IN THE SUPREME COURT OF THE STATE OF NEW MEXICO

No. 33,632

FIRST BAPTIST CHURCH OF ROSWELL, THE HISTORICAL SOCIETY FOR SOUTHEAST NEW MEXICO, INC., and THE ROSWELL WOMAN'S CLUB, INC., individually and on behalf of a class of similarly situated persons and entities,
Plaintiffs-Appellees-Petitioners,

v.

YATES PETROLEUM CORP., a New Mexico corporation,
Defendant-Respondent-Appellant.

On Writ of Certiorari to the Court of Appeals,
(Case No. 30,359) District Court of Chaves County
The Honorable Charles C. Currier, Judge

BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF YATES PETROLEUM CORP.

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INTRODUCTION

Yates Petroleum (Yates) operates the Runnin' AZH Com. No. 1 Well. The First Baptist Church of Roswell and other plaintiffs (First Baptist) own mineral rights to the well. Their contractual relationship is governed by division orders, specialized contracts developed for the petroleum industry through which the company that extracts the oil pays the owners of the mineral rights in proportion to their ownership interest. Standard division orders require owners to provide proof of title of ownership, and further provide that no interest is due on payments until the owner provides a satisfactory title determination. Yates accepts altered or substitute division orders, but all the plaintiffs in this case signed and returned the contracts without modification. The contract explicitly states, "In the event of failure to furnish such evidence of marketable title, [Yates] is authorized to withhold payments without payment of interest until the claim is settled." *First Baptist Church of Roswell v. Yates Petroleum Corp*., 2012 NMCA 64, 281 P.3d 1235 *3.

Notwithstanding this plain language, First Baptist filed a class action demanding payment of interest on the escrowed funds awaiting proof of clear title. The class bases its claim on the New Mexico Oil and Gas Proceeds Payment Act (Act), NMSA 1978, §§ 70-10-1 to -6, which states that interest accrues on funds held in suspense during the time title questions prevent disbursement, and once title is resolved, both principal and accrued interest are payable. The court below upheld the

contract, holding first that nothing in the plain language of the statute explicitly articulates a fundamental public policy that payment of compensatory interest is deemed to be of such importance, required in the public interest, that its payment cannot be waived. *First Baptist*, 2012 NMCA 64, 281 P.3d 1235 *21. The court relied on *Murdock v. Pure-Lively Energy 1981-A, Ltd.*, 108 N.M. 575, 578, 775 P.2d 1292, 1295 (1989), which held that payment of interest could be waived and noted that when the Legislature amended the Act in 1991, it did nothing to abrogate that decision. *First Baptist*, 2012 NMCA 64, 281 P.3d 1235 *23. Moreover, other parts of the statute anticipate contractual alteration as to the date of payment, which would then impact the amount of interest. *Id.* at *24. Finally, the court found that waiver of interest caused no significant injury to the general public. *Id.* at *25.

The decision below was correct and should be affirmed. Although public policy must be found within "positive law"—i.e., codified laws and regulations—not every "positive law" reflects an important public policy. In many cases, statutes serve to provide default rules that govern in the absence of contractual provisions stating otherwise. This is the case here. New Mexico courts have long approved the freedom of competent adults to contractually arrange their affairs. The reason these proceeds are held in suspense is because the mineral rights owners have not removed all clouds from their title. That is, the proceeds must be divided among true owners, and providing clear evidence of title is necessary to ensure that proceeds are not

misdirected to the wrong people. The sooner the owners provide clear evidence of title, the sooner their proceeds are released—the timing rests largely with the owners. There is no compelling public interest that would forbid parties from agreeing that interest shall not accrue during a period of clouded title.

