IN THE COURT OF APPEALS
OF THE STATE OF NEW MEXICO

CHISOS, LTD.,

Plaintiff-Appellant,

vs.

JKM ENERGY, L.L.C.,

Defendants-Appellee.

COA No. 29,265

APPEAL FROM THE FIFTH JUDICIAL DISTRICT COURT
LEA COUNTY
THE HONORABLE RALPH D. SHAMAS, DISTRICT JUDGE

ANSWER BRIEF

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I hereby certify that the body of the brief is thirty-one (31) pages and does not exceed thirty-five (35) pages, and that Microsoft Word 2007 indicates that the body of the brief uses a proportionally-spaced typeface and consists of 7,565 words and does not exceed 11,000 words.

SUMMARY OF ARGUMENT

Chisos, Ltd. (hereinafter "Chisos"), by virtue of a Conveyance and Bill of Sale dated September 1, 2005 (hereinafter "Conveyance"), assigned to JKM Energy, L.L.C. (hereinafter "JKM") all of its operating rights and net revenue interest in and to the W½ of Section 2, Township 19 South, Range 29 East, N.M.P.M., Eddy County, New Mexico (hereinafter "Subject Premises"), save and except the salvage rights in the State HL-2 No. 1Y Well (hereinafter "HL-2 Well") and a reserved overriding royalty interest.

The evidence and testimony presented at trial clearly shows (1) the Conveyance is ambiguous; (2) JKM's attached meaning should prevail under the Restatement of Contracts inquiry; and (3) if the evidence presented does not particularly bear upon the parties' knowledge of the other's attached meaning, the canons of construction require construction in favor of JKM.

Likewise, the evidence and testimony clearly demonstrate (1) Chisos was planning to rework the HL-2 Well since at least March of 2007, if not prior to October of 2006; (2) Chisos failed to give JKM proper notice of its reworking operations on the HL-2 Well pursuant to a November 12, 1999 Joint Operating Agreement (hereinafter "JOA"); (3) JKM did not become aware of the reworking operations until May 8, 2007; (4) Chisos attempted to cover its misconduct with a

May 11, 2007 letter; and (5) Chisos' conduct surrounding the reworking operations on the HL-2 Well was in bad faith.

SUMMARY OF ADDITIONAL FACTS

1. State Oil and Gas Lease B-7717-13 covers SW¼, N½NW¼, and SE¼NW¼ Section 2, which comprises a portion of the Subject Premises; together with E½ Section 2; All Section 1; N½NW¼, SE¼NW¼, NW¼NE¼, S½NE¼, and S½SW¼ Section 12, Township 19 South, Range 29 East, N.M.P.M., Eddy County, New Mexico, comprising approximately 1,560 acres, more or less. [Plaintiff's Ex. 38, page 4].

2. State Oil and Gas Lease B-9739-26 covers SW¼NW¼ Section 2, which comprises a portion of the Subject Premises; together with SE¼SE¼ Section 3; All Section 11; NE¼NE¼ Section 12, Township 19 South, Range 29 East, N.M.P.M., Eddy County, New Mexico, comprising approximately 760 acres, more or less. [Plaintiff's Ex. 38, page 5].

3. The HL-2 Well was completed on February 9, 1982. [Plaintiff's Ex. 25].

4. The Stetson "2" State Com. No. 1 Well (hereinafter "Stetson Well") was completed August 22, 2000. [Plaintiff's Ex. 32].

5. Both the HL-2 Well and the Stetson Well are located on the Subject Premises.

6. The HL-2 Well did not produce from the Atoka formation from July 2002 until August 2007.[1] [Defendant's Ex. P].

7. The Steston Well was recompleted in the Atoka formation on October 30, 2003, and began producing from that formation about the same time. [Defendant's Ex. M-50 - M-53].[2]

8. Jack Matthews, as principal of JKM, did not offer to purchase the "Stetson #1 Well" [BIC 3] for $43,000.00, but offered to purchase all of the working interest and net revenue interest in "Stetson #1 in Eddy County, New Mexico" for $43,000.00. [Plaintiff's Ex. 1].

9. Even in its internal discussion of JKM's offer, Chisos does not refer to the property being conveyed as a well, but generally refers to "Stetson". [Plaintiff's Ex. 2].

10. Sue Ann Craddock did not respond to JKM's offer by making a counter-offer of $55,000.00 for the "Stetson #1 Well" [BIC 3], but counter-offered to sell 100% of the working interest and a 75% net revenue interest in "Stetson No. 1 – Eddy County, New Mexico" for 55,000.00. [Plaintiff's Ex. 3].

11. Mr. Matthews did not agree to purchase 100% of the working interest and a 75% net revenue interest in the "Stetson #1 Well" [BIC 3-4] for $55,000.00,

[1] Appellant's Brief, citing Defendant's Exhibit P, states the HL-2 Well "had not actually produced from the Atoka" formation since 2003. [BIC 3].

[2] Appellant's Brief states that the Stetson Well was not completed in and producing from the Atoka formation until August of 2005. [BIC 3].

but did agree to purchase 100% of the working interest and a 75% net revenue interest in "Stetson 1, Eddy County, New Mexico" [Tr. 56, Vol. 1], which Mr. Matthews believed meant 100% of the working interest and a 75% net revenue interest in the Stetson Well *and* the operating rights in the leasehold estate attendant thereto [Tr. 9, Vol. 2], for $55,000.00.

12. The form of conveyance sent by JKM to Chisos was undisputedly an assignment of operating rights. [Tr. 191, Vol. 1; Tr. 9, Vol. 2].

