989 AAPL Model Form Operating Agreements contains language susceptible of such a reading. The two earlier forms provide that the operator 'shall conduct all operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or wilful misconduct.'[101]

One can hardly disagree with the position that participants in the operating agreement can adopt any standard they choose and make it applicable to all situations if they so desire. It seems hardly credible, however, that the parties really intended to apply a standard that permits conduct in every situation that falls just short of gross negligence or wilful wrongdoing. The entire language of the clause, read in context, also suggests to the contrary. The operations referred to are 'on the Contract Area' and the general standard applicable to those operations –'good and workmanlike'- seems more appropriate to physical activity than billings, purchasing and administrative decision making. Moreover, the usual reason for using an exculpatory clause is to preclude liability for blowouts or similar catastrophes, rather than to avoid liability for unintentional breaches of contract.[102]

An alternative reading of Article V.A. would treat it as expressly providing for variable standards rather than a single very low one. As one court has pointed out,[103] there is authority for equating 'good and workmanlike' with 'reasonable prudent operator.' There are numerous cases construing and applying the prudent operator standard to managerial and operational decisions under the oil and gas lease. This case law could readily provide a basis for evaluating equivalent decisions of an

[101] Smith, 'JOA Jurisprudence' above n 68, 847.
[102] Ibid 848-849.
[103] *Johnston v. America Cometra, Inc.*, 836 S.W.2d 711 (Tex. App. 1992).

operator under an operating agreement. The lower standard, which denies liability for negligence and unintentional misconduct would apply to purely physical activities, such as drilling and testing, within the geographical confines of the Contract Area itself.

2 *The Variable Duty Standard*

The variable duty approach is consistent with the parties' probable intent and the provisions of the operating agreement. It is also consistent with the approach of some courts. Although courts typically apply a single standard to the particular matter at issue, there is language in several opinions recognising that the standard will vary with the circumstances. The variable duty approach is possible even where fiduciary obligations arise from a relationship that preceded the execution of the operating agreement.[104]

E *Criticisms on the AAPL Operating Agreement Model*

The AAPL Model Form Operating Agreement though a well-tested operations manual is criticised for not addressing the protection of non-operators and primarily just a repository of solutions for technical drilling problems.[105] Though the AAPL Model as the industry contract does devote many pages to items operators want for smooth operations, including limits on their liability, it has done little for investors concerns. The model has remained incomplete for at least two reasons. One is immaturity. The AAPL Model Form is relatively a youthful legal form. However, the more fundamental cause of incompleteness is the limited pool of drafters and their industry orientation. The model being a product of one of the oil patch's core organisation[106] was initially tied directly to industry concerns. The 1956 form was a

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[104] Smith, 'JOA Jurisprudence' above n 68, 850.
[105] John Burritt McArthur, 'Coming of Age: Initiating the Oilfield into Performance Disclosure' (1997) 50 *S.M.U. L. Rev.* 663, 742-743.
[106] The AAPL's mission is to promote the highest standards of performance for all land professionals, to advance their stature and to encourage sound stewardship of energy and mineral resources' (AAPL

composite created by twenty-six oil companies as a 'synthesis' of seventeen companies' existing forms.

To state that the AAPL Model Form does not give investors the protection they need in undertaking an oil and gas investment, is not to deprecate the many benefits it brings to investors as well as to operators. This standard contract, the product of thousands of hours of unpaid labour by industry volunteers, has produced substantial order out of chaos that would exist without it. It creates a package of accounting procedures to help non-operators monitor their investment and it identifies key decisions on which operators must get investor permission before proceeding.[107]

However, the AAPL does not have an incentive to insert clauses whose sole purpose is investor protection nor does it have an incentive to side with investors when the two sides have conflicting interests, on such questions as whether operators should be bound by the cost estimates they prepare (as opposed to the current standard, under which they may be exculpated for even the wildest inaccuracies as long as they prepare the estimate in 'good faith'),[108] should have to escrow joint account funds, and should have to describe their past performance no matter how bad.[109]

The difficulty in getting the AAPL to adopt investor-protecting measures is demonstrated by the reaction to some quite narrow reforms proposed for the 1989 version. The first draft included a number of measures that would have benefited non-operators like establishing a process for easier removal of operators (removal without cause by majority vote); disclosure of affiliate use; escrow accounts for each investment; a trustee-like duty in spending joint account money; a requirement that the operator pay its share of joint costs when investor advances were due; and more stringent AFE provisions with an AFE on every well, apparently including the first well.[110]

Mission Statement). Landmen are professionals engaged in 'landwork', a range of activities whose common denominator is some relation to the properties on which the operator drilled. Virtually all landmen work for industry companies.

[107] McArthur, above n 104,747.

[108] AAPL Form Model Operating Agreement (1987).

[109] McArthur, above n 104, 747.

[110] Ibid 749.

Major industry companies reacted sharply to these proposals. A number refused to use the new form.[111] As a result, not one of these changes was adopted and many companies said that the model should document only common industry practices, meaning those of operators.[112]

IV A COMPARISON OF JOINT VENTURE/JOINT OPERATING AGREEMENTS (JVAs/JOAs) MODELS

Many early JOAs were based on North American forms such as the AAPL Model Form Operating Agreement and the Canadian Association of Petroleum Landsmen's (CAPL) Operating Procedure. While the AAPL model formed the basis for many of the early U.K. JOAs, the forms of agreements entered into were still quite diverse. In 1976, under the guidance of the U.K. Offshore Operators Association ('UKOOA'), a working group of in-house lawyers drafted a model form JOA. In the fifth round of UKCS offshore licensing in 1977, licenses were granted, continued in part on the licensees excluding JOAs with the state-owned British National Oil Corporation ('BNOC') in an acceptable form. The British National Oil Company (BNOC) reviewed the 1976 UKOOA draft and produced what is now known as the 'BNOC Proforma Joint Operating Agreement for Fifth Round Licences.' This has significantly influenced the form of subsequent UKCS JOAs, but no standard form U.K. JOA exists which parallels that in North America.[113]

JOAs typically specify that, among the parties, the relationship is one of tenants in common and not one of partnership.[114] In the U.K., such a provision is essential for tax reasons. The arrangement should also be distinguished from a mining partnership or from a unitisation agreement since it is not normally intended to affect the ownership of the minerals with the rights to produce. JOAs are sometimes confused with the broader so-called 'joint venture' label.

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[111] Ibid.
[112] Ibid 749-750.
[113] Alexander J. Black and Hew R. Dundas, 'Joint Operating Agreements: An International Comparison from Petroleum Law' (1992) 8 *J. Nat. Resources and Envt'l. L.* 49, 50-51.
[114] A. Lucas and C. Hunt, 'Oil and Gas in Canada' (1990) 165.

On the other hand, the interest of a participant in the Australian mineral and petroleum joint venture is twofold: proprietary and contractual. The proprietary interest is that of a tenant in common in the assets of the joint venture whereas the contractual interest comprises choses in action relating to the management of the common undertaking.[115]

In the U.S., JOAs do not create a separate tax entity.[116] Hence the proprietary interests in the JOA is characterised by the law of co-tenancy. A co-tenant cannot claim part of the property to the exclusion of other co-tenants, each being liable to the other both for waste and for receiving more than each co-tenant' share.[117]

A *Control of Joint Operations*

Petroleum in situ in the U.K. is vested in the Crown pursuant to the *Petroleum (Production) Act 1934,*[118] empowering[119] the Secretary of State[120] for Energy to issue licenses 'to search and bore for, and get, petroleum.' These provisions have been extended to the U.K. territorial sea and continental shelf while similar provisions are to be found in Section 1(7) of the *Continental Shelf Act 1964*[121] and Section 18 of the *Oil and Gas (Enterprise) Act 1982*.[122] The form of license is contractual, executed as a deed between the Secretary of State and the licensee. The licensee is granted an exclusive right to search, bore for, and remove petroleum from the sea bed and sub-soil under the relevant block. It has been further suggested this constitutes an *in rem* right. However, the license, although contractual in form, also performs significant regulatory functions.[123]

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[115] Michael Crommelin, 'The Mineral and Petroleum Joint Venture in Australia' (1986) 4 *Journal of Energy L. and Nat. Res.* 65, 70.
[116] Howard R. Williams and Charles J. Meyers, 'Oil and Gas Terms' (7th ed., 1987) 490.
[117] Statute of Westminster (1285), Statute of 4 Ann (1705).
[118] *Petroleum (Production) Act 1934*, 24 and 25 Geo. 5, clause 36.
[119] Ibid 2.
[120] Secretary of State for Trade and Industry from April 1992 following the elimination of the Department of Energy as a separate entity.
[121] *Continental Shelf Act 1964*, clause 29.
[122] *Oil and Gas (Enterprise) Act 1982*, clause 23.
[123] Contained in Model Clause 14-15, 17-33, 35-36 and 40-42; the other clauses are contractual in nature.

