DUTIES ARISING OUTSIDE OF THE FIDUCIARY RELATIONSHIP

ROBERT C. MUIR*

INTRODUCTION

The purpose of this paper is to determine if rights and duties akin to fiduciary duties can arise between persons where no fiduciary relationship exists. A further purpose is to relate the conclusions to some petroleum and natural gas situations.

It appears that situations can be found where duties do arise independant of the fiduciary relationship. These exist where the courts, in certain circumstances, imply covenants into contracts or where, despite the absence of a fiduciary relationship, constructive trusts are raised. First, therefore, the nature of the fiduciary relationship, the constructive trust and the implied covenant will be considered.

THE FIDUCIARY RELATIONSHIP

An English judge[1] once said that fiduciary relations are of many different types. "They extend from the relation of myself to an errand boy who is bound to bring me back my change up to the most intimate and confidential relations which can possibly exist between one party and another where the one is wholly in the hands of the other because of his infinite trust in him." This is a very wide definition of the fiduciary relationship. The judge later modified this definition by stating that the nature of the fiduciary relationship must be such that it justifies interference by the courts. He said that it would be "absurd" to "conclude that every kind of fiduciary relationship justifies every kind of interference."

To be more specific, a person is said to stand in a fiduciary relation to another when he has rights and powers which he is bound to exercise for the benefit of that other. Hence, he is not allowed to derive any profit or advantage from the relation between them, except with the knowledge and consent of the other person. Such is the relation between trustee and cestui que trust, solicitor and client, principal and agent, and generally wherever the relationship of the parties is such that one of them reposes confidence in the other.[2]

The criterion of dominance arising out of confidence appears necessary to the establishment of the fiduciary relationship. The courts sometimes use the phrase "confidential relationship" interchangeably with "fiduciary relationship".[3] An Oklahoma case[4] states that "confidential" and "fiduciary" relations are in law synonymous and exist wherever trust and confidence are reposed by one person in the integrity and fidelity of another.

*Robert C. Muir, Solicitor, The British American Oil Company Limited, Calgary.

1 Fletcher Moulton L.J., *In re Coomber*, [1911] 1 Ch. 723, 728.
2 Jowitt, *The Dictionary of English Law* (1959), 800.
3 *See*, for example *Brown* v. *Premier Trust Co.*, [1947] O.R. 50, 63.
4 *Fipps* v. *Stidham*, 50 Pac. (2 nd) 680, 683.

In the often-cited case of *Tate* v. *Williamson*,[5] Lord Chelmsford said:

> Wherever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relationship had existed.

An exact definition of the term "fiduciary relationship" has been avoided by the courts. Lord Chelmsford in the *Tate Case* stated that the principles applicable to the more familiar relations of a fiduciary character have been long settled but the courts have always been careful not to fetter their useful jurisdiction in these matters by defining the exact limits of its exercise.

It appears then, that a fiduciary relationship (or at least a fiduciary relationship of such a character that the court will interfere) arises where one party has dominance or influence over another party, which dominance is based upon a confidence reposed in him by that other party. The colorful language of an Ontario judge[6] in setting aside a deed of land by a 90-year old man to his son illustrates this type of dominance:

> The natural relation of the parties was reversed in this instance by the hand of time. The parent had become a child, and the child was guardian to the parent. There was the same dependence, overweening confidence and implicit acquiecense which had rendered one an automation in the hands of the other; . . . The wish of the agent had become the will of the principal. Whatever the former suggested the latter executed. There was no consent of two minds, but a merger of the principal's mind into the agent's.

Some may consider that the characterization of the fiduciary relationship as one based on dominance arising out of confidence is too narrow. However it is submitted that fiduciary relationships, if there be any, that are not so based, would not likely invoke the interference of the court. Further, it is submitted that there are other bases for imposing restraints upon parties to transactions as to which the law need not raise a fiduciary relationship.

Constructive Trusts

There are a good number of divergent descriptions and definitions of constructive trusts.

A constructive trust is said to be a species of trust created by implication or operation of law and has the characteristic of being independent of any intention to create a trust on the part of the parties concerned.[7] There is no mention here of the existence of a fiduciary relationship.

