IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

ARENA RESOURCES, INC.

Plaintiff-Appellee,

vs. **Docket No. 29,241**

OBO, INC.,

Defendant-Appellant.

APPELLEE ARENA RESOURCES, INC.'S ANSWER BRIEF

Gary L. Clingman, District Judge
(Cause No. 2007-207)
Lea County, New Mexico

FOR THE APPELLEE

Matt Catalano
New Mexico State Bar No. 25422
Susan Richardson *(pro hac vice)*
Texas State Bar No. 18061500
COTTON, BLEDSOE, TIGHE & DAWSON
A Professional Corporation
P. O. Box 2776
Midland, Texas 79702-2776
(432) 684-5782 (Phone)
(432) 682-3672(Fax)

I. TABLE OF CONTENTS

II. TRANSCRIPT OF PROCEEDINGS; CITATION TO THE RECORD; ABBREVIATIONS

In referring to the transcript of proceedings, Appellee Arena Resources, Inc. ("Arena") will use the date and time notations on the compact disc on which the hearings were recorded. Arena will use the times set forth on the official log to refer to the transcript of proceedings, which will be noted as follows: (TP: hearing of Month/Date/Year, Start time—End Time).

When citing to exhibits, Arena will refer to the number of such exhibit and, if necessary to avoid ambiguity, identify the hearing or type of proceeding (Arena's Trial Exhibit _____).

In citing to the record proper, Arena will use the numbers assigned by the clerk of the trial court in preparing the record for transmission to the Court of Appeals, (RP pages ____—____).

Throughout this Answer Brief, Arena will use the following abbreviations for phrases and titles commonly used in conjunction with this dispute:

- Appellant OBO, Inc. ("OBO")
- Appellee Arena Resources, Inc. ("Arena")
- Seven Rivers - Queen Unit ("Unit")
- Unit Agreement ("UA")
- Uni t Operating Agreement ("UOA")
- Elms, Faris & Company, Midland, Texas ("Elms")

III. List of Legal Issues

Answer Points

A. Arena properly pleaded and presented substantial evidence supporting its claims for equitable relief, thus, the Trial Court did not abuse its discretion in finding that OBO is not entitled to be unjustly enriched by Arena's substantial expenditure of drilling and operating expenses which greatly increased the value of the Unit and OBO's ownership interest therein.

B. The Trial Court properly ordered OBO to pay Arena $1,812,019 from OBO's share of Unit production.

C. OBO failed to plead or prove that it was entitled to affirmative relief and, thus, this Court may not remand this case to the Trial Court to direct that the Trial Court award the credit and additional affirmative relief now requested by OBO.

IV. TABLE OF AUTHORITIES

Cases

New Mexico

Other Jurisdictions

Statutes

Other Authorities

V. SUMMARY OF PROCEEDINGS

Arena offers the following to supplement the Summary of Proceedings set forth by Appellant OBO in its Brief in Chief. Effort has been made to avoid duplication except where necessary to provide context.

A. Nature of the Case

On or about March 15, 2007, Arena initiated this litigation against OBO in an attempt to recover for oil and gas drilling and operating expenses in the amount of approximately $1.8 million which Arena had expended on OBO's behalf in the Seven Rivers-Queen Unit in Lea County, New Mexico. (RP 1-67). Both Arena and OBO are working interest owners in the Unit, in which Arena acts as Operator. (RP 663-666; FOF 2, 4, 5, 7). Arena specifically sought the recovery of expenses attributable to the Unit that OBO had failed and refused to pay. (RP 1-67). At the time of trial, Arena's live pleading asserted claims for Breach of Contract and Recovery of Real Property Guaranteeing Title Through Foreclosure of Operator's Lien. (RP 103-105). Arena further plead for equitable relief as its grounds for recovery of this debt, including both a general request for equitable relief and a specific request for enforcement of an equitable lien. (RP 103-105). At the time of trial, OBO's live pleadings were defensive in nature and failed to set forth any claim for affirmative relief other than a general plea for "all relief to which it may be entitled at law or in equity." (RP 72-76). At no time did OBO

plead that it was entitled to damages or a monetary judgment against Arena. (RP 72-76).

Following a non-jury trial at which evidence and testimony supporting Arena's claims for recovery were presented, this Court issued its Findings of Fact and Conclusions of Law on March 12, 2008. (RP 663-667). Based on the undisputed evidence and testimony presented at trial, the Court explicitly made findings that Arena's drilling of new wells and the re-completing of existing wells in the Unit increased oil and gas production, improved the Unit, and benefited OBO's interest in the Unit. (RP 663-667, FOF 29-30, COL 7). Upon these findings, the Trial Court concluded that OBO would be unjustly enriched unless it pays its proportionate share of Arena's re-development project expenses from its share of Unit revenues. (COL 8). The Court further found that OBO was entitled to an Audit of Unit expenses and revenues in order to determine whether OBO was entitled to a credit for any overpayments that it had already made. (COL 6).

On or about June 18, 2008, OBO filed its Motion for Consideration and Notice of Filing of Court-Ordered Accounting in which OBO's retained accounting firm proposed two alternative scenarios. (RP 671-682). Under one scenario presented by the accounting firm, a scenario contrary to the Trial Court's Findings and the evidence adduced at trial, OBO's accountants assumed that OBO was NOT unjustly enriched and, therefore, argued that OBO has overpaid Arena

and is owed $2,204,213. (RP 675, 677-679). This scenario was later implicitly rejected by the Trial Court when it entered its Amended Judgment. (RP 791-792). Under the second scenario, a scenario which was consistent with the Trial Court's Finding that OBO should not be unjustly enriched, OBO's own accountants admitted that OBO owes Arena $1,812,019. (RP 675, 680-682).

