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Utility Shareholder Association of Utah et al v. Public Service Commission of Utah et al : Brief of Utah Department of Administrative Services

Utah Supreme Court

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THE SUPREME COURT OF
THE STATE OF UTAH

UTAH DEPARTMENT OF ADMINISTRATIVE SERVICES,

Plaintiff,

vs.

PUBLIC SERVICE COMMISSION OF UTAH, et al.

Defendants.

UTILITY SHAREHOLDER ASSOCIATION OF UTAH,
ALEX OBLAD and HAROLD BURTON,

Plaintiffs,

vs.

PUBLIC SERVICE COMMISSION OF UTAH, et al.

Defendants.

UTAH STATE COALITION OF SENIOR CITIZENS,

Plaintiff,

vs.

PUBLIC SERVICE COMMISSION OF UTAH, et al.

Defendants.

MOUNTAIN FUEL SUPPLY COMPANY; WEXPRO
COMPANY; UTAH DEPARTMENT OF BUSINESS REGU-
LATION, DIVISION OF PUBLIC UTILITIES; and
UTAH COMMITTEE OF CONSUMER SERVICES,

Intervenors.

Case No. 18304

Case No. 18286

Case No. 18303

FILED

BRIEF OF UTAH DEPARTMENT OF ADMINISTRATIVE SERVICES JUN 10 1982

ON PETITION FOR WRIT OF CERTIORARI TO
THE PUBLIC SERVICE COMMISSION OF UTAH

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BRIEF OF UTAH DEPARTMENT OF ADMINISTRATIVE SERVICES

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- § 54-4-1 to 54-4-7 Utah Code Ann.
- § 54-4-26 Utah Code Ann.
- § 54-5-26 Utah Code Ann.

The Department of Administrative Services files this brief in support of its Petition for Certiorari to set aside a Report and Order on Stipulation and Agreement dated December 31, 1981 (Report and Order) of the Utah Public Service Commission whereby the Commission approved a Stipulation and Agreement among Mountain Fuel Supply Company, Wexpro Company, the Division of Public Utilities, and the Committee of Consumer Services. The Report and Order is in wholesale violation and disregard of this Court's decision and mandate in Committee of Consumer Services v. Public Service Commission, 595 P.2d 871 (1979). The Report and Order divests the Commission of jurisdiction over public utilities and public utility properties; allows an unregulated subsidiary of Mountain Fuel to sell natural gas produced from utility properties to Mountain Fuel at market price; allows Mountain Fuel to transfer its utility function of exploring for oil and gas to subsidiaries without any determination whether such a transfer is in the public interest; and allows Mountain Fuel shareholders to expropriate utility properties without an adequate determination that they are paying fair market value. By approving the Stipulation and Agreement, the Public Service Commission not only disregarded this Court's mandate, but knuckled under to Mountain Fuel and its shareholders, who presented the Commission with a fait accompli that it would not engage in a regulated exploration

and development program, and then launched what the Division characterized below as an extraordinary attack on this Court's decision in three separate legal forums.

THE CASES ON REVIEW

The Report and Order on Stipulation and Agreement which this brief seeks to reverse was entered with respect to the following cases.

IN THE MATTER OF THE APPLICATION OF
MOUNTAIN FUEL SUPPLY COMPANY FOR A GENERAL
INCREASE IN RATES AND CHARGES INCIDENT TO
NATURAL GAS SERVICE RENDERED WITHIN THE STATE
OF UTAH.

CASE NO. 77-057-03
(Count II)

IN THE MATTER OF THE APPLICATION OF MOUNTAIN
FUEL SUPPLY COMPANY FOR A GENERAL INCREASE IN
RATES AND CHARGES INCIDENT TO NATURAL GAS
SERVICE RENDERED WITHIN THE STATE OF UTAH.

CASE NO. 79-057-03

IN THE MATTER OF THE APPLICATION OF MOUNTAIN
FUEL SUPPLY COMPANY FOR A GENERAL INCREASE IN
RATES AND CHARGES INCIDENT TO NATURAL GAS
SERVICE RENDERED WITHIN THE STATE OF UTAH.