13. JKM had previously utilized a wellbore only assignment in the acquisition of another property and could have submitted a wellbore only form of conveyance if that was what it had intended. [Tr. 9-10, Vol. 2; Defendant's Ex. S].

14. Ms. Craddock testified she informed Mr. Matthews that Chisos only intended to convey the wellbore of the Stetson Well to JKM [Tr. 58, Vol. 1], but the Trial Court did not find Ms. Craddock's testimony credible. [RP 329, FOF 12].

15. Chisos, through Ms. Craddock, informed JKM the form of conveyance needed to be changed; specifically, the reserved overriding royalty interest needed to be more carefully spelled out. [Tr. 13, Vol. 2].

16. Ms. Craddock, on behalf of Chisos, redrafted the form of conveyance and sent it to JKM. [Tr. 106, Vol. 1].

17. Mr. Matthews testified he noticed, pursuant to the prior conversation, the overriding royalty language had been changed. [Tr. 14, Vol. 2].

18. He further testified that although Chisos' draft was different in form, he believed the substance, which conveyed all of Chisos' operating rights in the Subject Premises, had not changed. [Tr. 17, Vol. 2].

19. Mr. Matthews testified that if Ms. Craddock had told him the Conveyance was only going to cover the wellbore rights of the Stetson Well, he would not have accepted the Conveyance. [Tr. 17, Vol. 2].

20. Notwithstanding its representations to JKM to the contrary, Chisos did not actually own 100% of the operating rights in the Stetson Well or the Subject Premises. [Tr. 51, Vol. 1; Tr. 95, Vol. 1; Plaintiff's Ex. 38].

21. Chisos owned 50% of the operating rights in the Subject Property and Pure Energy Group, Inc. (hereinafter "Pure") owned the remaining 50%. [Tr. 51, Vol. 1; Tr. 111, Vol. 1].

22. Pure elected to go non-consent on the drilling of the Stetson Well under the JOA and therefore relinquished its right to production from the well, but Pure still owned 50% of the operating rights in the Stetson Well subject to the non-consent provisions. [Tr. 51, Vol. 1; Plaintiff's Ex. 38].

23. Chisos misrepresented to JKM that it owned and could convey 100% of the operating rights in the Stetson Well. [Plaintiff's Ex. 3].

24. Appellant's own expert did *not* credit JKM with 100% of the operating rights in the Stetson Well, but credits Pure with 50% of the operating rights, or working interest, in the Stetson Well. [Plaintiff's Ex. 38, page 2].

25. At the time of the Conveyance, JKM did not know the HL-2 Well was also on the Subject Premises. [Tr. 11, Vol. 2].

26. Chisos planned to rework the HL-2 Well and place it back on production as early as August 21, 2006, the date upon which it sent a letter confirming Pure would be non-consent in the recompletion operations. [Plaintiff's Ex. 17].

27. In early 2007, Chisos, despite knowledge of JKM's claim, decided to make a second attempt to rework the HL-2 Well. [Tr. 127, Vol. 1].

28. On Chisos' second attempt to rework the HL-2 Well, it obtained a Limited Term Assignment dated March 13, 2007 (hereinafter "Term Assignment") of Pure's interest in the HL-2 Well.

29. Chisos, without JKM's knowledge, proceeded with its reworking operations on the HL-2 Well. [Tr. 127, Vol. 1].

30. On or about May 8, 2007, Mr. Matthews again noticed the reworking efforts on the HL-2 Well and, again, notified Chisos of his claim to the Subject Premises. [Plaintiff's Ex. 21].

31. In an effort to rectify its clear violation of OCD regulations and the JOA, Chisos "offered", by a May 11, 2007 letter, to provisionally allow JKM to participate in the HL-2 reworking operations in exchange for committing almost $170,000.00 in 48 hours. [Plaintiff's Ex. 22].

32. A response was sent to Chisos via e-mail dated May 11, 2007, in which Chisos was informed that, due to JKM's claim to the Subject Premises, Chisos proceeded at its own risk. [Defendant's Ex. J].

33. At the time of this exchange, JKM did not know of the Pure-Chisos Term Assignment and did not know Chisos had any claim or right to be "proposing" or actually conducting operations on the HL-2 Well; JKM only became aware of the Term Assignment by Letter dated May 18, 2007 from Chisos. [Plaintiff's Ex. 23].

34. Chisos planned well in advance of its May 11, 2007 letter to rework the HL-2 Well. [Tr. 131, Vol. 1].

ARGUMENT

I. THE TRIAL COURT'S CONCLUSION THAT THE CONVEYANCE IS AMBIGUOUS IS PROPER

STANDARD OF REVIEW

The question whether an agreement contains an ambiguity is a matter of law to be decided by the trial court. *Mark V, Inc. v. Mellekas*, 114 N.M. 778, 781, 845 P.2d 1232, 1235 (1993). A conclusion of law by the trial court is not binding and

the Court considers *de novo* the documents and evidence presented below. *Id.* at 782. The court may consider extrinsic evidence in determining whether an ambiguity exists. *Id.* at 781. Any determination should be made in light of the preliminary negotiations and other factors. *C. R. Anthony Co. v. Loretto Mall Partners*, 112 N.M. 504, 509 n. 3, 817 P.2d 238, 243 (1991). In construing the provisions of a written contract, the instrument as a whole is to be considered. *Manuel Lujan Ins., Inc. v. Jordan,* 100 N.M. 573, 575, 673 P.2d 1306, 1308 (1983).