However, it is also said that a constructive trust is raised by a court of equity wherever a person, clothed with a fiduciary character, gains some personal benefit by taking advantage of his position as trustee.[8] The inflexible rule of equity is that a person in a fiduciary position is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict.[9] Lord Herschell[10] was of the opinion that the rule was not founded upon principles of morality but rather upon the consideration that, human na-

5 (1866) L.R. 2 Ch. App. 35.
6 Bowie C. J., *Lavin* v. *Lavin*, 27 Gr. Ch. 567, 572, *aff'd* 7 O.A.R. 197.
7 W. G. Hart, *The Development of the Rule in Keech* v. *Sanford*, 21 L.Q.R. 258.
8 *Lewin on Trust*, 155 (15th ed. 1950).
9 *Bray* v. *Ford*, [1896] A.C. 44, 51.
10 *Ibid* 51, 52.

ture being what it is, there is danger of the person in a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he is bound to protect. The rule, therefore, is based on policy considerations. To that extent, it is not essential that there be any injury inflicted or any consciousness of wrong-doing. Here the constructive trust is based upon the existence of a fiduciary relationship .

However, the law appears to be that such a relationship is not necessary for the implication of a constructive trust.

In *re Biss*[11] was a case where a lessee (tenant from year to year) died intestate leaving a widow and three children. The widow and two adult children, one of whom was a son, continued to carry on a business under the tenancy. The widow and the son each applied for a new lease for the benefit of the estate, which was refused. Upon the termination of the yearly tenancy by notice, the son was granted "personally" a new lease. The widow applied to have the new lease treated as having been taken for the benefit of the estate. In deciding that the son was not a trustee of the lease; Romer L.J. said:[12]

> The cases which really demand full consideration are those where the person renewing the lease does not clearly occupy a fiduciary position. On inquiry into those cases it appears to me, as a result ,that a person renewing is only held to be a constructive trustee of the renewed lease if, in respect o the old lease, he occupied some special position and owed, by virtue of that position, a duty towards the other persons interested.

Romer L.J. is saying that the person renewing the lease need not be in a fiduciary relationship but only in some "special position" giving rise to duties. To illustrate, he gives the example of a tenant for life under a leasehold estate who obtains renewal of the lease. He states that equity demands that the renewal be treated as being held upon the same conditions as the old lease.

Thus a breach of duty where there is either a fiduciary relationship or some "special" relationship (not necessarily fiduciary) can give rise to a constructive trust.

Implied Obligations

It is submitted that the better view[13] is that implied obligations are founded in all cases upon the presumed intention of the parties. It has been said:

> A term can only be implied if it is necessary in the business sense to give efficacy to the contract; that is, if it is such a term that it can confidently be said that if at the time the contract was being negotiated some one had said to the parties, 'What will happen in such a case,' they would both have replied, 'Of course, so and so will happen; we did not trouble to say that; it is too clear.' Unless the Court comes to some such conclusion as that, it ought not to imply a term which the parties themselves have not expressed.[14]

It should be kept in mind that the express words of the parties are paramount and that a term they have not expressed is not to be implied simply because the court thinks it is a reasonable term. A term will be implied only if, upon consideration of the contract in a reasonable and business manner, and having regard to the circumstances under which it was entered into, the court is driven to the conclusion that the parties

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11 [1903] 2 Ch. 40.

12 *Id.* at 61.

13 For other views, *see* Cheshire and Fifoot, *Law of Contract*, 139 (5th ed. 1960).

14 *Reigate* v. *Union Manufacturing Co.* (*Ramsbottom*), [1918] 1 K.B. 592, 605.

have intended that the suggested stipulation should exist.[15] It is for the court to gauge in a case whether it will adhere strictly to the doctrine that it is not the function of the court to create a contract for the parties but only to enforce the contract which the parties have made or, on the other hand, whether it will by implication arrive at a contract which the parties are presumed to have made and then enforce that conract.

Varied Opinions Regarding Implied Obligations and Constructive Trusts

Lord Mansfield in *Moses* v. *Macferlan*[16] said:

> This kind of equitable action, to recover back money which ought not in justice to be kept, is very beneficial, and therefore much encouraged. It lies only for money which, ex aequo et bono (in equity and good conscience), the defendant ought to refund; . . . (it lies) upon an undue advantage taken of the plaintiff's situation, contrary to laws made for the protection of persons under those circumstances. In one word, the gist of this kind of action is, that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money.

