IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

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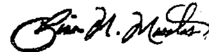

ARENA RESOURCES, INC.

Plaintiff-Appellee,

vs.

Docket No. 29,241

OBO, INC.

Defendant-Appellant.

APPELLANT OBO, INC.'S REPLY BRIEF

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

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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. TABLE OF AUTHORITIES

CASES

Builders Contract Interiors, Inc. v. Hi-Lo Indus., Inc.,
2006-NMCA-053, 139 N.M. 508, 134 P.3d 795 (2006). 9

Cone v. Fagadau Energy Corp.,
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732 S.W.2d 644, 645 (Tex. App.—Corpus Christi 1987, no writ). 6, 7

United Properties Ltd. Co. v. Walgreen Properties, Inc.,
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1996-NMCA-113, 122 N.M. 562, 928 P.2d 947 (1996). 9

STATUTES

Rule 1-054(C) NMRA 12

IV. SUMMARY OF PROCEEDINGS

OBO objects to the Summary of Proceedings set forth in Appellee's Answer Brief because it sets forth contentions that contradict specific Findings of the Trial Court, were not properly preserved for appeal, and violates the provisions of Rule 12–213 of the New Mexico Rules of Appellate Procedure.

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 an express contract. (RP 1-67). Specifically, pursuant to the terms of the UA and UOA 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 unilaterally approved by Arena as Operator. (RP 103-105). 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 trial on the merits, the Trial Court issued Findings of Fact and Conclusions of Law (the "Findings") on each of these Counts. (RP 663-667). The Trial Court entered its original Judgment on October 3, 2008 ("Original Judgment"), specifically denying each of Arena's claims and ordering Arena to credit OBO's interest for the unauthorized charges on the Unit. (RP 781-782). Without hearing, the Trial Court reversed itself, in part, and entered the Amended Judgment ("Amended Judgment")

maintaining the denial of Arena's claims, but ordering OBO to pay for $1.8 million dollars of re-development costs. (RP 791-792). It is undisputed that the Trial Court determined that Arena was the only party to breach the UA and UOA.

B. Course of Proceedings

OBO relies on its description of the Course of Proceedings set forth in OBO's Brief in Chief and maintains that this Honorable Court should 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 relies on the Summary of Facts set forth in its Brief in Chief. OBO objects to the extent that the Summary of Facts contained in Appellee's Answer Brief omits facts germane to this Appeal, or constitutes an abrogation of the Findings rendered by the Trial Court that have not been challenged by Arena. Most notably, in thirty-three (33) pages of briefing Arena fails to mention whatsoever that the Trial Court issued express Findings and Judgment that Arena was the only party to breach the UA and UOA. (RP 663-667, 781-782, 791-792). In addition, OBO maintains that the Summary of Facts included in Appellee's Answer Brief should not be considered or used to alter the following unchallenged Findings or Judgments by the Trial Court:

- Any "inaction" by OBO did not constitute an affirmative vote, that OBO did not breach the UA and UOA, that Arena failed to obtain the contractually required vote, and that Arena knew it did not have the

requisite assent when it conducted the re-development program. (RP 663-667; FOF ¶¶ 22, 23, 26; COL ¶ 3).

- Arena unilaterally commenced the re-development operations, and OBO did not breach the terms of the UA or UOA. (RP 663-667; FOF ¶¶ 24-27; COL ¶ 3).
- Arena has been improperly netting OBO's share of production to pay for "Arena's" unit re-development program. (RP 663-667; FOF ¶ 28; COL ¶ 5).
- Arena's claims for Foreclosure of Operator's Lien only sought a contractual lien based on the UA and UOA which was expressly DENIED by the Trial Court. (RP 645, 651, 663-667 [COL ¶ 9], 791).
- Arena was the only party to breach the UA and UOA, and Arena never mentioned unjust enrichment in any pleading or at trial. (RP 663-667; FOF ¶ 25; COL ¶¶ 4-5).