CASE NO. 80-057-01

IN THE MATTER OF THE APPLICATION OF MOUNTAIN
FUEL SUPPLY COMPANY FOR A GENERAL INCREASE IN
RATES AND CHARGES INCIDENT TO NATURAL GAS
SERVICE RENDERED WITHIN THE STATE OF UTAH.

CASE NO. 81-057-01

IN THE MATTER OF THE PETITION OF THE DIVISION
OF PUBLIC UTILITIES TO CONSIDER THE PROPOSED
TRANSFER OF CERTAIN WELLS, LEASES, LANDS AND

RELATED FACILITIES AND INTERESTS OF MOUNTAIN
FUEL SUPPLY COMPANY TO WEXPRO COMPANY ON
REMAND FROM THE UTAH SUPREME COURT.

CASE NO. 76-057-14

IN THE MATTER OF THE INVESTIGATION OF THE
TRANSFER OF CERTAIN WELLS, LANDS, LEASES AND
RELATED BUILDINGS AND INTERESTS OF MOUNTAIN
FUEL SUPPLY COMPANY AND/OR WEXPRO COMPANY TO
CELSIUS ENERGY COMPANY OR ANY OTHER ENTITY OR
PERSON.

CASE NO. 81-057-04.

The Report and Order is the final order of the
Public Service Commission (Commission) in Case Nos. 76-057-14
and 81-057-04. Case No. 76-057-14 is the case remanded to
the Commission by this Court's decision in Committee of
Consumer Services, supra, commonly referred to as the "Wexpro
case." Case No. 81-057-04 arose during proceedings before
the Commission on remand in the Wexpro case when the Division
of Public Utilities moved for a temporary restraining order
and preliminary injunction to enjoin Mountain Fuel Supply
Company's attempt, without Commission sanction, to transfer
oil and gas wells, leases and related property to a
newly-created subsidiary, Celsius Energy Company (Celsius).
Mountain Fuel created Celsius in response to this Court's
decision in the Wexpro case. The Commission established
Docket No. 81-057-04 to hear the Celsius matter.

Case Nos. 77-057-03, 79-057-03, 80-057-01 and
81-057-01 are general rate cases. The Report and Order

resolves contingencies in final orders previously entered in those cases, i.e., the rates set in those cases are to be adjusted by proceeds from oil and gas assets to the extent the Wexpro case determines those proceeds are available to reduce rates.

The issues resolved in the Report and Order are all based on issues determined by this Court in the Wexpro case.

PROCEDURAL SYNOPSIS OF THE WEXPRO CASE
AND THE POST-REMAND PROCEEDINGS

The regulatory proceedings which culminated in the Report and Order were commenced by a Petition for Investigation filed by the Division of Public Utilities (Division) on December 17, 1976, and designated Case No. 76-057-14. The Petition was occasioned by Mountain Fuel's announced intention to convey all of its claimed "non-utility" "oil" properties, including reserves, leases and related facilities, to a newly-formed, wholly-owned subsidiary, Wexpro, in exchange for all of the common stock of Wexpro at depreciated book value and to enter into a joint exploration arrangement with Wexpro to explore Mountain Fuel's wildcat acreage. The transfer was reflected in an Agreement of Purchase and Sale (P&S Agreement) and the exploration arrangement in a Joint Exploration Agreement (JEA). Both agreements were between Mountain Fuel and

Wexpro. Committee of Consumer Services, supra. MFS 1 & 2.¹ Mountain Fuel from the inception took the categorical position that the Commission had no jurisdiction over the transfer of properties from Mountain Fuel to Wexpro. Hearing 12/29/76 at 24.

The Petition for Investigation asked the Public Service Commission to exercise regulatory jurisdiction over these transactions and to determine after an evidentiary hearing whether they were in the public interest. Petition

¹ The following abbreviations are used for purposes of citation in this brief: With respect to the record made prior to remand of the Wexpro case, (1) "Ord." by date and without case number refers to orders in the Wexpro case; (2) "Tr." refers to the transcript page number from the evidentiary hearings September 12 through October 28, 1977, (3) other transcript citations are given by page and date, (4) citations to exhibits are to the exhibit number used in that proceeding--Mountain Fuel exhibits are referred to as MFS-__, Division exhibits are referred to as DIV-__, and Salt Lake County Exhibits are referred to as SLC-__; (5) pleadings or other papers are cited by the title and/or description, and (6) orders by case number and date only, refer to Commission orders in the cited case.