ARGUMENT

I

PUBLIC POLICY FAVORS ALLOWING PARTIES TO ALTER STATUTORY DEFAULT RULES

A. Freedom of Contract Permits Alteration of Default Rules

"Default" rules are simply intended to provide terms that are acceptable to the greatest number of people, so that those who forget or who choose to omit a provision will have the default provision incorporated into the contract. *See, e.g.*, *Hugo Boss Fashions, Inc. v. Federal Ins. Co*., 252 F.3d 608, 617-18 (2d Cir. 2001) ("When interpreting a state law contract, therefore, an established definition provided by state law or industry usage will serve as a default rule, and that definition will control unless the parties explicitly indicate, on the face of their agreement, that the term is to have some other meaning."). But default rules by themselves are neither better nor worse than customized rules. Christopher R. Drahozal, *Contracting Around RUAA: Default Rules, Mandatory Rules, and Judicial Review of Arbitral Awards*, 3 Pepp. Disp. Resol. L.J. 419, 420 (2003) ("The basic idea of a default rule is that it is simply

that: a default. If the parties do not address the issue in their contract, the default rule fills the gap. If the parties do address the issue in their contract, their agreement overrides the default, making it inapplicable."). In fact, generalized default rules are based on two assumptions: First, "it is more important for the law to be certain than to be right"; and second, parties are "quite capable of bargaining for customized alternatives." Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. Legal Stud. 597, 598 (1990).

As a matter of public policy, allowing parties to negotiate around default rules increases efficiency by ensuring that parties are not given costly overprotection, or deprived of protections that they desire. Requiring parties to abide by unwanted terms in a contract will in many cases cost more than their agreement to waive those default protections, and whenever this happens, parties will contract around those rules. "A law of contract not based on [such] efficiency considerations will therefore be largely futile." Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. Legal Stud. 83, 89 (1977).

Non-flexible contract rules, like other barriers to trade, raise costs to consumers and businesses, and deter economic growth. In some cases, such barriers are justified, so long as these ill effects are outweighed by the benefits. Friedrich Hayek, *The Constitution of Liberty* 224-25 (1960). But there should be "a strong presumption

against [them] because their over-all cost is almost always underestimated and because one disadvantage in particular—namely, the prevention of new developments—can never be fully taken into account." *Id.* at 225. Barring such waivers has genuine social costs. In his Nobel Prize-winning article *The Problem of Social Cost*, economist Ronald Coase explained that "[i]t is always possible to modify by transactions on the market the initial legal delimitation of rights." Ronald H. Coase, *The Problem of Social Cost, reprinted in The Firm, The Market and The Law* 114 (The University of Chicago Press 1990) (1960). Such modifications will tend to occur whenever they "would lead to an increase in the value of production." *Id.* In other words, default rules will be modified by contractual waivers whenever the parties find it more efficient to do so, and the more beneficial such a modification is, the greater the lengths to which parties will go to avail themselves of the freedom to modify. These considerations suggest that default rules with regard to contract should be "designed to give at least one party to the contract an incentive [to modify] . . . the default rule and therefore to choose affirmatively the contract provision they prefer." Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 91 (1989).

The ability of private individuals to contract as they choose is a fundamental part of their freedom. M.B.W. Sinclair, *Plugs, Holes, Filters, and Goals: An Analysis of Legislative Attitudes*, 41 N.Y.L. Sch. L. Rev. 237 (1996) (In America, the

"default position is freedom."). As long as a contract does not clearly violate legislatively established public policy or adversely affect non-consenting third parties, courts should uphold the validity of a contract. The freedom of contract

> guarantee[s] to individuals a sphere of influence in which they will be able to operate, without having to justify themselves to the state or to third parties: if one individual is entitled to do within the confines of tort law what he pleases with what he owns, then two individuals who operate with those same constraints should have the same right with respect to their mutual affairs against the rest of the world.

Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & Econ. 293, 293-94 (1975). *See also* Brian A. Blum, *Contracts* § 1.4.1 (2d ed. 2001) ("The power to enter contracts and to formulate the terms of the contractual relationship is regarded in our legal system as an exercise of individual autonomy—an integral part of personal liberty."). Consequently, this Court has repeatedly declared that it is not the role of the courts to rewrite private agreements.

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

United Wholesale Liquor Co. v. Brown-Forman Distillers Corp., 108 N.M. 467, 471, 775 P.2d 233, 237 (1989) (quoting *City of Artesia v. Carter*, 94 N.M. 311, 314, 610 P.2d 198, 201 (Ct. App. 1980)).

