

1980

Rio Algom Corporation v. Jimco Ltd et al : Brief in Support of Petition for Rehearing

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

* * * * *

RIO ALGOM CORPORATION,

Plaintiff-Appellant,

-vs-

JIMCO, LTD., HUMECA EXPLORATION
COMPANY, JIM L. HUDSON, JUANITA
J. MEYER AS EXECUTRIX OF THE
ESTATE OF DANIEL H. MEYER, ELDON
J. CARD, NORMA HUDSON, JEAN L.
CARD, JUANITA J. MEYER, N. J.
WHITE, AUDREY WHITE, WILMA WHITE,
OTIS DIBLER, DOROTHY MAE DIBLER,
GRACE DAVIS, and MARLOWE C. SMITH,

Defendants-Respondents.

CASE NO. 16032

BRIEF IN SUPPORT OF
PETITION FOR REHEARING

Petition for Rehearing from the Decision
of the Utah Supreme Court filed September 19, 1980

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Defendants-Respondents.

BRIEF IN SUPPORT OF
PETITION FOR REHEARING

Case No. 16032

* * * * *

Plaintiff and Appellant, Rio Algom Corporation, ("Rio"), pursuant to the provisions of Rule 76(e) of the Utah Rules of Civil Procedure, hereby submits its brief in support of its petition for a rehearing in this action. Rio asserts that this Court should grant it a rehearing with respect to the Court's decision in this matter for the following reasons:

THE COURT ERRED IN NOT DETERMINING THAT RIO
IS TO PARTICIPATE IN THE PROCEEDS RESULTING
FROM THE AUDREYS' PERMANENT NON-EXERCISE OF
THE OPTION TO RECEIVE ROYALTIES BASED UPON
THE FAIR MARKET VALUE OF CRUDE ORE.

Rio does not seriously quarrel with the basic logical reasoning of the Court's decision in this matter. The Court has carefully considered each legal argument advanced and rejected it on

grounds that, although not beyond argument, are certainly within reasonable parameters. Rio seriously urges, however, that by the simple accumulation of a series of proper syllogisms, as was the Court's opinion, an end result has been reached which is neither just nor equitable. What has happened, as Rio views it, is that the arguably correct application of a string of legal syllogisms has produced a result which is less than the sum of its parts, which is unjust, and which, viewed from a different perspective, should be overturned.

Rio frankly recognizes that in its quest before this Court it has had to strain and analogize to find applicable law. Rio further concedes that there is contract language which, viewed from a certain perspective, could be considered to be determinative of the issues. Rio respectfully suggests, however, that the Court's perspective in this matter has been myopic and that, viewed from a different vantage point, the result is inequitable and unfair. Rio is not critical of the Court for this result because the Court has been led into this failure of perception by the defendants' frequent reference to what they have done as merely being a "settlement" -- a characterization which, for all who are involved in litigation, quickly vibrates the heart's tuning fork. Settlement is good. Settlement ends disputes. Settlement should be encouraged and condoned wherever possible. The defendants have called their arrangement a settlement so frequently that it has evoked the Lewis Carroll response -- "What I tell you three times is true."

In an effort to give this Court a different perspective on the issues before it, and to request one more quick look at what should be perceived as a clear deprivation of Rio's rights, let Rio pose a totally apt hypothetical, and simply ask the Court to consider and compare it with the result in the instant case.

Assume that A and B jointly own property, A having a 75% and B a 25% undivided interest. They decide to lease the property to C for a one year term with an option to renew at the end of the term. Because of a conflict of interest, or any other reason, B gives A the complete, sole, unilateral power to set the amount of the rental C is required to pay for both the initial term and, if C exercises, under the option. A sets the rental at \$1,000 per month for the initial term of the lease. A and B split the rentals, A receiving \$750 per month and B \$250 per month in direct proportion to the interest in the property each holds.

At the end of the initial term it becomes clear to A that C can be required to pay, under the terms of the option to renew, a rental of \$2,000 per month. C, however, being fully aware of the sole power granted A by B to set the amount of rent required of C, goes to A and offers to pay A \$250 per month under an open, separate arrangement, if A will agree to leave C's rent requirement at \$1,000 per month when C exercises his option. A, in exercise of his power, agrees.

Under this arrangement C pays to A and B jointly \$1,000, and pays to A alone an additional \$250. A now receives from C \$1,000

and B gets only \$250. This is a result that no court would countenance, or fail to give B redress for, if B complained. Yet this result is precisely what the Court is approving by its decision in this matter. A, i.e. the Audreys,¹ is receiving increased rent or royalties from its lessee, B, i.e. the Jimcos, while B, a co-owner, i.e. Rio, is not sharing in that increase. In order to justly resolve the issues the Court must require the Audreys to share their increased royalties with Rio.