Arena seeks to implicitly change or abrogate the Trial Court's express Findings and determinations in order to fit its latest theory of recovery. Arena has not attacked a single Finding or preserved error on a single determination by the Trial Court. Arena's attempt to impliedly cross-appeal certain Findings and determinations by the Trial Court is untimely. Such challenges have been waived.

There is no evidence to support any claim by Arena for unjust enrichment, and the Trial court committed an error of law in using equity to abrogate the express contract between the parties.

D. Attack on Findings

OBO maintains its specific attack 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).

V. ARGUMENTS

A. The UA and UOA expressly govern the parties and issues presented in this lawsuit and precludes the application of unjust enrichment.

From the inception of this lawsuit, Arena sought relief under the express terms and governance of the UA and UOA. (RP 1-67, 79 (¶¶ 10-11)). The Trial Court held that the UA and UOA governed the parties relationship, interpreted specific provisions of the UOA governing voting requirements for approval of drilling operations, and determined that Arena breached the UOA by failing to achieve an affirmative vote from any minority working interest owner. (RP 663-667; FOF 3, 18-20, 25; COL 4-5). Now Arena, however, deliberately ignores the relevant and applicable provisions of the UOA and instead argues that the UOA is silent on what the Operator can do in the event it knowingly breaches the UOA to undertake operations. Arena never requested a Finding or determination from the Trial Court that the UA and UOA were silent as to any term or issue, there is no Finding by the Trial Court that the UA and UOA were silent, and Arena failed to challenge or preserve error in this regard. Notwithstanding, Arena's "silent" argument is wholly without merit.

New Mexico law does not support Arena's proposition that if a term is missing from an express contract then a court may use equity to nullify other provisions of the contract. Likewise, Arena's reliance on the *Fortune* case issued by the Texas Supreme Court is misguided. The general holding set forth in *Fortune* was that "the written contracts in this case foreclose any claims for unjust enrichment."[1] A party disputing unjust enrichment based on the existence of contract is required to secure findings from the trial court that an express contract existed.[2] Because Conoco failed to secure such a finding as to one of the parties, the Texas Supreme Court held that unjust enrichment could apply only as to the party in which a written agreement was not in place.[3] The rationale set forth in *Fortune* is favorable to OBO—the existence of an express written contract, the UA and the UOA, preclude any claims for unjust enrichment. The UA and UOA do not somehow become silent just because Arena did not want to comply with the express provisions.

The same analysis was used by the New Mexico Supreme Court in the *Harbison* decision. The Court held that when no contract (written or oral) existed as to a particular issue as determined by the trial court, then recovery could be found on

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1 *Fortune Prod. Co. v. Conoco, Inc.*, 52 S.W.3d 671, 685 (Tex. 2000).

2 *Id.*

3 *Id.* at 685.

an implied contract theory.[4] However, the Court expressly noted the general rule that "it is the rule that one may not plead an express contract and recover on an implied one."[5] An exception to this rule was acknowledged because both parties litigated the issue on the basis of quantum meruit by consent.[6] There is no such evidence in this case, and the transcript from trial contains repeated objections from OBO (which were sustained) concerning the admission of evidence or argument related to any unpled theory or claim. (TP: Non-Jury Trial March 10, 2008, 11:50–11:56 AM, 2:49–2:52 PM). OBO did not try the theory of unjust enrichment by consent in any capacity.

Arena also cites to two other Texas cases in support of its contention that Arena could somehow recover under a quasi-contract theory despite the undisputed existence and governance of the UA and UOA. Notwithstanding the fact that the Texas law so heavily relied upon by Arena is not controlling authority in this Appeal (but may be instructive), all of the Texas cases cited by Arena do not stand for the propositions for which they were cited. The *Neely* case concerned co-tenants that had <u>no written agreement</u> and operations that were required to preserve the leasehold

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4 *Harbison v. Clark*, 59 N.M. 332, 334-335, 284 P.2d 219, 221-222 (N.M. 1955).

