In the Supreme Court of the State of Alaska

State of Alaska, Department of Natural Resources,	)	
	)	Supreme Court No. **S-13730**
Petitioner,	)	
v.	)	**Order**
	)	
ExxonMobil Corporation; Operator of the Point Thompson Unit; BP Exploration (Alaska) Inc.; Chevron U.S.A. Inc.; ConocoPhillips Alaska Inc.,	)	
	)	
Respondents.	)	Date of Order: **September 6, 2011**
	)	

Trial Court Case # **3AN-06-13751CI**

On August 5, 2011 respondents filed a motion for judicial notice. On August 15, 2011, petitioners filed a partial opposition and a motion to strike portions of the respondents' brief. On August 25, 2011 respondents filed an opposition to the motion to strike portions of respondents' brief.

The motion to take judicial notice is **GRANTED IN PART**. The court will take judicial notice of all requested documents except the October 27, 2010 ExxonMobil news release.

The motion to strike is **DENIED**, however, to the extent that petitioner DNR takes issue with the Department of Revenue's 2006 findings, it may make its arguments in its reply brief. The petitioner may have one additional page in its reply brief to make its arguments challenging the documents to which the court takes judicial notice and to which petitioner objects.

Entered at the direction of an individual justice.

Clerk of the Appellate Courts

Claire Bruns, Deputy Clerk

cc: Supreme Court Justices

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A. *In re ANS Royalty Litigation*, No. 1JU-77-847, at 41-42 (Alaska Super. Mar. 13, 1991), attached as Exhibit 1.

B. November 16, 2006, Alaska Department of Revenue "Appendix T to Interim Fiscal Interest Finding dated November 16, 2006 Chronology of Negotiations" [hereinafter "Interim Findings"] at 36-43, available at http://www.revenue.state.ak.us/gasline/History%20of%20Negotiations.pdf, attached as Exhibit 2.

C. Transcript of October 10, 2008 prehearing conference before G. Nanette Thompson in "Appeal by Respondents of the Notice of the Director, Division of Oil and Gas, dated August 4, 2008, entitled Lease Expiration Due To Elimination From Unit for Oil and Gas Leases ADL 28380 et al.," attached as Exhibit 3.

D. October 27, 2010, ExxonMobil news release,

E. March 18, 2011, Petition for Review, Daniel S. Sullivan, Commissioner, State of Alaska, Department of Natural Resources v. Resisting Environmental Destruction on Indigenous Lands (REDOIL) et al, No. S-14216 (Alaska 2011), attached as Exhibit 5.

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

FIRST JUDICIAL DISTRICT AT JUNEAU

In the Matter of:

ANS ROYALTY LITIGATION

-Between-

STATE OF ALASKA,

Plaintiff,

COMMISSIONER OF NATURAL RESOURCES, STATE OF ALASKA, and DIRECTOR OF THE DIVISION OF LANDS, STATE OF ALASKA,

Involuntary Plaintiffs,

-And-

ARCO ALASKA, INC.; ATLANTIC RICHFIELD COMPANY; BP EXPLORATION (ALASKA) INC.; CHEVRON U.S.A., INC.; EXXON CORPORATION; GETTY OIL COMPANY; THE LOUISIANA LAND AND EXPLORATION COMPANY; MARATHON OIL COMPANY; MOBIL OIL CORPORATION; PHILLIPS PETROLEUM COMPANY; and TEXACO PRODUCING, INC.,

Defendants.

Case No.:

1JU-77-847 Civil

MEMORANDUM OPINION

REGARDING CROSS-MOTIONS FOR SUMMARY ADJUDICATION RELATIVE TO FIDUCIARY DUTY AND THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

I.

INTRODUCTION

On January 10, 1989, plaintiff State of Alaska filed its Third Amended Complaint in the above-referenced cause (known at that time as *State of Alaska v. Amerada Hess, et al.*). Paragraphs 44 through 49 allege, *inter alia*, that a "small group of major oil producers, most of them defendants in this action," control "almost every aspect of the production and disposition of ANS [oil and gas]." ¶44. It is further alleged that the Prudhoe Bay and Kuparuk River fields are remote from the major ANS markets and the refineries which process it. ¶45. Plaintiff contends that the producers are in nearly "complete control of every aspect of production, transportation and marketing of ANS." ¶45. The state urges, as a result, that the producers possess "superior knowledge". Id.

The state further alleges that it is "dependent on [the producers] for accurate information relating to the production, transportation, marketing and disposition of ANS." ¶46. It asserts that the DL-1 lease agreement between the state and the producers contains certain provisions "which demonstrate and establish *the special relationship of trust and confidence* between the State and the defendants". ¶47 (emphasis added). Under this asserted special relationship, the state contends that "the

defendants have a fiduciary duty and responsibility to the State with attendant obligations".[1] ¶48. The producers' asserted obligations are threefold:

(1) to use their best efforts to maximize the value of the state's royalty ANS;

(2) to refrain from placing their own profit interests ahead of the state's;

(3) to disclose "fully, faithfully, and honestly all relevant facts concerning the disposition and value of ANS."

¶48. Moreover, in Count XIII, the state charges that it reposed special confidence" in the ability of defendants ARCO, Chevron and Standard (BP)[1] to market ANS, to "disclose accurate information regarding the value of or the proceeds received for that oil", to transport the oil efficiently and report transportation costs accurately, and to "pay royalties in accordance with Alaska Lease Form DL-1 in a fair and equitable manner." ¶109. Plaintiff claims that the three named defendants breached the fiduciary duty, thus entitling the state to compensatory and punitive damages.

On December 1, 1989, plaintiff moved for a partial summary adjudication under Civil Rule 56. By its motion the state sought two rulings from the court:

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[1]The state does not contend that any of the producers other than those specifically named in Count XIII (ARCO, Chevron and Standard) breached a fiduciary obligation. However, the state in the present motion sought to establish such an obligation as to all producers because of certain procedural advantages said to flow from such a finding. State's Memorandum in Response to Order to Show Cause (October 15, 1990). Given the court's oral decision on the fiduciary duty question, it is unnecessary to reach these procedural issues.

(1) That "the producers of Alaska North Slope crude stand as fiduciaries to the State"; and

(2) Given the "special relationship of trust and confidence" that the state sought to establish between itself and the producers, a breach of the implied covenant of good faith and fair dealing (as alleged in Count XII of the Third Amended Complaint) "supports an action in tort and contract alike".[2]

All of the producers opposed the motion and made cross motions of their own for dismissal or summary judgment.[3] As framed by the producers in their several motions, four contentions were advanced:

(1) That the producers are not in a special relationship of trust and confidence with the state and do not owe a fiduciary duty to it, and hence, Count XIII should be dismissed;

(2) Rather, that the producers' duty to the state under the DL-1 lease should be measured by the "prudent operator" standard well-known to the law of oil and gas;

(3) That there is no implied covenant of good faith and fair dealing in the DL-1 lease; therefore, Count XII should be dismissed;

(4) However, should the court hold that DL-1 does

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[2]Such a ruling would open the door to the recovery of punitive damages on Count XII.

[3]Exxon cross-moved for summary adjudication on June 26, 1990. ARCO Alaska, Atlantic Richfield and BP Exploration cross-moved for judgment on the pleadings, or summary judgment on July 2, 1990. Chevron U.S.A. likewise cross-moved for judgment on the pleadings or summary adjudication on Counts XII and XIII on July 2, 1990. The remaining defendants (Getty Oil Company/Texaco Producing, Inc., Louisiana Land & Exploration Company, Freeport-McMoRan Oil & Gas Company, Marathon Oil Company, Mobil Oil Corporation and Phillips Petroleum Company), styling themselves as the "Small Interest Holders", also cross-moved for summary adjudication on July 2. Freeport-McMoRan settled with the state and was dismissed from the case before the court reached these issues on the merits.

contain the implied covenant of good faith and fair dealing, a breach thereof gives rise only to contract damages; not to tort or punitive damages.