A. THE TERM "WELL", AS DEFINED IN THE CONVEYANCE, IS AMBIGUOUS

In the first "Whereas" clause of the Conveyance, Chisos defined the term "Well" as "State Oil and Gas Lease – Stetson '2' State Com No. 1 Well" followed by an identification of and location of the Stetson Well. [Plaintiff's Ex. 6].[3] In the Conveyance, "Well" is a specifically defined term with the meaning attached to it by the parties. Even though words seem on their face to have only a single possible meaning, other meanings often appear when the circumstances are disclosed. RESTATEMENT (SECOND) OF CONTRACTS § 214 cmt. b (1979); *Branch v. Chamisa Development Corp.*, No. 28,367, slip op. at ¶ 33 (N.M. Ct. App. August 10, 2009) (the court is not restricted to the bare words of the agreement and may

[3] Appellant points to the definition of a "well" in Williams and Meyers, Oil and Gas Terms (13th Edition), in order to show the definition of "Well" in the Conveyance is unambiguous. [BIC 13]. However, Williams and Meyers provides only a generic definition for a generic term.

consider the context in which the agreement was made to determine whether a word is ambiguous) *quoting Mark V*, 114 N.M. at 781.

Appellant cannot deny the definition of "Well", which it drafted, includes the language "State Oil and Gas Lease". Utilizing "State Oil and Gas Lease" does not clarify that the Stetson Well is on state oil and gas lease lands or aid in the description of the well. The full name of the HL-2 Well is the "State HL-2 No. 1Y Well". "State" is not some added descriptive phrase for the HL-2 Well; it is an integral part of the actual name of the well. Likewise, "State" already appears in the full name of the Stetson Well. The name of that well is the "Stetson '2' State Com. No. 1 Well". It is already apparent from the full names of the wells that they are located on state oil and gas lease lands. The explicit use of "State Oil and Gas Lease" refers to a real property interest in the oil and gas lease and does not clarify subsequent provisions in the Conveyance. [Tr. 78-79, Vol. 2]. Thus, the inclusion of "State Oil and Gas Lease" creates an ambiguity as to what the parties intended to be assigned by the Conveyance.

"Well" is also used in the second "Whereas" clause. However, "Well" has already been defined in the Conveyance to include the oil and gas lease operating rights attendant to the state oil and gas leases and, therefore, adding such language does not evidence an intention to convey only a wellbore, but further adds to the ambiguity of the Conveyance.

B. PARAGRAPH A OF THE GRANTING CLAUSE IN THE CONVEYANCE IS AMBIGUOUS

Even if the "Whereas" clauses are not ambiguous, the granting clause is ambiguous. Both Ms. Craddock and Mr. Canon, Chisos' expert, testified the "Whereas" clause did not grant anything, but rather the clause following "Witnesseth" was the actual granting clause. [Tr. 112, Vol. 1; Tr. 195, Vol. 1]. JKM's expert, Mr. Brewer, also testified the actual granting comes after the recitals. [Tr. 79-80, Vol. 2]. Paragraph A of the granting clause in the Conveyance grants to JKM "100% of the operating rights and 75% of the net revenue interest in and to the Well and spaced unit, INSOFAR AS AND ONLY INSOFAR AS said lease covers" the Subject Premises. Within the granting clause, the terms "Well", "spaced unit" and "lease" are all used. As discussed before, "Well" includes the oil and gas leases and the operating rights therein.

The actual language states "INSOFAR AND ONLY INSOFAR AS said *lease* covers" the Subject Premises. [Plaintiff's Ex. 6 (emphasis added)]. Therefore, the plain language of the Conveyance says it is limiting the rights conveyed in a lease, not a "spaced unit" as Appellant contends. Appellant completely ignores that the insofar language refers to "said lease", indicating the lease or leases were identified before, as the first "Whereas" clause does. [Plaintiff's Ex. 6]. The inclusion of "lease" in the granting clause creates an ambiguity. [Tr. 202-203, Vol. 1].

Furthermore, this language is necessary because it actually limits the interest conveyed in the oil and gas leases. In a conveyance, all rights belonging to the granted estate shall be included in the conveyance, unless the contrary shall be stated in the instrument. NMSA 1978, § 47-1-34 (1947); *Twin Forks Ranch, Inc. v. Brooks*, 1998-NMCA-129, ¶¶ 20-21, 125 N.M. 674, 964 P.2d 838 (court is unwilling to include a reservation which is not clearly and convincingly part of the deed). The two state oil and gas leases which cover the Subject Premises also cover thousands of other acres. [Plaintiff's Ex. 38, pp. 4 and 5; Tr. 188, Vol. 1; Tr. 72-73, Vol. 2]. The conveyance itself specifically says insofar and only insofar as the leases cover the Subject Premises. [Plaintiff's Ex. 6]. Because the leases covered numerous other acres not being conveyed, Chisos, in drafting the assignment, had to limit the conveyance to the exact leasehold rights it was conveying.

The limiting language cannot add to what is granted; it can only limit what is granted. Chisos' expert was unwilling to say the use of "said lease" in the Conveyance was superfluous or did not add anything to the interpretation. [Tr. 203, 205, Vol. 1]. The only logical explanation is that the language was necessary to limit the operating rights in the state oil and gas leases being conveyed to the 320 acres attendant to the spacing unit for the Stetson Well.

