20130219

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

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| Golden Eye Resources, LLC,<br><br>Plaintiff, Appellee and Cross-Appellant<br><br>vs.<br><br>Debra K. Ganske, Wesley G. Borgen, Gay M. King, Michael R. Borgen, Sue E. Evans, and Linda R. McCoy,<br><br>Defendants<br>---<br>Debra K. Ganske, Wesley G. Borgen, Michael R. Borgen, Sue E. Evans and Linda R. McCoy,<br><br>Appellants and Cross-Appellees | Supreme Court Case No. 20130219<br><br>District Court Case No. 53-2010-CV-00536 |



# APPELLANTS AND CROSS-APPELLEES' REPLY BRIEF

APPEAL FROM THE DISTRICT COURT
NORTHWEST JUDICIAL DISTRICT
WILLIAMS COUNTY, NORTH DAKOTA
THE HONORABLE DAVID W. NELSON

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## LAW AND ARGUMENT

The Appellants' and Cross-Appellees have divided their brief into two parts: reply in support of their appeal and response in opposition to GER's cross-appeal. All prior briefings Appellants made to this Court, and the district court, on appealed issues are incorporated here by reference.

### I. Reply Brief: Failure to State a Claim, Rescission, and Cancellation.

#### A. Failure to State a Claim.

GER refuses to accept the legal effect of a rescission accomplished under N.D.C.C. § 9-09-04. The leases ceased to exist upon rescission. N.D.C.C. § 47-16-36 does not apply. Appellants did not declare a forfeiture of *valid* contracts because of a breach; they rescinded *voidable* contracts because their consent was obtained through fraud. The Appellants complied with the statutory rule governing rescission: a unilateral rescission was accomplished and GER did not have leasehold title that would support a quiet title action. GER admitted the notice of rescission complied with legal requirements, yet denies the legal effect. GER's filing of a notice of nonforfeiture with the county recorder is not relevant and did not negate rescission.

GER could have brought an action to set aside the accomplished rescission and to specifically enforce the lease contracts. A complaint seeking the equitable remedy of specific enforcement (or performance) must clearly show that the legal remedy of damages is inadequate. *Livinggood v. Balsdon*, 2006 ND 11, ¶ 16, 709 N.W.2d 723.

In the alternative to a claim for specific enforcement, GER could have brought an action under N.D.C.C. § 32-03-13 for damages for breach of an agreement to convey an estate (working interest) in real property. The measure of damages is the difference between the price agreed to be paid and the value of the estate agreed to be conveyed at the time of the breach. *Id.* If GER had not refused the Appellant's offer to restore the status quo set forth in their notice of rescission, GER could have taken the restored money and leased other mineral acres that were still abundantly available in May 2010. GER's landman, Ric Henricksen, testified that he stopped acquiring leases for GER about that time because GER had run out of money. Supplemental Appendix ("Supp. App.") 49. Appellants were deprived of notice of proper claims and a meaningful opportunity to defend themselves against proper claims under established legal rules.

Instead of bringing proper claims in the alternative, GER has litigated under its incorrect theory that it is entitled to both equitable and legal relief—double recovery. Through mischaracterization of the Appellants' accomplished rescission as an *attempted* rescission, GER has sought to gain through indirection what could not be gained directly. In addition to claiming it is entitled to equitable relief because Appellants' alleged "attempted" rescission clouded its title, GER claims this "clouding" also entitles GER to unspecified millions of dollars in breach of contract damages under the general statute, N.D.C.C. § 32-03-09, rather than the specific statute, N.D.C.C. § 32-03-13.

GER has not stated cognizable claims and the district court should have granted Appellants motion to dismiss. The Appellants have now spent nearly four years and substantial sums of money defending themselves against GER's baseless claims to hold

them liable in damages for millions of dollars. Because GER did not amend its complaint to state a proper claim, this Court should reverse the trial court's order denying the Appellants' motion.