In its Memorandum in Opposition and Reply (filed August 15, 1990) at 23, n.7, the state withdrew its claim of fiduciary relationship as to the Louisiana Land & Exploration Company and Marathon Oil Company. Pursuant to that concession, the court entered an order granting summary judgment to those defendants on that issue.[4] The remaining issues came before the court on October 26, 1990 for oral argument. At oral argument the state withdrew its motion, conceding that on the present record it was not entitled to summary disposition. However, the state argued that genuine issues of fact existed, precluding disposition in the producers' favor. At the conclusion of that day's proceedings, the court rendered an oral decision on the cross-motions for summary adjudication. The court ruled that:

(1) The state's motion was denied.

(2) The producers do not owe a fiduciary duty or obligation to the state arising out of the DL-1 lease form, or otherwise.

(3) Because the DL-1 lease form is a contract in the State of Alaska, a covenant of good faith and fair dealing is implied under the lease form.

(4) A breach of this obligation does not give rise to tort damages generally or punitive damages specifically, due to the lack of the

[4]Order Granting Summary Judgment re: Fiduciary Duty as to Certain Small Interest Holders (October 23, 1990).

requisite special relationship between the producers and the state.

(5) The producers also have an obligation under the DL-1 oil and gas lease to act as reasonably prudent operators.

The state's motion was thus denied; the producers' cross-motions were granted in part and denied in part. The court stated that it would file a written opinion explaining its reasons for the decision announced. This opinion completes the record of these motions.

II.

FIDUCIARY DUTY

(A) *Introduction*

"In litigation arising out of a royalty owner's claim of underpayment or improper accounting the court is almost invariably called upon to decide the extent of the lessee's obligation to represent the lessor in the marketing of leasehold production." Ashabranner, *The Oil and Gas Lease Royalty Clause -- One-Eighth of What?*, 20 Rocky Mt. Min. L. Inst. 163, 165 (1975). The state claims that the producers' obligation was of a high degree -- a fiduciary obligation. The court will first consider the nature of such an obligation.

The Alaska case law is not extensive. The seminal Alaska case is *Twelve Hundred "L" Street Corp. v. Inlet Company*, 438 P.2d 708, 709-10 (Alaska 1968), in which the court held that

> [a] fiduciary relationship exists when one imposes a special confidence in another so that the latter, in equity and good conscience, is bound to act in good faith and with due regard to the interests of the one imposing the confidence.

See also Paskvan v. Mesich, 455 P.2d 229, 232 (Alaska 1969) (defining confidential or fiduciary relation in a like manner); *Carter v. Hoblit,* 755 P.2d 1084, 1086 (Alaska 1988) (fiduciary obliged to disclose all facts which might affect the interests of entrusting parties).

"Fiduciary obligation is one of the most elusive concepts in Anglo-American law. . . . [It] resists tidy categorization." DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation,* 1988 Duke L.J. 879 (hereinafter "DeMott"). *See also United States v. Reed,* 601 F.Supp. 685, 704 (S.D.N.Y. 1985) *reversed as to venue,* 773 F.2d 477 (2d Cir. 1985) (confidential/fiduciary relationship "is by nature flexible and defiant of precise definition", and there is no "hard and fast rule" for determining whether one exists). It is clear that "[a] person in a fiduciary relation to another is under a duty to act for the benefit of the other as to matters within the scope of the relation." Restatement of Trusts (2d), §2 (1959). *Accord, Denison State Bank v. Madeira,* 640 P.2d 1235, 1241 (Kan. 1982) (a fiduciary is "a person with a duty to act *primarily for the benefit of another*).[5] The fiduciary's duties "go

[5]Emphasis in the original.

beyond mere fairness and honesty; they oblige him to act to further beneficiary's best interests.'" DeMott, *supra* at 882. Indeed, "if the 'trust' relationship does not require the trustee to administer the trust on behalf of the beneficiaries, one would view the parties' use of the term 'trust' as an oxymoron." DeMott at 901.[6]

In *Bayer v. Beran,* 49 N.Y.S.2d 2, 5 (N.Y.Sup. 1944), the court held that the fiduciary "has two paramount obligations: responsibility and loyalty". Moreover, this "concept of loyalty, of constant, unqualified fidelity, has a definite and precise meaning". "The fiduciary must subordinate his individual and private interests to his duty [in that case, to the corporation] whenever the two conflict." *Id.* The court observed that

> While there is a high moral purpose implicit in this transcendent fiduciary principle of undivided loyalty, it has back of it a profound understanding of human nature and of its frailties.... It tends to prevent a clouded conception of fidelity that blurs the vision. It preserves the free exercise of judgment uncontaminated by the dross of divided allegiance or self-interest. It prevents the operation of an influence that may be indirect but that is all the more potent for that reason.

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[6]It is unclear precisely what the state means when it uses the term "fiduciary". During oral argument the court asked counsel to give an example of a situation in which a producer would be required to put the state's interests ahead of its own, as a true fiduciary is required to do. Counsel responded that the state was contending only that a producer should be held to treat the state's interests equally to its own. However, by definition, such a claim fails as a assertion of fiduciary duty, unless, to use an author relied on by both sides in this dispute, the court adopts the view of words advanced by Humpty Dumpty ("When I use a word . . . it means just what I choose it to mean -- neither more nor less"). Carroll, *Through the Looking Glass* (1872).

49 N.Y.S.2d at 7. *See also Meinhard v. Salmon,* 164 N.E. 545 (N.Y. 1928).[7]

One commentator, discussing fiduciary law in its relation to franchise relationships, observed that

> Unfortunately, most fiduciary relationships have been so long established in the law that few occasions have arisen to analyze the basis of their inception. Consider, for instance, partners, attorney and client, employer and employee, trustee and beneficiary, and -- more recently -- officer, director, majority shareholder, and minority shareholder. It is submitted that in each of these examples the courts have relied upon three propositions: the pervasive powers held by one party; the gross disparity of the parties in a complex transaction, usually of long duration; and the rampant opportunities for abuse, particularly through clandestine self-preference.

H. Brown, *Franchising -- A Fiduciary Relationship,* 49 Tex.L.Rev. 650, 665 (1971) *cited in General Business Machines v. National Semiconductor Datachecker,* 664 F.Supp. 1422, 1426 n.4 (D.Utah 1987).

(B) *Fiduciary relationships in commercial relationships generally, and in oil and gas leases specifically*

(1) *Commercial relationships generally*

"In various cases efforts have been made to secure an adjudication that parties in business relations were in a

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[7] In this case Justice Cardozo coined his classic formulation of fiduciary duty: "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.... Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd." 164 N.E. at 546.

confidential relation to each other, but the courts have been inclined to deny such a finding, except in occasional cases." Bogert, *The Law of Trusts and Trustees*, §482 at 319-22 (Revised 2d Ed. 1978). And it has been held that "parties may deal at arms length for their mutual profit". *Appleman v. Kansas-Nebraska Natural Gas Company*, 217 F.2d 843 (10th Cir. 1954); *accord, Paul v. North*, 380 P.2d 421 (Kan. 1963). *See also Jacoby v. Shell Oil Co.*, 196 F.2d 855 (7th Cir. 1952) (in negotiations to secure filling station lease, there was no fiduciary relationship between plaintiff and realtor, although undoubtedly realtor "was anxious to see the deal go through and worked earnestly to that end").

