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.

APPELLANT OBO, INC.'S BRIEF IN CHIEF

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

FOR THE APPELLANT

Robert P. Crumpler, Jr.
State Bar No. 14961
Davis, Gerald & Cremer
A Professional Corporation
Attorneys for the Appellant
400 W. Illinois, Suite 1400 (79701)
P.O. Box 2796
Midland, Texas 79702
(432) 687-0011
Fax: (432) 687-1735

Mark Terrence Sanchez
State Bar No. 4672
Reagan & Sanchez, P.A.
Attorneys for the Appellant
1819 North Turner, Suite G
Hobbs, New Mexico 88240-3834
(575) 397-6551
Fax: (575) 393-2252

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

In referring to the transcript of proceedings, Appellant OBO, Inc. ("OBO") will use the date and time notations on the compact disc on which the hearings were recorded. OBO 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, OBO will refer to the number of such exhibit and, if necessary to avoid ambiguity, identify the hearing or type of proceeding (OBO's Trial Exhibit ____).

In citing to the record proper, OBO 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 Brief in Chief, OBO 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")
- Unit Operating Agreement ("UOA")

III. LIST OF LEGAL ISSUES

A. When express contracts (UA and UOA) govern the parties' relationship and conduct, the breaching party (Arena) should not be excused from liability for its breach and ultimately rewarded under the quasi-contract theory of unjust enrichment; the Trial Court may exercise its power of equity only in conformity with the law and, thus, may not use equity to avoid express contractual language.

B. A trial court may not issue a *sua sponte* award of unjust enrichment which was not pleaded, argued, or tried by the parties in any capacity; OBO did not receive fair notice of the theory of unjust enrichment and properly relied on the Trial Court's previous written order that Arena was precluded at trial from arguing or offering evidence in any capacity on any matter not included in Plaintiff's Second Amended Complaint.

C. Although there may be some perceived benefit based on an alleged increase in value resulting from a party's breach, this in and of itself is not evidence that the other party has been unjustly enriched; awarding Arena restitution based solely on increased production to the Unit deprives OBO of the rights and protections expressly granted to it under the UA and UOA and constitutes a re-writing of the contract.

D. The Trial Court's determination that OBO was entitled to a credit for overpayment on the Unit, related to expenses charged for the re-development program unilaterally implemented by Arena, is supported by the evidence submitted at trial and the Court's consideration of the Court-Ordered Accounting.

IV. TABLE OF AUTHORITIES

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V. SUMMARY OF PROCEEDINGS

A. Nature of the Case

This is an appeal from a breach of contract lawsuit filed by Arena against OBO concerning the interpretation and enforcement of a UA and UOA governing the parties. (RP 1-67). Specifically, Arena sought to recover approximately $1.8 million dollars of expenses charged to OBO, a minority working interest owner in the Unit, for a re-development program initiated and approved solely by Arena as Operator. (RP 103-105). OBO argued from the inception of this lawsuit that Arena did not have the requisite approval to conduct the re-development operations, and thus, was not authorized to charge OBO for the expenses. (RP 72-76). Arena's Second Amended Complaint was the live pleading at the time of trial and contained two (2) counts for relief: Count 1: Breach of Contract; and Count 2: Foreclosure of Operator's Lien. (RP 103-105).

After a non-jury trial, the Trial Court determined that Arena breached the UA and UOA because it failed to obtain the contractually required approval prior to incurring the expenses for unit operations it sought to collect from OBO and because Arena improperly netted the additional expenses of the re-development project against OBO's interest. (RP 663-667; FOF 22-26; COL 4-5).[1] In contrast, the Trial

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[1] For purposes of this Brief in Chief, the Court's Findings of Fact ("FOF") and Conclusions of Law ("COL") will be abbreviated as noted.

Court found that OBO did not breach the terms of the UA or UOA, ordered that OBO could conduct an audit of all expenses on the Unit, and that OBO would be entitled to a "credit for any over payment that it has made with interest." (RP 665-666; FOF 27; COL 6). After completion of the audit, OBO filed the Court-Ordered Accounting of record, and both parties filed motions seeking judgment from the Trial Court consistent with its determinations at trial and consideration of the Court-Ordered Accounting. (RP 683-712, 716-766, 771-777; TP: hearing September 30, 2008, 9:58—9:59AM).

The Trial Court entered its original Judgment on October 3, 2008 ("Original Judgment"), specifically denying all of Arena's claims and ordering Arena to credit OBO's interest for the unauthorized charges on the Unit. (RP 781-782). Arena filed a Motion for New Trial and Motion to Alter Judgment, citing to no legal authority but complaining that OBO should be required to pay its proportionate share of the re-development project based on the Trial Court's prior indication that OBO would not get "free wells." (RP 783-790; TP: Non-Jury Trial March 10, 2008, 4:25—4:30PM). Without an opportunity for OBO to respond and without a hearing, the Trial Court reversed itself and entered the Amended Judgment (of which this appeal complains) awarding the breaching party favorable relief, and ordering OBO to pay for millions of dollars of re-development costs which were not approved by any minority working interest owner in accordance with the express terms of the governing UOA. (RP 791-

792). Notwithstanding the Trial Court's determination that Arena was the only party in breach and that Arena should take nothing from OBO on its claims, the Trial Court ordered OBO to pay to Arena the sum of $1,812,019.00 based on a *sua sponte* finding of unjust enrichment. (RP 791-792). OBO timely objected, arguing that the Trial Court's application of unjust enrichment was done in a manner as to ignore the parties' express contracts, to circumvent the prior orders of the Trial Court, and to obviate the Trial Court's Findings of Fact and Conclusions of Law. (RP 654-661, 683-712, 771-777, 793-810).

B. Course of Proceedings

The Trial Court presided over a non-jury trial on the merits of two counts: Breach of Contract and Foreclosure of Operator's Lien. (RP 103-105, 628; TP: hearing March 5, 2008, 8:52—8:55AM). The Trial Court ordered that Arena take nothing on both of these counts and issued a Judgment and Amended Judgment after entry of the Court's Findings of Fact and Conclusions of Law and filing of the Court-Ordered Accounting. (RP 663-667, 781-782, 791-792). This Appeal arises from the Amended Judgment. (RP 791-792). OBO asks this Court to reverse the Trial Court's award of damages or reimbursement to Arena and render judgment issuing a credit to OBO in conformity with the express provisions of the UA and UOA.