UKCS licenses make references to 'licensee' in the singular, although this entity may include co-licensees whose obligations under the license are joint and several. However, licenses are silent about the bargain *inter se* of the co-licensees.[124] While the license notionally establishes a joint tenancy, the JOA percentage interest clause[125] effectively severs a joint tenancy and imputes to each of the participants as tenants in common with an undivided interest in the license commensurate with its percentage interest. Pursuant to Section 2(1) of the *Partnership Act* licensees are regarded as co-owners of the license and of any petroleum won and saved under that license.[126]

In the UKCS 'won' refers to the winning of access to minerals prior to the start of the extraction process and 'save' means 'brought into possession under control and that, as regards to the extraction of petroleum, this stage is reached either when the petroleum has passed the well-head or when it has passed through the initial separation and stabilisation processes on the production platform.'[127]

JOAs appoint one of the parties to the agreement as the operator, some of whose responsibilities include to 'conduct and direct and have full control, of all operations'[128] although in practice the Operating Committee may have overall supervision and control. The degree of control by the Operating Committee over the operator represents a significant difference between the U.K. and North American practice. Arising from BNOC's 1977 requirement to be able to manage its interests in every joint venture in which it was involved but with limited personnel resources, the U.K. JOA places the operator firmly under the control and direction of the Operating Committee, whereas the American model forms give the operator wider discretion.[129]

The operator acts as representative of the consortium and coordinate its activities. The operator has the right to be reimbursed for any expenditure incurred

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[124] Linklaters and Paines with Christopher Nightingale, 'Joint Venture' (1990)
[125] Daintith and Willoughby, 'Manual of the United Kingdom Oil and Gas Law' (1984), 96.
[126] Ibid 28.
[127] Ibid 441.
[128] Andrew B. Derman, 'Joint Operating Agreements: Working Manual', Natural Resources Law Section, American Bar Assoc., Monograph No. 2, 11 (1986)
[129] Black and Dundas, above n 112, 54.

on behalf of the operations (or, more frequently, to be funded in advance by cash calls), and it is implicit, and generally also stated explicitly in U.K. JOAs, that the operator shall neither make a profit nor a loss from activities in that capacity.[130]

Appointment as an operator requires a skilled and experienced person who must meet industry standards. Typically, the operator must conduct the operations in a proper and workmanlike manner in accordance with methods and practices customarily used in prudent oil and gas field practice and with that degree of diligence and prudence reasonably and ordinarily exercised by experienced operators engaged in similar activity under similar circumstances and conditions.[131]

Similarly, the CAPL Operating Procedure state 'the operator shall carry out all operations diligently in a good and workmanlike manner in accordance with good oil-field practice and in accordance with the Regulations.' Hence the standard required of the operator is in accordance with good oil-field practices,[132] which is akin to the broader 'reasonable person' test.

B *Fiduciary Duties*

When operators hold property in trust for the parties or act as their agent, they will generally be subject to fiduciary obligations.[133] Once fiduciary duty is established (defined in part by the terms of the JOA, and with respect to particular transactions),[134] it follows that an operator has specific obligations, namely:

- To disclose any personal interest he may have in the project
- To account for interest on monies invested;

[130] Martyn David, 'The Pitfalls of Joint Operating Agreement' (1983) 8 *Oil and Gas: L. and Tax Rev.* 180, 181.
[131] Michael P.G. Taylor, P.P. Windsor, and Sally M. Tyne, 'The Joint Operating Agreement: Oil and Gas Law' (1989), 10. Clarification of the traditional 'good and prudent oil and gas field practice' is far from straightforward; the phrase is regarded as including compliance with all recognised guidelines and standards, whether statutory, regulatory, advisory or otherwise – e.g., the seminal standards issued by the Institute of Petroleum would be considered persuasive in the U.K.
[132] For Canadian authority on this widely received point, see *Morgan v. Sunray Petroleum Corporation*, 2 WWR 603 (1941).
[133] Bowsted on Agency, 156 (15th ed. 1985).
[134] *Boulting v. Actat*, 2 QB 606, 1 All ER 716 (1963).

- To exercise the accounting procedure diligently, in accordance with general principles and with the JOA;
- To maintain the utmost good faith to his co-venturers, and not use his position to manipulate benefits for himself;
- To protect and maintain property, and not misuse it; and
- Not to misuse information with which he has been entrusted by virtue of his position.

In Canada, the operator of an oil and gas property is in a fiduciary relationship with the non-operators.[135] In the U.S., some authorities suggest that an operator is the agent of the parties to an operating agreement and therefore owes them a fiduciary duty.[136] Most other oil and gas producing states have also dealt with conflicts in the relationship between operators and non-operators, and more specifically, the duty owed to one another based on the terms of the operating agreements, the litigation of which produced a variety of results.[137] Conversely, another U.S. commentator suggests that the overall relationship between the operator and the non-operators under the AAPL Form 610 Model Form Operating Agreement is not that of agency.[138] Several other states have ruled that the operating agreement does not create a fiduciary duty, which include Oklahoma and Texas, both of which have decades of well-developed mineral law.[139]

Australian commentators suggest that under a typical mining or petroleum joint venture agreement, the law of agency determines the liability of the participants and

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[135] *Bank of Nova Scotia v. Societe General (Canada) and Others*, 58 Alta L.R.2d 193 (Alberta C.A.) (1988); see also *Midcon Oil and Gas Ltd. v. New British Dominion Oil Co*. 12 DLR (2d) 705 (1958); *Pine Pass Oil and Gas v. Pacific Petroleums* 70 DLR (2d) (1966); *Great Northern Petroleums and Mines Ltd. V. Merland Exploration Ltd*. 36 *Alberta L. Rev. (2 ND)* 97 (1984); E.M. Bredin Q.C. 'Types of Relationship Arising in Oil and Gas' (1964) 3 *Alberta L. Rev.* 333; D.A. MacWilliam, 'Fiduciary relationships in Oil and Gas Ventures' (1970) 8 *Alberta L. Rev.* 233.

[136] *Britton v. Green*, 325 F.2d 355 (10th Cir. 1963); *Reserve Oil Inc. v. Dickson*, 711 F.2d 1951 (10th Cir. 1983).

[137] The Tenth Circuit, in the case of *Dime Box Petroleum Co. v. Louisiana Land and Exploration Co*., 938 F.2d 659, 666 (Mich. 1990) applied Colorado law in a matter where the non-operator claimed breach of fiduciary duty. The court determined that the operator would owe the non-operator a fiduciary duty because of the joint venture created by the operating agreement. However, since the operating agreement included an exculpatory clause, which was found to eliminate the fiduciary duty, no fiduciary duty was found to exist. Thus the Tenth Circuit was willing to make a parallel between an operating agreement and a joint venture, but the exculpatory clause relieved the operator of any liability that did not rise to the level of gross conduct or wilful negligence.

[138] Smith, 'JOA Jurisprudence'above n 68.

[139] *Stine v. Marathon Oil Co*., 976 F.2d 254 (5th Cir. 1992).

the operator and participants are liable to third parties both in contract and in tort for the authorised actions of the operator, whether the authority for those actions is actual, implied, apparent or ostensible.[140] Furthermore, the operator owes a duty of good faith to the other participants, which does not depend upon the precise legal character of their relationship but arises from their association and from the character of the activities undertaken by the operator for the other participants.[141] Apart from duties imposed explicitly by the joint venture agreement, an operator owes fiduciary duties of three main kinds: not to make personal profit from the use of property committed to the venture, not to take personal advantage of information received or opportunities presented in the course of the venture' activities, and not to engage in conduct in which he may have a personal interest in conflict with those of other participants.[142] Subject to any express provision to the contrary in the joint venture agreement (or in any separate instrument of appointment), an operator will as a rule be guilty of actionable disloyalty if it: 1) has an undisclosed personal interest (direct or indirect) in any contract with or on behalf of the participants – eg. in purchases for the venture; in the sale of venture property; in consultancy agreements etc. 2) receives any undisclosed commission, discount, rebate etc. in a transaction effected in behalf of the participants without crediting them therewith eg. when paying outgoings or insurances; when billing them for purchases etc. 3) intentionally discriminates in favour of one participant at the expense or to the prejudice of another.[143]

C *Change of Operator*

Since JOAs may survive for a substantial term of years, a mechanism is often included for resignation or removal of the operator. Resignation typically requires 180 days notice, although usually the operator may not resign in certain express circumstances (as before completion of a specified task).[144] The JOA usually itemises circumstances under which the operating committee may remove the operator, and some U.K. JOAs will allow the operating committee (generally

[140] Michael J. Crommelin, 'Australian Joint Ventures' (1986), 4 *J. of Ener. and Nat. Res. L.* 65, 77.
[141] J. D. Merralls, 'Mining and Petroleum Joint Ventures in Australia: Some Basic Legal Concepts' (1988) 62 *Australian L.J.* 907, 919.
[142] Paul Finn, 'Fiduciary Obligations of Operators and Co-venturers in Natural Resources Joint Ventures' *1983 AMPLA Yearbook*, 160.
[143] Paul Finn, 'Good Faith, Unconscionability and Fiduciary Duties' (1990) *Energy Law*, 123.
[144] For example, see the Working Obligations of the (U.K.) License.

excluding the operator and its affiliates from voting), after a specified period of notice, to remove an operator without showing cause.