This view prevailed until 19th century judges sought a more legalistic basis for their decisions. Anson[17] states that "the spirit of the 19th century was opposed to such idealistic formulations as "aequum et bonum" and "natural justice"." Finally in 1914 Lord Haldane[18] said:

> So far as proceedings in personam are concerned, the common law of England really recognizes (unlike the Roman Law) only actions of two classes, those founded on contracts and those founded on tort. When it speaks of actions arising quasi ex contractu it refers merely to a class of action in theory based on a contract which is imputed to the defendant by a fiction of law.

The fiction of law referred to by Lord Haldane is the fiction of implying an actual contract where there was no contract.

Meanwhile in the United States opinion was being expressed that treatment of quasi-contract as based upon implied covenant was not only unscientific and theoretically wrong, but also destructive of clear thinking and therefore vicious in practice.[19] The theory currently held in the United States appears to be as follows:

> A person has a right to have restored to him a benefit gained at his expense by another, if the retention of the benefit by the other would be unjust. The law protects this right by granting restitution of the benefit which otherwise would, in most cases, unjustly enrich the recipient.[20]

The American theory is that the law has three divisions — contracts, torts and restitution. The principles under the third division, restitution, provide remedies in cases where there has been no failure to perform a promise (contract), and where there has been no breach of a general duty not to harm others (tort).[21]. Professors Scott and Seavey state[22] that restitution is meant to cover, *inter alia,* the situation where the person seeking restitution has not himself transferred the benefit to the recipient, but the latter has acquired it either rightfully or wrongfully without any act on the claimant's part.

At this same time in England a growing controversy existed between the adherents to the implied contract theory and the supporters of the

15 *Hamlyn & Co.* v. *Wood,* [1891] 2 Q.B. 488, 491, 494.
16 (1750) Burr. 1005, 1012.
17 Anson, *Law of Contract,* 570 (21st ed. 1959).
18 *Sinclair* v. *Brougham,* [1914] A.C. 398, 415.
19 Keener, *Quasi-contract, Its Nature and Scope,* (1893-94) 7 Harv. L. Rev. 57.
20 Seavey, Scott, *Restitution,* (1938) 54 L.Q.R. 29, 32.
21 *Winfield on Tort,* 8, 9, 802 (6th ed. 1954).
22 54 L.Q.R. 29, 31.

unjust enrichment theory. It was (and is) not merely a case of "for the Dons are so hard on the judges and the judges so rude to the Dons", for judges and Dons were arrayed on each side. It is submitted that the weight of judicial authority in English law supports the implied contract theory. In the case of *Reading* v. *Attorney-General*,[23] Lord Porter dealt with the doctrine of unjust enrichment as follows:

> It was suggested in arguments that the learned judge founded his decision solely upon the doctrine of unjust enrichment and that that doctrine was not recognized by the law of England. My Lords, the exact status of the law of unjust enrichment is not yet assured. It holds a predominant place in the law of Scotland and, I think, of the United States, but I am content for the purposes of this case to accept the view that it forms no part of the law of England and that a right to restitution so described would be too widely stated.

Lord Porter appears to found his decision upon the narrow principle that "any official position, whether marked by a uniform or not, which enables the holder to earn money by its use gives his master a right to receive the money so earned even though it was earned by a criminal act.'

In any event, as professor Winfield, a proponent of the unjust enrichment theory, says:

> If some distinguished lawyers prefer to use the old, winding country road of "implied contract," by all means let them do so, but they must not frown on others of us who would rather travel by the newer and speedier by-pass of "unjust benefit". At the journey's end we can congratulate each other on our arrival at the same place, whatever we may think of the different routes that have been taken.[24]

That apparently is what the matter comes down to, an academic argument; and "from a practical point of view it cannot be said that the adoption of one or other of these theories will make a great deal of difference in any specific case."[25] However, the point is that whether one travels by the old country road or by the speedier by-pass, one need not be encumbered with the excess baggage of fiduciary relationship.