C. Summary of Facts

OBO and Arena are parties to, and their rights and obligations are governed by, the UA and UOA dated August 24, 1973, for a producing oil and gas unit called the Seven Rivers-Queen Unit located in Lea County, New Mexico. (RP 663-667; FOF ¶¶ 1-3).[2] Arena acts as Operator of the Unit Area and owns a 71.13167 percent participation (working) interest in the unitized properties. (RP 663-666; FOF ¶¶ 4, 7). Defendant-Appellant OBO owns a 25.752 percent participation (working) interest in the Unit. (RP 663-667; FOF ¶ 5). The Evelyn Clay O'Hara Trust ("ECO Trust") also owned an approximate 3.117 percent of minority working interest in the Unit and was originally named as a defendant in this lawsuit, but Arena abandoned its claims against ECO Trust prior to trial. (RP 1-67, 103-105).

The UOA expressly requires that the drilling of any well for any purpose and the making of any expenditure in excess of $15,000.00, shall be approved by working interest owners. (UOA Section 3.2.2 & 3.2.4). (RP 178, 663-667; FOF ¶¶ 18-19). Such operations must be determined by (i) the affirmative vote of at least two working interest owners; (ii) with such owners owning at least seventy percent of the voting interest. (UOA Section 4.3.2). (RP 663-667; FOF ¶ 20).

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[2] Complete copies of the UA and UOA may be found in the Record Proper as follows: UA (RP 128-174); UOA (RP 175-215). It is undisputed that the UA and UOA govern the parties and were accurately represented in their entirety. (RP 253, ¶ 1).

In 2006, Arena sent OBO a written drilling proposal for a re-development program and the fracture stimulation of existing wells. (RP 663-667; FOF ¶ 21). The estimated total cost was over $3.6 million, with OBO's estimated proportionate share in excess of $900,000.00. (OBO Trial Ex. 3; Arena Trial Ex.11). OBO did not affirmatively vote for the drilling proposals and did not agree to any expenditures in excess of $15,000.00. (RP 663-667; FOF ¶ 23). Arena was the only working interest owner that approved the operations and resulting expenses prior to commencing the operations, and it failed to obtain the contractually required two votes to approve the operations at issue in the lawsuit. (RP 663-667; FOF ¶¶ 22, 25). This was undisputed at trial. (TP: Non-Jury Trial March 10, 2008, 10:44—10:46, 10:50—11:02AM, 3:41—3:43PM). Although Arena knew that it did not have the approval for the operations, it went forward with them anyway based upon a "corporate decision" to proceed. (RP 663-667; FOF ¶ 26; TP: Non-Jury Trial March 10, 2008, 9:37—9:39, 10:54—10:58AM). Arena unilaterally approved the drilling operations, proceeded with the drilling program, and subsequently demanded payment from OBO and the ECO Trust for its proportionate share of those expenses. (RP 663-667; FOF ¶ 24). In May 2006, Arena began charging OBO's revenue interest for the unauthorized expenses of the re-development program. (RP 674-682). Arena has continued to net OBO's interest and maintain control over these monies through the present date.

Arena filed this lawsuit on March 15, 2007 seeking recovery under two counts for relief: Count 1: Breach of Contract; and Count 2: Foreclosure of Operator's Lien. (RP 3-4, 79-80, 104-105). Initially, Arena sought recovery of approximately $1.8 million dollars from OBO and $220,000.00 from the ECO Trust for expenditures charged to the joint account for the unapproved re-development project. (RP 4, ¶ 11). Approximately six weeks prior to trial and six months after the deadline promulgated in the Minute Scheduling Order, Arena sought leave to file a Third Amended Complaint incorporating additional affirmative claims (or defenses) of waiver and ratification. (RP 94-96, 437-448). The Trial Court denied Arena's Motion for Leave. (RP 452). Next, Arena attempted to file supplemental discovery responses and Witness/Exhibit Lists (less than two weeks prior to trial) adding new witnesses and designating new experts, to which OBO filed a Motion to Exclude and Motion to Strike. (RP 459-502, 529-582). The Trial Court issued a written order that Arena was precluded at trial from mentioning, referring to, arguing, and/or offering evidence on any matter, claim, count, and/or cause of action not included in Plaintiff's Second Amended Complaint and that the late-designated witnesses would not be allowed to provide expert testimony at trial. (RP 628-637).

On March 10, 2008, the parties announced ready, and the case proceeded to a non-jury trial. Arena's president and chief operating officer, Phillip Terry, conceded that Arena failed to comply with the UOA as (1) Arena never received an affirmative

vote from OBO or any working interest owners approving the operation, but (2) nevertheless proceeded with the operations and "hoped" that it would gain the necessary vote(s). (TP: Non-Jury Trial March 10, 2008, 9:37—9:39, 11:02—11:05AM). Ultimately, Arena made a "corporate decision" to ignore the UOA and proceed with the operations without the requisite vote. (TP: Non-Jury Trial March 10, 2008, 9:37—9:39, 10:54—10:56AM). Mr. Terry admitted that only chargeable expenses (expenses incurred in conformity with the UOA) should be charged to the working interest owners, and based on this definition, Arena did not have the requisite vote to charge the unapproved expenses to the joint account. (TP: Non-Jury Trial March 10, 2008, 10:59—11:01AM). This admission was further corroborated by the testimony of William Broderick, Chief Financial Officer for Arena, who confirmed that the expenses sought by Arena in the lawsuit included those expenditures that had not been approved by the joint working interest owner group and that Arena takes an "aggressive" stance on capitalizing costs to pass on to its working interest owners. (TP: Non-Jury Trial March 10, 2008, 3:32—3:37PM).