The CAPL Operating Procedure allows replacement of the operator in the event of:

- insolvency or bankruptcy;[145] or
- assignment by the operator of its powers and responsibilities; or
- the operator ceasing to hold a 10% interest; or
- default by the operator as to his duties under the agreement and failure to rectify the same.[146]

A contentious "Challenge of Operator' clause is set out in the CAPL Operating Procedure, which takes effect in either of two situations:

- another joint venturer can offer to conduct the operation upon 'more favourable terms and conditions' following which, if operator is not prepared to meet the challenge, it must be replaced; or
- after two years as operator, it can propose to the other parties new terms and conditions for his operatorship; a party refusing to accept the proposal must offer to conduct the operations on other terms and conditions and such a counter proposal is treated as a challenge; however, neither provision is usually found in U.K. JOAs.[147]

D *Production in Kind*

[145] *Tri-Star Resources Ltd. v. J.C. International Petroleum Ltd. et al.* 2 W.W.R. 141 (Alberta Ct. Queen's Bench, 1987).
[146] 1990 CAPL Operating Procedure Cl. 202. Clauses similar to this provision will normally be found in U.K. JOAs.
[147] Dundas professed to have never seen such provisions in his 14 years of practice when he co-authored his paper with Black.

Typically, JOAs grant participants the right (and, in the U.K., the obligation) to take production in kind and separately dispose of their percentage share. This effectively gives each joint venturer a separate interest rather than the joint one under the license, and this is essential for U.K. tax purposes. One advantage is that the interest can be used as security for borrowing and the provision is frequently found in U.K. JOAs for this reason. For U.S. companies, this clause is extremely important because it helps avoid anti-trust issues by highlighting the fact joint marketing is not involved and helps in the taxation field.[148]

The CAPL Operating Procedure 1990[149] permits a party to take its proportionate share of production in kind and separately dispose of it and further states[150] that wherever a joint operator fails to take entitlement in kind, the operator shall have the authority to sell that party's share. Some Canadian operators take the position they will not exercise that authority and would leave the joint operator's reserves in the ground. But this is not necessarily a proper interpretation of the clause. When oil and gas are produced, for example, interest in the resources is owned by the parties in their proportionate shares and it is not possible to identify any one molecule of oil or gas as belonging to one party and not to another.[151] Thus ownership of oil and gas does not arise until it has been produced.[152]

The Australian joint venture agreement does not involve the sharing of gross returns but requires that each participant is entitled and bound to take in kind its share of the crude or the gas which is produced, either at the wellhead, or if conveyed ashore by pipeline, then at the terminal, and to sell its share for its own account. In

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148 James O'Byrne, '1990 CAPL Operating Procedure in Oil and Gas Operating Agreements: Coventional, Frontier and International' (1991), 1-36.

149 CAPL Clause 601 provides that each party 'has the right' to take in kind. Clause 602 provides that whenever a Joint Operator fails to take in kind, the Operator 'shall have the authority' to sell that Joint-Operator's share. This authority is 'revocable by that Joint-Operator at will,' yet effectively, if the Joint-Operator does not have a buyer for that production then it is not possible for that authority to be revoked. 'Whenever production occurs, each Joint-Operator's share is also produced, and it must be sold or otherwise disposed of in some manner.'

150 Ibid Clause 602.

151 O'Byrne, above n 147, 1-36.

152 The U.K. position is that title passes from the crown to the licensee effectively upon its being produced at the wellhead.

effect, the participants share the expenses of production but sell the products separately.[153]

E *Authorisation for Expenditure (AFE)*

The AFE relates to the general programs and budgets of the JOA but is more detailed, generally covering one discrete portion of the operations. Use of AFEs tightens control over the operator's fiscal discretion,[154] allowing greater involvement for non-operators who might otherwise be treated as investors rather than participants. The UKCS norm is for AFEs to require operating committee approval prior to the operator making any commitment, while the North American approach is generally that AFEs are provided to non-operators more by way of information and do not require prior approval. Some JOAs provide for approval of an AFE unless the operating committee votes against it within a specified time limit, but most UKCS practitioners consider the practice of deemed approvals dubious.

In practice some operators in the UKCS will seek to minimise the number of AFEs required by including as much work as possible within a single AFE. This tendency is often resisted by non-operators, since it works against their interests by diluting the primary purpose of AFEs by allowing overruns on one section of the work to be offset against underruns elsewhere. Hence, an AFE compartmentalises and controls JOA-related expenditure.

In Canada an operator customarily submits a revised informational AFE[155] if costs exceed 10% of the original AFE. This does not occur in the U.K. where JOA provisions are much stricter. But in the absence of gross negligence or wilful neglect,

[153] G.M. Lewis, 'Comment: The Joint Operating Agreement: Partnership or Not?' (Paper presented at the International Bar Association's Section on Energy and Natural Resources Regional Seminar, Singapore, September, 1985).

[154] *Monashee Petroleums Ltd. v. Pan Canada Resources Ltd.*, 70 AR 277 (1986). The content of an AFE was described by Justice Egbert: 'An AFE should contain the drilling commencement date, the location of the proposed well and the depth thereof. The very nature of the words authorisation for expenditure, would require that the estimated cost drilling, including completion costs also be included.'

[155] Art. 11.12 1974 Council of Petroleum Accountancy Societies (COPAS) or Art 11.15 of 1984 COPAS give grounds for challenge of an AFE if excessive costs were not 'necessary or proper' or that the costs were not 'reasonable and necessary.'

a non-operator is not likely to prevail in a suit to challenge the reasonableness of costs in excess of an AFE.

F *Sole Risk and Consent*

'Sole risk' or 'non-consent' clauses, which are based on the underlying principle of non-participation in an operation by at least one member of the group, are invariably incorporated in the JOA to alleviate problems in non-divergence of opinions among participants. The difference in applicability between the two clauses rests on the level of support a proposal obtains at the Operating Committee stage.[156]

A project will be 'sole risk' when it was proposed to the Operating Committee but failed to reach the pass mark needed in order for it to become a joint operation, and where less than all the parties elect to proceed. A project will be 'non-consent' when it did receive Operating Committee approval but a party exercises its JOA-given (if applicable) right not to participate, thus shielding itself from both the costs and risks involved. The latter clause is less common and is not included in the BNOC proforma.[157]

Contractual complications arise in the event the operator is not a sole risk party, and in such circumstances, UK JOAs generally provide for:

- The operator to opt out of acting as such; and/or
- The sole risk parties to request the operator to stand aside.

Conversely, the AAPL model form provides for an initial well, which will have to be commenced by a certain date with unanimous participation. Thereafter, should any party wish to drill any other well on the 'contract area,' it will be obliged to give notice to the other participants of the proposed operation. Usually the latter will have 30 days within which to notify the first party whether or not they wish to participate.[158]

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[156] Black and Dundas, above n 112, 65.
[157] Ibid.
[158] Ibid.