After considering the Accounting filed by OBO and its own Findings and Conclusions and the evidence adduced at trial, on or about October 14, 2008, the Trial Court entered its Amended Judgment which again reiterated that Arena's re-development of the Unit had enhanced OBO's interest therein and that OBO's proportionate share of the Unit expenses was $1,812,019. (RP 791-792). The Court did not award Arena a judgment in that amount, but instead ordered that Arena could recoup the $1,812,019 in expenses attributable to OBO's interest out of OBO's share of the Unit's future oil and gas production. (RP 791-792). It is from this Amended Judgment that OBO appeals.

B. Course of Proceedings

Arena does not see a need to supplement OBO's description of the Course of Proceedings found in OBO's Brief in Chief except to note that the relief prayed for therein is not supported by OBO's pleadings, the facts adduced at trial or the Trial Court's Findings and Conclusions.

C. Summary of Facts

Arena and OBO, together with the Evelyn Clay O'Hara Trust, are working interest owners in the Seven Rivers-Queen Unit located in Lea County, New Mexico. (RP 663-667, FOF 1, 3, 4, 5, 7). The Unit contains over 2,200 acres and is operated as a water flood unit which is designed to increase the recovery of oil from the Seven Rivers and Queen formations in the area for the benefit of the working interest owners. (TP: Non-Jury Trial March 10, 2008, 9:21:50-9:23:30AM). Unitization is beneficial to the working interest owners. (TP: Non-Jury Trial March 10, 2008, 9:23:40-9:26:02AM). Arena and OBO are successors in interest to a UA and UOA which govern the production of oil and gas in the Unit. (RP 663-667; FOF 1-3). Arena is the operator of the Unit. (FOF 7).

In 2006, Arena proposed to re-develop the Unit. (TP: Non-Jury Trial March 10, 2008, 9:25:50-9:26:05AM). In Arena's opinion, re-development of the Unit was in the best interest of the Unit because there was oil in place that additional development could reach. (TP: Non-Jury Trial March 10, 2008, 9:23:40-9:26:10AM). Pursuant to the terms of the UOA, Arena sought the consent of the remaining working interest owners to Arena's re-development plans. (RP 663-664; TP: Non-Jury Trial March 10, 2008, 9:30:00-9:30:11AM). OBO received the various letters and Authorizations for Expenditure ("AFE") from Arena seeking OBO's consent and advising of the planned operations. (TP: Non-Jury Trial March

10, 2008, 11:34:50-11:36:00AM; 1:36:35-1:37:00PM). However, OBO failed to respond despite the UOA's requirement that "Working Interest Owners shall exercise overall supervision and control of all matters pertaining to the development and operation of the Unit..." (RP 178; TP: Non-Jury Trial March 10, 2008, 9:19:40-9:20:55AM). In fact, OBO has never responded to any proposals for any work to be done on the Unit. (TP: Non-Jury Trial March 10, 2008, 9:19:40-9:20:55AM). Arena never tendered a "yes" vote and never tendered a "no" vote to Arena's proposed plan. (TP: Non-Jury Trial March 10, 2008, 11:38:30-11:38:45).

The UOA does not contain a provision by which working interest owners can non-consent or elect not to participate in the Unit. (TP: Non-Jury Trial March 10, 2008, 9:20:52-9:21:42AM). Arena's President considers OBO to be a "bad partner" because in a Unit Operating Agreement, unlike other Joint Operating Agreements, partners are required to act and "shall" act, failure to act is not an option. (TP: Non-Jury Trial March 10, 2008, 11:06:00-11:06:40AM). Arena felt it was entitled to move forward with the re-development plans without OBO's consent because OBO had failed to act as required by the UOA. (TP: Non-Jury Trial March 10, 2008, 11:10:10-11:10:55).

Arena's re-development efforts were very successful. (TP: Non-Jury Trial March 10, 2008, 9:41:00-9:43:05). In June, 2006, Arena informed OBO that the

first six proposed wells had been very successful and sought authorization for more new wells. *Id.* Given the success of the re-development project and the increasing price of oil and natural gas at the time, Arena's president/chief operating officer felt an obligation to Arena's shareholders and to the Unit's working interest owners to continue to move forward with re-development so as to continue to increase production. *Id.* At the time, oil production from the Unit was increased by approximately 450% and gas production had increase over 400% as a result of the re-development efforts of Arena. *Id.*

OBO has received credit for proceeds and revenues attributable to Arena's re-development efforts. (TP: Non-Jury Trial March 10, 2008, 11:49:17-11:49:55AM). In 2007, OBO agreed that the proceeds attributable to its Unit interest should be credited to the Unit expenses attributable to OBO's account and it was aware that those proceeds came in part as a result of Arena's re-development activities. (TP: Non-Jury Trial March 10, 2008, 11:52:00-11:55:13AM). No letter or written communication was ever received by Arena from OBO disputing Arena's charges against OBO's interest. (TP: Non-Jury Trial March 10, 2008, 3:11:45-3:12:10PM). As a result of 2007 communications with OBO, Arena was led to believe that it would receive all of OBO's proceeds from the Unit in payment for its share of Unit expenses. (TP: Non-Jury Trial March 10, 2008, 3:29:09-3:30:40PM). As of the date of trial, OBO had not exercised its right

to audit or make any exceptions to any of OBO's charges against OBO's share of production. (TP: Non-Jury Trial March 10, 2008, 11:40:35-11:41:20). As of the date of trial, OBO was not able to point to one area in which it took exception to Arena's Joint Interest Billings submitted to OBO. (TP: Non-Jury Trial March 10, 2008, 11:43:40-11:44:05AM).