C. *PARAGRAPHS B AND C OF THE GRANTING CLAUSE AND THE REMAINING PROVISIONS IN THE CONVEYANCE ADD TO THE AMBIGUITY*

Paragraph B of the granting clause grants to JKM all of Chisos' title and interest in, to and under or derived from "[a]ll other contracts, agreements and instruments which relate to the property and interests specifically described above". [Plaintiff's Ex. 6]. This clause, which is wholly ignored by Appellant, contemplates the conveyance of the oil and gas leases and is consistent with a conveyance of the operating rights in an oil and gas lease. [Tr. 81, Vol. 2]. Similarly, the wording of Paragraph C, which Appellant also ignores, tends to contemplate more than a wellbore assignment, but the wording is confusing and lacks clarity. [Tr. 82, Vol. 2]. Mr. Brewer pointed out a number of times where "interests" and "assets" were used in the Conveyance rather than "Well". [Tr. 81-85, Vol. 2]. Mr. Brewer also pointed out that Chisos specifically reserved an overriding royalty, but did not address what other rights were being reserved in terms of shallower or deeper depths, the right to drill out horizontally or the ability to develop other parts of the leasehold, all of which would normally be included in a wellbore only assignment. [Tr. 83-84, Vol. 2].

Appellant's arguments at trial, and in its Brief in Chief, focus on a limited portion of the Conveyance and ignores the portions, such as the limiting language which specifically refers to "said lease" and the language assigning "[a]ll other

contracts, agreements and instruments which relate to the *property* and *interests* specifically described above" (emphasis added). Appellant's limited scope of analysis is inapposite to New Mexico law. In construing the provisions of a written contract, the instrument as a whole is to be considered. *Manuel Lujan Ins., Inc.*, 100 N.M. at 575. When the instrument is read as a whole, it is obvious that the Conveyance is ambiguous.

D. THE CHANGES TO THE CONVEYANCE MADE BY CHISOS DO NOT EVIDENCE AN UNAMBIGUOUS INTENTION TO CONVEY ONLY A WELLBORE

Chisos did not delete, in its entirety, the language which describes the operating rights and lands actually conveyed from the first "Whereas" clause. The language was moved to the *granting* clause. [Plaintiff's Ex. 6 and 7]. Plaintiff's Exhibit 4 shows the form of conveyance submitted by JKM included in the first "Whereas" clause, "insofar as the lease covers the following described lands in Eddy County, New Mexico:

Township 19 South, Range 29 East, NMPM

Section 2: W/2".

Plaintiff's Exhibits 6 and 7 clearly show the language "INSOFAR AS AND ONLY INSOFAR AS said lease covers the West Half (W/2) of Section 2, Township 19 South, Range 29 East, NMPM, Eddy County, New Mexico" was added to the

granting clause by Chisos. Merely moving the language describing the Subject Premises does nothing to clear up the ambiguities of the Conveyance.

Another change to the granting clause was to take out the actual name of the Stetson Well and insert "Well and spaced unit". [Plaintiff's Ex. 7]. If, as Appellant contends, the true intent was to convey only a wellbore, it makes no sense to take the description of the well out of the actual *granting* clause.

Certain of the other changes were the revisions to the title of the instrument, overriding royalty and plugging and abandonment clauses and the deletion of a "Mother Hubbard" clause.[4] These changes do not evidence a clear, unambiguous intent to convey only wellbore rights. Mr. Brewer testified the changes may be consistent with changing a conveyance from one conveying operating rights to one conveying a wellbore only, but the changes also had other purposes and the changes do not necessarily cut one way or the other. [Tr. 90-95, 107, Vol. 2]. A myriad of possible explanations, all of which have absolutely nothing to do with changing the conveyance from one conveying operating rights to one conveying only wellbore rights, exists for these changes.

As with its reading of the Conveyance as a whole, Appellant's arguments focus on a limited portion of the Conveyance and the changes it made to those portions. But those changes, when examined under the totality of the

[4] A "Mother Hubbard" clause is also commonly referred to as a "catchall" clause. The purpose of such a clause is to include interests or property in a conveyance in the event that a real property interest is inadvertently omitted or misdescribed. [Tr. 181-182, Vol. 1].

circumstances, do not resolve any ambiguity or otherwise evidence an intention for the Conveyance to be only a wellbore assignment.

E. THE TESTIMONY AS TO THE PARTIES' INTENT ONLY ADDS TO THE AMBIGUITY

It is undisputed JKM intended to acquire all of the operating rights in the Subject Premises and intended the definition of "Well" to include the Stetson Well and the oil and gas lease operating rights. [Tr. 9, Vol. 2]. Chisos' expert testified JKM's submitted form of conveyance was definitely a conveyance of operating rights and JKM could have been using "Well" in the Conveyance as shorthand for the well and the lease rights attendant to it. [Tr. 191-192, Vol. 1]. The interest being conveyed was generally referred to as the Stetson #1 property during negotiations. [Plaintiff's Ex. 1; Plaintiff's Ex. 3]. JKM's experts testified it is common in the oil and gas industry for persons to refer to leases, or the operating rights therein, as wells or by well names. [Tr. 53, Vol. 2; Tr. 73-74, Vol. 2]. Ms. Craddock testified she has had instances where a producing well name is used as a shorthand reference to the well and the lease rights attached to the well. [Tr. 92, Vol. 1]. Therefore, the facts and circumstances surrounding the Conveyance demonstrate the parties attach a different meaning to the term "Well", as defined in the Conveyance, than they would "well" and demonstrate an ambiguity.

Further, the intentions of Chisos are clouded by its misrepresentation as to the working interest and net revenue interest being conveyed to JKM. Chisos

represented that it owned and could convey 100% of the operating rights and a 75% net revenue interest to JKM. [Plaintiff's Ex. 3]. Appellant utilized its best efforts at trial to confuse the difference between operating rights and a right to production pursuant to a non-consent clause in an operating agreement. [Tr. 95, Vol. 1; Tr. 110-111, Vol. 1]. Appellant has represented to this Court that prior to the conveyance it owned 100% of the operating rights in the Stetson Well. [BIC 5]. If, as Appellant contends, it owned 100% of the operating rights in the Stetson Well, and it conveyed those rights to JKM, then it would necessarily follow that JKM would own 100% of the operating rights in the Stetson Well. However, Appellant's own expert does not credit JKM with 100% of the operating rights in the Stetson Well, but credits JKM and Pure with 50% each. [Plaintiff's Ex. 38, page 2]. Chisos' misrepresentations only increase the difficulty of ascertaining its true intentions and add to the ambiguity of the Conveyance.