The importance of "certainty" should not be understated because enforcement of private contracts advances a state's economic growth. Certainty promotes business innovation and development by letting firms know what they can and cannot do, and avoiding a need for interpretation, clarification, or explanation. Certainty thus allows individuals to contemplate their actions based on an understanding of their agreement that does not change upon reaching the courthouse. Paul E. Loving, *The Justice of Certainty*, 73 Or. L. Rev. 743, 763-64 (1994). *See also* O. Lee Reed, *Law, The Rule of Law, and Property: A Foundation for the Private Market and Business Study*, 38 Am. Bus. L.J. 441, 461 (2001) ("[K]nowledge of the formal legal effect of contract law facilitates the trust and certainty necessary to place one's resources under the control of strangers . . . [and] substantially lowers the costs of transacting business."); Dick Thornburgh, *America's Civil Justice Dilemma: The Prospects for Reform*, 55 Md. L. Rev. 1074, 1077 (1996) ("[T]o remain competitive, manufacturers need as much stability in their costs as possible—including predictable liability costs . . . .").

The only times that it is appropriate for courts to interfere with the substance of agreements between private parties are when (a) the substance is so one-sided as to indicate some *procedural* impropriety which might have escaped detection, or (b) when the agreement imposes an externality on a third party who deserves protection. The former is just another permutation of the court's proper role in policing the procedural side of contract formation. The latter involve what are

traditionally called contracts "against public policy," or "illegal contract[s]." *State ex rel. Udall v. Colonial Penn Ins. Co.*, 112 N.M 123, 130, 812 P.2d 777, 784 (1991) (contracts in violation of public policy, as manifest in positive law, are unenforceable); *Dacy v. Ruidoso*, 114 N.M. 699, 702, 845 P.2d 793, 796 (1992) (illegal contracts are void *ab initio*). As shown below, neither exception controls this case.

B. Parties May Alter or Waive Statutory Rights via Contract

Plaintiffs focus on the word "shall" in the Act, Appellant's Opening Brief at 9, but even mandatory provisions can be waived. *County of Los Alamos v. Martinez*, 150 N.M. 326, 331, 258 P.3d 1118, 1123 (Ct. App. 2011) (a statute may provide for mandatory subjects of collective bargaining that nonetheless can be waived by a contract if the waiver is clearly and unmistakably expressed). Contracts are unenforceable as violative of public policy if they (1) clearly violate an explicit New Mexico public policy as expressed in a statute, (2) permit that which is expressly prohibited by statute, or (3) manifestly tend to injure the public in some way. *Berlangieri v. Running Elk Corp.*, 2002-NMCA-060, ¶ 11, 132 N.M. 332, 48 P.3d 70, *aff'd on other grounds,* 2003-NMSC-024, 132 N.M. 341, 76 P.3d 1098. The California Supreme Court, upon whose decisions New Mexico courts have found persuasive in this context, explained that, under this approach, "a party may waive a statutory provision if a statute does not prohibit doing so, the statute's 'public benefit

. . . is merely incidental to [its] primary purpose,' and 'waiver does not seriously compromise any public purpose that [the statute was] intended to serve.'" *DeBerard Props., Ltd. v. Lim*, 20 Cal. 4th 659, 668-69, 976 P.2d 843, 849, 85 Cal. Rptr. 2d 292, 298 (1999) (citations omitted). *See also National Bank of North America v. Associates of Obstetrics and Female Surgery, Inc.*, 425 U.S. 460, 96 S. Ct. 1632, 1633, 48 L. Ed. 2d 92, 94 (1976) (a bank may waive the mandatory provisions of a federal statute that determines venue for lawsuits against national banking associations); *Am. Soda, LLP v. U.S. Filter Wastewater Group, Inc.*, 428 F.3d 921, 927 (10th Cir. 2005) (contractual mandatory forum selection clause trumps the statutory right to remove a diversity case to federal court); *Perry v. Perry*, 1976 OK 57, 551 P.2d 256 (ex-spouses may voluntarily agree to deviate from statutory provision regarding usual termination of support alimony).