In the underlying litigation, Arena specifically sought the recovery of expenses attributable to the Unit that OBO had failed and refused to pay. (RP 1-67). At the time of trial, Arena's live pleading asserted claims for Breach of Contract and Recovery of Real Property Guaranteeing Title Through Foreclosure of Operator's Lien. (RP 103-105). Arena further plead for equitable relief as its grounds for recovery of this debt, including both a general request for equitable relief and a specific request for enforcement of an equitable lien. (RP 103-105). At the time of trial, OBO's live pleadings were entirely defensive in nature and failed to set forth any claim for affirmative relief other than a general plea for "all relief to which it may be entitled at law or in equity." (RP 72-76). At no time did OBO plead that it was entitled to damages or a monetary judgment against Arena. (RP 72-76). OBO never plead that it was entitled to money damages of any kind. (RP 72-76). OBO never plead for specific equitable relief. *Id.* In fact, OBO never plead any cause of action at all and never made a counter-claim herein. (RP 72-

76); (TP: Non-Jury Trial March 10, 2008, 11:18:50-11:19:44AM). All of OBO's pleadings were defensive in nature. *Id.*

Following a non-jury trial at which evidence and testimony supporting Arena's claims for recovery were presented, this Court issued its Findings of Fact and Conclusions of Law on March 12, 2008. (RP 663-667). Based on the undisputed evidence and testimony presented at trial, the Court explicitly made findings that Arena's drilling of new wells and the re-completing of existing wells in the Unit increased oil and gas production, improved the Unit, and benefited OBO's interest in the Unit. (RP 663-667, FOF 29-30, COL 7). Upon these findings, the Trial Court concluded that OBO would be unjustly enriched unless it pays its proportionate share of Arena's re-development project expenses from its share of Unit revenues. (COL 8). The Court further found that OBO was entitled to an Audit of Unit expenses and revenues in order to determine whether OBO was entitled to a credit for any overpayments that it had already made. (COL 6).

On or about June 18, 2008, OBO filed its Motion for Consideration and Notice of Filing of Court-Ordered Accounting in which OBO's retained accounting firm proposed two alternative scenarios. (RP 671-682). Under one scenario presented by the accounting firm, a scenario contrary to the Trial Court's Findings and the evidence adduced at trial, OBO's accountants assumed that OBO was NOT unjustly enriched and, therefore, argued that OBO has overpaid Arena

and is owed $2,204,213. (RP 675, 677-679). This scenario was later implicitly rejected by the Trial Court when it entered its Amended Judgment. (RP 791-792). Under the second scenario, a scenario which was consistent with the Trial Court's Finding that OBO should not be unjustly enriched, OBO's own accountants admitted that OBO owes Arena $1,812,019. (RP 675, 680-682).

After considering the Accounting filed by OBO and its own Findings and Conclusions and the evidence adduced at trial, on or about October 14, 2008, the Trial Court entered its Amended Judgment which again reiterated that Arena's re-development of the Unit had enhanced OBO's interest therein and that OBO's proportionate share of the Unit expenses was $1,812,019. (RP 791-792). The Court did not award Arena a judgment in that amount, but instead ordered that Arena could recoup the $1,812,019 in expenses attributable to OBO's interest out of the Unit's future oil and gas production. (RP 791-792). It is from this Amended Judgment that OBO appeals.

VI. STANDARD OF REVIEW

The trial court's findings of fact are to be reviewed for substantial evidence.[1] The trial court's application of the facts to the law is reviewed *de novo*.[2] The trial court's award of equitable relief is to be reviewed for abuse of discretion.[3]

A substantial evidence review requires this Court to "resolve all disputed facts and indulge all reasonable inferences in favor of the trial court's findings."[4] Substantial evidence is such relevant evidence that a reasonable mind would find adequate to support a conclusion.[5] The substantial evidence standard requires that the appellate court review the record and all reasonable inferences therefrom in a light most favorable to the district court's decision.[6] The object of the Court of Appeals review is not to determine whether substantial evidence supports an opposite result, but whether there is substantial evidence to support the decision of

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[1] *Allen v. Timberlake Ranch Landowners Ass'n*, 2005-NMCA-115, ¶13, 138 NM 318, 119 P.3d 743.

[2] *Id.*

[3] *Credit Inst. v. Veterinary Nutrition Corp.*, 2003-NMCA-010, ¶17, 133 N.M. 245, 252, 62 P.3d 339, 343.

[4] *Id.*

[5] *Salazar v. D.W.B.H., Inc.*, 2008-NMSC-054, ¶6, 144 NM 828, 192 P.3d 1205.

[6] *Romero v. Bank of the Southwest*, 2003-NMCA-124, ¶18, 135 N.M. 1, 6, 83 P.3d 288, 293.

the lower court.[7] In considering a substantial evidence claim, the court of appeals must resolve all disputed facts in favor of the successful party, indulge all reasonable inferences in support of a verdict, and disregard all evidence and inferences to the contrary.[8] In a bench trial, the trial court is the sole judge of the credibility of the witnesses and the weight to be given to their testimony.[9] The Court of Appeals must liberally construe the trial court's findings to sustain a judgment, if possible.[10] The Court should not reweigh the evidence nor substitute its judgment for that of the fact finder.[11]

The trial court does not abuse its discretion in awarding equitable relief unless its ruling was clearly contrary to the logical conclusions demanded by the facts and circumstances of the case.[12] The trial court should exercise its "broad powers" to fashion an equitable remedy that ensures that justice has been done to

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[7] *Id.*

[8] *Coates v. Walmart Stores, Inc.*, 1999-NMSC-013, ¶46, 127 NM 47, 976 P.2d 999.

[9] *Crumpacker v. Adams*, 77 N.M. 633, 426 P.2d 781 (1967).

[10] *Wine v. Neal*, 100 N.M. 431, 432, 671 P.2d 1142, 1143 (1983).