F. THE CONDUCT OF THE PARTIES DOES NOT RESOLVE ANY AMBIGUITY

A Change of Operator form is well-specific and it does not matter whether the Conveyance assigned operating rights or only wellbore rights, a Change of Operator form would still have to be filed for the Stetson Well. 19.15.9.9(A) NMAC (Rp, 19.15.3.100 NMAC, 12/1/2008); [Tr. 86, Vol. 2]. Moreover, the Change of Operator form pertains only to *wells*. So, a statement that the Change of Operator form should be the last step in transferring the well does not necessarily

mean, as Appellant contends, it is evidence of an intent to convey only a well. Since the form is used only for wells and would be required regardless of whether the Conveyance assigned operating or wellbore rights, the use of the form does not resolve any ambiguity created by the definition of "Well" in the Conveyance.

Additionally, JKM has never asserted it owns the leases. JKM asserts it owns certain operating rights in the leases insofar as they cover the Subject Premises. As Appellant is well aware, record title or official title to state oil and gas leases is a completely different real property right than operating rights in a lease. [Tr. 187-188, Vol. 1; Tr. 72-73, Vol. 2]. Operating rights in a state lease are routinely assigned without an assignment of record title. [Tr. 187-189, Vol. 1; Tr. 72, Vol. 2] In fact, New Mexico specifically contemplates such a scenario and the statute provides, in pertinent part:

> "Provided, however, the record owner of any mineral lease may enter into any contract for the development of the leasehold premises or any portion thereof, or may create overriding royalties or obligations payable out of production, or enter into any other agreements with respect to the development of the leasehold premises or disposition of the production therefrom, and it shall not be necessary for any such contracts, agreements or other instruments to be approved by the commissioner of public lands; but nothing herein contained shall relieve the record title owner of such lease from complying with any of the terms or provisions thereof, and the commissioner shall look solely and only to such record owner for compliance therewith, . . ."

NMSA 1978, § 19-8-28 (1955). Since JKM is not and has never asserted it is the record title owner of a lease, the fact that it has not requested lease files or offered

to pay rentals does not demonstrate an intention to acquire only a wellbore assignment.

Similarly, Chisos never made JKM aware of Pure's interest and Ms. Craddock specifically testified she did not feel it was necessary to tell JKM of Pure's interest. [Tr. 96, Vol. 1]. Therefore, the fact that JKM did not inform Pure that JKM had acquired the Subject Premises or communicate with Pure regarding the property does not demonstrate an intention to acquire only a wellbore assignment.[5]

G. THE TRIAL COURT'S CONCLUSION THAT THE CONVEYANCE IS AMBIGUOUS IS APPROPRIATE

Chisos' own expert testified there were questions as to exactly what the parties intended. [Tr. 168, Vol. 1]. Mr. Brewer also testified the Conveyance was one of the more poorly drafted instruments he had seen and he would make a requirement for inquiry as to what the Conveyance actually assigned. [Tr. 111, Vol. 2]. Mr. Canon testified he needed to examine extrinsic evidence in order to come to a conclusion. [Tr. 168, Vol. 1]. Mr. Canon further testified that if he had come across Plaintiff's Exhibit 6 in a title examination, he would have made a title requirement for clarification of the Conveyance and, even after a review of extrinsic evidence, he would still make a requirement for a party to clarify the

[5] It is worth noting that since JKM became aware of Pure's non-consent interest in the Stetson Well, JKM has been in contact with Pure and is working with Pure to set up a "payout account" to keep track of the production proceeds to be applied against Pure's share of operational costs and expenses and non-consent penalties.

instrument. [Tr. 192-193, Vol. 1]. Therefore, after a full examination of the Conveyance as a whole, in light of the surrounding circumstances and other factors, it is clear that the Conveyance is ambiguous.

II. THE TRIAL COURT'S FINDING THAT THE CONVEYANCE SHOULD BE INTERPRETED IN THE MANNER CONTENDED BY JKM IS APPROPRIATE

STANDARD OF REVIEW[6]

Assuming a determination that the contract is ambiguous, the Court must resolve the meaning of the instrument by considering the language and conduct of the parties and the circumstances surrounding the agreement, as well as oral evidence of the parties' intent. *Mark V*, 114 N.M. at 781-82. The meaning to be assigned the unclear terms is a question of fact. *Id.* at 781. If the evidence presented and testimony given at trial could lead to different, but reasonable, conclusions as to the parties' intent, the court should apply the evidence in the manner prescribed in Restatement (Second) of Contracts Section 201(2). *Farmington Police Officers Ass'n v. City of Farmington,* 2006-NMCA-077, ¶ 23, 139 N.M. 750, 137 P.3D 1204. Where the parties have attached different meanings to a contract term, it is interpreted in accordance with the meaning