The general rule is that "[s]ubjective trust, cordiality and the trust which prevails between businessmen which is the foundation of ordinary contract law" is insufficient basis for imposition of a fiduciary duty. *Rankin v. Naftalis*, 557 S.W.2d 940, 944 (Texas 1977). *See also Cranwell v. Oglesby*, 12 N.E.2d 81, 83 (Mass. 1937) (in a business relationship, 'the existence of the mutual respect and confidence does not make it fiduciary'; 'mere respect for the judgment of another or trust in his character is not enough to constitute such a relation'); *Lonsdale v. Speyer*, 19 N.Y.S.2d 746, 757 (N.Y.Sup. 1938), *affirmed without opinion*, 19 N.Y.S.2d 773 (N.Y.App.Div. 1940) ("most business relations between persons in a sense and to a degree rest upon confidence reposed by one in the other. Without it the commercial dealings of a

community would be seriously restricted"); *Rutherford v. Exxon Co. U.S.A.*, 855 F.2d 1141, 1146 (5th Cir. 1988) ("Women, men and companies... *do business* based on the understanding that those involved in the relationship may be trusted, in the colloquial sense of the term" [emphasis in the original]); *Stepp v. Ford Motor Credit Co.*, 623 F.Supp. 583, 594 (D.Wis. 1985) (no fiduciary duty exists by virtue of a contractual agreement; while every contract imposes a duty of good faith, fiduciary duty is "distinguished from the normal duty of good faith and fair dealing. The law is clear in this regard..."). *Accord W.K.T. Distributing Co. v. Sharp Electronics Corp.*, 746 F.2d 1333 (8th Cir. 1984) (although every contact includes an implied covenant of good faith and fair dealing, this covenant does not transform a business relationship into a fiduciary relationship).

In *Waverly Productions, Inc. v. RKO General, Inc.*, 32 Cal.Rptr. 73 (Cal.App. 1963), the plaintiff, a motion picture producer, entered into an agreement with defendant RKO for worldwide distribution of two motion pictures. Defendant undertook to enter into certain sub-licensing agreements for distribution of the pictures in various foreign countries. Waverly objected to this and sued, claiming, among other things, that RKO was "a trustee or other fiduciary which has not borne its burden of accounting and proving that it has acted in good faith". 32 Cal.Rptr. at 78. The trial court rejected that contention except

to the limited extent that RKO had a duty to account for the rentals received from its sub-licensees. The appellate court affirmed, stating that a "mere contract or debt does not constitute a trust or create a fiduciary relationship". *Id.* While conceding that California law provided (as does Alaska's) that every contract contains an implied covenant of good faith and fair dealing, "[b]eing of universal prevalence it cannot create a fiduciary relationship; it affords basis for redress for breach of contract and that is all". 32 Cal.Rptr. at 79. The court found it "clear" that RKO was not a fiduciary to plaintiff, characterizing the contention as a "false issue". 32 Cal.Rptr. at 80.

(2) *Oil and gas leases specifically*

The weight of authority holds that the parties to an oil and gas lease are not in a fiduciary relationship. "The oil and gas lease is best understood as a business deal." 39th Oil & Gas Inst. §1.03[2][a], pp. 1-18 to 1-19 (1988). "The relationship between lessor and lessee...is a complex one of mutual interest mingled with antagonism." Donahoe, *Implied Covenants in Oil and Gas Leases and Conservation Practice*, 33rd Oil & Gas Inst. 97, 98 (1982). "Courts have emphasized that the [lessor-lessee] relationship is one created solely by contract. Save in rare instances, rights arise and are enforceable solely in the context of traditional contract law." Stucky, *Current Developments and Views Concerning Rights and Status of Landowner-Lessors*, 21st Oil & Gas Inst. 83

(1970). Professor Williams conceded in *The Fiduciary Principle in the Law of Oil and Gas,* 13th Oil & Gas Inst. 201, 215-16 (1962), that

> It has not been customary to describe the relationship between the lessor and lessee under an oil and gas lease in fiduciary terms, and no useful purpose would be served by attempting such a description here. It is fair to observe, however, that much of the law of implied covenants is consistent with the application of fiduciary principles to the relationship of the parties.
>
> This is not to suggest, of course, that the lessee's performance of express and implied duties owed the lessor is to be measured in the same manner as is the performance of the duties owed by a trustee to a beneficiary. Performance is measured by the standard of the reasonably prudent operator.

Likewise, Godell and Schlauch in *Precious Metals Royalties,* 35 Rocky Mt. Min. L. Inst. 10-1 *et seq.* (1989), observe that "production royalties negotiated in arms' length transactions involve no special relationship of trust and confidence between the parties. In such typical royalty situations, a miner does not owe a fiduciary duty to a royalty owner."[8] *Id.* at §10.05[3], p. 10-27.

Ashabranner, *supra,* 20 Rocky Mt. Min. L. Inst. at 167, observes that

> In a case involving an accounting to royalty owners for gas sales under a lease where the lessee was obligated to pay roy-

[8]The quoted article does not deal specifically with oil and gas leases. However, significantly, all of the cases cited in the footnotes to the quoted passage deal with oil and gas.

> alty at market price, it was held that only a contractual relationship of debtor and creditor existed and that there was no fiduciary relationship. [*Phillips Petroleum Co. v. Bynum,* 155 F.2d 196 (5th Cir. 1946) *cert. denied,* 329 U.S. 714 (1946).] A realistic view of the oil and gas producing industry would seem to repudiate any idea of a fiduciary relationship between the lessor and lessee. The lessee purchases his contractual rights from the lessor for a valuable consideration in an arm's-length business transaction. His objective is to make a profit. His obligations are specified in the lease contract or imposed by well-defined case law. To make him a fiduciary, a trustee for his royalty owner, takes him out of the realm of business enterprise and puts him in a position where he must act for the royalty owner's sole benefit with complete disregard of the consequences to his own affairs.... If the lessee is a trustee for the royalty owner, then he cannot put himself in a position where his interest will or even may conflict with his lessor's interests and under usual fiduciary standards he could not in any situation purchase the lessor's share of the production.

(a) *Cases finding no fiduciary relationship*

Case law both ancient and recent supports the foregoing commentators. In the early case of *Colgan v. Forest Oil Co.*, 45 A. 119, 120 (Pa. 1899), the Pennsylvania Supreme Court rejected the urging that some special relationship existed between lessor and lessee: "There is no relation of special trust or confidence between lessor and lessee in gas or oil leases, any more than in any other. Like all other contracting parties, they deal at arm's length, each for his own interest." *Accord, O'Connell v. Snowden & McSweeny Co.*, 149 N.E. 253 (Ill. 1925); *relied on in Kirke v.*

Texas Co., 186 F.2d 643, 648 (7th Cir. 1951) (applying Illinois law). In *Cooper v. Ohio Oil Co.*, 25 F.Supp. 304 (D.Wyo. 1938) *affirmed* 108 F.2d 535 (10th Cir. 1939), plaintiffs alleged, much as the state does in this case, that they were "relying upon the experience, skill, integrity and resources of the defendant to assure the efficient exploitation of the oil and gas resources." 25 F.Supp. at 305. The court declined to find a fiduciary relationship, discerning no precedent for it and declining to become a "pioneer in converting the ordinary gas and oil lease contract into a trust relationship..." 25 F.Supp. at 309.

In *Honolulu Oil Corp. v. Kennedy,* 251 F.2d 424 (9th Cir. 1957), plaintiffs (Kennedy and another) sued Honolulu Oil for alleged underpayments of various oil royalties. Plaintiffs pursued a theory somewhat similar to that advanced by the state in the case at bar, claiming that "an artificially depressed price for oil, rather than its real market value, was used to determine the amount of the royalties due". 251 F.2d at 426. Honolulu Oil asserted that suit was barred by the statute of limitations. Plaintiffs pled that a confidential or fiduciary relation existed between itself and Honolulu's predecessor in interest which was binding upon Honolulu, and which would prevent the running of the statute. The parties submitted the case to the trial court on a stipulated record; the court rendered judgment in favor of plaintiffs. The Ninth Circuit Court of Appeals reversed, holding that the record

would not sustain the legal conclusion drawn by the trial court.

The record appears to have consisted of documents evidencing the transactions between Kennedy and Honolulu Oil's predecessor. Nowhere in the record could the appellate court find "an express trust mentioned in words". 251 F.2d at 428. The court observed that

> The fiduciary relationship which is alleged must necessarily have arisen, if at all, from the principles governing the situation in which the parties acted and the obligations created by the agreement.