[11] *Las Cruces Prof. Fire Fighters v. City of Las Cruces*, 1997-NMCA-044, ¶12, 123 N.M. 329, 940 P.2d 177.

[12] *Smith & Marrs, Inc. v. Osborn*, 2008-NMCA-043, ¶19, 143 N.M. 684, 180 P.3d 1183.

the fullest extent possible with respect to each of the parties to the lawsuit.[13] "A trial court may create broad equitable remedies to achieve substantial justice between the parties and bring an end to the litigation."[14] "Sitting in its equitable capacity, a court may avail itself of those broad and flexible powers which are capable of being expanded to deal with novel cases and conditions.[15] "Equity has the inherent power to supply a method in any suit to protect the rights of all interested parties."[16]

VII. ARGUMENTS

A. Arena properly pleaded and presented substantial evidence supporting its claims for equitable relief, thus, the Trial Court did not abuse its discretion in finding that OBO is not entitled to be unjustly enriched by Arena's substantial expenditure of drilling and operating expenses which greatly increased the value of the Unit and OBO's ownership interest therein.

1. It was within the Trial Court's discretion to grant the equitable relief requested by Arena because Arena presented sufficient pleadings and proof to support the Trial Court's judgment.

There is substantial evidence supporting the trial court's finding that "drilling new wells and re-completing existing wells . . . increased oil and gas

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[13] *Smith & Marrs, Inc.*, 2008-NMCA-043, ¶21.

[14] *See Smith v. McKee,* 116 N.M. 34, 37, 859 P.2d 1061, 1064 (1993).

[15] *Plaza Nat'l Bank v. Valdez*, 106 N.M. 464, 467, 745 P.2d 372, 375 (1987).

[16] *Id.*

production on the Unit and improved the Unit." (FOF 29). There is also substantial evidence supporting the Court's determination that such drilling benefited OBO's interest in the Unit. (FOF 30). When coupled with the Court's finding that "netting" OBO's share of expenses against its share of revenue was an accepted course of dealing between OBO and Arena, as Operator (FOF 8-11), the trial court did not abuse its discretion in concluding that Arena was entitled to "net" OBO's share of drilling and re-completing costs—$1.8 million—against its share of production as an award of an equitable lien to Arena.

At the time of trial, Arena's live pleadings sought an award of equitable relief. Arena's Second Amended Complaint presented both a general request for equitable relief and a specific request for the enforcement of an equitable lien. (RP 103-105). After hearing the evidence adduced at trial, the Trial Court ordered an accounting. Upon receipt of the accounting and Arena's response thereto (RP 716-743), the Trial Court entered its Amended Judgment in which it held that Arena would be entitled to receive slightly more than $1.8 million out of OBO's share of Unit production.

The Trial Court's Amended Judgment is wholly consistent with both the general and specific equitable relief pleaded by Arena. Although the Court did not explicitly state that it was awarding the enforcement of an equitable lien as pleaded by Arena, this is the clear effect of the Court's ruling. An equitable lien is

a creature of equity based upon the equitable doctrine of unjust enrichment, and is the right to have a fund or specific property applied to the payment of a particular debt.[17] This is precisely what the Trial Court awarded – the application of a fund (OBO's share of Unit production) to the payment of a particular debt (OBO's proportionate share of Unit re-development costs). As the Restatement of Restitution puts it, "[w]here property of one person can by a proceeding in equity be reached by another as security for a claim on the ground that otherwise the former would be unjustly enriched, an equitable lien arises."[18] As the Restatement further comments:

> Thus, where a person makes improvements upon the land of another under circumstances which entitle him to restitution, he may have an equitable lien upon the land, but he cannot charge the owner of the land as constructive trustee of the land for him and compel the owner to transfer the land to him . . . Thus, if a person makes improvements upon the land of another under circumstances entitling him to restitution for the value of the improvements, the court will not necessarily order an immediate sale of the land to satisfy the claim for

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[17] *Caldwell v. Armstrong*, 342 F.2d 485, 490 (10th Cir. 1965).

[18] Restatement (First) of Restitution §161 (1937).

the improvements. The character of the relief given will depend upon the circumstances...It might under some circumstances permit the plaintiff **restitution out of the increase of rentals due to the improvements . . .** [19]

Without stating explicitly that it was doing so, the Trial Court properly enforced an equitable lien in its Amended Judgment below based upon its conclusion that "netting" was an accepted practice between the parties and "OBO is not entitled to be unjustly enriched." OBO shall pay its proportion of Arena's re-development project from the production of Unit." (RP 666).

Because Arena properly pleaded for an equitable lien, the theory of unjust enrichment was properly before the Trial Court and the Court properly found that OBO was not entitled to be unjustly enriched by receiving the value attributable to Arena's drilling and re-working activities in the Unit without paying its proportionate share of the related expenses. A finding of unjust enrichment requires proof that (1) another knowingly benefited at one's expense, (2) in a manner such that allowance of the other to retain the benefit would be unjust.[20] Following a one day bench trial, the Trial Court entered factual findings: (i) that

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[19] *Id. at Comments a and b (emphasis added).*

[20] *Ontiveros Insulation Co., Inc. v. Sanchez,* 2000-NMCA-051, ¶11, 129 NM 200, 3 P.3d 695.

Arena's implementation of drilling new wells and the re-completion of existing wells increased oil and gas production on the Unit and improved the Unit; (ii) OBO had prior notice of Arena's activities in this regard; (iii) that such improvements benefited OBO; and (iv) that to allow OBO to avoid payment therefore would work an injustice. (FOF 12, 14, 16, 21, 29 & 30 and COL 8). In making such findings, the Trial Court heard from witnesses for both parties including the President of Arena and the Authorized Representative of OBO. The Trial Court weighed their credibility, their actions, their descriptions of the motivations behind those actions, and the outcomes of those actions in reaching its conclusion. The Court further weighed the results of the post-trial Accounting which the Court had ordered as part of its Findings. (FOF 31; RP 791-792). The Court then properly concluded that OBO would be unjustly enriched if it were permitted to retain the benefits of these improvements without paying for them out of future production. (COL 8).