5 *Id.*

6 *Id.* at 337.

estate.[7] This is vastly different from the scenario presented in this case which involves express contracts and a re-development program that was not necessary to preserve the Unit. Arena also cites to the *Cone v. Fagadeau* decision to advocate the position that this Court should uphold the Amended Judgment on the basis of a "reversionary co-tenancy argument." Contrary to Arena's misguided assertions, there is no common ownership in the Unit without the UA and UOA. Absent the express contracts, there would be no relationship between the parties. Arena cannot ignore the UA and UOA each and every time it does not want to comply with its terms—the parties must be bound by their contractual relationship and obligations.[8] The *Cone* opinion, however, is instructive on the decision of an operator to unilaterally undertake operations in direct violation of the express voting provisions contained in an operating agreement, rationalizing the voting requirement as follows:

> The provision does not restrict production activities which may be undertaken by the operator on the contract area. This provision is a limitation on the non-operator's exposure to liability for expenses incurred by the operator.[9]

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[7] *Neely v. Intercity Mgt. Corp.*, 732 S.W.2d 644, 645 (Tex. App.—Corpus Christi 1987, no writ).

[8] *Nearburg v. Yates Petroleum Corp.*, 1997-NMCA-069, 123 N.M. 526, 943 P.2d 560 (1997).

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

It is undisputed that Arena commenced the re-development program with knowledge that it did not have the contractually required affirmative votes. (RP 663-667; FOF ¶¶ 24-27; COL ¶ 3). Arena proceeded with the program at its own risk and should remain bound by the express contractual provisions that were designed to protect minority working interest owners in the Unit, such as OBO.

To adopt Arena's arguments, this Court must presuppose that it is appropriate to allow equity to override a written contract. Arena did not cite to a single authority to support this. Arena's deliberate conduct in failing to address the express provisions in the UA and UOA that govern the issues, should not be perceived as anything other than a ploy to misdirect this Court and ignore the basic foundation and protections afforded in an oil and gas unit with a written operating agreement in place. Arena failed to present any evidence that advocates a resort to equity when the entire basis of this lawsuit was premised on the enforcement of express provisions contained in the UA and UOA. The Trial Court's resort to equity was inconsistent with its Finding that the UA and UOA governed the parties and issues.

B. The Trial Court's Power of Equity Cannot be Exercised to Nullify the UA and UOA.

Unjust enrichment arises for reasons of justice and equity only where there is a lack of a contractual relationship between the parties.[10] A court's power of equity

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

is a legal discretion that must be exercised in conformity with the law.[11] Equity jurisdiction has never given the courts the ability to avoid contract terms in the name of fairness.[12] Here, the enforcement of the UA and UOA are guided by a longstanding principle of New Mexico law that enforces contractual obligations as they are written.[13] A court should allow equity to interfere with a contract only when there is grossly inequitable conduct such as unconscionability, mistake, fraud, or illegality.[14] A finding of one of these recognized exceptions essentially voids or sets aside the contract, thus implied or quasi-contract principles can apply. In the absence of fraud, unconscionability, or other grossly inequitable conduct, 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] There is neither evidence contained in the record nor a Finding by the Trial Court proving one of the recognized exceptions to enforcement of the UA and UOA that would trigger a resort to equity.

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11 *Nearburg*, 1997-NMCA-069, ¶ 32.

12 *Id.* at ¶ 31; *United Properties Ltd. Co. v. Walgreen Properties, Inc.*, 2003-NMCA-140, ¶ 19, 134 N.M. 725, 729, 82 P.3d 535, 539 (2003).

13 *United Properties*, 2003-NMCA-140, ¶ 12.

14 *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)).

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

The Trial Court's ruling essentially sends this message—an operator governed by the express terms of an operating agreement may breach the agreement and be rewarded for that breach as long as the operator believes the breach is beneficial. The Trial Court failed to address the fact that oil and gas prices vary and that the perceived "benefit" of the re-development project at $140/barrel oil is vastly different than the $40/barrel oil the industry experienced a few months ago. As a direct result of the re-development program, 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, 2:12–2:22 PM). The parties to the UA and UOA designed a system of checks and balances so that this exact situation would not occur; an abuse of an operator's authority (and the majority working interest owner) to increase the operator's bottom line at the expense of the minority working interest owners. The Trial Court has rewarded the breaching party and stripped OBO of the protections afforded under the UA and UOA. 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. Arena must be bound by its promises under the UA and UOA to protect the sanctity of the freedom of contract.