Id. The court held that there was no fiduciary relationship between the parties: "It was the plain intention of the instrument and each of the parties to create none". 251 F.2d at 431. In conclusion, the court pointed out that if the parties had desired to establish an express trust, "there would have been no difficulty for an expert draftsman to have chosen apt language to create such a relationship".[9] 251 F.2d at 432. The cause was remanded for entry of judgment in favor of Honolulu Oil.

In *Waechter v. Amoco Production Co.*, 537 P.2d 228 (Kan. 1975) *affirmed on rehearing*, the Kansas Supreme Court reversed the trial court's finding that an oil lessee owed its lessors a duty of the "utmost good faith . . . . [T]he term 'fiduciary' is not an

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[9]The court cited *Differding v. Ballagh*, 8 P.2d 201 (Cal.App. 1932) as a case in which this was done. In *Differding*, investors in an oil field set up a Massachusetts Trust, with three trustees who "occupied a position of trust and confidence towards the production owners". 8 P.2d at 202.

exaggeration . . . ." 537 P.2d at 243-44 (quoting from the trial court's findings). The appellate court stated that it knew of "no precedent" to support the trial court's conclusion, and further that "[i]t seems well established that a lessee under an oil and gas lease is not a fiduciary to his lessor; his duty is to act honestly and fairly under a contractual relationship." 537 P.2d at 248.

See also Peterson v. Koch Industries, Inc., 684 F.2d 667 (10th Cir. 1982) (applying Utah law, held that execution of oil lease during lessor's minority did not give rise to a fiduciary or quasi-fiduciary relationship; the parties were competent to contract and dealt at arm's length); *Jeanes v. Henderson*, 703 F.2d 855 (5th Cir. 1983) (applying Texas law, upheld trial court's directed verdict dismissing oil investor's claim of breach of fiduciary duty; parties were involved in 'an arm's length nonfiduciary relationship from the beginning to the end'); *Garfield v. True Oil Co.*, 667 F.2d 942, 945 (10th Cir. 1982) (duties of defendants "were and are substantial"; the requirement of "good faith in the operation of the property is clear"; however, this does not create fiduciary relationship as that term is ordinarily used).

In *Texas Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24 (Tex.App. 1984), royalty owners in three gas units owned by Texas Oil & Gas (TXO) brought an action alleging that TXO had failed to pay the proper royalties on gas production from the units. After a nonjury

trial the lower court found in favor of the plaintiffs, awarding in excess of $1.5 million in actual and exemplary damages and attorney's fees. 683 S.W.2d at 27. Among the lower court's conclusions were that "TXO breached its position of confidence toward plaintiffs and failed to act in good faith and fairness in its obligation to market the gas for the highest price reasonably obtainable". 683 S.W.2d at 27-28. The Texas Court of Appeals affirmed the award of exemplary damages, stating that

> An oil and gas lessee owes its lessors a higher than ordinary duty to market the production from the leases in a manner which will obtain the best and highest price reasonably obtainable. The standard required in such cases has been stated to be that of the highest good faith or the best of good faith. This duty of highest good faith places the lessee in a position of trust and confidence toward its lessors.

683 S.W.2d at 29 (citations omitted). TXO sought review in the Texas Supreme Court, which reversed the intermediate appellate court on the fiduciary duty issue. *Texas Oil & Gas Corp. v. Hagen*, 31 Tex.Sup.Ct.J. 140 (No. C-3768, December 16, 1987).[10]

The Texas Supreme Court observed that while there was indeed an implied duty for lessees to market production, it was "well-

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[10]The Texas Supreme Court's slip opinion in *Hagen* was subsequently withdrawn as moot because the parties reached a settlement. *Texas Oil & Gas Corp. v. Hagen*, 760 S.W.2d 960 (Texas 1988) (judgment and opinion of December 16, 1987 *withdrawn*, judgment of the Court of Appeals *set aside*). Hence, the Texas Supreme Court's opinion is not binding precedent. Nevertheless, it is entitled to careful consideration by this court as an indication of the views of the highest court of a jurisdiction which has played a major role in the development of oil and gas law.

settled" that the standard of care was that of a "prudent operator". The court went on to state that

> This court has never adopted a fiduciary or 'highest good faith' or 'utmost fair dealing' standard in any oil and gas implied covenant case. To the contrary, we have specifically held that unless the lease document itself creates in law a trust, or unless a relationship of trust and confidence necessarily results from the lessor-lessee relationship, the standard of conduct of the lessee cannot be appropriately categorized as fiduciary. This conclusion is consistent with decisions of other Texas court which have also rejected the establishment of a fiduciary duty resting solely on the basis of a lessor-lessee relationship. The appropriate standard of care in this case is that of a reasonably prudent operator.

Texas Oil & Gas v. Hagen, LEXIS® Slip Opinion at 4-5 (citations omitted). This conclusion led the court to strike the award of exemplary damages. Under Texas law, exemplary damages were not available in the absence of an independent tort. The lower courts had reasoned that TXO was guilty of the tort of breach of fiduciary or quasi-fiduciary duty. However, the supreme court, upon ruling that "[t]he relationship between the lessor and the lessee, absent evidence of some additional special relationship, is purely contractual, being created and governed by the lease agreement", held that plaintiffs had shown no basis for an award of exemplary damages. Slip Opinion at 6-7.

The most recent oil and gas case finding no fiduciary duty is *Cambridge Oil Co. v. Huggins,* 765 S.W.2d 540 (Tex.App. 1989). In that case Huggins was a royalty holder in certain lands developed by lessee Cambridge Oil. Lessee fell six months behind in its royalty payments. The parties executed an amendment by which Cambridge agreed to be more timely with its royalty payments. The amendment granted Huggins the right to terminate the agreement. Huggins subsequently sued Cambridge, claiming among other things that Cambridge had breached a fiduciary duty to "handle future royalty payments with more propriety than it had in the past". 765 S.W.2d at 542. A jury agreed, awarding Huggins $1.6 million in compensatory and punitive damages. The Texas Court of Appeals reversed, finding nothing in the record to support Huggins' claim that the relationship between the parties had been transformed from lessor-lessee into a fiduciary relation. On the contrary, the court found that the relationship was "purely contractual", and that, far from trusting the oil company, plaintiff had amended the agreement to add some "teeth" after lessee had fallen behind on its payments.

The court will next review oil and gas cases in which a confidential or fiduciary relationship has been held to exist.

(b) *Cases in which a fiduciary relationship has been held to exist are distinguishable from the instant case.*

A number of cases have been reported in which it was held that a party holding an interest in an oil-producing property was in a fiduciary relation with the lessee. After reviewing them the court concludes that they are all distinguishable on their facts from the present case and that they are outweighed by the contrary authority addressed above.

In *Ludey v. Pure Oil Co.*, 11 P.2d 102 (Okla. 1931), plaintiff held a one-third interest in certain lands which were subject to an oil lease by Pure Oil and its codefendant oil producers. The lease called for a one-eighth oil royalty. Ludey brought suit to recover the value of one-third of the casinghead gas taken from the land in question. Pure Oil admitted that it had produced and sold a quantity of that product from the land; that it had tendered royalty checks to Ludey for the casinghead gas, calculated according to Pure Oil's theory of value, one-third of one-eighth, but that Ludey had declined them. 11 P.2d at 103. Pure Oil contended that should it be held liable for an amount in excess of its own royalty formula, that Ludey's claim should be precluded by the statute of limitation. *Id.*

The trial court overruled the statute of limitations defense; the Oklahoma Supreme Court affirmed. The court reasoned that when Ludey did not make timely demand for his interest in the casinghead gas, "the lessee defendants properly acted when they sold it". 11 P.2d at 104. However, the producers and Ludey "became as tenants

in common". *Id.* That is, "{t}here was a trust of [sic] fiduciary relation between the parties .'. . . A tenant in common receiving the common property . . . holds it as trustee for his co-tenant to the extent of the interest of the co-tenant, who may compel an accounting". *Id.* The statute of limitations would not run until the confidential relation was terminated. The court thus concluded that Ludey's claim was not time-barred. Without explicitly saying so, the court in *Ludey* appeared to act out of a concern that plaintiff there had a meritorious case but would be without a remedy in the absence of a court finding of fiduciary duty. Here, the state is in no such position.