It does not appear necessary to categorize parties to contracts or conveyances into such a relationship in order to prevent one party from inequitably or unlawfully obtaining a benefit from the other party. The essence of the fiduciary relationship is dominance based on confidence and, having regard to the jurisdiction of the courts in implied contract and constructive trust, it seems unnecessary to raise the fiction of a confidence between parties to contracts and signatories to conveyances.[26]

Some Petroleum and Natural Gas Situations

In the *Midcon Case*[27] the Supreme Court of Canada rejected the argument that the parties to an operating agreement stood in a fiduciary relationship. There are two interesting points about the case. First, the clauses of the operating agreement considered in the case were not widely-used in the industry. Second, the majority of the judges, although deciding that no fiduciary relationship existed, nevertheless held that the operator owed to the non-operator "the duty to act in good faith in its efforts to sell" the production.

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23 [1951] A.C. 507, 513.
24 Winfield, *American Restatement of Law of Restitution*, (1938) 54 L.Q.R. 530.
25 Anson, *Law of Contract*, 573 (21st ed. 1959).
26 It may be objected that in using implied contracts, the courts are relying on fictional agreements so they may as well find fictional confidences as well. Disenchantment with these fictions leads to a law of restitution based on unjust enrichment.
27 *Midcon Oil & Gas Ltd.* v. *New British Dom. Oil Co. Ltd.*, [1958] S.C.R. 314.

Rand J. in his dissenting judgment states: "Generally speaking, to be operator meant having authority to proceed with the exploitation almost as if the property were one's own." While this statement is qualified somewhat by reference to action which in limited cases could only be taken after consultation, it nevertheless creates the impression that the operator was, under the agreement, free to exploit as he saw fit. While there may have been some justification for this view under the *Midcon* agreement, it would have no application to the forms of agreement now commonly in use in Alberta. Generally farmout agreements and unit operating agreements do not give operators such authority. In the case of farmout agreements a well can be drilled, deepened, reworked or abandoned only after all parties have been given an opportunity to participate in the work. If a party does not wish top articipate, the joint account is not charged with his share of the cost of the work and the other participating parties are reimbursed out of any production which might be obtained. In the case of abandonment, the party not consenting to abandonment receives the well. No distinction is made between operator and non-operator except that where all parties to the agreement join in the work, the work is done by the operator. Unit operating agreements contain elaborate voting procedures with which there must be compliance before unit wells are drilled. Rand J. also said: "The scope of management included marketing the product." The agreement in the *Midcon Case* provided that the non-operator was not entitled to take its share of production in kind, nor was he entitled to make agreements for the disposal of his share. Most farmout agreements and unit agreements provide that each party is obliged to take its share of production in kind. If a party does not so take its share the operator has the authority to dispose of it, but this authority can be rescinded on notice. Thus, if the non-operator not taking in kind is dissatisfied with price, he is free to locate other markets.

It might be added that most operating agreements contain provisions to the effect that ownership of land, production and other property are to be held by the parties as tenants in common and not as joint tenants, and that nothing in the agreement is to be construed so as to create any partnership or joint venture between the parties. The following quotation from a case heard on appeal in the Oklahoma Supreme Court[28] is of interest on this point:

> Regardless of what the preliminary negotiations might have been, or what the discussion might have been as to how the property would be acquired and thereafter operated, defendants cannot avoid the fact that they signed written instruments which clearly stated that they are owners of the property as tenants in common, that they are not partners or mining partners therein, and that said written agreement superseded entirely any other agreement or relationship which might in any way have theretofore existed between the parties . . . . . Defendants cannot be tenants in common and obtain income tax deductions thereby and execute written agreements to that effect so as to allow them to make such deductions, and at the same time be mining partners with plaintiff in order to impose upon plaintiff a fiduciary duty in the acquisition of this property so as to reap an additional financial advantage. They cannot change their legal relationship to plaintiff, at their whim and as it suits their financial advantage of the moment, in derogation of their written contracts.

[28] *The Oklahoma Co. v. O'Neil*, 333 Pac.(2d)534.

The comment on a similar clause in the *Midcon Case* was as follows:

> While the agreement expressly provided that the operator should not act qua agent, . . . this does not mean that the respondent company did not owe to the appellant the duty to act in good faith in its efforts to sell.

The second point about the *Midcon Case* is that, despite the absence of a fiduciary relationship, the respondent did owe to the appellant "the duty to act in good faith in its efforts to sell". The court did not go into the basis of this duty. Perhaps it arose out of the "special relationship" created bby the clause which restricted the rights of the appellant in entering into contracts for the sale of its share of production.