Many types of statutory rights and duties that implicate private rights far more than any public interest may be waived or exempted by contract. For example, in *Leventhal v. Atlantic Finance Corp.*, 316 Mass. 194, 206, 55 N.E.2d 20, 27 (1944), the Massachusetts Supreme Judicial Court upheld a stockholders' waiver of his statutory right to seek dissolution of a corporation because the procedural mechanism for dissolution of a corporation does not implicate public policy. Similarly, the creation and dissolution of a marriage also involves primarily private concerns, allowing divorcing spouses to waive statutory rights. *See, e.g.*, *Newey v. Newey*, 161

Colo. 395, 404, 421 P.2d 464, 469 (1966) (antenuptial agreement is binding as waiver of statutory property, alimony, and support rights); *Perry v. Perry*, 1976 OK 57, 551 P.2d 256 (1976) (property, alimony and support statutory rights may be waived by contract). Statutory inheritance rights may be waived by contract, *In re Estate of Burgess*, 646 P.2d 623, 626 (Okla. Civ. App. 1982), as may defenses related to usury. *Dunbabin v. Brandenfels*, 18 Wash. App. 9, 12, 566 P.2d 941, 943 (1977).

This Court held in *Colonial Penn Ins. Co.*, 112 N.M. at 130, 812 P.2d at 784, that "[c]ontracts in violation of our public policy, as manifest in positive law, are unenforceable," but the designation of all statutory language as "positive law" does not alter the ability of contracting parties to choose provisions that vary from statutes that affect only *private* interests rather than the public. While every statute represents "positive law," not every statute embodies an important public policy. If it were otherwise, people could never contract around statutory default rules, yet New Mexico courts uphold waivers of statutory rights. *Moss Theatres, Inc. v. Turner*, 94 N.M. 742, 744, 616 P.2d 1127, 1129 (Ct. App. 1980). *See also Outboard Marine Corp. v. Superior Ct., Cty. of Sacramento*, 52 Cal. App. 3d 30, 124 Cal. Rptr. 852 (1975) (The doctrine of waiver is generally applicable to all the rights and privileges to which a person is legally entitled, including those conferred by statute unless otherwise prohibited by specific statutory provisions.), *cited by Moss Theatres*, 94 N.M. at 744, 616 P.2d at 1129.

Professor M.B.W. Sinclair explains the various functions of statutes, all of which could be labeled "positive law," but which vary greatly in their intent, immutability, and effect. Statutes fall generally into one of four categories: plugs, holes, filters, and goals. A "plug" is an absolute prohibition, or an absolute command with minimum room allowed for maneuver. Sinclair, 41 N.Y.L. Sch. L. Rev. at 249. A hole is a permissive. *Id.* A filter "lets some behavior through and prohibits or penalizes other behavior of similar kind . . . . [a] filter works by creating a presumption and thus allocates a burden of proof. Filters are surely the most pervasive of statutory forms." *Id.* at 250. Finally, a goal is an aspiration. "Unlike plugs and holes, for which breach is fairly well-defined, or filters, for which a judgment call is required, failure to succeed does not count as violation of a goal. Failure to try, or working to the contrary, is the only way to violate a goal statute." *Id.* These categorizations demonstrate that statutes serve various functions, and play different roles in conveying public policy to society at large. Notice that "filters," the most common statutory form, make presumptions; that is, they set a default, as in this case. The party seeking to transform a "filter" into a "plug"—an absolute prohibition, should have the burden of proving that the public interest cannot allow individuals to freely choose whether to alter the default statutory arrangements.