In its decision the Court approved the Audreys' permanent revocation of the right of Rio and the Audreys to receive royalties based upon the fair market value of crude ore. However, in approving the Audreys' right to permanently revoke this election, the Court overlooked the requirement that the proceeds arising out of any election belong to both Rio and the Audreys, because of Rio's status as a co-owner of the subject properties and because of the terms of the Amended Audrey Lease. Consequently, all proceeds resulting from the exercise or non-exercise of the election rightfully belong to both Rio and the Audreys, and the consideration received by the Audreys from the Jimcos for the Audrey's permanent non-exercise of the option belong to both Rio and the Audreys.

¹ The term "Audreys" as used in this Brief is as defined in Footnote 3 of the Court's September 19, 1980 decision in this matter. The term "Jimcos" as used in this Brief is as defined in Footnote 2 of that decision.

The Court's failure to require the Audreys to share the proceeds of their permanent non-exercise of the fair market value option with Rio produces an unjust result because the effect is to diminish Rio's royalty interests as a 1/4th interest co-owner and co-lessor. In the event royalties based upon the irrevocably waived formula would exceed royalties based upon the formula in effect under the settlement agreement, both the Audreys and Rio receive less. The Audreys, however, will be compensated for the smaller payment by virtue of the Jimcos' agreement to pay the Audreys an additional 2.5% of the yellowcake sales price due the Jimcos. The Audreys will thus receive as their share of the total royalties an amount equivalent to 5.5% of the total sales price of yellowcake. On the other hand, Rio receives nothing to compensate it for the loss of its right to share in royalties that would be received under the fair market value option. Such a scheme is patently unfair to Rio.

The Court's opinion indicates that the terms of the Amended Audrey Lease contemplate that Rio may receive a smaller royalty payment under an election by the Audreys. That lease, however, does not contemplate or suggest that Rio would receive a royalty payment smaller in proportion to the required one-fourth/three-fourths ratio. Although the Court's opinion states that the Audreys and Rio share proportionately in the royalty payments made pursuant to the Audrey lease, this statement fails to address the realities of the situation. Instead of a one-fourth/three-fourths

ratio, the Audreys will receive three-fourths of the amount computed from the lower-yielding formula plus a further share of royalties to be paid by the Jimcos. Rio, on the other hand, does not receive one-fourth of the amount received by the Audreys. Rather, it receives one-fourth of the smaller sum computed from the lower-yielding formula, without a proportionate share of the additional payment received from the Jimcos. The parties to the Amended Audrey Lease never intended, or agreed, that Rio would receive less than one-fourth of the amount paid to the co-owners of the Audrey claims.

Under the Amended Audrey Lease all royalties and proceeds flowing from the property rightfully belong to all the owners of the property, including Rio. (Record 80-83.) These include all royalties based upon either a yellowcake proceeds calculation or a crude ore fair market value calculation. (Record 80-83.) In the settlement agreement the Audreys permanently revoked the right of Rio and the Audreys to receive royalties based upon the fair market value calculation, in exchange for an additional 2.5% royalty assigned by the Jimcos. This permanent non-exercise of the fair market value option became effective on January 1, 1979 and remains in effect permanently thereafter. Thus, the additional monies received by the Audreys from the Jimcos, after January 1, 1979, is consideration for the non-exercise of the fair market value option and the proceeds of that non-exercise are, by the terms of the settlement (and the Court's opinion), a royalty

related to production from the property which rightfully belong to Rio and the Audreys, even though Rio is not entitled to participate in the option decision.

Although there does not appear to be any case law totally on point with the instant case, there is a relevant line of oil, gas and mineral cases dealing with very similar fact situations. Those cases deal primarily with the question of what obligation, if any, is owed by the holder of the executive right to lease to the owners of non-executive royalty or mineral interests.

The owners of non-executive interests have no participation powers. They have no right to enter upon the premises for development purposes and no right to execute leases to others. As a consequence, they are almost wholly dependent upon the self-interest of the mineral owner and upon certain principles of equity and fair play to require the executive mineral owner to mine the resources and protect their interest. Martz and Hames, Implied Rights of the Royalty Owners, 30 Rocky Mtn. L. Rev. 1, 2 (1957).

Although the self-interest of the holder of the executive right frequently coincides with that of the non-executive, there may be instances when the self-interest of the executive will diverge from that of the non-executive. When those interests are divergent, courts have not left the royalty owner completely at the mercy of the holder of the executive-leasing privilege. Indeed, the great weight of authority holds that an implied duty

governs the exercise of the executive right. 2 H. Williams & C. Meyers, Oil & Gas Law § 339.2, at 201 (1977), (hereinafter "Williams & Meyers"), and cases cited therein. The duty, which arises through the relation created by a reservation or granting of the exclusive right to lease, is to protect the non-participatory interests that are dependent to a great extent on the executive. Id.; Blass and Richey, An Analysis of the Rights and Duties of the Holder of the Executive Right, 41 Miss. L. J. 189, 224-225 (1970). Stated conversely, the executive operates under a duty to not exercise the executive right for the purpose of benefiting himself at the expense, in a preferential way, of the non-executive Williams & Meyers, § 339.3 at 210.