Generally speaking, under the usual form of operating agreement, the position of the operator is not like that of the old Scottish overseer managing vast tracts of Irish lands for absentee owners who have not inspected the lands in three generations. Under operating agreements such freedom as is consistent with the existence of co-ownership should prevail so as to allow each party to pursue his own interest regarding the lands subject to the agreement and adjoining thereto. The operator is merely one of the owners who, for the time being, and subject to the express provisions of the agreement as to supplying information, etc., carries on the routine tasks of hiring contractors to drill wells, lay flow lines and store production. Discussion as to exploitation takes place between the parties, subject to voting provisions, as equal co-owners.

Conclusion

Professor Williams says,[29] "It has not been necessary to describe the relationship between the lessor and lessee under an oil and gas lease in fiduciary terms." He goes on to say, however, that much of the law of implied covenants is consistent with the application of fiduciary principles. On what basis are covenants implied into oil and gas leases? A. W. Walker, after pointing out that it is doubtful if any other legal instrument can be found in which one of the parties has so much potentially at stake with so little express contractual protection, states:[30]

> Looking beyond the mere language of our decisions and considering the grounds relied upon to justify the implication of these covenants, it seems to the writer that the implication is viewed as one of fact and not of law. It will be observed that all of these implied covenants are directed towards one end: the protection of the royalty interest of the lessor. . . . The emphasis is tntirely upon the fact that a royalty is reserved, and the theory of the Courts seems to be that the creation of a royalty, the payment of which is to be governed by the amount of production, is enough, standing alone, to justify the implication of any reasonable obligation looking to its protection. This implication is based upon the thought that the prospective royalties constitute one of the primary inducements for the execution of the lease, and, since the lease makes the payment of this compensation to the lessor dependent upon the diligence and care with which operations are conducted by the lessee, the parties must have intended that these operations would be conducted with a reasonable regard for the interests of the lessor and not solely from the selfish standpoint of the lessee. If this is a correct interpretation of the theory of our cases the implication of these covenants is predicated upon the intention of the parties and is one of fact and not of law.

Professor Merrill states,[31]

> The parties have not agreed consciously upon the terms which the law implies; it is even possible that they have never consciously directed their attention to the

29 Williams, *Fiducairy Standards in the Law of Oil and Gas*, 13 Annual Institute on Oil and Gas Law and Taxation, Southwestern Legal Foundation.
30 A. W. Walker Jr., *The Nature of the Property Interests Created by an Oil and Gas Lease In Texas*, (1933) 11 Texas L. Rev. 399, 404.
31 *Covenants Implied in Oil and Gas Leases*, 27, 469 (2nd ed. 1940).

> matter. The obligations are imposed, not by the agreement of the parties, but by operation of law. . . . Is not the real basis of the doctrine of implied covenants in oil and gas leases to be found in a theory of enforcing that conduct which, under the circumstances, fair dealing between lessor and lessee fairly demands that the latter pursue. Do not the conditions which have been reviewed justify the judicial imposition of that standard of conduct upon the lessee?

Whether the covenants are implied in fact or in law, it is certain that courts in the United States do not consider fiduciary relationship as the basis of the implication.[32]

Are there implied duties between the grantor and the grantee of a profit à prendre? In one case[33] the profit à prendre was "the exclusive right of shooting and sporting in, over and upon" the lands in question. Scrutton, L.J. stated that "both landlord and tenant must use their land reasonably having regard to the interest of the other, and will be liable for damage caused to the other by extraordinary, non-natural, or unreasonable action." Now, if in law the grantee of a profit à prendre of oil and gas acts unreasonably so as to damage the royalty or "reversionary" interest of the grantor, it seems an action for damages would lie. It is but one short step to apply the test of "the reasonably prudent operator" and from there to raise implied covenants so as to impose duties upon the grantee.

In conclusion, it is submitted that Canadian courts need not rely on fictional confidences to impose duties of fair dealing. They can rely on implied contracts. To those who would object that implied contracts are based on fictional agreements perhaps the answer is to develop the doctrine of unjust enrichment. At least it is hoped that Canadian courts will give careful and explicit consideration to the complex relationships arising under oil industry agreements.

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32 For a discussion of implication in law and implication in fact, see 7 Harv. L. Rev. 58 to 63.
33 *Peech* v. *Best*, [1931] 1 K.B. 1, 14.