With respect to the post-remand record, (1) R. __ refers to transcript page number and to the record citation to all other pleadings, papers and orders; (2) pleadings or other papers are cited by title and/or description, with a designation to the place in the record. For example, Petition for the Establishment of a Fund for Attorneys' and Expert Witness Fees for the Division of Public Utilities, R. 2506; (3) the Report and Order on Stipulation and Agreement R. 007, was only designated with a record number on every other page, and for that reason citations in this Memorandum to the Report and Order are given by original page and/or paragraph number.

for Investigation at 3. The issues raised by the Petition for Investigation included (1) "are the assets being transferred, in fact non-utility property, and have they always been non-utility property" and (2) "do the utility rate-payers and the utility operations have any interest in the oil operations of Mountain Fuel Supply Co." Petition for Investigation, ¶¶ 6(a), 6(j).

Without ever having held any evidentiary hearing, the Public Service Commission on July 20, 1977, at the urging of Mountain Fuel, issued a Final Report and Order holding the Commission had no jurisdiction over the transaction transferring Mountain Fuel's "non-utility" "oil" properties to Wexpro. The Order terminated the case. Ord. 7/20/77 at 4-5.

While motions for rehearing were pending, on August 23, 1977 the Commission heard a report from the parties concerning a proposed settlement by Mountain Fuel which provided for the amendment of the P&S Agreement and the JEA.

On August 29, 1977, the Commission entered its Order on the Petitions for Rehearing. The Commission affirmed its July 20 Order and denied the Petitions for Rehearing, except that the Commission granted a rehearing for the purpose of having Mountain Fuel present the amendments to the P&S Agreement and the JEA that it had proposed at the August 23 conference. Ord. 8/29/77.

On September 12, 1977, the Commission commenced an evidentiary hearing under the scope of the Commission's Order of August 29, 1977. The evidentiary hearing on Mountain Fuel's proposed amendments to the Wexpro agreements continued for 18 days.

On April 11, 1978, the Commission adopted verbatim an 80-page Order prepared by counsel for Mountain Fuel. Letter of transmittal by Mountain Fuel and Proposed Report and Order on Rehearing, 11/10/77. The Commission affirmed its position that it had no jurisdiction over the properties held in Mountain Fuel's "non-utility" "oil" accounts, and rejected the Division's and Committee's positions that the ratepayers were entitled to have the net profits from the oil operations applied to reduce rates. The Commission pass[ed] on every significant issue of fact and law" raised by the Mountain Fuel-Wexpro transactions. Ord. 4/11/78 at ¶ 100.

This Court reversed the April 11, 1978 Order and remanded "for a hearing in accordance with the principles set forth in this opinion." Committee of Consumer Services, supra, at 873. This Court ordered, among other things, that a hearing must be held to determine whether the assets were utility assets pursuant to a three-pronged test. This Court also ordered that the proceeds from utility assets must reduce gas rates and that any transfer of utility assets

must be for fair market value. According to this Court's test, virtually all the assets transferred to Wexpro are, as a matter of law, utility assets.

Mountain Fuel, Wexpro, Alex Oblad, Harold Burton and Carlyle Harmon filed a Petition for Writ of Certiorari with the United States Supreme Court (Petition for Certiorari), submitted herewith as Appendix "A". Their petition states that this Court's opinion held that the "non-utility" oil properties transferred by Mountain Fuel to Wexpro "had always been and are utility assets, and that these properties and the oil revenues generated therefrom should be 'applied to reduce the cost of gas' to the Utah utility customer." Mountain Fuel Petition for Certiorari at 13. The Petition for Certiorari stated that this Court's Order was reviewable in that "all that remains is an accounting proceeding." Petition for Certiorari at 17, n.7. Certiorari was denied on January 7, 1980. Mountain Fuel Supply Company v. Utah Commission of Consumer Services, 444 U.S. 1014 (1980).