The AAPL model form envisages that the operator will carry out the work for the consenting parties. The obligations created proscribe the rights of co-tenants who drill on jointly owned property without the benefit of an operating agreement. Each co-tenant can enter the land and drill without the consent of other co-tenants, who cannot deny their right to enter the land. Similar provisions are to be found in the CAPL Operating Procedure, which allow a party to carry out an 'independent operation' by giving notice to the other parties.[159]

G *Liabilities of Operator*

1 *Liabilities to Third Parties*

The question of operator liabilities in relationships with third parties remains one of the most complex issues in JOAs. In English law, this stems principally from the interface with the law of agency. For example, the operator will normally be the person who initiates transactions with third party contractors and suppliers to insure that day to day operations are carried out. The relationship between the operator and those third parties is largely dictated whether by the operator's status as agent or as principal.[160]

The answer to the question is to be found in the general law of agency, rather than in any peculiarity of the JOA. Generally speaking the operator will be regarded as an agent of the JOA. For the operator's status to be that of principal rather than agent will necessitate contracting as such without disclosing the existence of the joint venture or of co-venturers. General principles of contract apply as an important distinction is drawn between a disclosed principal and an undisclosed principal whose existence is not made known by the agent to the third party. The latter is contracting with the agent with the understanding the agent is an independent party, namely a principal in his own right. Although in limited cases, the common law permits an undisclosed principal to acquire rights and be subjected to liabilities of a contract made by an agent, in most circumstances this will not be so. In the petroleum

[159] Ibid 65-66.
[160] Ibid 66.

industry, this situation should not arise—thus, express or ostensible, agency law invariably answers the question.[161]

The result is the other JOA parties can sue and be sued on the contract since the doctrine of privity of contract will not be strictly enforced. In a practical sense, it is not relevant whether the operator escapes personal civil liability; because of the nature of the JOA, the operator will still be held liable to the extent of its respective share under the agreement.[162]

In cases other than those imposing civil liability, the operator will usually be deemed to be a principal since the operator would normally be thought of as an independent contractor. The question of non-operators' liabilities to third parties in such circumstances can be expected, at least in English Law, to turn on the extent to which the act or omission giving rise to the liability has been authorised or subsequently ratified. In circumstances other than subsequent ratification, the operator will be liable to a third party on a contract but will have recourse against the non-operators for their respective share under the agreement. The BNOC proforma (and probably all current U.K. JOAs) provides that each participant indemnifies the others to the extent of their individual percentage interest share of any claim or from liability to any third party arising from joint operations.[163]

An underlying principle of law of damages is that a plaintiff will only be able to recover what he or she has lost (i.e., damages are compensatory). In the JOA situation, the losses of non-operators could not be taken into consideration,[164] except to the extent that (in English law) non-operators who pay more than their proportionate share of any liability have a right to reimbursement from their co-venturers.[165] Privity will prevent non-operators from suing on the contract itself.[166]

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[161] Ibid.
[162] Ibid.
[163] Ibid 66-67.
[164] *Woodar Investment Development v. Wimpey Construction*, 1 WLR 277, 300 (1980) where Lord Keith expressed that it was time for a review of the inconvenient rule that precludes a *jus quaesitum tertio* in English Law.
[165] *Civil Liability (Contributions) Act 1978.*
[166] Black and Dundas, above n 112, 67.

To circumvent this difficulty, the JOA imposes an obligation on the operator to use his best endeavours to include provisions in contracts to the effect that the operator is contracting as principal but nevertheless can recover losses of non-operators while at the same time precluding any action by the third party in contract/delict/tort against them.[167] In such cases, third party creditor rights against non-operators are limited.[168] Recent U.K. experience suggests this position fluctuates with market forces, with contractors and suppliers accepting such a limitation in a recessionary period while rejecting it when the market has turned their way.[169]

An issue of particular relevance to the Australian mineral and petroleum joint venture is whether the liability of participants to third parties in respect of the actions of the operator is joint or several. While such liability is joint, it has been suggested however, that several appointments rather than a joint appointment of the operator by the participants may achieve several rather than joint liability of the participants to third parties.[170] While Crommelin concedes that several appointments of an agent may give rise to several agency relationships and thus several liability, he finds it difficult to see how such result can be achieved in the context of the mineral and petroleum joint venture. He explains that the very nature of the undertaking for which the participants are engaged in, precludes its division into distinct activities performed on behalf of individual participants. If the courts then are guided by the substance rather than the form of the matter, he concluded that the appointment of the operator and the liability of the participants for its action must be joint.[171]

2 *Liabilities to Non-Operators*

Another question concerns the extent the operator should be liable to the non-operators, particularly as a consequence of normally being precluded by the JOA

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[167] This solution is considered uneven and arguably unfair by some UKCS operators, but is conventionally insisted upon by non-operators.
[168] For a recent Alberta case, see *Panamerica de Bienes y Servicios, SA v. Northern Badger Oil and Gas Ltd*., AR 575 (Alberta Ct App. 1991) which considered whether the cost of abandoning the wells should be ordered by the Energy Resources Conservation Board to be paid out of funds held by the receiver for secured creditors or out of funds payable to the trustee in bankruptcy.
[169] Black and Dundas, above n 112, 67.
[170] Gerald L. J. Ryan, 'Role of the Operator under a Joint Venture Agreement: Comment on Liability Considerations' (1982) 4 *Australian Mining Petroleum L.J.* 280.
[171] Crommelin, 'Australian Joint Ventures' above n 139, 78.

from making any profit as operator. This practice precludes any 'financial cushion' against the cost of mistakes. Despite this general principle, it is clear that in certain circumstances, the courts will uphold provisions in JOAs making the operator personally liable. For example, the AAPL model form provides[172] that 'the Operator is exonerated from all losses sustained or liabilities incurred except those losses which may result from gross negligence and wilful misconduct.' Likewise, the position created by the BNOC 5th round proforma is that, in general, the operator will only be liable for loss which results from 'wilful misconduct.'

'Wilful misconduct' is conventionally defined as an 'intentional and conscious, or reckless disregard' of any provision of the JOA or of a program of operations under the JOA 'not justifiable by any circumstances, but shall not include any error of judgment or mistake made by any director, employee, agent or contractor of the operator in the exercise, in good faith, of any operation, authority or discussion conferred upon the Operator.'[173] The BNOC proforma ensures the operator is liable only for 'wilful misconduct' or negligent failure to obtain insurance.

However, wilful misconduct is a defined term in the proforma, thus removing much of the subjectivity from disputes. On the other hand, 'gross negligence' includes the 'failure to take even the slightest care,' and this term was used in the U.K. before the BNOC proforma was introduced. But, negligence is an 'on-off' switch that cannot be categorised into degrees since any adjective placed before the word makes no difference with respect to liability.[174]

H *The Default Clause*

Default clauses contemplate the possibility that a non-operator may not be sufficiently funded to meet joint venture commitments. Early JOAs often proceeded on the basis that the non-defaulters would have a lien over the defaulter's share of joint property and joint petroleum as produced. Problems such as this arose insofar as such a lien was deemed to constitute a registrable charge and, if not registered within

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[172] Art V.
[173] Taylor, Winsor and Tyne, above n 130, 11.
[174] David, above n 129, 181.

21 days in accordance with the U.K. Companies Act (1948 through 1985), it could not be forced against a liquidator or other creditors of a defaulter. Also, as the lien attached principally to production, it would be of little use where production had not yet commenced.[175]

The modern form of JOA normally includes 'forfeiture for default clause.' Such a clause does not constitute a registrable charge. The justification for this somewhat radical clause was that nothing short of an outright forfeiture of a defaulter's interest would provide sufficient protection for the operator and non-defaulters.[176] However, some Australian courts suggest outright forfeiture may yet be attacked as either a penalty or as interference with the rights of creditors in liquidation.[177] Mindful of this, Australian and New Zealand resources joint venture agreements conventionally include provisions where the defaulter obtains some value from the defaulted interest after settlement of outstanding obligations.

Complex legal issues arise from the default clause. First, where the defaulter is uncooperative in executing the necessary documents to transfer its interest under the JOA (and under the relevant license) to the non-defaulting parties, the non-defaulters have to use recourse to legal proceedings for specific performance, thereby wasting time and money. To circumvent this, JOAs commonly include a power of attorney (usually in favour of the operator), which, if framed properly, will be irrevocable. If so this should transfer the interests to the non-defaulters. Americans practitioners in the U.K. suggest that such power of attorney might not withstand judicial considerations in U.S. courts, however.[178]

As a general principle of law, moreover, a court will refuse to enforce a contractual clause presupposing the payment of money resulting from a breach of contract if the clause is regarded by the court as a penalty (as opposed to a proper

[175] Black and Dundas, above n 112, 70.
[176] Taylor, Windsor, and Tyne, above n 130, 11.
[177] *Mosaic Oil NL v. Angari Pty Ltd. (No. 2)* 8 AALC 780 (S.Ct. New S. Wales 1990) per young J; see also J. Waite and D. Dawhorn, 'Contractual Forfeiture of Joint Venture Interests: Are Such Clause Enforceable?' (1990) 11 *Oil and Gas L and Tax. Rev.* 389.
[178] Black and Dundas, above n 112, 72.

attempt to calculate compensation for the breach).[179] The question then arises whether the clause is a form of liquidated damages or a penalty. If the clause is deemed to be a penalty clause, and this is purely a matter of interpretation for the court, the result is that it would be unenforceable in respect of that clause, although the entire agreement would not be void.[180] The principal argument that the clause is a penalty will be the fact the value of the defaulter's interest may be greater than the amount in default.