**B. Enforcement of Rescission Claim.**

Real property owners have the right to lease, or not lease. *Sanford v. Sanford*, 301 N.D.2d 118, 122 (N.D. 1980). The Appellants had the right to choose who to lease with based on matters important to them. *Stude v Madzo*, 217 N.W.2d 5, 12 (N.D. 1974). They informed GER's agents that they would only lease to an experienced driller of horizontal wells that was actually going to drill and operate oil wells on the leased premises. Oil and gas leases are contracts executed for the purpose of procuring development upon the lessor's premises *by the lessee*. *Schank v. North American Royalties, Inc.*, 201 N.W.2d 419, 433 (N.D. 1972). The Appellants made it clear they did not want to contract with a lease flipper or a holding company. Supp. App. 48, 50. GER fraudulently obtained the Appellants' consent to lease when GER's agents induced the Appellants to rely on false statements, which were outlined in the Appellant's initial brief.

GER's argument that its misrepresentations contradicted the pooling and unitization clause lacks merit. The clause requires pooling and unitization be conducted in accordance with state law. Under state law, voluntary pooling could not take place without the Appellants' consent. *Egeland v. Continental Resources, Inc.*, 2000 ND 169, ¶ 12, 616 N.W.2d 861; N.D.C.C. § 38-08-08(1). The clause requiring GER's compliance with the law as well as other clauses were *consistent* with representations that GER would be the driller and operator. Paragraph 8 states GER

"shall exercise the diligence of a reasonably prudent *operator*. . ." and paragraph 10 provides GER must act as a reasonably prudent *operator*. Appellants' Appendix ("App.) 28-29 (emphasis added). This language is consistent with the representations made during negotiations.

The habendum clause provided that the lease was for a term of three years and as long thereafter as oil and/or gas was produced in paying quantities. This is standard language in oil and gas leases and is not contrary to the representations made by GER's agents. Furthermore, GER's agent explicitly addressed the Appellant's questions and concerns and stated there were only two things that would prevent GER from developing the leased premises during the lease term: An inability to acquire a drilling rig or the collapse of the economy, *i.e.*, oil prices plummeting. GER's agent reassured Appellants that GER did not foresee any problem acquiring a rig because GER was a well-funded company and its owner was well-connected in the industry and wealthy. GER's agent asked for an option to extend the term for an additional two years because of a shortage of available rigs. The agent stressed GER was investing millions of dollars in its development plan and they wanted the ability to secure additional time to drill in the unlikely event that a rig could not be secured.

"When a party responds to an inquiry about the subject matter of a contract, the response must disclose full, accurate, and truthful information." *West v. Carlson*, 454 N.W.2d 307, 310 (N.D. 1990). GER responded to the Appellants' with falsehoods. These false statements induced the Appellants to execute the contracts.

GER's reliance on *First State Bank v. Moen*, 529 N.W.2d 887 (N.D. 1995), is misplaced. The contract term at issue in *Moen* explicitly provided that the bank was

not agreeing to provide future financing, thus Moen could not rely a verbal representation that the bank would provide future financing as grounds for a fraud claim. Those circumstances are not present here. None of lease terms contradict any of the representations made as inducement. For example, GER's false representation that it was experienced in drilling horizontal wells did not conflict with any contract terms. There was no contract term that provided only *inexperienced* operators who have never drilled a horizontal well shall be allowed to drill wells on the leased premises. The fraud alleged does not conflict with the lease terms and, as previously argued, evidence of fraud in the inducement is an exception to the parol evidence rule.

Statements of opinion based on false facts are actionable as fraud. *Allen v. Devon Energy Holding, LLC*, 367 S.W.3d 355, 370 (Tex. App. 2012) (mixed statements of opinion and fact). GER had no experience in drilling horizontal wells, successful or otherwise. GER cannot assert its numerous misrepresentations were mere puffery. For example, GER did not have drilling control, a permit man waiting for Appellants' leases, or 7,000 nma's in the area (among other misrepresentations). GER's agents falsely claimed it was going to start drilling as soon as it acquired its rig and Appellants acres would be first on their list to drill. GER relied on false facts to induce Appellants to sign quickly.