The decision of whether equitable relief should be granted is within the sound discretion of the trial court.[21] A court of equity should afford relief where obviously there is fraud, real hardship, oppression, mistake, or unconscionable

[21] *Nearburg v. Yates*, 1997-NMCA-069, ¶32, 123 N.M. 526, 943 P.2d 560.

results, and on other grounds of righteousness, justice and morality.[22] OBO concedes that both parties pleaded for all relief available at law or equity. (RP 690). Notwithstanding this concession and notwithstanding the fact that OBO itself received its own equitable relief on the exact same general pleading in the form of the court-ordered Accounting, it now argues that Arena's more specific pleadings are insufficient to support the relief awarded by the Trial Court. Specifically, although it did not plead for an equitable accounting and instead relied on its general pleadings for equitable relief, OBO sought such an accounting and received such relief from the Court in its Findings. Now, OBO is attempting to use that accounting to argue that Arena is not entitled to damages but instead owes OBO over $2.4 million for alleged overpayments.[23] OBO cannot have it both ways. If OBO's general pleading authorized the Court to grant an equitable accounting, then Arena, whose pleadings are more specific and include both a general plea for equitable relief and a specific request for enforcement of an

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[22] *United Properties Ltd. Co. v. Walgreen Properties, Inc.*, 2003-NMCA-140, ¶31, 134 NM 725, 82 P.3d 535.

[23] By way of example, OBO's position, if applied herein, would result in the following hypothetical and grossly inequitable result: A well costs $400,000 to drill, making OBO's approximate 25% share of the drilling expense $100,000. That same well may be expected to produce $3 million in oil revenue over the course of its life. Applying the argument OBO makes herein, OBO would not only not have to pay its $100,000 share of the drilling expenses, but would also receive the windfall of 25% of the $3 million in production from the well.

equitable lien, is also entitled to the equitable remedies for which it has pleaded, and such relief was properly awarded by the Court below.[24]

Contrary to OBO's assertions, OBO had fair notice of the equitable relief sought by Arena and had an adequate opportunity to litigate this issue before the Court. Arena's pleadings for equitable relief have been before this Court and known to OBO since this case was first filed. (RP 1-67). Both parties adduced evidence at trial of the communications between the parties during 2006 and 2007 including OBO's knowledge of Arena's re-development activities, of OBO's complete lack of objection to the Arena's Unit enhancing activities, of the benefits conferred upon OBO's interest in the Unit due to Arena's activities and the expenses associated therewith, of the amounts expended on OBO's behalf by Arena, and of the revenues attributable to OBO's Unit interest thanks to Arena's expenditures, all of which occurred without any objection or even communication from OBO until late in the day, after the work had already been substantially completed.[25] The Court further heard evidence, both at trial and in the form of the

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[24] *See In re Furrs Supermarkets, Inc.*, 2008 WL 820076 *10-11 (Bkrtcy.D.N.M. 2008) (finding that Plaintiff's pleading for "all other just and proper relief" constituted a request for equitable relief under New Mexico state law).

[25] *See In re Furrs Supermarkets, Inc.*, 2008 WL 820076 at *10-11 (awarding equitable relief where Defendant stood idly by while knowingly receiving overpayments because it would be unjust to allow Defendant to retain the benefits of said payments).

(continued)

Court-ordered accounting, of the substantial, seven-figure, amounts by which OBO would be unjustly enriched if it were to receive a windfall by not having to pay its proportionate share of Unit expenses incurred by Arena. OBO essentially received a no-risk interest-free loan from Arena because Arena fronted 100% of the costs of the projects and will only be allowed to recoup those expenditures made on OBO's behalf out of OBO's future production. OBO seeks not only to avoid paying its proportionate share of expenses out of production, but, after pay-out, OBO wants to reap the future benefits of increased production from the new and re-worked wells without ever paying a dime to achieve the increased revenue. This issue was properly tried before the Trial Court and the Trial Court had ample evidence by which to enter its Conclusion that OBO should not be unjustly enriched.

Based upon its finding that OBO would be unjustly enriched to the detriment of Arena unless it paid its proportionate share of Unit expenses out of its share of Unit revenues, the Trial Court ordered OBO to pay its proportion of the re-development project out of its share of future Unit revenues. If this Court were to now reverse the Trial Court and not grant the relief requested by Arena, the interests of justice and equity would be offended and Arena would be placed in an

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(continued)

unconscionable situation of having expended multiple millions of dollars in its role of Operator of the Unit to OBO's benefit with no available recourse. OBO should not be allowed to enjoy a substantial windfall and to reap the benefits flowing from the Unit without sharing the reasonable costs and expenses involved in creating those benefits. Because the Trial Court's Conclusions of Law are well supported by its Findings of Fact and the evidence adduced at trial, they should not be disturbed, despite OBO's contentions otherwise and the Trial Court's Amended Judgment should be affirmed.[26]

2. ***The express contract between the parties is silent as to the subject matter of this dispute and the Trial Court's resort to equity was appropriate.***

Arena agrees that, generally speaking, when a valid and express contract governs the subject matter of a dispute, there can be no equitable recovery for unjust enrichment where such recovery would be inconsistent with the express contract.[27] However, this rule only applies where the express agreements already address the matter in dispute.[28] Also, the rule is not without exception, as New

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[26] *Romero v. J.W. Jones Const. Co.,* 98 N.M. 658 (1982) (A court's conclusions should be upheld so long as they are justified by one or more findings of fact).