Finally, the question again arises whether such a default/forfeiture clause is deemed to be a mortgage or a registrable charge in security for money lent. The U.K. Registrar of Companies has taken the view it is not and that such JOA provisions need not be registered at Companies House as charges. However, a court may hold differently and it may be prudent to register the particulars under the companies' legislation. This however, may affect relief against forfeiture as the defaulters may have a stronger claim if it were treated as such.[181]

The forfeiture clause is not necessarily the only provision available for default. Two other types, the 'withering' and the 'purchase price' clauses, proceed on the same assumption, e.g. that the defaulter should at least retain some benefit for the money expended on joint operations before default. The withering clause appeared in the 1970s when smaller companies became concerned that they could be maneuvered into default. The clause operates to the effect that the defaulter does not lose his entire interest but can retain a reduced one, typically calculated on the basis of his total monetary contributions related to total joint venture costs. An advantage to this is less chance of such a provision being regarded as a penalty clause.[182]

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[179] For instance, the parties may agree that the debtor shall pay a sum as liquidated damages in the event of breach of contract. However, this sum must, at the time the contract is made, be a genuine pre-estimate of the loss likely to flow from the breach as opposed to being imposed in terrorem to dissuade the debtor from committing an act of default. See *Dunlop Pneumatic Tyre Co. Ltd. V. New Garage and Motor Co. Ltd.* A.C. 79, 86 House of Lords (1915).
[180] Many U.K. JOAs incorporate a provision that operates to sever any clause deemed void, illegal or otherwise unenforceable, from the rest of the JOA, thereby endeavouring to prevent voiding of the whole agreement consequent on one portion being so deemed.
[181] Black and Dundas, above n 112, 74.
[182] Ibid.

The ‘purchase price’ clause common in Australia and New Zealand is based on the assumption that the non-defaulters are obligated to pay the defaulter the purchase price of his percentage interest, net of sums in default. Another type of clause is the ‘cross charges’ clause where parties to the JOA could create cross charges over each other’s interests. This is arguably untenable, because it is a slower and more complicated remedy to implement.[183]

In Canada, the CAPL Operating Procedure makes provision[184] for the operator to have a lien on the interests of joint operators in the joint lands and in production wells and equipment. Where failure to pay continues for 30 days after a default notice has been served, the operator has a number of options. For instance, the operator can withhold information from the defaulting party, or take an automatic assignment of the defaulting party’s share of production and joint property. Pertinent powers include the right to sell a joint operator’s interest in the joint land. The proceeds of sale in this instance are to be applied, first to pay costs of default, and second to pay any residue to the defaulter.[185]

The question of equitable relief from forfeiture has also arisen in Canada. The judiciary has, as in the U.K., managed to avoid answering the question directly as to whether the courts may be entitled to relieve the party of the effects of forfeiture provisions.[186]

V THE HIBRIDISATION OF THE LEGAL SYSTEMS

A *The Development of the Early Civil and Common Law Systems*

A legal ‘tradition’ has been described as ‘a set of deeply rooted, historically conditioned attitudes about the nature of law, about the role of law in the society and the polity, about the proper organisation and operation of the legal system, and about

[183] Ibid 74-75.
[184] 1990 CAPL Operating Procedure Clause 505.
[185] Black and Dundas, above n 112, 75.
[186] In *Wetter v. New Pacalta Oils* 2 W.W.R. (NS) 290 (Alberta 1989), Chief Justice O’Connor refrained from commenting upon whether the instant case was one where relief from forfeiture could be given under the *Judicature Act, R.S.A. 1989* s. 10.

the way the law is or should be made, applied, studied, perfected, and taught.'[187] The legal tradition relates the legal system to the culture of which it is a partial expression, and puts it into cultural perspective.[188] Merryman used this concept to categorise the majority of the legal systems of the contemporary world into three families: the civil, common, and socialist law families.[189]

The civil law tradition of compiling and codifying Roman law is traceable since 553, with the introduction of the first three books of the Institutes of Justinian (Of Persons, Of things, and Of Obligations). The Roman law influenced codification of law in Europe in a variety of codes such as the Visigoth Code and other barbarian codes written between the sixth and ninth centuries and the Customs of Paris. Such codes for the most part collected the law in existence without changing or rearranging the law.[190]

In striking contrast, the Code Napoleon[191] embraced and embodied sweeping changes in politics, social perspective, and legal technique. It provided comprehensive, logical organisations of general principles of law to be applied by the process of deduction and extended by analogy to new circumstances.[192]

The foundations of the civil law tradition can be traced to the Italian universities during the Renaissance period.[193] Scholars developed this system based on the assumption that the most appropriate way to formulate laws was through a rational, intellectual process.[194] They created a set of codes, which could be applied to any

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187 John Henry Merryman, 'The Civil Law Tradition: An Introduction to the Legal Systems of Western Europe and Latin America (1969) 2.
188 Ibid.
189 A legal family consists of legal systems which have characteristics, uniquely shared by them, that distinguish them, as a group, from other systems. The oldest and most widely distributed is the civil law. It can be found in most Western European countries, all of central and south America, and many parts of Asia and Africa. The common law family includes the legal systems of England, Ireland, the United Sates, Canada, Australia, New Zealand, and many nations in Asia and Africa.
190 Patrick H. Martin and J. Lanier Yeates, 'Lousiana and Texas Oil and Gas Law: An Overview of the Differences' (1992) 52 *La. L. Rev.* 769, 773.
191 The Code Napoleon was spread throughout Europe by Napoleon's conquest. It was the most influential of the civil law national coded and was the basis of the *Austrian Civil Code of 1811*, the *Italian Civil Code of 1865*, the *Spanish Civil Code of 1888*, and the *German Civil Code of 1900*. Other comprehensive codes were compiled in Belgium, Romania, Bulgaria, Japan, Egypt, and many countries in Latin America.
192 Martin and Yeates, above n 189, 773.
193 Francesco A. Avelos, 'The Mexican Legal System' (1992), 13.
194 Ibid 15.

situation so as to minimise active interpretation by the judiciary, which concept became the cornerstone of the early civil law tradition.[195]

A strict separation of powers developed within the governments and the power to enact laws was bestowed upon the legislatures.[196] The role of the judiciary was greatly limited because judges simply selected the proper statutes to apply to specific situations.[197] Judges did not interpret incomplete, conflicting, or unclear legislation. They referred ambiguities back to the legislature for interpretation.[198] This prevented the creation of laws through judicial decisions, causing the principle of binding precedent and stare decisis to have no effect on these systems.[199]

As the civil law evolved in Western Europe, it became evident that the orthodox tradition could not function precisely as the Italian scholars had formulated. Legislatures could not enact code provisions that would ideally apply to all situations.[200] Judges often found it necessary to resort to the prior reasoning of their colleagues in order to formulate appropriate decisions in difficult areas.[201] Lawyers began citing previous decisions in their arguments, in an attempt to buttress their position and influence the judges.[202] These practices developed into a limited form of precedent, which was integrated into the early civil law systems, despite the fact that the civil law tradition does not officially recognise them.[203]

The English Common Law Tradition evolved much differently than its civil law counterpart. It originated nearly nine hundred years ago as an attempt by the King of England to consolidate his power through the application of uniform laws.[204] Royal courts, staffed by the King's closest advisors, travelled about the Kingdom settling disputes by applying customs and laws purported to be commonly accepted throughout the country, which allowed this decisions to be applied similarly in all

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[195] Ibid.
[196] Ibid 21.
[197] Ibid.
[198] Ibid.
[199] Ibid.
[200] Ibid 47.
[201] Ibid.
[202] Ibid.
[203] Ibid.
[204] See New York University School of Law, Fundamentals of American Law 9 (Alan B. Morison ed., 1996).

parts of England.[205] The Common Law Tradition instructs that the best way to administer uniform justice is to keep judicial decisions as consistent as possible.[206] This philosophy precipitated the principles of binding precedent and *stare decisis*.[207] Incorporating former decisions into current adjudications produced a body of principles, which reflected a line of similar reasoning in deciding cases.[208]

The judicial role in the early common law tradition was quite distinct. The law was developed through reasoning of the court from case to case.[209] This resulted in active judicial participation being paramount to the law-making process, even in situations governed by statutory law.[210] This is substantially different from the limited role played by the judiciary in the civil law tradition.