Thereafter, on remand before the Commission, Mountain Fuel's shareholders launched what the Division characterized below as an extraordinary attack on this Court's decision, including, in the Division's words,

an attempt to make this hearing more than a ministerial proceeding by introducing convoluted evidence on the issues of shareholder contribution, shareholder risk, and their analysis of the "public interest." [This is]

only an attempt to relitigate issues on which Mountain Fuel has already lost but an affront to [the Public Service] Commission in light of Mountain Fuel's statement to the United States Supreme Court.

Utah Department of Business Regulation, Division of Public Utilities' Hearing Brief on Remand (Division Brief on Remand), R. 2482, at 2491.

On remand, no evidentiary hearing of any kind was ever held until after Mountain Fuel, Wexpro, the Division, and the Committee executed the Stipulation and Agreement. The evidentiary hearings held after the execution of the Agreement were limited to the issue whether or not the Stipulation and Agreement should be approved.

The Commission issued its Report and Order approving the Stipulation and Agreement on December 31, 1981.

SUMMARY OF PLAINTIFF'S POSITION

The plaintiff in summary claims:

(a) The Report and Order on Stipulation and Agreement errs in divesting the Commission of its statutory jurisdiction. This Court held in the Wexpro case that the Commission has jurisdiction over Mountain Fuel's oil and gas operations and properties because the exploration and development of oil and gas is a utility business, and because the ratepayers bore the risk of exploration and development of oil and gas. This Court held that properties explored and developed with ratepayer funds are utility assets. This

Court also held that Wexpro is a public utility, and under this Court's decision Celsius, a newly created subsidiary which will own Mountain Fuel's wildcat acreage, is as a matter of law a public utility. The Commission, however, in approving the Stipulation and Agreement, divested itself of jurisdiction over utility assets. It also divested itself of jurisdiction over Celsius and Wexpro.

Notwithstanding the Commission's statutory duty to regulate all of the business of every public utility, and therefore to regulate Mountain Fuel's oil and gas exploration and development business, the Commission divested itself of jurisdiction over sales of natural gas by Celsius to Mountain Fuel. And notwithstanding its statutory jurisdiction to hold hearings and make determinations pursuant thereto, the Commission approved a provision that arbitration is the sole remedy for parties claiming default under the Stipulation and Agreement.

The statutes of this state, not the Stipulation and Agreement, must define the jurisdiction of the Commission, but the Commission acquiesced in a serious encroachment on its statutory power.

(b) The Division, without legislative authority, gave up its power to challenge actions of Mountain Fuel, Wexpro or Celsius in violation of its duties to represent the public interest before the Commission.

(c) The approval of the Stipulation and Agreement violates the mandate of this Court. While this Court remanded the case for a hearing in accordance with principles set forth in its opinion, the Commission failed to hold any such hearing. The only evidentiary hearing held by the Commission was a hearing on approval of the Stipulation and Agreement. Nothing was done in accordance with the mandate. The Commission was told to classify assets as utility or non-utility in accordance with a three-pronged test, but there was never a hearing on classification. The Commission was told that any transfer of utility assets must be for fair market value and in the public interest, but there was never a reasoned determination of fair market value, and in fact the Commission denied the Utah State Coalition of Senior Citizens' motion for a valuation of the assets. The Commission violated this Court's mandate that the ratepayers were entitled to have rates reduced by all oil profits from properties explored and developed at ratepayer risk. While this Court expressly stated that if a subsidiary were to engage in oil and gas operations there must be a determination by the Commission of whether Mountain Fuel could divide its utility functions between itself and its subsidiary, the Commission in approving the Stipulation and Agreement allowed such a division without any such determination. All of those actions violated this Court's

mandate.

An administrative agency has no power to ignore the mandate of this Court, whether or not a case is settled. In fact, an administrative agency has a duty not only to carry out the letter but to serve the purposes of this Court's mandate, and the Commission by approving the Stipulation and Agreement has frustrated virtually every purpose of this Court's mandate.