[6] Appellant argues, based upon its set of selective facts, the Trial Court's finding, as a matter of law, that the Conveyance assigned all of Chisos' operating rights in the Subject Premises was in error and the Conveyance, as a matter of law, only conveyed the rights to the Stetson Well. [BIC 19]. However, the Trial Court did not make such a finding and no such finding, in either direction, could be made. Once the agreement is found to be ambiguous, the meaning to be assigned the unclear terms is a question of fact. *Mark V*, 114 N.M. at 781. Either the Conveyance is unambiguous or a factual determination must be made. The Trial Court found the Conveyance ambiguous and proceeded to make a factual determination. [RP 329, FOF 22 and 23; RP 329, COL 2 and 3].

attached by one of them if at the time the agreement was made (a) that party did not know of any different meaning attached by the other, and the other knew the meaning attached by the first party; or (b) that party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party. RESTATEMENT (SECOND) OF CONTRACTS § 201(2) (1981). This is a question of fact. *J. R. Hale Contracting Co. v. Union Pacific R.R.*, 2008-NMCA-037, ¶ 54, 143 N.M. 574, 179 P.3d 579 (*citing Farmington Police Officers Ass'n,* 2006-NMCA-077 at ¶ 23). Factual questions are reviewed for substantial evidence. *Sitterly v. Matthews*, 2000-NMCA-037, ¶ 22, 129 N.M. 134, 2 P.3d 871. Substantial evidence is relevant evidence that a reasonable mind would find adequate to support a conclusion. *Id.* In reviewing a party's claim of insufficiency of the evidence, the Court considers the evidence of record to support the prevailing party below, exercises all reasonable inferences in favor of the trial court's decision, and ignores all evidence and testimony to the contrary. *Tres Ladrones, Inc. v. Fitch*, 1999-NMCA-076, ¶ 16, 127 N.M. 437, 982 P.2D 488. Where there is conflicting evidence, the trial court, as fact finder, resolves all disparities in the testimony and determines the weight and credibility to be accorded to the witnesses. *Id.*

A. RESPONSE TO APPELLANT'S "SUMMARY OF EVIDENCE SUPPORTING NO SUBSTANTIAL EVIDENCE CLAIMS"

Appellant contends the Trial Court's finding that Chisos knew or should have known JKM intended to obtain all of Chisos' operating rights in the Subject Premises is in error and not supported by substantial evidence and points out a few "undisputed" facts. [BIC 8-9]. In support of its contentions, Appellant uses the phrases "under this set of undisputed facts" and "under this set of facts". [BIC 9-10]. In doing so, Appellant merely points to facts which could support its position taken at trial rather than address the factual support relied upon by the Trial Court and show how such factual support does not constitute substantial evidence. Because Appellant has merely pointed out alternative evidence, it has not demonstrated a lack of substantial evidence to support the Trial Court's conclusion that Chisos knew or should have known of JKM's intent or that JKM did not know and should not have known Chisos intent. Even if this was the correct standard of review and assuming the validity of Appellant's selected facts, it is still unclear how any of them contradict the Court's findings. However, it is not the correct standard of review and Appellant's failure to specifically attack each fact relied upon by the Trial Court precludes its attack on sufficiency of the evidence. Rule

12-213(A)(4) NMRA; *Tres Ladrones*, 1999-NMCA-076 at ¶ 17. Appellant's argument must therefore fail.[7]

B. THE TRIAL COURT'S FINDING THAT CHISOS KNEW OR SHOULD HAVE KNOWN THAT JKM INTENDED TO ACQUIRE ALL OF CHISOS' OPERATING RIGHTS IS SUPPORTED BY SUBSTANTIAL EVIDENCE

Chisos knew or should have known JKM intended the Conveyance to assign all of Chisos' operating rights in the Subject Premises. The form of conveyance submitted by JKM was undisputedly a conveyance of operating rights and put Chisos on notice of JKM's intent. [Plaintiff's Ex. 4]. Appellant admits the form of conveyance submitted by JKM was a conveyance of operating rights. [BIC 19]. Chisos' own expert testified the form of conveyance submitted by JKM was undoubtedly a conveyance of operating rights [Tr. 191, Vol. 1], and evidenced JKM's intent to obtain the operating rights in the Subject Premises. [Tr. 191, Vol. 1]. In the face of this evidence, it is obvious that Chisos knew or should have known JKM intended to acquire the operating rights in the Subject Premises.

Mr. Matthews testified he understood from the conversations he had with Ms. Craddock that JKM was receiving all of the operating rights in the Subject Premises. [Tr. 9, Vol. 2]. Ms. Craddock stated a number of times Chisos did not know JKM intended the Conveyance to cover all of the operating rights in the

[7] This appears to be the same argument Appellant uses in its Argument section on Pages 20-24 of its Brief in Chief and, for the same reasons, Appellant has failed to challenge the Trial Court's findings. Therefore, the Court should affirm the findings of the Trial Court.

Subject Premises. However, the Trial Court found Ms. Craddock's testimony was not credible. [RP 329, FOF 12]. Determinations of credibility are the unique province of the finder of fact. *State v. Quintana*, No. 27,859, slip op. at ¶ 22 (N.M. Ct. App. August 26, 2009). Based upon the evidence presented and the testimony of the parties, it is evident that the Chisos knew of should have known JKM intended to acquire the oil and gas leasehold operating rights in the Subject Premises.

As discussed above, a Change of Operator form would be required for the transfer of the Stetson Well regardless of whether the Conveyance assigned the operating rights in the Subject Premises or only the Stetson Well. Thus, the use of the form and reference to the Stetson Well therein do not, in any way, negate the fact that Chisos knew or should have known JKM's intent was to acquire all of Chisos' operating rights in the Subject Premises.

Therefore, the Trial Court's finding that Chisos knew or should have known JKM intended to acquire all of Chisos' operating rights in the Subject Premises is supported by substantial evidence.