The models created by comparing the early civil and common law systems emphasise the differences in the sources of law and the role played by the judiciary in the law-making process. When these models are used to compare modern systems, scholars tend to focus only on these features. This generates a method of comparison, which minimises the derived similarities. It can create the illusion that all civil and common law legal systems are grossly disparate and divert attention from the important accomplishments that have promoted practical uniformity.[211]

B *Property Law: Civil and Common Law Dichotomy*

The different approaches of the common and civil law traditions to structuring business relationships affect the nature of mining rights and property rights in general. While the common law focuses on the concept of estates in land, the civil corpus juris is a law of ownership. For example, in Latin America and in the Philippines, ownership of all natural resources in place is in the State, and resource developers obtain their right to work mineral deposits by grant of the State, through concessions,

[205] Ibid 9.
[206] William Burnham, Introduction to the Law and Legal System of the United States 40 (1995).
[207] Ibid.
[208] New York University School of Law, above n 31, 10.
[209] Merryman, above n 186, 35.
[210] Ibid.
[211] Joseph E. Sinnot, 'The Classic Civil/Common Law Dichotomy and its Effect on the Functional Equivalence of the Contemporary Environmental Law Enforcement Mechanisms of the United States and Mexico' (1999) 8 *Dick. J. Envt'l. L. & Pol'y* 273, 279.

production sharing agreements or other forms of permission. In contrast, the U.S. common law generally provides that the fee simple owner of the surface estate also owns the subsoil estate in fee simple. Under the civil law system, ownership of the subsoil minerals is always in the state, inalienable and prescriptible.[212] In Latin America, mining rights granted to private interests are not a grant of an ownership interest in the mineral in place. Rather, the rights are concessions or licenses that merely provide a right to attach the minerals and reduce them to ownership upon separating them from the reserves.[213] Moreover, the concessions or licenses are considered separate property from the real estate where they are located. 'The state retains the right to control, in the public interests, any property rights it has not given away.'[214]

Concession holders in Latin America may transfer or mortgage their interests in the concession, as well as pledge the extracted or treated minerals to a third party.[215] These transactions may be beneficial to the mining investor because the mining rights can serve as security for loans or other financing, a practice recognised by almost all Latin American countries.[216] However, unlike in the United States, in Latin America a concession grant does not allow the concessionaire to freely alienate its property. The State may not convey, along with the concession, the right to free transferability of the concessionaire's interest in the mining property, and prior government approval may be required for any transfer to be effective.[217] On the other hand, the day-to-day rights and obligations of miners under the common law of fee ownership and under

[212] This view has found expression in Art. XII, Sec. 2 of the 1987 Philippine Constitution: 'All lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, fisheries, forests or timber, wildlife, flora and fauna, and other natural resources are owned by the State…The exploration, development, and utilization of natural resources shall be under the full control and supervision of the State. The State may directly undertake such activities, or it may eneter into co-production, joint venture, or production-sharing agreements with Filipino citizens, or corporations or associations at least sixty *per centum* of whose capital is owned by such citizens…The President may enter into agreements with foreign-owned corporations involving either technical or financial assistance for large-scale exploration, development, and utilization of minerals, petroleum, and other mineral oils according to the general terms and conditions provided by law, based on real contributions to the economic growth and welfare of the country.'

[213] Kenneth S. Culotta, 'Forma Cinco? Getting the Benefits of Form 5 in Latin American Mining Ventures' (1993) 39 *Rocky Mtn. Min. L. Inst.* 9-1, 9-25.

[214] Ibid.

[215] Juan F. Pardini, 'Mining Investment regimes in Latin America' (Paper presented at the International Oil, Gas and Mining Development in Latin America Conference, Houston, April 1994).

[216] Ibid.

[217] Ibid. See also *Ley General de Mineria del Peru* arts. 172-177; *Codigo de Mineria de Chile* arts 217-222; *Codigo Minero de Panama* arts. 106-107.

the civil law concession system typically tend to be quite similar.[218] Whether a lessee or a concessionaire, the rights of the miner are subject to fulfilment of certain obligations, such as the payment of surface fees and royalties on production.[219]

Most company forms available in most civil law jurisdictions are comparable to those in common law countries such as in the United States. Depending on the size and length of the transaction, however, the formation of a company as a local corporation, partnership, limited liability company, or foreign subsidiary may not be advantageous or necessary. From a practical standpoint, joint ventures with local entities may be more attractive than other company forms.[220] While under the common law the parties to a joint venture may agree to hold their interest in the mining property as tenants in common, the civil law disfavours schemes for co-ownership of property as a matter of principle.[221] Moreover, the civil law would not force anyone to preserve an undivided legal ownership or to remain in a co-ownership situation.[222] Thus, a waiver of the right to partition under a joint venture agreement may not be upheld and as a result, one of the parties could force a partition and, possibly, a sale of the mining property, regardless of a contrary provision in the joint venture agreement.[223]

Another important issue is the civil law's reluctance to allow freedom of contract.[224] While most Latin American company forms are based on contract law, specific statutes that closely circumscribe the freedom to contract govern these contracts.[225] For example, co-venturers may not validly agree within the context of a *Sociedad de Responsabilidad Limitada* (limited liability company) that their interests will be adjusted according to contract dilution provisions. Under civil law, this agreement may be unenforceable since prior governmental approval may be required for any effective transfer of the concession. The government may decide, on the one hand, to negotiate the terms of the concession as consideration for its consent to the

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[218] Culotta, above n 212, 9-26.
[219] Ibid.
[220] Sandra Orihuela, 'Latin America: A New Era for Mining Investment' (1996) 30 *Int'l Law.* 31, 34.
[221] Culotta, above n 212, 9-23.
[222] Ibid.
[223] Ibid.
[224] Orihuela, above n 218, 34.
[225] Pardini, above n 213.

transfer.[226] On the other hand, political considerations may dissuade the mining authorities from approving the transfer of a concession interest, especially where approval results in a foreign investor's greater participation at the expense of a local investor.[227]

In contrast, the philosophy of individualism that characterises the innovations in the *Philippine Civil Code* is not that of the old Roman law; it is the individualism of American common law, from which some provisions were borrowed.[228] Explaining the philosophy behind these innovations, the then Chairperson of the Code Commission, Dean Jorge Bocobo, underscored the need for individualism:

> The thought of the Code Commission is that democracy draws its breath of life from the spirit of rugged individualism, and should not derive its effectiveness from the action of public officials. The philosophy of the Anglo-American torts is that private wrongs should be redressed in a private civil action. When this principle shall have seeped into the general consciousness of our people, there will arise and develop a spirit of individual independence on which, when all is said and done, popular government rests.[229]

In property law, the *Philippine Civil Code* is cast in economic individualism where the sovereignty of the property owner is the basic tenet. Its provisions on ownership: the rights to possess, use, manage, and receive income; the powers to transfer, convey, exclude, and waive; the privilege to consume, alienate or destroy; and the liability for execution of a court judgment- all point to possessive individualism and founded on natural law theories derived from the old Roman law. However, the principles of transfers for value have been imported from American law, but the principles hew to the basic philosophy of absolute liberty of the contracting parties, and their corresponding responsibility in case of breach of contract.[230]

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[226] Culotta, above n 211, 9-26.
[227] Ibid 9-27.
[228] Pacifico A. Agabin, 'The Philosophy of the Civil Code' (1991) 66 *Phil. L. J.* 1, 20. Thus the Philippine Civil Code have provisions on (1) independent civil actions, similar to the American law on torts, and (2) action for damages for violation of the rights enumerated in the Bill of Rights, or the violation of privacy.
[229] Ibid.
[230] Ibid 22.

The *Philippine Civil Code* provisions on contracts and obligations are also grounded on the natural law philosophy. According to Dean Pound, 'the idea of deduction from the nature of man as a moral creature and of legal rules and legal institutions was put to work upon existing materials and the result was a reciprocal influence of the conception of enforcing promises as such because morally binding.'[231] It was only later in the 19th century; with the creation of more wealth and property that man became more interested in freedom to contract than about enforcement of promises. 'The important institution was a right of free exchange and free contract, deduced from the law of equal freedom as a sort of freedom of economic motion and locomotion,' continues Pound, so that jurists 'saw freedom as a civil or political idea realising itself in a progress from status to contract in which men's duties and liabilities came more and more to flow from willed action instead of from the accident of social position recognised by law.'[232] It was at this point that the drafters of the *Philippine Civil Code* borrowed from the *Spanish Civil Code of 1889* the Roman and the scholastic philosophy of the law of contracts, bonded it with Anglo-American elements of individualism, and produced a hybrid, which is recognisable in natural law.[233]

Although the United Sates is considered to be a common law country, it is an error to say that 'judge-made' law continues to be the prevalent source of law today.[234] Since the beginning of the twentieth century, there has been an influx of statutory requirements in both federal and state legal systems.[235] Many of the early statutes were codifications of widely accepted common law principles, and replaced the common law in that area.[236]

Although statutory law is now prevalent, and supersedes the common law wherever applicable, it does not have the same purpose as in civil law countries. Common law judges view statutes as specific rules, which are to be applied according

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[231] Pound, 'An Introduction to the Philosophy of Law' (1954), 143.
[232] Ibid 149-150.
[233] Agabin, above n 227, 23.
[234] Burnham, above n 205, 48
[235] Ibid 49. The average state in the U.S. has as many statutes as the civil law countries in Europe.
[236] Ibid. Many of the private law areas, such as contracts, torts, and property remained governed primarily by the common law, with only minor statutory modifications.