In *Kennedy v. Seaboard Oil Co. of Delaware,* 99 F.Supp. 730 (D. Cal. 1951), the court likewise held that a fiduciary relationship existed which would preclude the normal running of the statute of limitations.[11] As in *Ludey,* the court seems to have endeavored to avoid the harsh result of the statute of limitations: "courts will go far to find a trust in order to protect a party from the inequitable conduct of an assignee or grantee . . . . equity and justice weigh heavily in favor of the plaintiff herein, and should not be defeated when, as it appears, an unjust enrichment is the inevitable result". 99 F.Supp. at 733-34. Again, no such circumstances exist here.

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[11]Plaintiffs in the case under discussion (the heirs of the Kennedy estate) lost on a similar claim of fiduciary relationship against another oil company in *Honolulu Oil Corp. v. Kennedy, supra.*

The state relies heavily upon two Oklahoma cases which relate to a body of law developed under that state's "unitization" statute. In *Young v. West Edmond Hunton Lime Unit,* 275 P.2d 304 (Okla. 1954), pursuant to statute, an oil field composed of tracts owned by various owners was consolidated under a single management body, which then selected the Sohio Company to "operate and develop and produce" oil from the unit. 275 P.2d at 306. The unitization procedure "deprived the various lessees of any further right or authority or duty to operate their respective leased premises, or to produce oil therefrom." *Id.* Under the statutory scheme, a calculation was made of the potential productivity of each separate leasehold tract of land, which was then entitled to a percentage of the proceeds of the unit organization. The court observed that under the statute the owners of the mineral rights "are *compelled* to surrender all right to produce and take oil from the particular tract, and in lieu thereof they become entitled to a share in the total production by the unit organization". 275 P.2d at 308 (emphasis supplied). Thus, unitization causes the owners to "lose the right to produce or control the disposition of the production from the particular tract and that right passes exclusively to the unit organization". *Id.*

In the *Young* case various holders of royalty interests brought suit, contending that during the period in question the unit operator (Sohio) sold oil to other companies, and to itself, at a

price of $2.65 per barrel, although it was undisputed that during that same period Phillips Petrbleum was purchasing oil in the same locality at a price of $3.00 per barrel. 275 P.2d at 307. Plaintiffs prayed for judgment in an amount equal to the $.35 per barrel discrepancy. The trial court granted judgment in defendant's favor. The Oklahoma Supreme Court reversed, holding that

> The unit organization with its operator stands in a position similar to that of a trustee for all who are interested in the oil production either as lessees or royalty owners. The law applicable to this unitization required no notice to royalty owners, and afforded them no voice in the organization or management of the unit or in the selection of the unit operator.

275 P.2d at 309. The court held further that where the owners of the royalty interests neither took their oil "in kind" nor authorized the unit to deliver the oil to a specific purchaser, that the statutes "require the operator of the unit... to account to all the owners of oil rights within the unit area for their respective portions or percentages of the unit production at the highest market price available at the time of such production". 275 P.2d at 310. *Accord, Olansen v. Texaco Inc.*, 587 P.2d 976 (Okla. 1978) (reaffirming fiduciary duty arising under unitization statute).

The unitization cases are clearly distinguishable from the present case. There, the lessors had "no voice in the organization

or management of the unit or in the selection of the unit operator." Here, the state made the initial choice of tracts to be leased, made the initial choice of the producers (utilizing a bid method), and retains substantial rights in its relations with the producers (*e.g.*, DL-1, ¶22 [approval of plans], ¶24 [records]).

(C) *The four contentions advanced by the state do not create a legal or factual issue sufficient to withstand summary judgment in the producers' favor.*

The state contends that four factors present in the instant case "together combined to create a 'special relationship of trust and confidence.'" State's Opposition and Reply at 2 (quoting from its opening memorandum at 21). Those factors are: (1) the nature of the DL-1 lease agreement; (2) the assurances allegedly made by the producers to the state so as to reasonably induce reliance; (3) the unique nature of the ANS trade ("concentrated ownership and remote markets controlled by the defendants"); and (4) the presence of public policy concerns.

Having considered the four factors in light of the relevant law, the court concludes that the state's claim must fail as a matter of law. The four factors will be discussed in turn.

(1) Nature of the DL-1 Lease Agreement

The state conceded in its briefing, and in oral argument, that the DL-1 lease form, standing alone, does not create a fiduciary

relationship between itself and any producer.[12] However, the state urges that the DL-1 lease is not "irrelevant" to a determination of whether a fiduciary relationship might arise between the parties; that the contract "colors and shapes" the relationship.

The court agrees that DL-1's provisions are not irrelevant to the instant inquiry. However, far from supporting the state's position, an examination of the DL-1 lease seriously undercuts the state's claim of fiduciary relationship.

At the outset it should be noted that in the typical oil and gas lease the lessee dictates the terms. *Jackson v. Farmer,* 594 P.2d 177 (Kan. 1979). This case is different from the typical case. As it was in *State v. Davis Oil Co.,* 728 P.2d 1107, 1114 (Wyo. 1986) "the lease form is 'take it or leave it' for oil companies who do business with the State." (Urbigkit, J. concurring and dissenting in part). Moreover, the contract is "an elaborate one, which undertakes to define the respective rights and duties of the parties". *Waverly Productions, Inc. v. RKO General, Inc., supra,* 32 Cal.Rptr. at 78 (no fiduciary relationship). Where contracting parties are sophisticated, represented by highly competent counsel, and have demonstrated that they are capable of dealing in the written word, a court should be hesitant to go

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[12]Although the ARCO defendants have settled with the state those claims scheduled for trial in November of 1991, they participated in the instant motion to the limited extent of seeking a ruling that they have no continuing fiduciary obligation to the state as lessee-producers under the DL-1 lease. Given the state's concessions in the briefing and in the oral record, it is clear that ARCO and Atlantic Richfield do not owe the state such a fiduciary obligation.

outside the contract in search of an implied relationship.[13] The state retained wide powers under the DL-1 lease (e.g. ¶22 [approval of plans]; ¶24 [right to examine books and records]; ¶28 [state may direct suspension of production]). *See Cambridge Oil Co. v. Huggins, supra,* 765 S.W.2d at 544 (lessor had "serious problems" with lessee and therefore put some "teeth" into amended lease). *Compare Differding v. Ballagh,* 8 P.2d 201 (Cal.App. 1932) (investors in oil field entrusted their money to trustees of Massachusetts Trust; investors had no rights even to advise). Given its authority under the lease, the state was hardly "at the mercy of its lessee", *Davis v. CIG,* 789 F.2d 328, 332 (5th Cir. 1986), as is sometimes the case. Assuming that the state failed to exercise its reserved powers of oversight under the lease, instead trusting the producers to look after its interests -- which is disputed -- such reliance could only be characterized as "inexcusable trustfulness", *Moses v. Carver,* 298 N.Y.S. 378, 387 (N.Y.Sup. 1937) verging on "conscious and purposeful ignorance", *Southern National Bank of Houston v. Crateo, Inc.,* 458 F.2d 688, 693 (5th Cir. 1972).

(2) Nature of the ANS Trade

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[13]The law of implied contract furnishes a useful analogy: where parties have entered into an express contract, a court will not normally imply a different one relating to the same subject matter. *See Swanson v. Levy,* 509 F.2d 659 (9th Cir. 1975); *Dutcher S.A. Celulose E Papel Candoi, Parana, Brazil v. Inter-American Development Bank,* 253 F.Supp. 568 (D. D.C. 1966) (where contract between parties is detailed and specific, courts will not improvise an implied contract. *Accord, Mitford v. de Lasala,* 666 P.2d 1000, 1006 n.1 (Alaska 1983).