A representation relating to a future event (*e.g.* we're going to drill as soon as we get our rig), may constitute actionable fraud when made without intention of performance. *Reitz v. Ampro Royalty Trust*, 61 N.W.2d 201, 203-04 (S.D. 1953). GER knew it did not have drilling control, technical ability, staff, or experience required by the Commission in drilling permit matters. *See, e.g.*, N.D.A.C. § 43-02-03-

16.2; Supp. App. 9. A jury may reasonably infer that GER was not going to be able to fulfill its representations and used deception to defraud mineral owners into leasing their property they would otherwise reject if they knew of the false statements.

Lease paragraph 9 states: "After a well producing, or capable of producing, oil and/or gas has been completed on the leased premises, lessee *shall* exercise the diligence of a reasonably prudent operator in drilling such additional well or wells as may be reasonably necessary for the proper development of the leased premises and in marketing the production therefrom." App. 20 (emphasis added). The existing units have been zoned for additional wells, but GER does not have the technical ability, experience, drilling control, equipment, or staff necessary to drill. GER is not the operating company it falsely claimed to be. Appellants must now deal with several other companies (Petro-Hunt/Halcon, Liberty/Kodiak, and Oasis) with whom they do not have contracts on lands covering four large units in the hope of gaining full development of these units and mitigating the dilution of their royalty interests. GER's argument that it has the contract right to participate in wells that other companies *might* drill in these large "spacing" units over the next 20 or 30 years, if ever, is meaningless to Appellants. The Appellants cannot possibly enforce GER's obligation under Paragraph 9.

North Dakota law, incorporated into the contract, cannot be construed to authorize lease flippers and speculators to falsely represent themselves and commit fraud upon mineral owners without consequences. GER's cited cases on page 16 of its brief do not support its argument that the Appellants must prove "justifiable reliance" as an element of their claim to enforce their rescission. GER argues if the Appellants



Corrected Page

were unjustified (negligent) in relying on the misrepresentations, then the Appellants cannot assert a fraud claim as a matter of law. Nothing substantiates the argument that a defrauded party's alleged negligence serves to deprive them of their legal remedies under North Dakota law.

The Appellants are not the only ones who GER made false representations to. Other lessors in the general area of the subject property were also told by GER that it would be operator. Supp. App. 3-5, 7. GER has so far succeeded in leasing hundreds of acres by misrepresentation without consequence.

The district court found that injury had occurred to the Appellants. App 149. Appellants have maintained damages are not required for rescission to be effective. *See Crane & Ordway Co. v. Sykeston Sch. Dist. No. 11*, 162 N.W. 413 (N.D. 1917) ("A contract induced by fraud is voidable because the consent of one contracting party was not freely given, and it is not essential that pecuniary damage has been sustained"). Because free consent was not given by the Appellants, the lease was not binding on them. *Erickson v. Brown*, 2008 ND 57, ¶ 25, 747 N.W.2d 34.

GER was sophisticated in the sense it knew how to get mineral owners to sign leases. GER agents represented that it was a premier company with experience in horizontal drilling. Yet GER had never actually drilled any horizontal wells, had a limited and small staff, and was essentially a company that specialized in "flipping" leases to operating oil companies. This factual scenario is akin to *Miller Enterprises, Inc. v. Dog N'Cat Pet Centers*, 447 N.W.2d 639 (N.D. 1989). In *Miller*, the defendant lacked the training and expertise to actually deliver on what was stated—which constituted actual fraud. *Id.* at 644-45. In the same way, GER simply did not have the

ability or intent to carry through on the representations made to the Appellants. At the end of the day, GER just decided operating and drilling wells itself would be too much work. Supp. App. 9.