C. The Trial Court Appropriately Determined that OBO was entitled to a credit for overpayment on the Unit.

Arena attempts to confuse OBO's request for a credit for overpayments on the Unit with an affirmative claim for monetary damages, and fails to even address the Trial Court's Findings in this regard. In actuality, OBO's request is merely an attempt to return the account on the Unit attributable to OBO's interest to the same position it would have been in if Arena had not breached the Agreement. Arena's assertion that OBO did not plead for affirmative relief is puzzling in light of the express request for affirmative relief contained in Defendant OBO, Inc.'s Answer to Plaintiff's Original Complaint which states:

> 17. Plaintiff is in material breach of the Unit Agreement and Unit Operating Agreement and is therefore precluded from collecting the cost it seeks against OBO.... To the extent that Plaintiff has incurred costs in the development of the Unit, it has done so without the appropriate approval of the working interest owner group in accordance with the voting procedures set forth in the Unit Operating Agreement. As such, OBO is not liable for the sums that Plaintiff seeks to charge against OBO's interest in the Unit. (RP 74).

From its initial appearance in this lawsuit, OBO consistently pled and argued that OBO was not entitled to charge OBO's account for the re-development program. The Trial Court expressly found that Arena breached the UOA by unilaterally implementing the re-development program and improperly netting the expenses related to the re-development program, thus the Trial Court should have ordered a credit, adjustment, or return of any amounts improperly charged by Arena. (RP 663-

667; COL ¶¶ 4-7). Which ever verbage you use to describe such relief, it is consistent with New Mexico statutory law which holds that "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 the party's pleadings."[16] OBO seeks a credit to the Unit account for the sums attributable to the re-development program charged in error or in breach as determined and set forth in the Findings by the Trial Court. OBO requests that this Court direct the Trial Court to order Arena to credit OBO's account on the Unit for all expenses of the re-development program (other than LOEs and overhead) improperly charged or netted against OBO's share of the production on the Unit for the time period of 5/31/2006 through the present date.[17]

D. Arena did not make a specific request for an equitable lien, and the Trial Court expressly overruled Arena's lien claim in its entirety.

For the first time since the inception of the underlying lawsuit, Arena states in its Answer Brief that it made a specific request for enforcement of an equitable lien, and that "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."[18] Both of these statements are false and not contained in the record.

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[16] Rule 1-054(C) NMRA.

[17] Ironically, this was the exact relief expressly granted in the Original Judgment. *See* RP 781-782.

[18] Appellee's Answer Brief, p. 13.

Arena disingenuously asserts that it made a specific request for enforcement of an equitable lien, when in actuality the only lien ever addressed by Arena was a contractual lien sought pursuant to the UA and UOA. (RP 645, 651, 663-667 (COL ¶ 9), 781, 791). If in fact the request was "specific," then why did Arena not mention the issue in any motion, request a finding form the Trial Court on the issue, or seek a ruling at the time of trial? The answer to this question is straightforward—no specific request for an "equitable lien" was ever made. The absurdity of this new position on appeal is the fact that it is a clear attempt by Arena to distance itself from the contract that it sued upon to enforce in the first place. It is abundantly clear that Arena only sought enforcement of an operator's contractual lien as evidenced redundantly in Arena's Proposed Findings of Fact and Conclusions of Law filed with the Trial Court in anticipation of Trial:

- FOF 5: "The Unit Operating Agreement granted an <u>operator's lien</u> to the Unit Operator..."
- FOF 6: "The <u>operator's lien</u> created by the UOA granted the <u>operator's lien</u> to the predecessor in interest to Arena.
- FOF 8: "The <u>operator's lien</u> granted a lien in the following interests."
- FOF 9: "The UOA granted Arena as the Unit Operator the <u>operator's lien</u>..."
- COL 14: "The <u>operator's lien</u> created by the Unit Operating Agreement... is a valid encumberance held, owned, protecting, and currently belonging to Arena, the Unit Operator."
- COL 15: "The Unit Operating Agreement creates a valid, binding and enforceable lien in favor of Arena against OBO." (RP 638-653).