The state asserts that the business of producing and marketing ANS is, "in a structural sense, unique." State's Opening Memorandum at 27. These "unique" aspects include a concentration of ownership, in which a small number of producers

> transport the crude they produce through the transportation systems they own and control to markets they select and supply many thousands of miles removed from the point of production.

State's Opening Memorandum at 29. The state also points to "lack of a substantial market at Pump Station No.1", which necessitates sale of the ANS in distant markets. Thus, the ANS price "at the well" is a construct arrived at by a "netback" calculation employing numbers derived from transportation costs of shipping the ANS to market. The state, while acknowledging that the nature of the business makes a netback calculation necessary, argues that the process has given the producers "unfettered discretion and control". Moreover, the state alleges that "much" of the ANS produced has been disposed of via internal transfers between divisions of the same oil and gas producer. This procedure, in turn, contributes to a relative dearth of public information on oil markets, prices and proceeds, and tends to obscure the search for a "true" market price. State's Opening Memorandum at 31. The result, says the state, is that it is "dependent" upon the producers for "accurate, complete, and honest information concerning the transportation and disposition of ANS crude oil".

State's Opening Memorandum at 32-33.

The state's position on this issue is not persuasive. Under ¶24 of the DL-1 lease the state reserved broad powers to require the producers to maintain information regarding the production and dispositon of ANS, and to disclose those matters upon demand. The state's failure to exercise those rights is unexplained on the present record.[14] Moreover, as the state's own expert witness designations demonstrate, the state has the capacity to inform itself concerning the matters on which it professes ignorance. The state's contention is not well-founded in law or fact.

(3) Alleged Assurances to the State

The state next alleges that some of the producers[15] made certain "assurances" which induced it to reasonably rely upon its oil lessees to protect its interests. While posed as a single issue in the briefing, this argument actually raises a three-part inquiry: (1) What assurances, if any, were made?; (2) Were the assurances in fact relied upon? and (3) Did the state behave

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[14]In oral argument the court questioned counsel for the state as to why the procedures under ¶24 had not been invoked. Counsel's answer was that the state had relinquished its ¶24 powers in favor of discovery procedures in the instant action. That answer fails to address the underlying reality: that the state is not at the mercy of the producers concerning information flow.

[15]Twenty-five (25) documents were appended under Tab "A" to the Opening Memorandum filed by the state on December 1, 1989. Six (6) were purported statements by ARCO; twelve (12) related to BP/Standard; four (4) to Exxon; and one (1) to Chevron. The sources of the documents found at Tab "A" 1 and 2 are unclear. The relevance of the ARCO documents was rendered moot by the settlement embodied in the agreement filed on September 13, 1990. The state produced no evidence at all of any assurances made by defendants Getty/Texaco, Mobil, or Phillips. During oral argument the state conceded in essence that its motion was not well-founded as to Chevron.

reasonably in so relying? These questions may be quickly resolved.

Taking the third question first, the court concludes as a matter of law that the relevant state officials could not have reasonably expected any adverse party to commercial litigation to place the state's interests ahead of its own in producing and marketing ANS crude.[16] Moreover, the evidence advanced by the state does not support the inference that state officials relied upon the producers, or any of them, to place the state's interests *ahead of their own,* as a fiduciary is obligated to do. Rather, the deposition testimony presented shows, at most, that the state officials expected the producers to act honorably and in good faith in discharging their contractual obligations.[17]

Finally, the statements made in the documents appended to the state's Opening Memorandum do not constitute the sort of "assurances" which would justify the state in believing that it could abandon all regard for its own interests and entrust them to the producer making them. This claim is both legally and factually infirm, and summary judgment for the producers is proper.

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[16]As this court's predecessor observed in a different connection, "a cynic might suggest that this arrangement was not unlike the farmer asking the fox how best to protect his chickens". Memorandum of Decision and Order at 9, n.3, *State v. Amerada Hess, n/k/a ANS Royalty Litigation*, April 6, 1979 (Compton, J.).

[17]*See* Testimony of Eason (assumed producers would "act in good faith and report accurate numbers"); Testimony of Maynard (expected lessees "would report the underlying facts in good faith because it would be too easy to trace"); Testimony of LeResche ("I as the State of Alaska basically trusted your clients at that time"); Testimony of Donna Wood Johnson ("we (the state officials) relied on the companies to give us accurate information and accurate numbers"). These assertions are a long way from demonstrating the type of confidence, for example, that a ward reposes in a guardian, or a client in an attorney.

(4) Public Policy Concerns

The "importance of oil and gas resources and revenues to the State of Alaska" is a matter of judicial notice. *Chevron U.S.A. Inc. v. LeResche,* 663 P.2d 923, 928 n.11 (Alaska 1983). And there can be no doubt that the state officials charged with management of Alaskan oil resources hold a weighty public trust. However, the case law does not support the state's contention that the relationship between itself and the producers is somehow permeated by this importance, thereby rendering the relation "qualitatively unlike that existing in a conventional commercial transaction". State's Opening Memorandum at 3.

In *Standard Oil Co. of California v. Hickel,* 317 F.Supp. 1192 (D.Alaska 1970) *aff'd sub nom. Standard Oil Co. of California v. Morton,* 450 F.2d 493 (9th Cir. 1971), the court stated flatly that the "Government's rights and obligations as lessor of public lands are no different from those of any other lessor. The rules of construction applicable to Government contracts are the same rules applied to contracts between private parties." 317 F.Supp. at 1197 (citations omitted). Moreover, the usual rule that a contract is construed against the party who prepared the instrument "is not vitiated by the mere fact that the federal government drafted the instrument." *Id. See also Chicora Const. Co. v. United States,* 252 F.Supp. 910 (D. N.C. 1965) (the United States has no greater contract rights than a private individual under the same

circumstances); and *State v. Davis Oil Co.*, 728 P.2d 1107, 1114-15 (Wyo. 1986) (SII "Interpretation of State Contracts", Urbigkit, J., concurring and dissenting).

Finally, in *United States v. General Petroleum Corporation*, 73 F.Supp. 225 (D. Cal. 1946) *aff'd sub nom. Continental Oil Co. v. United States*, 184 F.2d 802 (9th Cir. 1950), a case which bears some similarities to the one at bar,[18] the court held that in a case concerning a dispute over valuation of oil and gas for royalty purposes that

> the government's role is taken to be no different from that of any private lessor or proprietor, for while the Kettleman Hills lands involved are public mineral lands, and as such until their disposition are under the supervision of Congress, the government as to such lands acts in a proprietary capacity, and treats with them in the same way as does the private landowner. Regardless of the type of lease Congress might authorize, a lease executed in accordance with what it *has* authorized becomes a private, contractual matter and is to be interpreted according to the general rules of law respecting contracts between individuals.

73 F.Supp. at 234 (citations omitted; emphasis in original). In

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[18]That case involved, among other issues, the "very perplexing problem" of determining the amounts due to the United States government as royalties from the Kettleman Hills oil field in California. Among the relief requested was "a decree prescribing the proper basis upon which determination of the value of the government royalty interest shall be made". 73 F.Supp. at 230. Between 1929 and 1931, the Secretary of the Interior became "convinced" that the prices at which the lessees were disposing of the oil and gas "were inadequate to reflect the true worth or value of those products . . . when the government took its royalties in money". 73 F.Supp. at 232. However, suit was not brought until 1939. The lengthy bench trial (the opinion refers at 249 to "months of trial . . . upon [a] single issue") covered parts of at least the two years 1944 and 1945. 73 F.Supp. at 262.

view of the legal doctrine illustrated by the foregoing authorities, it is clear that the state's claim that the transactions at issue should be viewed in a different light than the usual commercial transaction is not well taken, and that argument is rejected.