**C. Cancellation**

"Rights" is not defined in the leases. "The words of a contract are to be understood in their ordinary and popular sense rather than according to their strict legal meaning, unless used by the parties in a technical sense, or unless a special meaning is given to them by usage. . . ." N.D.C.C. § 9-07-09. The lessee has rights in the lease other than working interests. Paragraph 17 states lessee cannot assign *or* sublease rights in whole or in part without prior approval from lessor. No approval was sought by GER—they simply assigned over-riding royalty interests and entered into a participation agreement ("PA").

An oil and gas lease is not merely a conveyance of a working interest; it is a contract for the development of the lessor's mineral interests by the lessee. Unless the parties provide otherwise, rights may be transferred by assignment or sublease. N.D.C.C. § 9-11-01. Obligations, however, cannot be transferred without the consent of the party entitled to its benefit. N.D.C.C. § 9-11-03.

The first clause in Paragraph 17 states: "The rights of Lessee hereunder may not be assigned or subleased in whole or in part without Lessor's prior written consent." App. 21. Appellants retained a royalty interest of 18.75 percent of the production. GER acquired the working interest/contract right to the remaining 81.25 percent, subject to 100 percent of the costs of development and all other obligations under the lease contract. *Slawson v. N.D.I.C.*, 339 N.W.2d 772, 776 n.3 (N.D. 1983). In

violation of Paragraph 17, GER assigned its right to production, in part, to another company as an overriding royalty interest, reducing GER's right to production to 78 percent.

Under the PA, GER transferred its right to 58.32 percent of its 78 percent of the production in the "Borrud Unit" to NOG subject to NOG paying 83.32 percent of GER's costs of development. After this, GER was left with the right to 41.68 percent of 78 percent of the production, which is 32.5104 percent of the production subject to 16.68 percent of the costs of development. NOG has participated in and shared in the production of the wells drilled in the Borrud unit because of the assignment or transfer of rights in Appellants leases in violations of paragraph 17.

The remainder of paragraph 17 simply states that if written consent is obtained by the lessee to assign the lease, the assignor and assignee remain subject to the terms of the lease, "including *but not limited to* any express or implied covenants or exploration, development and protection from drainage...." App. 40 (emphasis added). Obligations cannot be transferred without the consent of the party entitled to its benefit. N.D.C.C. § 9-11-03. The second clause of paragraph 17 is a novation clause and sets forth the circumstances under which GER will be relieved of its obligations under the leases only. The second clause deals with the transfer lessee's obligations, it does nothing to modify the prior clause that deals with the transfer of lessee's rights. Golden Eye Royalties was assigned an overriding royalty interest and should be bound by the terms. NOG received rights in the leases when the PA was executed. GER violated paragraph 17 and Appellants were within their rights to cancel pursuant to paragraph 16.

There can be no doubt that conveying interests in the leases to NOG through the PA violated paragraph 17. Even if working interests were not conveyed to NOG, despite NOG's public claims that working interests were conveyed (App. 337-38), the leases do not state "working interest rights" they state "rights." Any conveyance of any part of the lease is a conveyance of "rights" in the lease. This is especially true here because NOG has used its rights in the leases to secure financing. App. 342-77.

"No particular words are necessary to effect an assignment; it is only required that there be a perfected transaction between the assignor and assignee, intended by those parties to vest in the assigned a present *right* in the things assigned." *Leon v. Martinez*, 638 N.E.2d 511, 513 (N.Y. 1994) (emphasis added). Assignments and subleases are the only means to transfer rights under a lease contract. GER can call an assignment or sublease anything it wants to, but transfers of rights are still assignments or subleases. The PA states: "Golden Eye and NOG are interested in participating jointly to evaluate, explore and develop the subject Leases...." App. 289, 290. The PA states a working interest is acquired by NOG. App. 290. The PA then attempts to state such is not an assignment or conveyance, even though NOG acquires a WI upon payment to Petro-Hunt. App. 290. In the event NOG fails to pay pursuant to Section 2.1 of the PA, NOG agreed to quitclaim to GER all interest, if any, in the leases. App. 291. NOG is responsible for its share of the operating costs of the Borrud well. App. 292.