(d) The Report and Order also violates the law of Utah. In direct contravention of the law, the Commission approved a sale of gas by Mountain Fuel's wholly-owned subsidiary, Celsius, to Mountain Fuel at market prices rather than cost of service. To add insult to injury, that gas will come from properties acquired and held in utility accounts. In contravention of the law, Wexpro is entitled under the Stipulation and Agreement to 46% of the net profits on oil from new wells drilled in gas reservoirs. In contravention of the law, the Stipulation and Agreement lead immediately to the end of Mountain Fuel's utility exploration and development program.

The Report and Order is the result of a compromise--plain and simple. The shareholder interests were unwilling to live with this Court's decision that oil and gas exploration and development is a utility activity. The shareholder interests wanted an unregulated oil company and

presented the Commission with a fait accompli that they would not operate a regulated exploration and development company. That fait accompli flouted this Court's decision. To promote their desire for an unregulated oil company, the shareholders launched a massive litigative attack on this Court's decision. The Stipulation and Agreement were a compromise of the Division's victory in the Wexpro case to avoid long and expensive litigation. The Commission, feeling itself "in a box", approved the Stipulation and Agreement.

QUESTIONS PRESENTED

1. Whether the Public Service Commission, in approving the Stipulation and Agreement, unlawfully divested itself of its statutory jurisdiction:

(a) in relinquishing jurisdiction over assets which are as a matter of law utility assets;

(b) in relinquishing jurisdiction over Wexpro and Celsius, which are as a matter of law public utilities; and

(c) in relinquishing jurisdiction over sales of natural gas from Celsius to Mountain Fuel.

2. Whether the Public Service Commission, in approving the Stipulation and Agreement, unlawfully divested itself of its statutory jurisdiction to determine whether the public interest allows Mountain Fuel to divide its utility function between itself and a subsidiary.

3. Whether the Public Service Commission, in approving the Stipulation and Agreement, unlawfully divested itself of its statutory ratemaking jurisdiction in allowing an unregulated rate of return on production from utility assets.

4. Whether the Division unlawfully divested itself of its statutory power to act as a party in litigation before the Public Service Commission.

5. Whether the approval of the Stipulation and Agreement violates this Court's mandate in Committee of Consumer Services v. Public Service Commission, 595 P.2d 871 (Utah 1979)

(a) by failing to hold a hearing to classify assets;

(b) by failing to hold any hearing to determine whether the transfer of assets was in the public interest and for fair market value;

(c) by failing to determine whether it is in the public interest for Mountain Fuel to divide its utility function between itself and a subsidiary;

(d) by failing to determine the benefits to which ratepayers are entitled by having oil profits applied to reduce rates; and

(e) by allowing Mountain Fuel to pay Celsius market prices for natural gas;

6. Whether the Report and Order violates the law of Utah:

(a) by allowing Mountain Fuel to purchase gas from a subsidiary at market prices;

(b) by allowing Wexpro 46% of the net profits on oil obtained from gas reservoirs;

(c) by allowing Mountain Fuel to divide its utility function between itself and its subsidiary without a determination whether such division is in the public interest; and

(d) by depriving ratepayers of a reduction in rates from the net proceeds from all hydrocarbons obtained from utility properties.

7. Whether the Report and Order is arbitrary and capricious and internally inconsistent in approving the Stipulation and Agreement despite the Commission's findings that:

(a) cost of service gas is an important consideration to the public interest;

(b) there are potential conflicts of interest or sweetheart relationships between Mountain Fuel and its oil subsidiaries;

(c) exploration and development of energy resources are appropriate utility activities; and

(d) non-utility activities should enhance rather than jeopardize utility operations.

STATEMENT OF THE CASE

A. This Court's Decision And Mandate In The Wexpro Case Rejected Mountain Fuel's Shareholders' Attempt To Create An Unregulated Oil Company Because Of The Inseparability Of Mountain Fuel's Oil Operations From Its Utility Exploration And Development Program And Because The Ratepayers Bore The Risk Of Mountain Fuel's Exploration For Oil And Gas.

The regulatory issues in this case arise out of Mountain Fuel's exploration for oil and gas. Utility "oil" operations are by nature inseparable from natural gas operations. 595 P.2d at 874. Discovery of oil in a utility exploration and development program is not by design, but is incidental to the exploration for gas. What type of hydrocarbons, if any, may be discovered is unknown prior to drilling. Until exploratory wells are drilled, it is not possible to determine whether the ultimate production, if any, will be oil or gas, or both. 595 P.2d at 879.