(D) *The existence of litigation between the state and the producers strongly suggests that no relationship of trust and confidence could have arisen between the parties, or that any pre-existing fiduciary relationship would have been repudiated thereby.*

ARCO and BP suggest that the fiduciary duty question may be easily resolved simply by looking to the pleadings filed by the state in this cause. Defendants argue that the state's pleadings constitute binding judicial admissions that the state did not repose trust or confidence in the producers or their reported values, and that any such claim ought to be summarily dismissed. This argument has considerable merit. The state and the producers have, after all, been engaged in legal combat since 1977, and court proceedings certainly "contemplate an adversary situation". *State v. Board of County Commissioners, Johnson County,* 642 P.2d 456 (Wyo. 1982). Indeed, for a cause properly to be before a court, "there must be an actual controversy, and adverse interests". *Lord v. Veazie,* 49 U.S. 251, 12 L.Ed. 1067 (1850). While it is true that "friendly suits" exist, *Reyes v. Prince George's County,* 380 A.2d 12 (Md.App. 1977), their "amity" springs from the parties'

desire to obtain a decision without incurring "needless expense and trouble". *Veazie,* 12 L.Ed. at 1069. While such amity is "always approved and encouraged", as it "facilitate[s] greatly the administration of justice between the parties", *id.*, it cannot be said to create a fiduciary relationship.

No cases have been located in which it has been held that adverse parties to litigation may stand in a relationship of trust and confidence. Such a contention has been flatly rejected in a number of divorce cases. *See generally Blair v. Blair,* 370 P.2d 873 (Mont. 1962) (no confidential relationship; parties represented by counsel at "extended conferences" and were dealing at arm's length); *Shlensky v. Shlensky,* 15 N.E.2d 694, 698 (Ill. 1938) (parties "were in disagreement" after wife filed for divorce: "Each had employed counsel in an action against the other. It is difficult to perceive the existence of a confidential or fiduciary relationship under such circumstances"); *Craft v. Craft,* 478 So.2d 258, 262 (Miss. 1985) (once spouses have obtained competent counsel and suit for divorce commenced, "[t]hey are adversaries plain and simple"). *Cf. O'Melia v. Adkins,* 166 P.2d 298, 302 (Cal.App. 1946) (no confidential relationship between ex-spouses; divorce "swept away all private and secret relations").

See also Chandler v. Dubey, 325 A.2d 6 (Me. 1974) (no fiduciary relationship between codefendants in civil litigation over land title, where each party was claiming full and exclusive

ownership); *Hal Taylor Associates v. Unionamerica, Inc.*, 657 P.2d 743, 749 (Utah 1982) ("[a]dversarial postures in a lawsuit do not suggest confidence or trust"); *Paul v. North*, 380 P.2d 421, 428 (Kan. 1963) (appellant's own conduct not consistent with a fiduciary relationship). And *see United States v. Birrell*, (S.D.N.Y. 1968), *McDonald v. Swope*, 79 F.Supp. 30 (D.Cal. 1948) (generally filing of lawsuit by client against counsel automatically terminates confidential relationship between attorney and client).

In *Kasey v. Molybdenum Corporation of America*, 336 F.2d 560 (9th Cir. 1964), Kasey brought an action in federal court seeking recovery of certain mining properties. Defendant pled the statute of limitations as a bar to such relief; the trial court sustained that defense and dismissed the case. On appeal, Kasey argued that the statute of limitations was "irrelevant" as the parties were in a fiduciary relationship by virtue of a royalty agreement between them. 336 F.2d at 569. The Ninth Circuit rejected that reasoning, taking judicial notice of a series of prior state-court lawsuits between the parties:

> If appellants mean by their fiduciary relationship argument that the royalty agreement creates an express trust, we think appellants in their 1953 complaint alleged so many repudiatory statements and acts of misconduct on the part of appellee that appellants cannot now claim that the express trust, if there was one, was not repudiated by appellee more than five years before the commencement of this suit in

1959.

336 F.2d at 570. In view of the prior litigation between the parties, the court found that, if any fiduciary relation had existed between them (which the court did not decide), the relation had been effectively repudiated.

In its claim that two parties to litigation may stand in a relationship of trust and confidence as to the subject matter of the litigation the state is clearly "traveling light as [a] legal theorist". DeMott *supra* at 889. The relationship between the state and the producers is "wholly inconsistent with the fiduciary relationship advocated by plaintiff". *Worldvision Enterprises v. American Broadcasting,* 191 Cal.Rptr. 148, 151 (Cal.App. 1983).

(E) *The disparity between the parties necessary for the existence of a confidential relationship is lacking on the present record.*

What constitutes a fiduciary relation is "often a subject of controversy". *Wells v. Shriver,* 197 P. 460 (Okla. 1921). It is a broad concept, "not susceptible of exact definition", but may "exist under variant circumstances". *Roecher v. Story,* 5 P.2d 205 (Mont. 1931). A fiduciary relationship may exist as a matter of law in certain well-established instances such as "attorney and client, principal and agent, guardian and ward", but likewise in "every case in which a fiduciary relation exists in fact, where confidence is reposed on one side and domination and influence

result on the other". *Finn v. Monk*, 178 N.E.2d 701 (Ill. 1949).

Despite the ambiguous nature of this equitable concept, the reported cases illustrate certain indicia which may signal the presence of a confidential or fiduciary relation. In *Denison State Bank v. Madeira*, 640 P.2d 1235 (Kan. 1982), the court observed that

> "There is no invariable rule which determines the existence of a fiduciary relationship, but it is manifest in all the decisions that there must be not only confidence of the one in the other, but there must exist a certain inequality, dependence, weakness of age, of mental strength, business intelligence, knowledge of the facts involved, or other conditions *giving to one advantage over the other.*"

640 P.2d at 1241, *quoting Yuster v. Keefe*, 90 N.E. 920 (Ind.App. 1910) (emphasis in the original). In *First Bank of Wakeeney v. Moden*, 681 P.2d 11 (Kan. 1984), the court similarly held that .

> Some of the indicia of a fiduciary relationship include the acting of one person for another; the having and the exercising of influence over one person by another; the reposing of confidence by one person in another; the inequality of the parties; and the dependence of one person upon another. In addition, courts have considered weakness of age, mental strength, business intelligence, knowledge of the facts involved or other conditions giving to one an advantage over the other.

681 P.2d at 13. *See also United States v. Reed*, 601 F.Supp. 685, 705 (S.D.N.Y. 1985) (disparity between parties treated as highly important or as absolutely essential); *Zarnowski v. Fidula*, 103

A.2d 905, 907 (Pa. 1954) (confidential relation exists "only where parties do not deal on equal terms and one side exercises an overmastering influence on the other"); *Dean v. Cole*, 204 P. 952 (Or. 1922) (fiduciary relations exist when parties to a transaction "do not meet on equality"; one party having a full knowledge and the other not, and the latter places confidence in the former); *Oehler v. Hoffman*, 113 N.W.2d 254 (Iowa 1962) (confidential relation depends largely on proof of dominance). *Accord Stephenson v. Kulichek*, 101 N.E.2d 542 (Ill. 1951) (in determining whether fiduciary or confidential relationship exists facts to be taken into account are degree of kinship, if any, disparity in age, health and mental condition, and relative education and business experience of parties, and the like).

However, the law presumes that a party possesses "ordinary firmness" to resist the "designing" of one who seeks its confidence, *Messick v. Pennell*, 35 A.2d 143 (Md.App. 1943), and a person who is "not under any disability or disadvantage may not abandon all caution and responsibility for his own protection and unilaterally impose a fiduciary relationship on another", *Denison State Bank v. Madeira, supra*, 640 P.2d at 1243-44. And this is "particularly true" where a party "is fully competent and able to protect his own interests". *Id.*, 640 P.2d at 1244. *Accord, DeWitt County Public Bldg. Com'n v. DeWitt County*, 469 N.E.2d 689 (Ill.App. 1984) (no fiduciary relationship where party allegedly

subject to influence is "fully capable of attending to its business affairs"; government agency did not contend that it was incapable of obtaining competent and independent advice before entering into contract); *Mahan v. Dunkleman,* 234 P.2d 366 (Okla. 1951) (plaintiff was sufficiently competent mentally to know what he was doing; no evidence that relationship with alleged confidante "lulled him into any sense of security"); *Jacoby v. Shell Oil Co., supra,* 196 F.2d at 857 (plaintiff "was and is an experienced attorney" who understood meaning of contract language). And while it may be true that "an oil and gas lessor is often at the mercy of his lessee," *Davis v. CIG Exploration, Inc.,* 789 F.2d 328, 332 (5th Cir. 1986) such is not the case here. The state dictated the terms of the DL-1 lease, in contrast to the usual case where the lessee drafts the lease form or dictates its terms. *Jackson v. Farmer,* 594 P.2d 177 (Kan. 1979).