During the trial, Arena again attempted to file Plaintiff's Third Amended Complaint, which included additional affirmative claims or defenses for waiver and ratification. (TP: Non-Jury Trial March 10, 2008, 3:52—3:53PM). The Third Amended Complaint did not contain any claim for unjust enrichment or contain factual allegations of unjust enrichment to OBO. (RP 103-105). The Trial Court

again denied Arena's amendment request and consistently sustained OBO's relevancy objections throughout the course of trial for any evidence offered by Arena regarding claims or defenses that were not contained in Plaintiff's Second Amended Complaint. (TP: Non-Jury Trial March 10, 2008, 11:50—11:56AM, 2:49—2:52PM). Arena did not offer any expert testimony on any issue presented at trial. (RP 628-637; TP: Non-Jury Trial March 10, 2008, 9:18—9:19, 9:22, 10:02—10:20AM).

Lowell Dunn, corporate representative for OBO, testified that OBO "deliberately elected not to agree and affirm" the operations and resulting expenses in question. (TP: Non-Jury Trial March 10, 2008, 11:38AM, 1:37—1:40PM). OBO did not learn that Arena had not obtained the requisite vote until after this lawsuit was filed. (TP: Non-Jury Trial March 10, 2008, 1:46—1:47PM). It was also undisputed at trial that Arena failed to inform owners of the alleged "vote" on the proposed operations—another breach of the UOA. (TP: Non-Jury Trial March 10, 2008, 1:45—1:48PM). OBO asserted that because the charges attributable to the re-development program were not approved, these charges and expenses should be reversed out or exempted from the joint account. (TP: Non-Jury Trial March 10, 2008, 1:50—1:54PM). Counsel for Arena attempted to question Mr. Dunn regarding whether OBO received and retained the benefits of the increased production—the Trial Court sustained defense counsel's relevancy objection based on an "unpled theory and claim." (TP: Non-Jury Trial March 10, 2008, 11:50—11:56AM). In fact,

Mr. Dunn ultimately testified that OBO believes the re-development program resulted in selling oil at "half-price" for an extended period to the detriment of OBO rather than constituting a benefit. (TP: Non-Jury Trial March 10, 2008, 2:07—2:10PM). Moreover, Mr. Dunn testified that the actual cost of the re-development program approximated nearly $14 million dollars, nearly $10 million dollars over what had been originally been proposed to the working interest owners when Arena sought approval of the operations. (TP: Non-Jury Trial March 10, 2008, 1:43—1:46PM).

After considering the evidence presented at trial and the arguments of counsel, the Trial Court issued its Findings of Fact and Conclusions of Law on March 12, 2008. (RP 663-667). In those Findings, the Trial Court determined that the UA and UOA are the controlling contracts and that Arena breached the UA and UOA by failing to obtain the affirmative vote of a minority working interest owner approving the re-development program. (RP 663-667; COL 4). The Trial Court issued an express finding that "Arena has been improperly netting OBO's share of production to pay for OBO's proportion of ordinary unit operation expenses as well as OBO's proportion of Arena's unit re-development project" and would be entitled to a credit for any overpayment made. (RP 663-667; FOF 28; COL 6). Although only testimony and evidence concerning the consequences of Arena's unapproved re-development program was presented at trial, the Court found that the Unit (not OBO) had been

improved and that even considering Arena's breach, OBO could not be unjustly enriched. (RP 663-667; FOF 29-30; COL 7, 8). To afford complete relief in the case, the Trial Court ordered OBO to make a full and complete audit of all expenses on the Unit prior to Judgment. (RP 663-667; FOF 31; COL 6).

On June 18, 2008, OBO filed its Motion for Consideration and Notice of Filing of Court-Ordered Accounting and Motion for Judgment asking this Court to enter Judgment in its favor in accordance with the Court's findings of a breach by Arena. (RP 671-712). Subsequent to the hearing on these Motions and consistent with the Court's previous findings of Arena's breach of the UA and UOA, the Trial Court entered the Original Judgment on October 3, 2008, in this matter in favor of OBO. (RP 781-782). In sum, the Trial Court denied the relief requested by Arena and Ordered that Arena pay to OBO $1,812,019.00 (out of production from the Seven Rivers-Queen Unit) as a result of Arena's breach and consequential netting of OBO's share of Unit revenue. (RP 781, ¶ 3). This Judgment comported with the Trial Court's factual findings and determinations that OBO should not be netted for the re-development expenses. (RP 663-667; FOF 28; COL 6). Arena filed a Motion for New Trial citing no authority, wherein it asked the Trial Court to set aside or otherwise modify its Original Judgment based on the unfounded representation that the Judgment somehow provided OBO with a "windfall." (RP 783-790). On October 14, 2008, prior to the deadline for OBO to file any response or hearing on Arena's

Motion for New Trial, the Trial Court entered an Amended Judgment, reversing itself and awarding the breaching party (Arena) over $1.8 million dollars. (RP 791-792).

OBO filed a Motion for New Trial and Motion to Amend Judgment on October 23, 2008. (RP 793-810). The Trial Court denied this motion on December 10, 2008. (RP 874-875). The Notice of Appeal was timely filed on January 7, 2009. (RP 879-883).

D. Attack on Findings

Specific attack is hereby made on the following findings and conclusions of the Trial Court filed on March 12, 2008: findings Nos. 29 and 30, and conclusions Nos. 7 and 8. (RP 663-667). OBO further seeks relief from the Trial Court's Amended Judgment, ¶¶ 4, 5, 6, 7, and 9. (RP 791-792). These enumerated Findings of Fact and Conclusions of Law and Amended Judgment are inconsistent and incongruent with the Trial Court's determination, and undisputed evidence, that the UA and UOA are the express contracts governing the parties. The award to Arena, the party in breach of the UA and UOA, amounted to a *sua sponte* finding of unjust enrichment that was never pleaded, argued, tried, nor supported by any evidence at trial. The divergent approaches taken by the Trial Court in the Original Judgment as opposed to the Amended Judgment appear to demonstrate its reluctance or resistance to enforcing the contracts as written for one purpose, while, in the name of equity, ignoring the contracts for another purpose. The pervading legal issue before this Court is as

follows—May a trial court use the doctrine of unjust enrichment to abrogate the express terms of a contract and award relief to a breaching party?