Mountain Fuel, at least since 1947, engaged in an extensive exploration program for oil and gas. Case No. 2906 (1947). Mountain Fuel met the risk of oil and gas exploration in a unique manner. It maintained a utility account

105 in which it held its unexplored or wildcat acreage. That acreage was deemed used and useful in the utility business and was included as a capital asset in rate base. 595 P.2d at 875. The Commission traditionally allowed funds for exploration and development to be charged to ratepayers as a just and reasonable expense as part of the utility function of Mountain Fuel. Therefore, Mountain Fuel was allowed to recover in rates costs for lease acquisition, lease maintenance (delayed rentals), non-productive well drilling (dry hole exploration), abandoned leases, and other authorized exploration expenses. 595 P.2d at 875. When exploration was successful, exploration costs were capitalized, MFS-8; when it was unsuccessful, they were expensed, DIV-1; Tr. 687-88, 1026-27. Mountain Fuel expensed all of the cost of unsuccessful exploration in utility accounts for cancelled leases, delayed rentals, other exploratory expenses and dry holes.

Between 1960 and 1977, \$44,981,000 was authorized by the Commission as a utility exploration expense, reflected in rates and charges for the sale of natural gas. 595 P.2d at 875.

Mountain Fuel's stockholders, prior to 1972, did not stand any of the risk of exploring for "oil" and "gas." Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972). Mountain Fuel's stockholders did not bear any cost of "oil" and "gas" exploration until exploration resulted in the discovery

of "oil" or "gas". Id. Mountain Fuel's stockholders' financial participation in "oil" and "gas" exploration prior to 1972 was limited to capitalizing the cost of successful "oil" and "gas" wells. Only when "oil" and "gas" exploration was successful did the stockholders put up their money. If exploration was unsuccessful, the ratepayers put up the money and bore all of the risk. Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; Tr. 312-14, 687-89, 691, 701, 2394. Successful "gas" wells were capitalized in Mountain Fuel's "utility" accounts and included in the ratepayers' "cost of service." Successful "oil" wells were transferred and capitalized in the "non-utility" "oil" accounts and all the income from production went to the stockholders.

Under the uncontroverted facts, until 1972, all of the costs of exploration and development prior to the successful discovery of "oil" or "gas" were charged to Mountain Fuel's "utility" accounts. Mountain Fuel was allowed to pass on every single cent it incurred in exploration and development expense in its gas rates to the ratepayers.

Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; Tr. 312-14, 687-89, 691, 701, 2394. The ratepayers thus assumed all of the risk of "oil" and "gas" exploration and development during this period.

The stockholders of Mountain Fuel, prior to 1972,
did not pay for one single dry hole. Id.; R. 2711.

In 1972, for the first time, the Commission required the Company's "oil operations" to pay \$300,000 per year toward Mountain Fuel's exploration and development expense. Case No. 6369 (1972); Tr. 688. In 1974, the Commission ordered Mountain Fuel's "oil" "non-utility" accounts to pay 32.8 percent of Mountain Fuel's exploration and development expense Case No. 6668 (7/18/74). Finally, effective 1976, the Commission required the exploration and development expense of Mountain Fuel to be divided equally between its "utility" and "non-utility" accounts. Case No. 7113 (12/1/75); Tr. 688-89.

Between 1966 and 1976 the utility expense account (i.e., ratepayers) paid for 73.3 percent of dry hole exploration and the non-utility account (i.e., shareholders) paid 26.7 percent of this expense. The utility expense account paid 95 percent of the cancelled and delayed rentals on leases and the non-utility account paid 5 percent of this expense. Of the total exploration expenses for the ten-year period, \$37,250,000 was paid from the utility account and \$8,222,000 was paid by the non-utility account. 595 P.2d at 875.