II

PARTIES ARE FREE TO CUSTOMIZE SPECIALIZED CONTRACTS

A. Division Orders, While "Specialized," Are Analyzed under Standard Contract Law

First Baptist seeks to avoid the usual flexibility of contract law by characterizing division orders as "not contracts in the traditional sense," but as "specialized contracts" demanding rigid rules. AOB at 11 (citing *Murdock v. Pure-Lively Energy 1981-A, Ltd.*, 108 N.M. 575, 579, 775 P.2d 1292, 1296 (1989)). The term "specialized contract" has two different meanings, depending on context. First, a "specialized contract" may be so designated because it contains technical terms of art that would supplant a plain meaning interpretation of those terms. *Pennsylvania R.R. v. Day*, 360 U.S. 548, 553, 79 S. Ct. 1322, 3 L. Ed. 2d 1422 (1959) ("provisions in railroad collective bargaining agreements are of a specialized technical nature calling for specialized technical knowledge in ascertaining their meaning and application"); *Kona Tech. Corp. v. S. Pac. Transp. Co.*, 225 F.3d 595, 611 (5th Cir. 2000) (finding expert testimony properly admitted to interpret contract provisions having a specialized meaning in the railroad industry). Second, a "specialized contract" may simply refer to the narrow, or specialized, subject matter of the agreement, in which case regular rules for contract interpretation apply. *U & W Indus. Supply v. Martin Marietta Alumina*, 34 F.3d 180, 186 (3d Cir. 1994) (applying

general obligation of contractors to act in good faith to specialized contract); *Crouch v. Bent Tree Cmty.*, 310 Ga. App. 319, 320, 713 S.E.2d 402, 405 (2011) (applying general rules of interpretation to a "specialized contract" containing restrictive covenants on real estate); *Amoco Oil Co. v. First Bank & Trust Co.*, 759 S.W.2d 877, 878 (Mo. Ct. App. 1988) (characterizing a letter of credit as a "specialized contract" and applying usual rules of interpretation).

Oil and gas contracts fall into this second category of "specialized contract," governed by standard contract law doctrine. *Murdock*, 108 N.M. at 579, 775 P.2d at 1296; *In re B & L Oil Co.*, 782 F.2d 155, 158 (10th Cir. 1986) ("We have no difficulty holding that the oil division order is a single contract."); *Akandas, Inc. v. Klippel*, 250 Kan. 458, 464-68, 827 P.2d 37, 44-46 (1992) (Applying general rules of contract construction to a division order); *Welsch v. Trivestco Energy Co.*, 43 Kan. App. 2d 16, 21, 221 P.3d 609, 613 (2009), *rev. denied*, 291 Kan. 917 (2010) ("The rights and obligations of those operating in the Kansas oil patch are governed by the terms and conditions of specialized contracts, and each dispute arising in this context can and should usually be resolved by the construction and application of such contracts.").

Thus, just as courts do when interpreting other specialized contracts, such as collective bargaining agreements or restrictive covenants, the Court should apply basic contract law principles in this case. *See, e.g.*, *United Food and Commercial*

Workers Local No. 222 v. Iowa Beef Processors, Inc., 683 F.2d 283 (8th Cir.), *cert. denied*, 459 U.S. 1088, 103 S. Ct. 571, 74 L. Ed. 2d 933 (1982) (affirming arbitrator's use of common law contract principles in interpreting a collective bargaining agreement); *Arizona Laborers v. Conquer Cartage Co.*, 753 F.2d 1512, 1517 (9th Cir. 1985) (applying contractual principles of looking to intent of parties in interpreting collective bargaining agreement); *Glisson v. IRHA of Loganville, Inc.*, 289 Ga. App. 311, 312, 656 S.E.2d 924, 926 (2008) (rejecting argument that because they are specialized contracts, restrictive covenants are not subject to standard rules of construction).

B. Standard Contract Law Allows Customization of "Specialized" Contracts

Division orders may be described as "specialized," but as shown above, this description applies to many other types of contracts as well and under standard contract law, all types of specialized contracts may be customized to best suit the needs of the parties. For example, escrow contracts, which like division orders also address the distribution of property, are interpreted under standard contract law doctrines and may be customized in myriad ways. *Hayber v. Department of Consumer Protection*, 49 Conn. Sup. 192, 198, 866 A.2d 732 (2004) (36 Conn. L. Rptr. 603), *aff'd*, 87 Conn. App. 625, 866 A.2d 644 (2005) ("The escrow agent's duty is limited by the terms of the escrow agreement . . . . [I]t is not in his province to

interpret or construe a contract where he has a duty to perform; he must be guided in his duty by what the contract says." (Citation omitted; internal quotation marks omitted)); *State ex rel. Mo. Highway & Transp. Comm'n v. Maryville Land P'shp*., 62 S.W.3d 485, 489 (Mo. App. 2001) ("the Escrow Agreement is a complete and unambiguous contract"); *Marks & Taylor Realty v. Koontz*, 2004 Ohio 2256, *P14 (Ct. App. 2004), 2004 Ohio App. LEXIS 2005 ("[T]he language of the escrow agreement is clear and unambiguous, and courts should not rewrite or interpret contracts beyond the plain meaning of the words therein.")