to their terms, but not beyond.[237] Subject matter, which falls outside the specific terms of the statute remain governed by the common law.[238] Contrary to the civil law, common law systems do not intend that a code completely abolish all other law in a specific area.[239] It is expected to perfect certain points and be supplemented by the existing case law.[240]

Sinnott believes that when conducting a comparative study of civil and common law countries, careful consideration must be given to the practical operation of the individual legal systems and the use of traditional civil and common law models, when used as a comparison guide, may produce erroneous conclusions because of the evolution of contemporary systems away from their original predecessors. In actuality, the contemporary descendants of the original models have developed many similarities, which have resulted in a much higher level of practical uniformity than would be expected.[241]

The role of the judiciary in both civil and common law systems has also changed substantially as common law countries have been unable to sustain a legal system based entirely on judicial decisions. The complexity of changing societies has required that statutes dictate much of the law and the judicial role, as to these areas of law, is interpretation of the legislative intent and application to various situations. This has provided the common law system with a taste of the civil law tradition.[242]

The same societal complexity has had the reverse effect in civil law countries. As legal issues become more complex, it is necessary for these systems to incorporate more judicial interpretation into their statutory scheme. The result has been the incorporation of common law principles into the civil law tradition.[243]

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[237] Burnham, above n 205, 50,
[238] Ibid. U.S. Courts will not interpret statutes broadly because the broad principles they adhere to in resolving matters outside the strict construction of the statute can be found in the common law. When the legislature in a civil law country passes a code, it is intended to be the entire law on the subject addressed. The exception to this is the practical situations where 'gap-filling' interpretation is required by the judiciary to resolve problematic situations not adequately covered by statute.
[239] Merryman, above n 186, 32.
[240] Ibid.
[241] Sinnott, above n 210, 296-297.
[242] Ibid.
[243] Ibid.

The result of this hybridisation of the common and civil law systems is that a practical uniformity has been substantially achieved in many facets of these legal systems. The classic traditions, although still recognised, have given way to modern methods that utilise the most functional aspects of both systems. It is no longer possible to categorise a system as either civil or common law and expect to accurately assess the operation of its mechanism based on the classic models. Evaluation of the contemporary systems requires an in-depth understanding of individual mechanisms in order to fully understand the extent of hybridisation and how it compares to other systems.[244]

C *Mineral Leases in the Context of Civil Law: The Louisiana Experience*

The State of Louisiana began its existence as a colony with a legal system based on the civil code and for this reason, the Louisiana Civil Code is very much a part of the modern civil code tradition which even preceded many of the other civil code systems of Europe. Roman civil law, canon law, and commercial law are the principal historical source of the concepts, institutions, and procedures of modern civil law systems. From these come the basic codes that are typically found in a civil law jurisdiction: the civil code, the commercial code, the code of civil procedure, the criminal code, and the code of criminal procedure. The civil law system found today in Louisiana is archetypal insofar as it embraces all of the five basic codes; however, much in the manner that specialised commercial laws developed in other civil law systems, in Louisiana special treatment has been given to minerals.[245]

Ownership in Louisiana is allodial, which is freehold. 'Estates' in the common law sense of the word are neither part of Louisiana civil law, nor does the law embrace any division between legal and equitable title.[246] All things are 'owned' in the same manner. Under the *Louisiana Civil Code*, ownership is the right that confers on a person direct, immediate, and exclusive authority over a thing.[247]

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[244] Ibid.
[245] Martin and Yeates, above n 189, 773-775.
[246] Ibid 782-783.
[247] *Louisiana Civil Code*, Art. 500.

The historical underpinnings of Louisiana law provided by the Roman civil law with its strong emphasis on the individual and his autonomy establish private property and liberty of contract as fundamental institutions that should be limited as little as possible. The Roman civil law was basically a law of property and contract. In contrast to the common law, civil law systems emphasise different concepts of order in the holding and disposition of property. The civil law places property in the hands and under the control of the living. Civil law promotes commercialisation of all property, including land, whereas the common law adheres to notions born in the age of feudalism. By the late eighteenth century, in civil law one acquired ownership and complete title to land, but in common law jurisdictions one still spoke of having an 'interest' or an 'estate' in real property.[248] The entire thrust of the civil law is to identify the owner with the thing owned, whereas common law tends to keep them separate. Modern civil law embodies the Roman civil law concept of absolute dominion while the common law continues to wrestle with more fragmented notions of property, the relativity of title, competing claims of present and future property holders and the differences between legal and equitable ownership.[249] Under the *Louisiana Civil Code*, a thing always has an absolute owner; limited rights of enjoyment such as usufruct, habitation and servitude are mere encumbrances, burdens or charges on absolute ownership.[250]

However, the law of eighteenth and early nineteenth century Spain and France from, which Louisiana's legal system is derived was not developed with any thought to oil and gas exploration and production.[251]

When oil and gas exploration did begin in Louisiana the courts were left with the responsibility for fashioning a body of law governing the rights for development of petroleum. The *Civil Code of Louisiana* had not been drafted with any thought to minerals.[252] The legislature did not enact a specific body of mineral law until 1974.

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[248] Martin and Yeates, above n 189, 783.
[249] Ibid.
[250] Ibid 784.
[251] Ibid 775.
[252] Colonel John. H. Tucker spoke of the mineral law of Louisiana as being explicable by the aphorism *'au-dela du code civil mais par le code civil'* – beyond the civil code but through the civil code. He said, 'Louisiana developed its mineral law quite logically by following the practice indicated, arriving at the basic decision that the sale or reservation of mineral rights by the owner of the immovable to which it is applied created a real right in the nature of a predial servitude, to which the rules relating to

The earliest book on Louisiana mineral law was published in 1922. Its author, George G. Dimick of the Shreport bar made the following observation:

> The discovery of oil in Louisiana found the State with no mining laws, as that industry was unknown in this section. The few antiquated sections of the Codes and statutes which might apply were evidently casual and accidental expressions and illustrations enacted without the remotest idea that they would ever apply to the production of oil and gas.[253]

Daggett, the noted authority, dedicated her treatise on Louisiana oil and gas law to the Louisiana judiciary during the years 1900 until 1939 for their role in shaping Louisiana mineral law. She observed:

> The law of oil and gas is new and without precedent… [T]he courts of Louisiana were without aid from the legislature. They could receive little from counsel, though the members of the Louisiana Bar who are concerned in these issues have not been unmindful of the complexity of the problems. The decisions of other states were of small value because Louisiana is a civil-law state with an old civil code. The French, Spanish, and Roman sources furnished no precedents because the problem was unknown to those forefathers. The judiciary has never been a determining factor in defining frontier interpretation of new social and economic policies. The history of legal thought cannot neglect the role of judge-made law. Louisiana jurisprudence on oil and gas is a continuing tribute to the patience, research, wisdom, and fairness of the members of the bench of the state.[254]

The Louisiana Supreme Court, faced with its first oil and gas lease case in *Escoubas v. Louisiana Petroleum and Coal Oil Co.*,[255] fashioned its decision by referring to established law of conventional obligations and immovable property. The *Escoubas* case is an example of the manner in which mineral law, the development of the body of law governing minerals in Louisiana before the adoption of the *Mineral Cod*e, was reposed in decisions of courts, principally, the Louisiana Supreme Court. A hazard of this method of legal development was a degree of doctrinal inconsistency

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predial servitude would be applied as near as may be.' John H. Tucker, 'Foreword' *Louisiana Civil Code*, vii (Yiannopoulus ed. 1981). A more developed exposition by Colonel Tucker of the Civil Code foundations of Louisiana's mineral law is his article entitled 'Au-dela du Code Civil mais par le Code Civil' (1974) 34 *La. L. Rev.* 957.

[253] George G. Dymick, 'Louisiana Law of Oil and Gas' (1922), 3.

[254] Harriet S. Daggett, 'Mineral Rights in Louisiana' (1939), xxxiv-xxxv.

[255] 22 La. Ann. 280 (1870).

and unpredictability that appeared in some cases,[256] and occasional application of principles ill-suited to the industry.[257] It is not surprising that comprehensive legislation was seen as desirable.

The Louisiana legislature enacted the *Mineral Code* in 1974, which has removed from question some areas of existing judicial decisions that may have been of doubtful authority. Because the Code is now statute rather than a body of judicial decisions, the principles embodied in the articles will not be capable of being changed by judicial decision even when the courts are no longer persuaded of the wisdom of the judicial decisions which were codified.