This attack is made pursuant to Rule 12-213(A)(3) and (4) of the Rules of Appellate Procedure. OBO submitted proposed Findings of Fact and Conclusions of Law on March 5, 2008. (RP 654-661). OBO properly preserved all of the issues presented for consideration by virtue of the following Motions and Orders of the Trial Court:

(i) Defendant's Motion to Exclude and Motion(s) to Strike (RP 459-502, 529-582);

(ii) Order Granting Defendant's Motion to Exclude (RP 628-637);

(iii) Multiple objections made by OBO's counsel at trial and ruled upon by the Trial Court (TP: Non-Jury Trial March 10, 2008);

(iv) Defendant OBO, Inc.'s Proposed Findings of Fact and Conclusions of Law (RP 654-661);

(v) Court's Findings of Fact and Conclusions of Law (RP 663-667);

(vi) Defendant OBO, Inc.'s Motion for Consideration and Notice of Filing of Court-Ordered Accounting (RP 671-682);

(vii) Defendant OBO, Inc.'s Motion for Judgment (RP 683-712);

(viii) Defendant OBO, Inc's Response to Arena Resources, Inc.'s Motion for Judgment (RP 771-777);

(ix) October 3, 2008 Judgment (RP 781-782);

(x) October 14, 2008 Amended Judgment (RP 791-792);

(xi) Defendant OBO, Inc.'s Motion for New Trial and Motion to Amend Judgment and Response to Plaintiff Arena Resources, Inc.'s Motion for New Trial or, in the Alternative, Motion to Alter Judgment or, in the Alternative Motion for Relief from Judgment (RP 793-810);

(xii) Order denying Defendant OBO, Inc.'s Motion for New Trial and Motion to Amend Judgment (RP 874-875).

VI. STANDARD OF REVIEW

Interpretation of an unambiguous contract is a question of law which is reviewed de novo.[3] To the extent, however, a district court granted equitable relief, it must be reviewed for abuse of discretion.[4] An abuse of discretion will be found when a trial court's decision is clearly untenable or contrary to logic and reason.[5] "Although the decision of whether equitable relief should be granted is within the sound discretion of the trial court, [s]uch discretion is not a mental discretion to be exercised as one pleases but is a legal discretion to be exercised in conformity with the law."[6] When an attack is made on the findings of fact rendered by the trial court, the absence of substantial evidence to support a particular finding will constitute an

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[3] *Nearburg v. Yates Petroleum Corp.*, 1997-NMCA-069, ¶ 7, 123 N.M. 526, 531, 943 P.2d 560, 561 (1997) (citing *Peck v. Title USA Ins. Corp.*, 108 N.M. 30, 33, 766 P.2d 290, 293 (1988)).

[4] *Id.*; *Credit Inst. v. Veterinary Nutrition Corp.*, 2003-NMCA-010, ¶ 17, 133 N.M. 245, 252, 62 P.3d 339, 343 (2002).

[5] *Credit Inst.*, 2003-NMCA-010, ¶ 17.

[6] *Nearburg*, 1997-NMCA-069, ¶ 32, (quoting *Cont'l Potash, Inc. v. Freeport-McMoran, Inc.*, 115 N.M. 690, 697, 858 P.2d 66, 73 (1993)) *cert. denied*, 510 U.S. 1116 (1994).

abuse of discretion.[7] Conclusions of law are reviewed de novo.[8] When a party is challenging a legal conclusion, the standard of review is whether the law was correctly applied to the facts.[9] These standards apply to all issues presented in this Appeal.

The Trial Court determined, based on the stipulations of OBO and Arena, that the UA and UOA are the contracts governing the parties' dispute. (RP 663-667, ¶ FOF 3). The entirety of this lawsuit concerned the interpretation and enforcement of unambiguous contracts, and the Trial Court concluded that Arena was the only party in breach. (RP 663-667; ¶ FOF 27; COL 4-5). Thus, the Trial Court's award to the breaching party, pursuant to the terms of the UA and UOA, is a question of law which should be reviewed de novo. Although OBO acknowledges that the standard of review concerning a court's power of equity is an abuse of discretion, this case does not present any factual predicate for the invocation of equity to override express contractual terms. Alternatively, even applying an abuse of discretion standard, the Trial Court did not act in conformity with the law when disregarding the UA and

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[7] *See Strata Prod. Co. v. Mercury Exploration Co.*, 121 N.M. 622, 627, 916 P.2d 822, 827 (1996).

[8] *See id.*

[9] *Golden Cone Concepts, Inc. v. Villa Linda Mall Ltd.*, 113 N.M. 9, 12, 820 P.2d 1323, 1326 (1991).

UOA to fashion an equitable remedy which contradicted its factual and legal conclusions.

VII. ARGUMENTS

A. When express contracts (UA and UOA) govern the parties' relationship and conduct, the breaching party (Arena) should not be excused from liability for its breach and ultimately rewarded under the quasi-contract theory of unjust enrichment; the Trial Court may exercise its power of equity only in conformity with the law and, thus, may not use equity to avoid express contractual language.

OBO asserts that the Trial Court committed reversible error when it applied the doctrine of unjust enrichment to parties and relationships governed by express contracts. Well-defined contract principles require that courts enforce the terms of the contract to avoid resorting to equity in disregard of the express contractual language and the law. The legal issue that is dispositive is as follows—Could the Trial Court use the doctrine of unjust enrichment to alter the UA and UOA? The well-settled and controlling law unequivocally requires the answer—No.

The Trial Court determined that the UA and UOA are the express written contract(s) governing the parties relationship which precludes analysis of this dispute under any implied or quasi-contract theory. (RP 663-667; FOF). OBO asserts that because the parties are governed by the UA and UOA, the doctrine of unjust enrichment has no relevance or application to disputes regarding charges assessed and sought to be recovered pursuant to the UA and UOA. In the entirety of Arena's briefing and arguments filed prior to entry of the Amended Judgment, Arena did not

cite a single case supporting the untenable position that equity may be used as an unlawful theory to set aside contract terms for the benefit of a breaching party.