It is true Mountain Fuel's "non-utility" "oil" operations did contribute from 1972 through 1976, under the

orders of the Commission, approximately \$8 million toward Mountain Fuel's combined exploration and development expense, DIV-1, but those funds came out of the enormous oil profits already obtained by the shareholders. The ratepayers in the same period contributed over \$17 million. DIV-1. In 1972, Mountain Fuel's profit contribution from its "oil" operations was over \$1.6 million; in 1973, \$2.3 million; in 1974, \$7.2 million; in 1975, \$14.4 million; and in 1976, \$24 million. SLC-1 at 8. During this period of time, the profit from Mountain Fuel's "oil" operations held in its "non-utility" accounts for the sole benefit of Mountain Fuel's stockholders amounted to over \$47 million. Id.

In short, during this period, the \$8 million contribution that Mountain Fuel's "non-utility" "oil" accounts or its stockholders made toward Mountain Fuel's exploration risks was made out of the vast profits generated by Mountain Fuel's "non-utility" "oil" operations that had been developed at the risk of ratepayers.

The total risk, therefore, of Mountain Fuel's exploration and the development of its "non-utility" "oil" properties transferred to Wexpro was in economic reality borne by Mountain Fuel's ratepayers.

Therefore this Court stated:

Thus, as early as 1957, the traditional principles of utility law were modified by the Commission, e.g., generally

the investor supplies the risk capital and sustains the losses in a speculative venture; the ratepayer only pays a return on that portion of the investment which is found used and useful in rendering the utility service. Although the exploration and development costs which were reflected in the rates and charges were characterized as a just and reasonable expense of the utility by the Commission, these charges were, in effect, a capital contribution to a speculative venture for the purpose of developing oil and gas sources. 595 P.2d at 876 (emphasis added).

On January 14, 1974, the Commission indeed found that the oil operations were so incidental to and inseparable from the production and sale of natural gas as to be a part of Mountain Fuel's utility operations. The Commission ordered on that date that the investments, revenues and expenses of the oil operations be included in the appropriate utility accounts for ratemaking purposes. While the Commission, in response to cries of financial ruin from Mountain Fuel, later rescinded the order rolling in revenues, this Court held that those findings "were not rejected." The January 14, 1974 Order caused Mountain Fuel to attempt to set up Wexpro as an unregulated oil company. Thus the essence of what was before this Court in Committee of Consumer Services was the shareholders' attempt to have an unregulated oil company explore properties acquired, held, and developed at the risk of the ratepayers of Utah. In this Court's words:

These [January 14, 1974] findings, in regard to the inseparable nature of the oil

and gas operations, were the sword of Damocles Mountain Fuel sought to have beaten into a non-regulated oil derrick. 595 P.2d at 874.

This court rejected that attempt. See Part E, infra, at 29-34.

B. Prior To This Court's Decision In The Wexpro Case Mountain Fuel Used Its Own System Of Property Classification As A Test Of Jurisdiction And A Principle For Allocation Of Benefits.

A central basis for this Court's decision that the April 11, 1978 Order was defective was that the Commission had allowed Mountain Fuel, in effect, to determine whether assets were jurisdictionalized or not depending on Mountain Fuel's own system of oil and gas classification. This Court stated:

Mountain Fuel, . . . developed a system of classification based on custom or usage. This classification was never reduced to writing by either the utility or the Commission. If the exploration and development produced a successful well, it was classified as oil or gas based on the "value of production." This system involved measuring the product at the well head or field separator facility, and then comparing the field price of gas and oil. Whichever substance had greater value determined whether the site was a gas or an oil well. Thus, any disparity between gas and oil prices at the time of classification could play a decisive role in determining whether it was a gas or an oil well. If it were a gas well, the drilling costs were capitalized and the well was held in a utility account, and any incidental gas and oil sales were credited to a utility account. If it were an

oil well, the drilling costs were capitalized and held in the non-utility account; any associated gas was credited at field price to the non-utility account. In addition, any acreage logically related to the discovery was transferred and capitalized in the corresponding account. 595 P.2d at 876.