The *Mineral Code* is seen as a specialised extension of the *Civil Code of Louisiana*.[258] The *Civil Code* or other laws are applicable in instances in which the *Mineral Code* 'does not necessarily or impliedly provide for a particular situation.'[259] The courts do have occasion to go to the Civil Code for matters not expressly resolved by the *Mineral Code*.[260]

There is a stylistic difference between certain provisions of the *Mineral Code* and the *Civil Code*. Typically a code expresses the most general principles, leaving it to the court to apply the broad principles to a specific set of facts. Much of the *Mineral Code* is in this tradition. But there are portions of the *Mineral Code* that go into rather more detail, more like a typical statute that attempts to cover all circumstances that may arise.[261]

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[256] Compare *DeMoss v. Sample*, 143 La. 243, 78 So. 482 (1918) and *Calhoun v. Ardis*, 144 La. 311, 80 So.548 (1919) with *Frost-Johnson Lumber Co. v. Salling's Heirs*, 150 La. 756, 91 So. 207 (1922).
[257] *Gulf Refining Co. v. Glassel*, 186 La. 190, 171 So. 846 (1936); *Tyson v. Surf Oil Co*., 195 La. 248, 196 So. 336 (1940).
[258] *Louisiana Civil Code*, Art. 561.
[259] La. R.S. 31:2 (1989).
[260] *Davis Oil Co. v. Steamboat Petroleum Corp*., 583 So.2d 1139 (La. 1991); *Amoco v. Thompson*, 516 So. 2d 376 (La. App. 1st Cir. 1987), 520 So.2d 118 (1988); *Darby v. Rozas*, 580 So. 2d 984 (La. App. 3d Cir. 1991); *Hincley v. Hinckley*, 583 So. 2d 125 (La. App. 4th Cir. 1991); *Succession of Doll v. Doll*, 577 So. 2d 802 (La. App. 2d Cir.), 582 So. 2d 845 (1991).
[261] Martin and Yeates, above n 189, 778.

Louisiana has had problems with the characterisation of the mineral lease.[262] As early as 1913 Justice Sommerville, in the case of *Rives v. Gulf Refining Co.*,[263] said the oil and gas lease was in a class by itself, which partook of the nature both of sale and of lease. The case of *Arent v. Hunter*[264] ruled that a mineral lease conveys a servitude on the land. But then the 1936 case of *Gulf Refining Co. v. Glassel*[265] treated the lease as a lease thereby not allowing the lessee to protect its interest through a claim of trespass, a real action. Thus, mineral leases were made subject to the same general principles, as were leases for agricultural or commercial purposes. *Act 205 of 1938* was passed to overcome the result in *Glassel* and made retroactive. Confusion continued in the courts because *Act 205* was treated as applying only to procedure and not as to substance in treating mineral leases as real rights.[266]

The *Mineral Code* resolves the matter by saying that the mineral lease is a contract[267] but it is a real right. The comments to Article 16 refer to the mineral lease as a 'hybrid institution.' The effect of these two articles is to continue the rule that a mineral lease is not subject to liberative prescription as it is not a servitude, but gives to the lessee the capacity to assert and defend title through the use of real actions. As stated by the Comments, 'All things considered, the lease has the major characteristics of a real right: the mineral lessee may follow the land, regardless of transfers of ownership; the mineral lessee may assert his rights against the world just as the proprietor of any other real right; he may enjoy directly and draw from the land a part of its economic advantages by appropriating a wasting asset; he has certain rights of preference; and he holds a right that is in reality susceptible of a type of possession through exercise.'[268]

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[262] The subject is well covered in William M. Hall, Jr., 'The Juridical Nature of the Louisiana Mineral Lease' (1964) 11 *L.S.U. Min. L. Inst.* 106.
[263] 133 La. 178, 62 So. 623 (1913).
[264] 171 La. 1059, 133 So. 157 (1930).
[265] 186 La. 190, 171 So. 846 (1936).
[266] *Arnold v. Sun Oil Co.*, 218 La. 50, 48 So. 2d 369 (1949).
[267] La. R.S. 31:114 (1989).
[268] Martin and Yeates, above n 189, 825.

V 'GOOD AND WORKMANLIKE MANNER': THE REQUIRED PERFORMANCE STANDARD

In the competition for foreign investment in the resources sector, developing countries have started to reappraise their legal regimes to accommodate MNCs. It is also quite plausible to assume that the increased presence of foreign business in the newly privatised or denationalised industries of host countries have resulted in a substantial evolution of the dichotomy between common law and civil law traditions. It cannot be denied that the ethos of a particular jurisdiction is driven by various cultural, social, political and economic elements. Common law practitioners often prefer to regulate in utmost detail the nuances and ramifications of every contractual clause. The legal practice in newly opened-economies on the other hand are more focused on the start-up of business relationships and this can be attributed to both the relative unsophistication of their legal systems and the exigencies of surviving in a newly-globalised political and economic order. However, the resources industry of common law countries has experienced adversarial processes in dispute resolution, which gave rise to numerous judicial authorities on petroleum and mineral agreements. Their courts have long shown their willingness to redress egregious imbalances in contractual rights among the participants, whether they be lessor, lessee, co-joint venturers, operators, non-operators and third parties.

Understandably, the disparity in the bargaining position between the newly-opened economies and the MNCs can be compared to that which characterised the early U.S. mineral leases. This disparity led to the lessor-landowners benefiting from the lease format and the numerous judicial interventions, which laid down the standard between the oil companies and the lessors.

For economies whose state resources companies have adequate experience in dealing with MNCs through whatever form of development agreements in placed in their jurisdictions, they cannot be compared to the landowners negotiating mineral leases with oil companies. Relatively mature state resources companies and MNCs in development agreements can be more likened to parties in an operating agreement where both possess expertise in the resources industries or by the means by which to acquire it. Parties in JVAs/JOAs, unlike parties to an oil and gas lease, commonly bargain from positions of equal strength and participants are capable of setting out their reciprocal rights and duties in writing and, if they so wish of varying standards by which these duties are to be performed. Also, some production sharing agreements requires the contractor to pay the state oil company a management fee for facilitating the work program; thus, the state oil company retains management control over the manner in which the work is performed. This feature creates a resemblance between the production-sharing agreement and the typical joint venture.

When the relationship of the host government/state resources company vis a vis the MNC is taken in context, only then can we establish the negligence standard between the parties. More importantly, when the framework of the negligence provisions of the JVA/JOA is clearly identified, only then will an in depth evaluation and comparison of the individual facets of the JVA/JOA show that these systems are sufficiency similar in practice and structure to produce practical uniformity.

Where there is disparity in the bargaining position, the development agreement between the host country and the MNC should be construed under rules associated with relational contracts, like the mineral lease. On the other hand, when the state resources company and the MNC are in a JVA/JOA where there existed arms length negotiation between the parties, the agreement must be construed under the traditional rules of construction. Thus, the standard of conduct for the operator that requires performance in a 'good and workmanlike manner' must be designed to govern a unique relationship within the scope of the specific transaction. Under this circumstance, there is no basis then for implying terms through the 'good and workmanlike' standard in the JVA/JOA in the same way as it is done with the prudent operator standard in the mineral lease. For covenants to be implied in the JVA/JOA as under the prudent operator standard, the instrument must either qualify as a relational contract or allow the addition of duties under the classical rules of contract construction. The exculpatory clause that is attached to the performance standard in the operating agreement may however restrict the application of these implied covenants.

The total lack of clarity of the standard imposing a fiduciary duty on the operator also restricts its application to the JVA/JOA covenants. Many courts and some commentators treat the operator as a fiduciary, but others leave the issue to the jury or impose a lower standard like contract good faith. And even courts that find a fiduciary duty may limit it to the express terms of the JVA/JOA. Moreover, whatever fiduciary duty that existed will nevertheless be restricted in at least some courts because of the amendment introduced in 1989 to the AAPL standard which disclaims such fiduciary duty. It is not clear whether this disclaimer will be enforceable. At the minimum however, the amendment expands the confusion in an already troubled area.

VI CONCLUSION

This paper has attempted to use a pragmatic approach to reconcile operating agreements in the resources industry by developing interpretative standards, which would be applied flexibly in ascertaining the rights of the participants.

We have also reviewed the various property and contractual provisions of model forms currently in use in the industry in response to the change in commercial objectives of resources companies and the extent government are cautiously willing to dispense with sovereignty. If agreements are entered among private interests, the resolution of issues arising from the terms of the operating standard will most likely be subject to private covenants, express or implied, and adjudicated with relatively ease using the courts or alternative dispute resolution mechanisms. However, as transition economies of developing countries mature which will see more interface between their governments and MNCs, the allocation of rights and responsibilities between them will be subject to a large extent to commercial law interpretation, which of course will rely on precedents from developed legal systems. The performance standard then will precariously thread the grey area between relational and contingent contracts, depending on the relative bargaining position of the parties.

While the remedy offered in this paper may be subject to refute if a more comprehensive analysis on the balance between national sovereignty and business interest is undertaken, the author hopes that further work on the subject matter will take into consideration the arguments set forth.