The leases provide in section 1 that the "Lessor, in consideration of the lease signing bonus . . . and royalties, covenants and conditions contained herein to *be kept and performed by the lessee*, does lease *exclusively to lessee* the property described . . .

." App. 19 (emphasis added). The leases plainly provide the importance to Appellants of having only GER involved with the rights associated with oil and gas leases.

## II. Response Brief Issues: Breach of Contract, Quiet Enjoyment, Interference, and Jury Trial

### A. Breach of Contract

A summary of the arguments are: 1) GER must elect a remedy for the alleged breach of contract—either performance or damages; 2) GER cannot seek damages based on rescission being exercised; 3) GER failed to present competent and admissible evidence of damages.

#### *i. Election of Remedies*

The district court correctly held GER was not entitled to both specific performance and damages on its breach of contract claim. App. 206-08. Even in the oil and gas lease context parties cannot claim both damages and specific performance for breach of contract. *See NRG Exploration, Inc. v. Rauch*, 905 S.W.2d 405, 410 (Tex. App. 1995) (holding election of remedies bars recovery of both damages and specific performance for a breach); *see also Sofi Classic S.A. de C.V. v. Hurowitz*, 444 F. Supp. 2d 231, 238 (S.D.N.Y. 2006); *Morse/Diesel, Inc. v. Fidelity and Deposit Co. of Maryland*, 768 F. Supp. 115, 117 (S.D.N.Y. 1991). While Appellants disagree with the district court's rescission decision, it was correct that GER cannot receive both specific enforcement and damages.[1]

The doctrine of election of remedies is alive and well in North Dakota. *Hanson v. Boeder*, 2007 ND 20, ¶ 5, 727 N.W.2d 280; *Johnson Farms v. McEnroe*, 2002 ND

[1] Appellants maintain this as an alternative, mutually exclusive, argument. *See supra*, §I.A.

122, ¶ 28, 656 N.W.2d 1. GER's attempt to recover damages, after it has been awarded specific performance by the district court, must be rejected.

*ii. Statutory Rights*

GER asserts that rescission of the leases caused Appellants to breach the leases, making them liable to GER for damages. The leases do not contain any provision that bars Lessors from asserting rights under North Dakota law. And even if such a provision existed, it would be unenforceable as contrary to public policy and statute. N.D.C.C. § 9-09-03; N.D.C.C. § 1-02-38 (statutes are enacted for a reason and are deemed enforceable in the public interest). GER's attempt to premise its breach of contract claim on the Borgen Appellants use of N.D.C.C. § 9-09-04 must be rejected. *Egeland*, 2000 ND 169 at ¶ 13 (penalizing a citizen's use of statutory procedure would inhibit the very use of statutory procedure).

*iii. No Damages*

GER's claim fails because it has not made a "showing" of damages. "No damages can be recovered for a breach of contract if they are not clearly ascertainable in both their nature and origin." N.D.C.C. § 32-03-09; *see Matter of Estate of Ridl*, 455 N.W.2d 188, 195 (N.D. 1990) (disallowing damages for potential future and undetermined penalties). GER claims it will be subject to risk penalties and that it was forced to enter into a participation agreement. But it failed to put forth any evidence to support a "showing" of such speculative damages.

Only the North Dakota Industrial Commission ("NDIC") has the authority to assess risk penalties; the statute provides that the NDIC "may" impose such. N.D.C.C. § 38-08-08(3). Risk penalties can only be assessed by the NDIC against an "owner."

Because the current dispute exists, it is not possible to deem GER an "owner" as defined by N.D.C.C. § 38-08-02(9). If GER is not an "owner," there can be no risk penalties. And if GER is determined an "owner," it is only at that time that an operator can send an invitation to participate pursuant to N.D.A.C. § 43-02-03-16.3. Supp. App. 10-12 (NDIC order concluding no risk penalties until after an invitation to participate is sent).