If labeling the division order as a "specialized" contract has no effect, First Baptist offers another label, describing the division order as a "contract of adhesion." AOB at 12. However, this label similarly does not remove the analysis from the realm of contract law which permits customization and waiver of statutory default rules. For example, in *United Nuclear Corp. v. Allstate Ins. Co.*, 2012 NMSC 32, *10, 285 P.3d 644, 648, this Court noted that although insurance policies commonly are contracts of adhesion, the plain language of the contract (the insurance policy) controls in determining the intent of the parties. As with any other type of contract, "[r]eviewing courts should not 'create ambiguity where none exists, and an ambiguity does not exist merely because the parties hold competing interpretations' about the

meaning of a policy provision."[1] *See also Montano v. Allstate Indem. Co.*, 135 N.M. 681, 685, 92 P.3d 1255, 1259 (2004) (although insurance contracts are contracts of adhesion, and caselaw expressed broad public policy in favor of stacking, a clearly written contract that limited stacking coverage with the payment of a single premium does not violate public policy); *Padilla v. State Farm Mut. Auto. Ins. Co.*, 133 N.M. 661, 667 n.3, 68 P.3d 901, 907 n.3 (2003) (citing extra-jurisdictional authority to demonstrate widespread application of contract law principles to contracts of adhesion. "If an insurance contract does not violate public policy, is not grossly unfair due to terms that unreasonably favor the insurer, and is unambiguous, 'we must give effect to the contract and enforce it as written.' ").

CONCLUSION

"Contract is the most flexible, strategic tool that the law offers to the business community." Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 Am. Bus. L.J. 727, 735 (2010). The ability to waive default rules and customize contracts is long established in New Mexico, to the

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[1] *See Progressive Casualty Ins. Co. v. Marnel*, 587 F. Supp. 622, 624 (D. Conn. 1983) ("There is no logic nor reason to create an obligation contrary to and beyond the clear, plain language of a policy . . . . To create such would oblige a party at the whim of one whose personal interests are served by the conversion of an expectancy to a right. It would permit the rewriting of a contract by a court . . . . There is no more reason, logic nor justification to enlarge an insurance policy to match an insured's expectations than to permit the rewriting of any contract, on the same basis. That, this court will not do.").

benefit of the state's economy. No public policy justifies a departure from the general rule permitting contracting parties to waive statutory rights in a matter involving private allocation of interest on mineral rights during a period of clouded title.

The decision below should be affirmed.

DATED: December 20, 2012.

Respectfully submitted,

By _____
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CERTIFICATE OF COMPLIANCE

Pursuant to 12-213(c)(1)(A) NMRA, I hereby certify that the foregoing BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF YATES PETROLEUM CORP. is proportionately spaced, has a typeface of 14 points or more, and pursuant to WordPerfect X5, the word processing program used to prepare this brief, contains 4,078 words.

DATED: December 20, 2012.

_____

DEBORAH J. LA FETRA

CERTIFICATE OF SERVICE

I, DEBORAH J. LA FETRA, certify as follows:

I am a resident of the State of California, residing or employed in Sacramento, California.

I am over the age of 18 years and am not a party to the above-entitled action.

My business address is 930 G Street, Sacramento, California 95814.

On December 20, 2012, a true copies of BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF YATES PETROLEUM CORP. were placed in envelopes addressed to:

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I declare under penalty of perjury that the foregoing is true and correct and that this declaration was executed this 20th day of December, 2012, at Sacramento, California.

_____

DEBORAH J. LA FETRA