The interpretation and enforcement of the UA and UOA are guided by a longstanding backdrop of New Mexico law that enforces contractual obligations as they are written.[10] A court cannot change contract language for the benefit of one party to the detriment of another, and in the absence of ambiguity, the court must interpret and enforce the clear language of the contract.[11] A court should allow equity to interfere with a contract only when there is grossly inequitable conduct such as unconscionability, mistake, fraud, or illegality.[12] The fact that some of the terms of an agreement result in a hard bargain or subject a party to exposure of substantial risk will not render a contract unconscionable.[13] Moreover, no one can predicate "mistake" on his own negligent omissions or failure to perform—simply stated, equitable principles will not save a party from the circumstances it created.[14] In the absence of fraud, unconscionability, or other grossly inequitable conduct, New

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[10] *United Properties Ltd. Co. v. Walgreen Properties, Inc.*, 2003-NMCA-140, ¶ 12, 134 N.M. 725, 729, 82 P.3d 535, 539 (2003).

[11] *See Nearburg*, 1997-NMCA-069, ¶¶ 31-32.

[12] *Id.*; *see also Builders Contract Interiors, Inc. v. Hi-Lo Indus., Inc.*, 2006-NMCA-053, ¶ 8, 139 N.M. 508, 511, 134 P.3d 795, 798 (2006) (*citing Winrock Inn Co. v. Prudential Ins. Co. of Am.*, 1996-NMCA-113, ¶ 36, 122 N.M. 562, 570, 928 P.2d 947, 955 (1996)).

[13] *Nearburg*, 1997-NMCA-069, ¶ 31.

[14] *See United Properties*, 2003-NMCA-140, ¶¶ 30-31; *see also Builders Contract Interiors*, 2006-NMCA-053, ¶ 11.

Mexico courts do not have the discretion to relieve parties of their contractual obligations or interfere with contractual rights and remedies which go to the heart of the bargain.[15]

Unjust enrichment as a basis for restitution is a cause of action based on a quasi-contract theory, distinct from a claim based on an express contract that rests on the mutual assent of the parties.[16] Such an obligation is created for reasons of justice and equity only where there is a lack of any contractual relationship between the parties.[17] Although the decision of whether equitable relief should be granted is within the sound discretion of the trial court, it is a legal discretion that must be exercised in conformity with the law.[18] Equity jurisdiction has never given the courts the ability to avoid contract terms in the name of fairness.[19] When an express contract governs the subject matter of the parties' dispute, there can be no recovery under unjust enrichment because it is generally inconsistent with, or foreclosed by, application of the express contract.[20]

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15 *United Properties*, 2003-NMCA-140, ¶ 28.

16 *Hydro Conduit Corp. v. Kemble*, 110 N.M. 173, 175, 793 P.2d 855, 857 (1990).

17 *See id.*; *see also Fortune Prod. Co. v. Conoco, Inc.*, 52 S.W.3d 671, 684-685 (Tex. 2000).

18 *Nearburg*, 1997-NMCA-069, ¶ 32.

19 *Id.* at ¶ 19; *United Properties*, 2003-NMCA-140, ¶ 19.

20 *See Fortune*, 52 S.W.3d at 684-686; *see also United Properties*, 2003-NMCA-140, ¶ 31; *Builders Contract Interiors*, 2006-NMCA-053, ¶ 11.

In the present case, there was no evidence submitted by Arena proving one of the recognized exceptions to enforcement of the express contract that would trigger a resort to equity. Arena, not OBO, breached the UA and UOA by failing to obtain the affirmative vote of OBO prior to embarking on the re-development program and then netting OBO for the expenses related to these operations. (RP 663-667; COL 4-5). Arena knew it did not have the requisite approval but made a "corporate decision" to proceed anyway on the "hope" that it would later obtain the requisite votes. (RP 663-667; FOF 26; TP: Non-Jury Trial March 10, 2008, 9:37—9:39; 10:54—10:55, 11:03—11:05AM). The actual cost of the re-development program ultimately exceeded the original unilaterally approved AFE amounts by over $9 million dollars, yet Arena seeks to shirk the consequences of its breach by and through this lawsuit. (TP: Non-Jury Trial March 10, 2008, 1:43—1:46PM). Strict enforcement of the UA and UOA, whether harsh or not, must be adhered to and Arena must be the party to bear the burden and risk of its corporate decision and risk of unilaterally going forward with the re-development program. OBO is entitled to a credit, with interest, for the unauthorized charges that were netted by Arena from OBO's revenue interest on the Unit. (RP 671-682, 793-810).

Equity should not be used to save Arena, who comes to the court with unclean hands, from its deliberate decision to ignore the UA and UOA, yet strip OBO of the protections afforded to the minority working interest owners under these agreements.

To do so would create unlimited exposure for a non-operator's liability for expenses incurred by the operator, allow operators to unilaterally proceed and charge for operations of any kind and of any nature under the guise of "equity," and ultimately render meaningless the purpose and intent of all operating agreements—to govern the parties. A recent Texas case affirms that voting provisions requiring approval for expenditures over a specified amount are designed to limit a non-operator's (OBO) exposure to liability for expenses incurred by the operator without approval.[21] The grave consequences of affirming the Trial Court's incongruent ruling would impact not only parties to oil and gas operating agreements but parties to contracts as a whole. The UA and UOA did not intend to give the operator unbridled authority to inflate costs on the Unit. Such unbridled authority would encourage tyrannical behavior by all operators and curtail the protections afforded to the working interest owners. For the sake of good economics, fairness, and return on investment, Arena must be bound by its promises under the UA and UOA.

The New Mexico Supreme Court addressed the public policy concerns regarding the freedom of contract in the context of a liability release, holding that:

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[21] *See Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147, 157-158 (Tex. App.—Eastland 2002, pet. denied).

> New Mexico ... has a strong public policy of freedom to contract that requires enforcement of contracts unless they clearly contravene some law or rule of public morals. "Great damage is done where businesses cannot count on certainty in their legal relationships and strong reasons must support a court when it interferes in a legal relationship voluntarily assumed by the parties."[22]

Proof of "some benefit" regardless of party, purpose, or intent, would become the minimal standard required to invoke a trial court's power of equity to subvert or rewrite any express contractual term. This directly contravenes New Mexico's well-established precedent enforcing strict adherence to contractual limitations. There is no evidence or arguments by Arena contained in the Record Proper or Transcript of Proceedings that supports nullifying the freedom of contract in favor of equity.