III.

THE DL-1 LEASE FORM CONTAINS AN IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

An oil and gas lease is merely a contract between parties and is to be tested by the same rules as any other contract. *Leonard v. Barnes,* 404 P.2d 292 (N.M. 1965). The DL-1 oil and gas lease at issue herein is governed by the law of Alaska. As such, it contains an implied covenant of good faith and fair dealing "that neither party will injure the right of the other to receive the

benefits of the agreement". *Guin v. Ha,* 591 P.2d 1281, 1291 (Alaska 1979). *See also Alaska Pacific Assurance Co. v. Collins,* 794 P.2d 936, 947 (Alaska 1990) (covenant of good faith and fair dealing is an implied component of all contracts as a matter of law); *City of Kenai v. Ferguson,* 732 P.2d 184 (Alaska 1987). This obligation of good faith and fair dealing is distinguished from a fiduciary obligation. *Stepp v. Ford Motor Credit Co.,* 523 F.Supp. 583, 594 (D. Wis. 1985); *Waverly Productions, Inc. v. RKO General, Inc., supra,* 32 Cal.Rptr. at 79.

Given the Alaska Supreme Court's repeated mandate that *all* contracts contain the implied covenant of good faith, the state must prevail on this question.

IV.

MEASURE OF DAMAGES FOR BREACH OF THE IMPLIED COVENANT

While the DL-1 lease form contains the implied covenant of good faith, the state is not entitled to recover tort damages, including exemplary or punitive damages, in the event that it demonstrates that either Chevron or BP breached the implied covenant. Alaska case law holds that "punitive damages are not recoverable for breach of the implied covenant of good faith and fair dealing." *ARCO Alaska, Inc. v. Akers,* 753 P.2d 1150, 1154 (Alaska 1988). The only context in which breach of the implied covenant has been recognized as a tort in this state is where an insurance company wrongfully withholds benefits from its insured.

State Farm v. Nicholson, 777 P.2d 1152 (Alaska 1989); *Alaska Pacific Assur. Co. v. Collins*, 794 P.2d 936 (Alaska 1990). The state does not press the analogy very forcefully, but seems to suggest that the instant case might be "sufficiently akin to the insurance cases so as to warrant tort recovery for a breach of the implied covenant". State's Opposition and Reply at 34. The producers have successfully distinguished the insurance cases in their briefing and in oral argument.[19] The state has failed to show any "special relationship" which would justify the granting of punitive damages for breach of the implied covenant. Therefore, the producers' position on this question is sustained, and the prayer for exemplary damages in Count XII is stricken. The state shall be limited to contract damages should a breach of the implied covenant be proven.

V.

THE PRODUCERS HAVE AN OBLIGATION TO ACT AS REASONABLY PRUDENT OPERATORS

In *Brewster v. Lanyon Zinc Co.*, 140 F. 801 (8th Cir. 1905), the "most cited and quoted opinion in the area of implied

[19]Some of the factors which distinguish this case from the insurance situation are: (1) the contract in question was not a contract of adhesion -- quite the contrary; and (2) while the insured cannot obtain other insurance after a calamity occurs, the state need not depend upon the producers -- it can take its royalty in kind and market it itself. These factual differences severely undercut the assertion that the DL-1 lease is "particularly susceptible to public policy considerations." *State Farm v. Nicholson, 777 P.2d at 1157.*

covenants"[20], the court adopted an objective standard for measuring the conduct of a lessee to a mineral lease:

> Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required.

140 F. at 814. The prudent operator standard is the "generally applicable test for determining whether the lessee has breached his implied covenants". Williams, *Manual of Oil & Gas Terms* (6th Ed. 1984). One commentator observes that "the prudent-operator standard has the same function in oil and gas litigation as the reasonable man standard has in negligence litigation". Williams & Meyers, *Oil and Gas Law*, §806.3 at 42 (1989). The prudent operator standard is an established doctrine in the common law of oil and gas. While no case has been cited to the court where the doctrine has been employed by the Alaska Supreme Court, the prudent operator standard is nevertheless part of the common law, and appropriately applied as a rule of decision unless inconsistent with the federal or state constitutions, or the Alaska Statutes. AS 01.10.010. The court holds that the producers have an obligation to act as reasonably prudent operators in performing their duties under the DL-1 lease.

In the briefing and oral argument on this question, there was

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[20] Kramer & Pearson, *The Implied Marketing Covenant in Oil and Gas Leases: Some Needed Changes for the 80's*, 46 Louisiana L. Rev. 787, 789 n.16 (1986).

a tendency to frame the issue in terms of the application of a prudent operator duty *versus* the imposition of a duty of good faith and fair dealing. However, the court sees no contradiction in the imposition of *concurrent* duties upon the defendants. The prudent operator standard imposes an *affirmative* duty to do certain things in a given factual scenario. In the same scenario, the covenant of good faith and fair dealing commands the lessee to *refrain* from doing anything to injure the lessor's right to receive benefits under the oil and gas lease. *See generally* Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195, 215-17 (1968) (obligation to act in good faith best understood as an "excluder" of various forms of bad-faith behavior); *Waverly Productions, Inc. v. RKO General, Inc., supra*, 32 Cal.Rptr. at 79 (under implied covenant of good faith and fair dealing, "primary obligation [is] negative, to refrain from conduct calculated to deprive plaintiff of the legitimate fruits of her bargain").

The state's motion is denied insofar as it sought to impose a more stringent standard upon the producers.

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VI.

CONCLUSION

For the reasons set forth above, the cross-motions for summary adjudication were orally **GRANTED IN PART** and **DENIED IN PART** on the record on October 26, 1990, as follows:

(1) The state's motion for partial summary adjudication is denied.

(2) The producers do not owe a fiduciary duty or obligation to the state arising out of the DL-1 lease form, or otherwise. Count XIII is dismissed with prejudice.

(3) Because the DL-1 lease form is a contract in the State of Alaska, a covenant of good faith and fair dealing is implied as a matter of law. The producers' motion to dismiss Count XII is denied.

(4) A breach of the obligation of good faith and fair dealing does not give rise to tort damages generally or punitive damages specifically, due to the lack of the requisite special relationship between the producers and the state. The prayer for punitive damages contained in Count XII is dismissed.

(5) The producers also have an obligation under the DL-1 oil and gas lease to act as reasonably prudent operators.

IT IS SO ORDERED.

DONE at Juneau, Alaska this 13th day of March, 1991.[21]

Walter L. Carpeneti

WALTER L. CARPENETI
SUPERIOR COURT JUDGE

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[21]Effective October 26, 1990. Civil Rule 58.1(a)(1).

CERTIFICATE OF SERVICE

The undersigned certifies that on March 14, 1991 a true copy of the foregoing was served upon the following counsel of record:

VIA JUNEAU COURTHOUSE BOX:

- Bruce Botelho
- Michael L. Lessmeier
- William B. Rozell

VIA FIRST-CLASS MAIL:

- Wilson L. Condon
- Carl J.D. Bauman
- James P. Murphy
- Robert E. Jordan III/F. Michael Kail
- John C. Held
- Julian L. Mason
- Paul R. Griffin

Pat Bock

Secretary to Judge Carpeneti