GER did not dispute invitations to participate sent by operators. In fact, GER opposed a request by Debra Ganske at the NDIC to withdraw Liberty's invitation to participate. Supp. App. 13-33. GER was not forced to participate in the costs of the wells and had a viable option, and duty, to dispute invitations to participate until the "owner" was determined.

Even though GER claims to have entered into the participation agreement with NOG because of this dispute, GER included other lessors where no dispute over ownership existed. App. 296. When asked why other lessors were included in the PA, GER's Dick McKee responded: "We just included them as our interest." Supp. App. 37-38. McKee also conceded that participation agreements are "commonplace with independents" for financing. *Id.* at 35-36. GER cannot claim it was forced into a participation agreement because of this dispute because it freely entered into an agreement that included other interests not subject to a dispute. Any claimed damages are speculative at best.

### B. Breach of Implied Covenant of Quiet Enjoyment

The district court properly dismissed this claim because "such a claim has not been pled and is not before the Court. . . ." App. 202. The Cross-Appellees rely on

their prior briefing on this issue: 1) there is no stated claim; 2) even if there was a stated claim, it fails as a matter of law. *See* Docket Nos. 193, 211.

### C. Intentional Interference with Contract

It is unclear whether GER is attempting to re-argue their dismissed intentional interference with contract claim at paragraph 71 of its brief. To the extent it is, the district court properly dismissed this claim with prejudice because GER admitted it could not establish a prima facie case. App. 201, 212. The Appellants rely on their prior arguments on this claim. *See* Docket Nos. 148, 193.

### D. Jury Trial

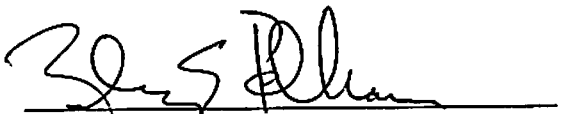
The district court properly decided this issue in its order on reconsideration and the Appellants rely on the district court's rationale and their prior briefings to the district court on this issue. Supp. App. 39-46; Docket Nos. 35, 136, 140.

## CONCLUSION

The district court's dismissal of Appellants' actions to enforce rescission and cancellation, as well as its denial of Appellant's motion to dismiss, should be reversed. The district court's dismissal of GER's claims for breach of contract damages, breach of quiet enjoyment, and intentional interference with contract should be affirmed. The district court's decision to allow a jury trial on the Appellants' rescission enforcement counterclaim, should this Court allow the rescission enforcement action to proceed, should be affirmed.

Dated this 27th day of January, 2014.

**PEARCE & DURICK**



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STATE OF NORTH DAKOTA )
) ss.
COUNTY OF BURLEIGH )

Annette Kirschenheiter, being first duly sworn, deposes and says that on the 27th day of January, 2014, she mailed a copy of the foregoing: 1) *Appellants and Cross-Appellees' Reply Brief* and 2) *Appellants and Cross-Appellees' Supplemental Appendix* by placing true and correct copies thereof in an envelope, addressed to the following:

| | |
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and depositing the same, with postage prepaid, in the United States mail at Bismarck, North Dakota.

Annette Kirschenheiter
Annette Kirschenheiter

Subscribed and sworn to before me this 27th day of January, 2014.

Linda M. Reis
Notary Public

LINDA M. REIS
Notary Public
State of North Dakota
My Commission Expires Mar. 25, 2018

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STATE OF NORTH DAKOTA )
) ss.
COUNTY OF BURLEIGH )

Annette Kirschenheiter, being first duly sworn, deposes and says that on the 29th day of January, 2014, she mailed a copy of the foregoing corrected page six of Appellants and Cross-Appellees' Reply Brief by placing true and correct copies thereof in an envelope, addressed to the following:

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Annette Kirschenheiter
Annette Kirschenheiter

Subscribed and sworn to before me this 29th day of January, 2014.

Dayna Barone
Notary Public

DAYNA BARONE
Notary Public
State of North Dakota
My Commission Expires October 10, 2018