B. A trial court may not issue a *sua sponte* award of unjust enrichment which was not pleaded, argued, or tried by the parties in any capacity; OBO did not receive fair notice of the theory of unjust enrichment and properly relied on the Trial Court's previous written order that Arena was precluded at trial from arguing or offering evidence in any capacity on any matter not included in Plaintiff's Second Amended Complaint.

Generally, a court should not grant judgment for relief which is neither requested by the pleadings nor within the theory on which the case was tried.[23] Parties must be given "fair notice" of the claims and defenses, and due process requires that the opposing party have notice and an opportunity to defend against any

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[22] *Berlangieri v. Running Elk Corp.*, 2003-NMCA- 024, ¶ 20, 134 N.M. 341, 348, 76 P.3d 1098, 1105 (2003).

[23] *Credit Inst.*, 2003-NMCA-010, ¶ 32.

theory.[24] If unjust enrichment was not pleaded, argued, or tried by the parties and the defendant did not have notice of the theory until judgment, the trial court inappropriately relieves the plaintiff of its burden of proof, and the trial court errs in *sua sponte* awarding restitution.[25]

In *Credit Institute*, a Seller and Buyer entered into an express contract for the sale and purchase of 20,000 customized labels. Upon receipt of the labels, the Buyer notified the Seller that the labels were the wrong size and color. The Seller advised the Buyer to use the incorrect labels until corrected labels could be tendered. The Buyer used approximately 4500 of the incorrect labels, and the Seller turned the matter over to a collection agency based on enforcement of the original contract. The trial court determined that the Seller had breached the contract by providing incorrect labels but found that the Buyer was "enriched" by the use of the 4500 labels and awarded the Seller damages for the proportionate amount. The Court of Appeals characterized the trial court's award as a *sua sponte* award and ultimately reversed the award of damages to the Seller and remanded for entry of a judgment in favor of the Buyer. In doing so, the Court of Appeals focused on the lack of "fair notice" to the Buyer to defend against a theory that was not contained in the pleadings.[26] Moreover,

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[24] *Id.* at ¶ 25.

[25] *Id.* at ¶ 32.

[26] *Id.* at ¶¶ 25-26.

the Court of Appeals concluded that "without anything to alert Buyer that the issue of unjust enrichment had entered the case at trial, Buyer could not have consented to trial of the issue" and was unfairly prejudiced by the *sua sponte* award.[27]

Similarly, OBO had no notice of the theory of unjust enrichment and could not have consented to try the issue in any capacity. At least some factual predicate for unjust enrichment must be set forth in the complaint to give fair notice.[28] In the present case, the record is completely devoid of any factual predicate for unjust enrichment. To the contrary, Arena never pled unjust enrichment in any pleading (including Plaintiff's Third Amended Petition), and the Trial Court expressly ruled that Arena could only present evidence on the claims asserted in Plaintiff's Second Amended Petition. (RP 628-637). Arena did not present a single expert witness at trial on any issue, including unjust enrichment. (RP 628-637; TP: Non-Jury Trial March 10, 2008, 9:18—9:19, 9:22, 10:02—10:20AM). OBO consistently objected to any evidence that went beyond the breach of contract claim pleaded, and the Trial Court repeatedly sustained the objections based on relevance or an unpled theory or claim. (TP: Non-Jury Trial March 10, 2008, 11:50—11:56 AM, 2:49—2:52PM). Arena never filed any proposed findings of fact or conclusions of law concerning unjust enrichment, nor filed a motion to amend or conform the pleadings to the

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[27] *Id.* at ¶¶ 25-26, 32.

[28] *Id.* at ¶ 22 (citing *Electro-Jet Tool Mfg. Co. v. City of Albuquerque*, 114 N.M. 676, 685, 845 P.2d 770, 779 (1992)).

evidence submitted at trial prior to the entry of the Amended Judgment. OBO could not have tried by consent a cause of action that was never even mentioned until after trial, and to which Arena (to this day) never requested to be included in the pleadings.

C. Although there may be some perceived benefit based on an alleged increase in value resulting from a party's breach, this in and of itself is not evidence that the other party has been unjustly enriched; awarding Arena restitution based solely on increased production to the Unit deprives OBO of the rights and protections expressly granted to it under the UA and UOA and constitutes a re-writing of the contract.

The theory of unjust enrichment was not tried by express or implied consent, and there was no evidence to support the Trial Court's remedy. The only findings by the Trial Court of enrichment from the re-development program concerned increased production and improvement to the Unit, not OBO. (RP 663-667; FOF 29; COL 7, 791 ¶ 4). The Trial Court determined there was a benefit to OBO, not an unjust or wrongfully procured benefit. Any award to Arena premised on these findings misapplies the doctrine of unjust enrichment.

A defendant is unjustly enriched only to the extent that proof is made of a net benefit—a benefit received in excess over harm suffered.[29] It is the plaintiff's burden to prove that the damages suffered by the defendant are less than the benefit conferred on it.[30] Here, although there was evidence of increased production on the Unit and

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[29] *See Credit Inst.*, 2003-NMCA-010, ¶ 3 (citing George E. Palmer, THE LAW OF RESTITUTION § 5.4 at 583-84).

[30] *See id.* at ¶ 31.

some temporal increase in value to OBO's interest, it is not synonymous with evidence of a net benefit or unjust enrichment.[31] To the contrary, Arena took what was a positive cash flow property for OBO and turned it into one buried in excessive costs and expenses with no possibility of payout for decades. (TP: Non-Jury Trial March 10, 2008, 2:12—2:22PM). OBO clearly stated that it did not believe the re-development program was prudent and exceeded the AFEs by over 300%. (OBO Trial Exhibit 6). Moreover, the Trial Court's finding of a benefit to the Unit was impliedly predicated on the favorable economic considerations (crude oil prices were nearly $100/barrel) at the time of trial and prior to the entry of the Amended Judgment. Would the Trial Court determine the same "benefit" to the Unit when oil prices fell to $40/barrel? The inherent fluctuation in the Trial Court's determination of a gross benefit based on market conditions solidifies the need for strict reliance on the contract itself as opposed to fashioning an unsupported and unsubstantiated equitable remedy.