[27] *Fortune Production Co., v. Conoco Inc.,* 52 S.W.3d 671, 684-685 (Tex. 2000).

[28] *Id.*

Mexico courts have allowed a party to plead breach of contract, yet still recover on an equitable basis where the facts supported such claim.[29]

The two agreements at issue are the UA and UOA signed by the parties' predecessors in interest in 1973. Upon review, it is clear that the agreements do not expressly provide for the effect of a failure to receive consent prior to initiating a Unit re-development plan and the effect, if any, on a party's obligations to pay proportionate expenses, particularly when the re-development plan has significantly enhanced the production of the Unit and greatly enhanced the value of all parties' interests in the property. Despite OBO's contentions to the contrary, neither the UA nor UOA address the situation that the Trial Court faced below. Neither agreement provides for a scenario in which all but one working interest owner are silent in the face of a re-development proposal. OBO would have this Court find that in such a scenario, the operator (Arena) is forced to either abandon all development of the Unit indefinitely or pay for the other owners' share of re-development expenses out of its own pocket without any right of equitable reimbursement. It is only if the drilling and recompletions are successful, thus benefiting all working interest owners, that recoupment is possible and

[29] *Harbison v. Clark,* 59 N.M. 332, 336-37, 284 P.2d 219 (N.M. 1955).

appropriate. It is not fair nor reasonable that Arena had to forgo a successful drilling program or pay for its co-tenants' expenses when the UA and UOA simply don't address the scenario. The Trial Court was fully justified in making its factual findings and in deciding to award equitable relief for a successful project which provided a means for the operator to move forward with re-development of the Unit and to subsequently recover its expenses while at the same time requiring that said expenses only be recovered out of Unit production. If this Court were to adopt the outcome urged by OBO, it would be in contravention of New Mexico's public policy which is "designed to further oil and gas exploration and development" while at the same time properly allocating the monetary risks of keeping oil wells in production.[30]

Although there is a paucity of case law addressing similar factual scenarios in the oil and gas context, a Texas court of appeals case may be helpful. In *Cone v. Fagadau Energy Corp.*, Texas' Eastland Court of Appeals was faced with a scenario in which a working interest owner (Cone) failed to give its consent to a Unit re-development project and then alleged various torts and breach of contract against the operator who proceeded to re-develop the Unit despite Cone's non-consent and despite a contractual provision requiring that the operator obtain the

[30] *Bellet v. Grynberg*, 114 N.M. 690, 694-95, 845 P2d 784, 788-89 (1992).

consent of all working interest owners for expenses in excess of $15,000.[31] There, the Eastland court found that the consent requirement, similar to that found in the UOA, was a limitation for accounting purposes only and did not prevent the operator from going forward with the re-development activities.[32] Because the parties to the agreement in *Cone* were co-tenants in the Unit, just as are the parties to this appeal, the non-extracting co-tenant (in this case OBO) had a remedy for the re-development activities to which it had not consented – the extracting co-tenant (in this case Arena) must account for the value of the minerals extracted less attendant expenses.[33] The *Cone* case is not completely analogous to the case at bar because the *Cone* operating agreement also contained specific non-consent provisions which the UA and UOA do not, but the *Cone* court's treatment of the parties' relationship as co-tenants who are also parties to an operating agreement is instructive. As mineral co-tenants, Arena and OBO had certain rights and duties with regards to the Unit, including the right to develop the unitized properties. Arena properly exercised this right even though it did not obtain OBO's consent. Because the UA and UOA do not provide for a scenario in which a working

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[31] *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex.App.-Eastland 2001, pet. denied).

[32] *Id.* at 156-158.

[33] *Id.*

interest owner non-consents, resort to the principles of co-tenancy is appropriate.[34] Both the principles of co-tenancy and equity, as expressed by the Trial Court, hold that Arena is entitled to be reimbursed its expenses out of the proceeds of Unit production.[35] The Trial Court awarded the appropriate remedy.

OBO is asking this Court to protect what to date has been an unearned windfall and enable it to enjoy the continuing benefits of the improved Unit without paying its proportionate equitable share. After observing the witnesses and hearing their testimony and reviewing the documentary evidence, the Court noted at trial that "neither party is blameless in this matter." (TP: Non-Jury Trial March 10, 2008, 4:27:37–4:28:16). Despite this observation, the Trial Court clearly found that Arena was entitled to equitable relief. The Trial Court was uniquely situated to make this determination and, thus, the decision as to whether either party was entitled to receive equity or whether either was disqualified as

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[34] *Neeley v. Intercity Management Corp.*, 732 S.W.2d 644, 646 (Tex.App.-Corpus Christi 1987, no writ) (finding that "if an operating agreement does not include an express promise by a nonoperator to contribute to the expenses of acquisition, exploration, development and operation costs, the operator is usually not entitled to reimbursement **except** out of proceeds") (emphasis added).

[35] *See Bellet v. Grynberg*, 114 N.M. 690, 694-95, 845 P2d 784, 788-89 (1992).

having "unclean hands" was within the Trial Court's sound discretion and should not be disturbed on appeal absent clear abuse of that discretion.[36]

OBO has made the further contention that an unjust enrichment remedy is only available where there is a total lack of any contractual relationship between parties.[37] However, this is not necessarily the case and New Mexico courts have held that if the issue of unjust enrichment is brought to the Court's attention by the evidence, a party may plead an express contract and still recover on an implied agreement.[38] This principle should apply here where the contract between the parties clearly did not anticipate the factual scenario presented in the Trial Court below. As noted by the Trial Court's findings, ample evidence and uncontradicted testimony were introduced without objection showing that the Unit had been increased by the sole efforts and at the expense of Arena, and that such efforts had increased the production and value of the Unit, including OBO's proportionate interest. (TP: Non-Jury Trial March 10, 2008, 10:16:36–10:17:00, 10:01:30–10:01:38). Based on these findings, the Court came to the reasonable conclusion

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[36] *Romero v. Bank of the Southwest*, 2003-NMCA-124, ¶37, 135 N.M.1, 83 P.3d 288.