C. THE TRIAL COURT'S FINDING THAT JKM DID NOT KNOW OR SHOULD NOT HAVE KNOWN THAT CHISOS INTENDED TO ASSIGN ONLY THE WELLBORE RIGHTS IS SUPPORTED BY SUBSTANTIAL EVIDENCE

JKM did not know and should not have known Chisos' intent was to convey only the wellbore rights to the Stetson Well. The Trial Court found, through the

testimony of the parties, Chisos never informed JKM of its intent to convey only the wellbore. [RP 329, FOF 13; Tr. 15-16, Vol. 2]. JKM knew, from the use of a "wellbore assignment" in a prior transaction, the typical provisions of a "wellbore assignment". [Tr. 9-10, Vol. 2; Defendant's Ex. S]. That this understanding is reasonable is obvious, based upon the testimony of the experts retained in this case. [Tr. 168, Vol. 1 (Mr. Canon stated that he read and reread the instrument and there were questions as to what the parties intended); Tr. 75, Vol. 2 (Mr. Brewer testified that he would construe the instrument as a operating rights conveyance)]. JKM believed the draft of the Conveyance submitted by Chisos was still a conveyance of operating rights. [Tr. 14, Vol. 2]. It does not make any economic sense for JKM, which had agreed to pay and had actually paid $55,000.00 for the operating rights in the Subject Premises prior to receiving Chisos' redrafted conveyance, to believe it was now only getting the wellbore rights for the same amount of money.

As noted above, (1) the changes to the Conveyance made by Chisos, and shown on Plaintiff's Exhibit 7, have other purposes than to just transform the conveyance into one of wellbore rights only [Tr. 90-95, Vol. 2]; (2) in the oil and gas industry, people refer to a well name even though they may actually be referring to a lease and the operating rights attendant thereto [Tr. 92, Vol. 1; Tr. 53, Vol. 2; Tr. 73-74, Vol. 2]; and (3) a Change of Operator form would be required regardless of whether the Conveyance assigned operating or wellbore rights. None

of these facts support a conclusion that JKM knew or should have known Chisos only intended to convey the Stetson Well.

Therefore, the Trial Court's finding that JKM did not know and should not have known Chisos only intended to the Conveyance to assign the Stetson Well is supported by substantial evidence.

D. THE TRIAL COURT'S CONCLUSION THAT THE CONVEYANCE SHOULD BE INTERPRETED IN ACCORDANCE WITH JKM'S UNDERSTANDING IS APPROPRIATE

It is clearly evident, when examining all of the evidence and testimony presented at trial, as opposed to a selected set of facts, that the Trial Court's findings that Chisos knew or should have known of JKM's intent and JKM did not know and should not have known of Chisos' intent are supported by substantial evidence. Because the Trial Court's findings are supported by substantial evidence, it has properly applied Restatement (Second) of Contracts Section 201(2), and has made a proper determination that the Conveyance assigned all of Chisos' operating rights in the Subject Property.

E. THE TRIAL COURT'S APPLICATION OF THE CANONS OF CONSTRUCTION WAS NOT IN ERROR

In the alternative, if no evidence is introduced by the parties bearing or shedding light upon what the other knew or should have known under the Restatement (Second) of Contracts Section 201(2) inquiry, the Court, while

remaining alert to the possibility that there was a failure of mutual assent, may resolve any ambiguity as a matter of law using the canons of construction. *Farmington Police Officers Ass'n*, 2006-NMCA-077 at ¶ 24.

Appellant does not challenge the manner in which the Trial Court applied the canons of construction and, therefore, if, as stated above, the use of the canons was correct, the Trial Court's findings pursuant to the canons must also be proper.

III. THE TRIAL COURT'S FINDINGS THAT CHISOS VIOLATED THE NOTICE PROVISIONS OF THE JOINT OPERATING AGREEMENT AND THAT CHISOS ACTED IN BAD FAITH IN VIOLATING THE NOTICE PROVISIONS OF THE JOINT OPERATING AGREEMENT ARE APPROPRIATE

STANDARD OF REVIEW

Breach of contract is a question of fact. *Collado v. City of Albuquerque*, 2002-NMCA-048, ¶ 15, 132 N.M. 133, 45 P.3d 73. Whether a party has acted in good faith or bad faith is generally a question of fact. *McKay v. Farmers and Stockmens Bank of Clayton*, 92 N.M. 181, 183, 585 P.2d 325, 327 (Ct. App. 1978). Questions of fact are reviewed under the substantial evidence standard. *Collado*, 2002-NMCA-048 at ¶ 15.

A. SUBSTANTIAL EVIDENCE EXISTS TO SUPPORT THE TRIAL COURT'S FINDING THAT CHISOS DID NOT GIVE PROPER NOTICE TO JKM

Chisos did not give proper notice to JKM under the terms of the JOA. *See generally, Nearburg v. Yates Petroleum Corp.*, 1997-NMCA-069, 123 N.M. 526, 943 P.2d 560 (the subsequent operations provisions create a time line of notice and

election to which the parties must adhere). Chisos attempted to recomplete the HL-2 Well in October of 2006 without any notice to JKM; however, Mr. Matthews noticed the operations and informed Chisos it was trespassing. [Plaintiff's Ex. 19]. As a result, Chisos halted its operations. [Tr. 75-76, Vol. 1]. Chisos knew by August 21, 2006, it was going to recomplete the HL-2 Well. [Plaintiff's Ex. 17]. In fact, Chisos had already notified Pure of the proposed recompletion. [Plaintiff's Ex. 17].