Recall, the only evidence in the record (supplied by Arena's President) is that Arena acknowledged that it did not have the approval for the operations, discussed the risks of proceeding and went forward with the operations anyway based upon a "corporate decision." (RP 663-667; FOF 26; TP: Non-Jury Trial March 10, 2008,

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[31] *See Tom Growney Equip. Inc. v. Ansley*, 119 N.M. 110, 113, 888 P.2d 992, 995 (1994), *cert denied*, 119 N.M. 168, 889 P.2d 203 (1995).

9:37—9:39, 10:54—10:58AM). Despite being contractually required to inform working interest owners of the result of any vote to approve operations, Arena failed (or simply chose not) to abide by that contractual duty as well and never informed the owners that Arena failed to obtain approval. (TP: Non-Jury Trial March 10, 2008, 1:46—1:47PM). As a result, Arena essentially misrepresented to OBO that it had obtained contractual approval for the disputed work by billing those amounts to the joint account. Arena knowingly breached the contracts and exercised unfettered control over charges to the joint account Unit, thereby fabricating the "benefit" on which the Trial Court predicated its *sua sponte* award. The only evidence in the record of "bad conduct" was on the part of Arena, yet the Amended Judgment rewards Arena its breach and abrogates governance of the UA and UOA.

The law is well settled—where a party has the right to choose for himself whether to receive a benefit, and where restitution would deprive him of the choice by requiring payment for a "benefit" the defendant may not want, restitution should be denied.[32] Although there may be some enrichment to a defendant based on an increase in value, this does not prove that a party has been enriched unjustly.[33] While the results may be harsh, a greater inequity would occur if a party were required to

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[32] *Mayfield Smithson Enterps. v. Com-Quip, Inc.*, 120 N.M. 9, 16, 896 P.2d 1156, 1163 (1995).

[33] *Tom Growney Equip. Inc.*, 119 N.M. at 113.

pay for something "he did not request, did not authorize, and possibly did not want."[34] Here, this Court determined that OBO did not authorize the proposed drilling operations. (RP 663-667; FOF 13, 15, 17, 23). Awarding Arena some form of restitution under these circumstances would deprive OBO of its rights and protections as a minority working interest owner.

Assuming that the issue of unjust enrichment was tried by consent (which OBO asserts it was not), Arena was required to prove that: (1) OBO knowingly benefitted at Arena's expense (2) in a manner such that allowance of OBO to retain the benefit would be unjust.[35] The only evidence adduced at trial is that OBO did not approve of the proposed drilling operations, was never notified of the results of the vote in any capacity, and believed that the operations constituted a detriment as opposed to a benefit. (TP: Non-Jury Trial March 10, 2008, 1:45—1:48, 2:07—2:10PM). The purpose and intent of the voting provisions set forth in the UA and UOA was to create a system of checks and balances between the minority working interest owners and Operator on the Unit and, in part, prevent the Operator (Arena) from having unfettered discretion on the Unit to burden the minority working interest owners with unlimited expenditures. The Trial Court abrogated OBO's right to protect OBO's

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34 *Id.*

35 *Credit Inst.*, 2003-NMCA-010, ¶ 21.

revenue interest and instead rewarded Arena's unilateral implementation of the re-development program. (RP 180, UOA Section 4.3.2).

The Trial Court incorrectly determined, in the absence of any evidence, that OBO "benefitted" from increased production. In actuality, the Trial Court merely determined that the Unit had increased production, without any consideration of the excessive cost required to make that production possible or the negative impact on cash flow. (RP 663-667; FOF 29). At most, the Trial Court concluded that there was a gross benefit to the Unit which is not sufficient to support evidence of unjust enrichment to OBO.[36] Under these pretenses, unjust enrichment should not have been considered or applied by the Trial Court.

D. The Trial Court's determination that OBO was entitled to a credit for overpayment on the Unit, related to expenses charged for the re-development program unilaterally implemented by Arena, is supported by the evidence submitted at trial and the Court's consideration of the Court-Ordered Accounting.

On June 18, 2008, OBO filed its Motion for Consideration and Notice of Filing of Court-Ordered Accounting and Motion for Judgment asking this Court to enter Judgment in its favor in accordance with the Court's findings of a breach by Arena of the UA and UOA. (RP 671-712). The Trial Court entered an Original Judgment in this matter in favor of OBO and ordered that Arena credit OBO's account. (RP 781-782). Arena filed a Motion for New Trial citing no authority, asserting that

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[36] *See id.* at ¶ 30.

the Original Judgment somehow provided OBO with a "windfall" and misrepresenting that OBO had not paid any amounts to Arena pertaining to the Unit. (RP 783-790). The Trial Court entered an Amended Judgment, flip-flopped its decision, and awarded the breaching party (Arena) over $1.8 million dollars. (RP 791-792).

Schedule I of the Court-Ordered Accounting represents the amount that OBO was owed (as of March 31, 2008) if only the Lease Operating Expense ("LOE") and monthly overhead allocation were charged to OBO's revenue interest. (RP 678-679, 801-803). That number takes into account OBO's obligation to pay the monthly LOE and overhead on the re-development wells even though Arena did not receive approval from any minority working interest owner. That is, OBO acknowledges that it must pay the monthly expenses associated with operating those wells but disputes that it must pay the unauthorized capital expense associated with the drilling or reworking of the re-development wells. (RP 671-682; TP: Non-Jury Trial March 10, 2008, 2:16—2:20PM).

In sharp contrast, Arena states that OBO's payment of the LOE and monthly overhead somehow equates with OBO getting "free wells and free operations." (RP 785 ¶ 4). Aside from the fact that such statements ignore the terms of the UOA and the findings by the Court, these statements are absolutely false. OBO's accounting (Schedule I) provides for payment by OBO for "operational

expense"—lease operating expense and monthly overhead—but not for the unauthorized development expense at issue in this case. The final number represents a credit owed to OBO of approximately $2.4 million (as of March 31, 2008). Since trial, and throughout the pendency of this appeal, Arena continued to net OBO's interest for the re-development expenses, thus the amount of the credit owed to OBO has increased proportionately. The amount of the credit to OBO's revenue interest will continue to increase until Arena is ordered to stop charging OBO for the unapproved expenses of the re-development program.