[37] OBO relies on *Hydro Conduit Corp. v. Kemble*, 110 N.M. 173, 793 P.2d 855 (1990) for this proposition. *Hydro Conduit* makes no such statement, rather it spends quite some time analyzing unjust enrichment in the context of the subcontractor/contractor relationship in a claim versus the state.

[38] *Harbison v. Clark,* 59 N.M. 332, 337, 284 P.2d 219 (N.M. 1955).

that OBO was not entitled to be unjustly enriched, and equity requires that OBO pay its proportionate share of the costs involved in improving the Unit.

*3. **Arena's pleadings gave adequate notice to OBO of Arena's claims.***

As mentioned above, OBO has conceded, and Arena agrees, that each party requested equitable relief from this Court, thereby injecting equitable principles into this litigation. OBO received sufficient notice that the equitable principle of "equitable lien" and the related principle of unjust enrichment were at issue and that issue was tried to the Court. The Court heard ample testimony to support its finding that OBO was not entitled to be unjustly enriched and must pay its share of the Unit's re-development expenses from its share of Unit production.

"Except as to a party against whom a judgment is entered by default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings."[39] In unique circumstances, a court in equity may grant relief consistent with the pleadings even though such relief is not specifically pleaded.[40] A prayer for general equitable relief justifies a court in granting relief beyond what is asked for in specific prayers, as long as such relief is consistent with the pleadings and

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[39] SCRA 1986, 1-054(D); *Wilburn v. Stewart*, 110 NM 268, 794 P.2d 1197, 1201 (1990).

[40] 61b Am.Jur.2d Pleading § 935.

the evidence does not surprise the opposing party.[41] Likewise, where pleadings allege facts that would support a particular claim and both parties present evidence of that claim at trial, the court can grant the remedy associated with that claim, even if that remedy is not sought in the claimant's prayer for relief.[42] Recently, courts have allowed recovery based on evidence adduced at trial, even if that recovery varies from the relief requested in the party's pleadings.[43] Both the New Mexico Rules of Civil Procedure and the Federal Rules of Civil Procedure provide that except as to a party against whom a judgment is entered by default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings.[44]

From the inception of this lawsuit, Arena's stated goal was to recover monies properly owed to it arising out of its efforts to develop and increase production of the Unit. Arena alleged breach of contract and requested equitable relief throughout the course of this litigation. OBO had knowledge and cannot claim surprise that Arena intended to explore the various equitable theories that

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[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] *Id;* SCRA 1986, 1-054(D).

would enable Arena to recover its rightfully owed debt from OBO. Evidence and testimony was admitted which led the Court to make findings that Arena's efforts had increased oil and gas production on the Unit, improved the Unit, that this was known to OBO, and that OBO's interest in the Unit benefited from Arena's efforts. (FOF 21, 29, 30). OBO had ample opportunity to introduce evidence and testimony to dispute these facts, but failed to do so convincingly and the Trial Court properly entered its Amended Judgment below.

B. The Trial Court properly ordered OBO to pay Arena $1,812,019 from OBO's share of Unit production.

After the bench trial below, the Trial Court entered Findings of Fact and Conclusions of Law in which it ordered that OBO was "entitled to make a full and complete audit of all expenses and revenues of the Unit from March 1, 2005 until present." Pursuant to that finding and order, OBO retained the accounting firm of Elms, Faris & Company in Midland, Texas which purported to conduct an "accounting" for the Unit for the period of March 1, 2005 through March, 2008. That "accounting" was completed on June 16, 2008 and was filed with the Trial Court on June 18, 2008. (RP 671-682). Because the "accounting" conducted by Elms had several serious flaws and inadequacies, Arena prepared and filed a response which was on file for the Court's review prior to entry of the Court's Amended Judgment. (RP 716-743). Arena's response to the OBO Accounting

demonstrated the flawed and one-sided work that went into Schedule I of the Elms' "accounting." In its "accounting", Elms purported to have reviewed Arena's Joint Interest Billing Statements ("JIB's") for the Unit for the period March 2005 through March 2008 and to have accepted the amounts reported by Arena in the monthly JIB's as true. Elms acknowledged that it did not audit the invoices that supported the monthly JIB's. If Elms had properly audited said invoices, Elms' purported "accounting" would have looked very different as demonstrated by Arena's response. (RP 721-724).

More specifically, Schedule I of the Elms "accounting" purported to calculate a cumulative balance due to OBO from Arena by calculating "Authorized LOE and Overhead." However, as demonstrated in Arena's response, the Elms "accounting" is erroneous because it makes multiple erroneous assumptions regarding which expenditures were "authorized" under the Unit Operating Agreement and which were not. Elms never contacted Arena to obtain additional information or explanations regarding Arena's coding practices. Elms never contacted Arena for explanations regarding the various expenditures which it assumed to be unauthorized. Rather, it employed a simplistic analysis of Arena's AFEs in order to provide OBO with the "accounting" outcome it desired. The Elms "accounting" failed to account for the fact that many of the costs that Elms categorized as "unauthorized" were in fact tied to AFEs which Arena

submitted to OBO. Further, as demonstrated by Arena's response, many of the expenses were below the $15,000 expenditure authorization limit set forth in the UOA, yet Elms failed to account for this. Thus, Schedule I to Elms' "accounting" was simply incorrect and misleading advocacy and provided no basis for the Trial Court to enter Judgment in this matter.