On March 13, 2007, Chisos, after discussions with Pure about going non-consent a second time, acquired an interest in the HL-2 Well from Pure. [Plaintiff's Ex. 20]. Obviously, Chisos had a proposal for a second attempt at recompleting the HL-2 Well sometime prior to March 13, 2007, since Ms. Craddock testified she said to Larry Risley of Pure, "Larry, why don't you just give me, if you are electing to go non-consent on *my second proposal* to recomplete this well, just give me a term assignment." [Tr. 78, Vol. 1 (emphasis added)]. Subsequently, Chisos again began reworking operations on the HL-2 Well without any notice to JKM. [Tr. 127, Vol. 1]. For the second time, JKM only learned of the reworking operations on the HL-2 Well when Mr. Matthews was checking on the Stetson Well and saw the equipment on the HL-2 Well location and JKM reiterated its claim as to the operating rights in the Subject Premises and, therefore, any production from the HL-2 Well. [Plaintiff's Ex. 21].

Only after the May 8, 2007 letter to Chisos and only in response to that letter did Chisos send JKM a letter dated May 11, 2008, which Chisos asserts provided "notice" of its proposed operations. [Plaintiff's Ex. 22]. Chisos knew it was going to be conducting reworking operations more than 30 days prior to May 11, 2007. [Tr. 131, Vol. 1]. All of the above facts support the Trial Court's finding that Chisos did not give proper notice to JKM of its proposed operations under the JOA.

Furthermore, the JOA requires notice of *proposed* operations. [Plaintiff's Ex. 16, page 5 (emphasis added)]. Chisos already had a workover rig on site before it "notified" JKM of the operations. [Plaintiff's Ex. 21 and 22]. Obviously, the operations were no longer proposed; the operations had begun. Because Chisos began its operations prior to any notification to JKM, its operations were no longer proposed. Thus, JKM did not receive notice pursuant to the JOA.

The JOA provides, and Appellant admits, for 48 hours notice only when a drilling rig is on location. Chisos did not have a drilling rig on location. [Tr. 132, Vol. 1]. Ms. Craddock testified there is a difference between a drilling rig and a workover rig. [Tr. 132-133, Vol. 1]. The expense of having a drilling rig on standby and, at times, the scarcity of drilling rigs provide the primary reasons for the exception. However, the rationale is not the same for workover rigs. Particularly in light of the fact that the JOA notice of subsequent operations

provision contemplates drilling, deepening, plugging back and reworking operations but only provides an exception for a drilling rig. Furthermore, Chisos had been planning the reworking operation since at least October of 2006 and taken an Assignment from Pure as of March 13, 2007. This gave Chisos, at a minimum, two months (March 13, 2007 to May 11, 2007) in which to notify JKM of the proposed operations. The rationale behind the exception is not to let an operator sit around for an extended period of time and then spring its "proposed operation" on a nonoperator and force it to choose to participate within 48 hours.

Because Chisos did not send notice of its proposed operations to JKM and because the 48 hour notice exception is inapplicable to the situation at issue here, all of the evidence presented supports the Trial Court's finding that Chisos violated the terms of the JOA.

B. SUBSTANTIAL EVIDENCE EXISTS TO SUPPORT THE TRIAL COURT'S FINDING OF BAD FAITH

The Trial Court also found Chisos acted in bad faith with regard to the 48 hour "notice" provided by Chisos. [RP 329, FOF 33]. As discussed above, the 48 hour notice exception is not applicable here. Even if it was applicable, Chisos still twice attempted to rework the HL-2 Well without notification to JKM of any kind and, on its second attempt, Chisos only provided 48 hour "notice" after JKM realized work was already being conducted on the HL-2 Well and inquired about the work. [Plaintiff's Ex. 18, 21 and 22]. Again, Chisos had, at the very least, two

months to propose the operations to JKM. Chisos failed to do so and then, in an attempt to cover its misconduct, sent the May 11, 2007 letter and now tries to pigeonhole the letter into the terms of the JOA. The letter, which JKM received late on a Friday afternoon, demanded almost $170,000.00 within 48 hours. [Plaintiff's Ex. 22]. Thus by attempting to rework the HL-2 Well without notice and then force JKM to make an election to participate in 48 hours, Chisos acted in bad faith. The Trial Court's finding in this matter is appropriate and is supported by substantial evidence.

CONCLUSION

Based upon the Conveyance, the evidence presented, and the testimony of the parties and their respective experts, it is clear that:

1. The Conveyance is ambiguous and the Trial Court's finding such as a matter of law is not in error.

2. Appellant does not actually attack the substantial evidence relied upon by the Trial Court in its application of Restatement (Second) of Contracts Section 201, but instead attempts to substitute its selected set of facts.

3. The Trial Court's finding that Chisos knew or should have known that JKM intended to acquire all of Chisos' operating rights in the Subject Premises is supported by substantial evidence.

4. The Trial Court's finding that JKM did not know and should not have known Chisos intended to convey only the wellbore rights to Stetson Well is supported by substantial evidence.

5. Therefore, the Trial Court properly interpreted the Conveyance in accordance with the meaning attached to the Conveyance by JKM.

6. In addition, the Trial Court properly applied the canons of construction, if such are necessary at all.

7. By attempting to rework the HL-2 Well and actually beginning reworking operations twice without any notification to JKM, Chisos violated the terms of the JOA.

8. Further, by attempting to rework the HL-2 Well without JKM's knowledge and attempting to force JKM in to non-consent status with its 48 hour "notice", Chisos acted in bad faith.

WHEREFORE, Appellee requests that the Court affirm the Trial Court's Final Judgment in favor of Appellee.

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CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of September, 2009, I caused a true and correct copy of the foregoing Answer Brief to be mailed to the following counsel of record:

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