In the present case, Rio's position is similar to that of a non-participatory royalty owner. Because of a conflict of interest, Rio has granted the Audreys the exclusive right to elect which royalty formula will be utilized in a given year. Thus, like the non-participatory royalty owner, Rio has no input in an elective decision affecting the royalty payment. Normally, it would be reasonable for Rio to place its trust in the self-interest of the Audreys since the parties stand together as co-lessors and would appear to have the same common interest --to choose that formula which would maximize the co-lessors' royalty payments.

In this case, however, the Audreys have used the advantage conferred on them by Rio to deprive Rio of its rightful share of proceeds arising out of the properties subject to the Amended

Audrey Lease.² The Audreys have circumvented the provisions of the Amended Audrey lease by entering into an arrangement with the Jimcos which benefits the Audreys to the exclusion of Rio.

Although the courts in the non-executive royalty owner cases have found an implied duty of equitable treatment and fair play on the part of the executive in his dealings with the non-participating or non-executive owner, there is not complete agreement on the nature of the duty owed. The standard of conduct governing the exercise of the executive right ranges from a fiduciary duty to a standard of ordinary care and good faith. Williams & Meyers, § 339.2 at p. 208; Jones, Non-Participating Royalty, 26 Tex. L. Rev. 569 (1948). Irrespective of the proper standard, any of the overwhelming majority of the cases finding that a duty is owed would find a breach of the duty when the executive -- in this case, the Audrey defendants -- uses the special position he has for his own special advantage to the exclusion of the interests of

² As argued above, Rio will receive one-fourth of a lower-yielding formula instead of one-fourth of the higher-yielding formula. The Audreys, on the other hand, will receive three-fourths of the lower-yielding formula, but in addition, they will receive additional sums from the Jimcos from which Rio will not be given its proportionate share. Further, it should be noted that although the Court has characterized this as an agreement by which the Jimcos paid 2.5% of the yellowcake price to the Audreys, it is clear that any monies paid to the Audreys has to come out of the monies designated for the Jimcos because the co-owners of the Audrey claims have priority with respect to the royalties to be paid.

the non-executive, in this case, Rio. Williams & Meyers, § 339.3 at 210; 41 Miss. L. J. at 227.

Consequently, as has been demonstrated above, even though the Audreys may have the absolute right to forego exercise of the fair market value option, regardless of Rio's interest, they may not exercise or not exercise that option without sharing in the proceeds resulting from that decision with Rio. This is precisely what the approval by this Court of the settlement agreement between the Audreys and the Jimcos effects. This approval, foreclosing Rio's full participation in the proceeds of the non-exercise of the fair market value option from 1979 forward, constitutes a denial, and a derogation, of Rio's property and contract rights. This is clear error and the Court should rehear this matter and reverse itself with respect to this oversight.

THE COURT ERRED IN CONCLUDING THIS
LAWSUIT HAS BEEN SETTLED.

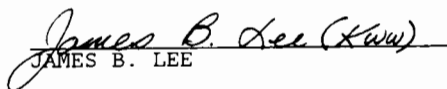
The Court's opinion in this action, at page 11, concludes that the agreement at issue in this appeal settles "lengthy and costly litigation over the disposition of royalty payments." In fact, lengthy and costly litigation still remains. Yet to be resolved is the disposition, as between the Jimcos and Rio, of royalty payments which have accrued to both parties for the years 1976 through 1978. The court still must determine what the "fair market value of crude ore" at the mine portal is and allocate to Rio one-fourth of 8% of that determined value. Additionally, all

the allegations of the Jimcos' counterclaims remain for resolution. The "settlement stipulation" approved by the Court in its opinion leaves in place, for costly and time consuming litigation, these issues. Consequently, one of the major reasons for the judicial policy of encouraging settlement, i.e. conservation of judicial resources, does not apply to the rationale set out in the Court's opinion used in reaching the result obtained. Judicial resources will not be conserved as a lengthy, time consuming and expensive court proceeding remains.

CONCLUSION

For the reasons set out in Rio's Petition for Rehearing and in this Brief, the Court should grant Rio's Petition for Rehearing and reverse its opinion filed in this matter on September 19, 1980. Further, the Court is requested to authorize oral argument with respect to the Petition for Rehearing.

Respectfully submitted this 23rd day of October, 1980.


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CERTIFICATE OF HAND DELIVERY

On this 23rd day of October, 1980, I hereby certify that I caused to be hand-delivered a true and accurate copy of the foregoing BRIEF IN SUPPORT OF PETITION FOR REHEARING, to the following parties of record:

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MAILING CERTIFICATE

On this 23rd day of October, 1980, I hereby certify that I caused to be mailed a true and accurate copy of the foregoing BRIEF IN SUPPORT OF PETITION FOR REHEARING, to the following parties of record:

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