However, Schedule II of Elms "accounting" simply analyzed and calculated Net Revenue against all Unit expenses. This analysis is consistent with the Trial Court's Findings of Fact and Conclusions of Law where the Court found that "OBO is not entitled to be unjustly enriched" and that "OBO shall pay its proportion of Arena's re-development project from [OBO's share of] the production of the Unit." Schedule II properly accounted for the OBO's share of Unit revenues and expenses and, when taken in conjunction with the pleadings and evidence adduced at trial, provided the Trial Court with an adequate basis for its Amended Judgment requiring OBO to reimburse its share of Unit re-development expenses out of its share of Unit production.

C. OBO failed to plead or prove that it was entitled to affirmative relief and, thus, this Court may not remand this case to the Trial Court to direct that the Trial Court award the credit and additional affirmative relief now requested by OBO.

OBO wants to have its cake and eat it too. On the one hand, OBO argues that Arena did not sufficiently plead and prove its right to equitable relief, yet on

the other hand OBO argues that it is entitled to receive a remanded judgment in excess of $2.4 million despite failing to counterclaim or plead for such relief and despite offering pleadings and proof that were far less substantive than those offered by Arena. Arena plead specifically for an equitable lien and for equitable relief in general. Arena's pleadings put OBO on notice that Arena claimed it was entitled to equitable relief and at trial would put on proof of approximately $1.8 million in damages. Despite receiving this adequate notice of the amount and basis for Arena's claims, OBO contends on appeal that it was not properly put on notice of Arena's claims herein.

However, OBO does not stop there. Despite pleading and proof that does not come close to measuring up to the notice provided by the pleadings and proof put forward by Arena about which OBO complains, OBO now contends that this Court should reverse the trial court's judgment and instead remand this action to the trial court with instructions to enter a judgment in OBO's favor in the amount of approximately $2.4 million plus interest, an outcome which the Trial Court already rejected. OBO's contentions are disingenuous at best and are not supported by the pleadings or the evidence adduced at trial. If Arena's pleading and proof is inadequate to support the trial court's judgment as OBO contends (which Arena disputes), then OBO's pleadings and proof are by definition inadequate to support the remanded judgment which OBO now seeks.

Unlike Arena, OBO never plead that it was entitled to money damages of any kind. (RP 72-76). Unlike Arena, OBO never plead for specific equitable relief. *Id.* In fact, OBO never plead any cause of action at all and never made a counter-claim herein. (RP 72-76); (TP: Non-Jury Trial March 10, 2008, 11:18:50-11:19:44AM). All of OBO's pleadings were defensive in nature. *Id.* Thus, a remand would act as an impermissible surprise and work a substantial injustice against Arena and is not supported by the pleadings.

VIII. Conclusion

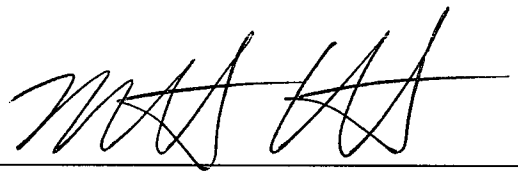
The Trial Court properly awarded Arena equitable relief when it found that Arena's re-development efforts had increased the value of the Unit and that OBO should not be permitted to be unjustly enriched by such increase in production, revenue and value, but that instead OBO should pay its proportionate share of Unit expenses from its share of future Unit production. Any other outcome, including the result prayed for herein by OBO, would result in a windfall to OBO in excess of $2.4 million dollars in the past and potentially millions in the future all at Arena's expense. The Trial Court did not abuse its discretion in finding that such an outcome was not appropriate and would result in the unjust enrichment of OBO. Accordingly, this Court should uphold the Trial Court's Judgment and the Findings and Conclusions which support said Judgment.

IX. PRAYER FOR RELIEF

For all of the foregoing reasons, Appellee, Arena Resources, Inc., respectfully requests that this honorable Court deny OBO, Inc.'s appeal in its entirety and affirm the Amended Judgment of the Trial Court. Appellee prays further for such relief to which it is justly entitled at law and in equity.

Respectfully submitted,

COTTON, BLEDSOE, TIGHE & DAWSON
A Professional Corporation
P.O. Box 2776
Midland, Texas 79702
(432) 684-5782
(432) 682-3672 (Fax)

By: 

Matt Catalano
New Mexico State Bar No. 25422
Susan R. Richardson (*pro hac vice*)
Texas State Bar No. 18061500

ATTORNEYS FOR APPELLEE
ARENA RESOURCES, INC.

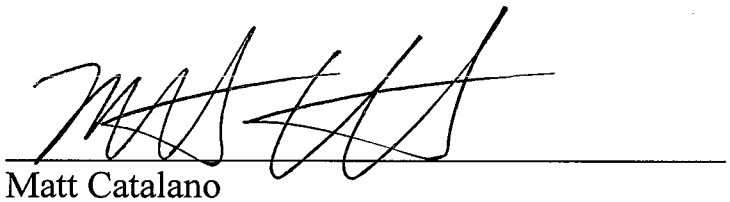
X. PROOF OF SERVICE

I hereby certify that I served the above and foregoing Appellee's Answer Brief on the persons listed below in the method described below, on this 4th day of August, 2009 to:

Robert P. Crumpler, Jr. (hand delivery)
Davis, Gerald & Cremer
A Professional Corporation
P.O. Box 2796
Midland, Texas 79702

Mark Terrence Sanchez (certified U.S. mail, return receipt requested)
Reagan & Sanchez, P.A.
1819 North Turner, Suite G
Hobbs, New Mexico 88240-3834

Attorneys for Appellants



Matt Catalano