Arena further contends that OBO has never paid any amounts for the operations in dispute. To the contrary, Arena has been "netting" OBO's production revenue since it took over as Operator on the Unit for all charges (including the unauthorized development expense). (TP: Non-Jury Trial March 10, 2008: 10:59—11:02). OBO has paid by virtue of the fact that Arena has withheld monies that are rightfully owed to OBO. It is disingenuous for Arena to now argue that because OBO did not physically issue a check, despite Arena's withholding of revenue amounts due to OBO, that this equated to non-payment. The process of "netting" was acknowledged by the Trial Court to be the normal course of dealing between the parties and ironically was not an issue until Arena unilaterally incurred $14 million dollars of expenses to the Unit. Arena's improper charging of OBO's revenue interest to pay for the unauthorized re-development expenses, in reality, gave

Arena the use and control of OBO's money for the past three years. (RP 663- 667; FOF 8-11).

The Original Judgment that ordered Arena to "credit Defendant OBO, Inc.'s revenue interest for all unauthorized charges" was inappropriate for Arena's deliberate disregard of the UA and UOA. Such an award to OBO does not grant OBO "free wells" because it still contemplates charging OBO with its proportionate share of the lease operating and overhead expenses on all Unit wells, including the re-development wells. OBO requests that this Court direct the Trial Court to determine and order Arena to credit to OBO, or reverse all charges, attributable to the expenses of the re-development program (other than LOEs and overhead) previously charged or netted against OBO's share of the production on the Unit. The calculation to determine the amount should be for the time period of 5/31/2006 through the present date. OBO's accounting tendered to the Trial Court reflects the amounts to be credited to OBO's interest from the inception of the re-development program through March 31, 2008. In order to provide complete relief to OBO such methodology needs to be applied to revenue and expenses through the present. OBO further requests that OBO also be awarded pre-judgment interest at the rate of eight and three-fourths

percent (8 3/4 %) on the this credit and post-judgment interest at the statutory rate of eight and three-fourths percent (8 3/4%).[37]

VIII. CONCLUSION

It is undisputed that the UA and UOA are the express contracts governing the parties' dispute. The Trial Court determined and issued Judgment that Arena, as Operator on the Unit, was the only party to breach the UA and UOA. Thus, application of equity has no place in this matter. This lawsuit was tried solely as a breach of contract suit, and the theory of unjust enrichment was never pleaded, argued, or tried by consent in any capacity. Unjust enrichment should not have been used, *sua sponte*, to reward the breaching party to the detriment of OBO. Awarding Arena some form of restitution under these circumstances would deprive OBO of its rights and protections expressly granted to it as a minority working interest owner under the contract, constitutes a rewriting or abrogation of the UA and UOA, and results in grave consequences to the longstanding principle of freedom of contract.

IX. PRAYER FOR RELIEF

For the reasons indicated, OBO, Inc. requests that the Court of Appeals reverse the Trial Court's Amended Judgment awarding Arena expenses in the amount of $1,812,019, and direct the Trial Court on remand to: (1) determine and order Arena

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[37] N.M. Stat. Ann. § 56-8-4 (1978) (Interest shall be allowed on judgments and decrees for the payment of money from entry and shall be calculated at the rate of eight and three-fourths percent per year.).

to credit to OBO's interest, or reverse all charges, for expenses of the re-development program (other than LOEs and overhead) previously charged or netted against OBO's share of the production on the Unit, (2) order Arena that it may not charge OBO's share of production in the future for any unapproved expenses for the re-development program (other than LOEs and overhead), (3) award pre-judgment and post-judgment interest at the rate of eight and three-fourths percent (8-3/4%) on the full amount credited to OBO's interest, and (4) grant any other such relief in as it may be justly entitled.

Respectfully submitted,

DAVIS, GERALD & CREMER
A Professional Corporation

By: _____

Robert P. Crumpler, Jr.
State Bar No. 14961
Attorneys for the Appellant
400 W. Illinois, Suite 1400 (79701)
P.O. Box 2796
Midland, Texas 79702
(432) 687-0011
Fax: (432) 687-1735

REAGAN & SANCHEZ, P.A.

Mark Terrence Sanchez
State Bar No. 4672
Attorneys for the Appellant
1819 North Turner, Suite G
Hobbs, New Mexico 88240-3834
(575) 397-6551
Fax: (575) 393-2252

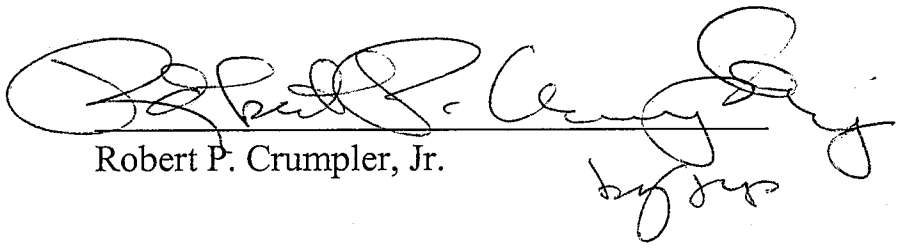
ATTORNEYS FOR THE APPELLANT

X. PROOF OF SERVICE

I certify that I served the foregoing Appellant's Brief on the following persons by placing true and correct copies thereof addressed to the persons listed below in the manner indicated on May 22, 2009.

VIA FEDERAL EXPRESS
Ms. Gina Maestas
Chief Clerk
New Mexico Court of Appeals
237 Don Gaspar, Room 116
Santa Fe, NM 87501

VIA HAND DELIVERY
Mr. Matt Catalano
Ms. Susan Richardson
Cotton, Bledsoe, Tighe & Dawson, P.C.
500 W. Illinois, Suite 300
Midland, TX 79701



Robert P. Crumpler, Jr.