Arena never made a request for enforcement of an equitable lien, and in fact, again, specifically sought the protections of the UA and UOA to enforce its operator's contractual lien from the inception of this lawsuit. (RP 2 (¶ 8), 78 (¶ 8)).

The Trial Court ruled that all other tendered Findings of Facts and Conclusions of Law not consistent with the Trial Court's ruling were denied and issued judgment that Arena's claim for Foreclosure of Operator's Lien was denied. (RP 667, 781 ¶2, 791 ¶ 2). It is wholly illogical and unreasonable to discern from the Trial Court's express denial of Arena's claims to an operator's lien, that the Trial Court actually intended to grant relief on the same theory but disguised as "equity." Even more unreasonable is Arena's assertion that its general pleading for enforcement of a lien is synonymous with a claim for unjust enrichment. Arena cites to no case law to support such legal maneuvering and fails to contradict governance of this issue by the *Credit Institute* case cited by OBO in its Brief in Chief.[19] 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.[20] Parties must be given "fair notice" of the claims and defenses, and due process requires that the opposing party have notice and an

[19] OBO's Brief in Chief, pp. 20-22.

[20] *Credit Inst. v. Veterinary Nutrition Corp.*, 2003-NMCA-010, ¶¶ 17, 32, 133 N.M. 245, 252, 62 P.3d 339, 343 (2002).

opportunity to defend against any theory.[21] Here, when unjust enrichment was not pleaded, argued, or tried by the parties, OBO did not have notice of the theory until judgment, and the Trial court inappropriately relieved Arena of its burden of proof.[22]

VI. CONCLUSION

Arena goes to great lengths in their Brief to manipulate, abrogate, and undermine the context and parameters of this Appeal. Arena never challenged any of the Trial Court's Findings, and did not file a cross-appeal as to any issue. It is undisputed that the UA and UOA are the express contracts governing the parties' dispute and that Arena was the only party to breach the UA and UOA. Awarding Arena under a sua sponte theory of unjust enrichment is contrary to recognized principles of law, deprives OBO of the rights and protections expressly granted to it as a minority working interest owner under the contracts, constitutes a re-writing or abrogation of the UA and UOA, and results in grave consequences to the longstanding principle of freedom of contract. The Trial Court's Amended Judgment is inconsistent on its face and constitutes an error of law.

VII. PRAYER FOR RELIEF

OBO, Inc., relies on the prayer set forth in its Brief in Chief.

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21 *Id.* at ¶ 25.

22 *Id.* at ¶ 32.

Respectfully submitted,

DAVIS, GERALD & CREMER
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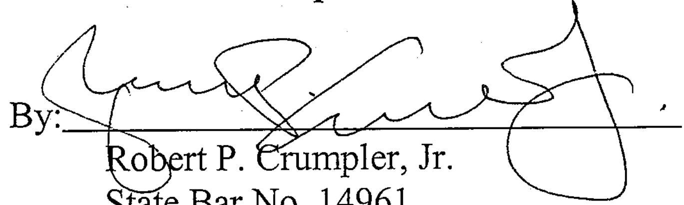

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VIII. PROOF OF SERVICE

I certify that I served the foregoing Appellant OBO, Inc.'s Reply Brief on the following persons by placing true and correct copies thereof addressed to the persons listed below in the manner indicated on August 28, 2009.

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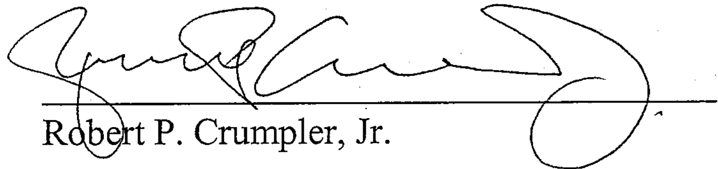

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