The Commission in the April 11, 1978 Order based its jurisdictional determination on Mountain Fuel's classification of its assets. Id. at 877. This of course had the effect of nonjurisdictionalizing assets with substantial gas reserves and giving Mountain Fuel's shareholders a healthy unregulated return on oil production. This Court noted the extreme importance of this classification:

The classification of this property is of utmost importance, since this property is being transferred to Wexpro at a depreciated book value of \$33.1 million. The claimed gross revenue from this property for 1976 was approximately \$39 million. An expert from Mountain Fuel estimated the fair market value of the property at \$150 million. If, in fact, after a hearing the property should be classified as a utility asset, the ratepayers by this transfer, would be deprived of benefits to which they are entitled. Id. at 877.

This Court agreed with the petitioners that there was no statutory or legal basis to determine the issue of the Commission's jurisdiction in this manner.

The net effect of the Commission's initial determination was that their jurisdiction was based on Mountain Fuel's classification. This classification, in turn, was based on the value of production; and

whether the substance was deemed gas or oil was based upon the end use of the product. There is no statutory or legal basis to sustain such a classification. Id.

C. The Wexpro Transactions Previously Rejected By This Court Involved An Attempt To Shield Mountain Fuel's "Oil" Operations From Regulation; To Deprive The Commission Of Jurisdiction Over Utility Assets; And To Appropriate All Benefits From Oil Operations To The Shareholders.

The Wexpro transactions approved by the April 11, 1978 Order and then rejected by this Court were reflected in four basic agreements between Mountain Fuel and Wexpro: (1) the original Agreement of Purchase and Sale (P&S Agreement) dated December 21, 1976, MFS-1; (2) the original Joint Exploration Agreement (JEA) of the same date, MFS-2; (3) the proposed Amended Agreement of Purchase and Sale (Amended P&S Agreement), MFS-4; and (4) the proposed Amended Joint Exploration Agreement (Amended JEA), MFS-5.

The P&S Agreement provided, effective January 1, 1977, (1) for the transfer of all properties held by Mountain Fuel in its "non-utility" "oil" accounts to Wexpro at book value in exchange for all of Wexpro's common stock; (2) reserved all natural gas in the Dakota and Weber formations of the Brady Field after "blow down" to Mountain Fuel, and in effect transferred such reserves to Mountain Fuel's "utility" accounts; and (3) gave Mountain Fuel the first right of

refusal to purchase at market prices (a) all natural gas produced from the "non-utility" "oil" properties transferred by Mountain Fuel to Wexpro, and (b) all natural gas discovered and developed by Wexpro in an eight-state area for a ten-year period. MFS-1.

The JEA (1) granted Wexpro, effective January 1, 1977, the right jointly to explore with Mountain Fuel the 2.9 million wildcat acres of oil and gas leases held by Mountain Fuel in its "utility" accounts (105 accounts), SLC-1 at 12; Tr. 462-63, 588; (2) required Mountain Fuel and Wexpro to share the cost of exploration of Mountain Fuel's acreage on a equal basis with a joint annual commitment of \$6,240,258.00; (3) provided for a division of ownership of hydrocarbons discovered under Mountain Fuel's "oil" and "gas" method of classification on a well-by-well basis, MFS-2; Tr. 72, 455, 599; (4) provided that all "oil" wells and leases "logically related" to such wells would be transferred to Wexpro; (5) provided that on combination "oil" and "gas" wells that were classified as "gas" wells, Wexpro would have a right to purchase all "oil" at market prices from Mountain Fuel, and on all combination wells that were classified as "oil" wells, Mountain Fuel would have the right to purchase all "gas" from Wexpro at market prices; and (6) provided Mountain Fuel could farm out acreage under the JEA; but granted Wexpro the right

to all "oil" production pursuant to any farm-out arrangement.

The fundamental change provided by the proposed Amended P&S Agreement and the proposed Amended JEA was that all gas produced from the properties transferred to Wexpro and all gas discovered under the JEA would go to Mountain Fuel at "cost of service" prices. MFS-4 and 5; Tr. 68-69. The proposed Amended JEA also provided that incidental "oil" produced from a combination "gas" well would go to Wexpro at "cost of service" prices. The Amended P&S Agreement and Amended JEA, for the first time in Mountain Fuel's history, reduced Mountain Fuel's definition of "oil" and "gas" to writing. MFS-4 and 5; Tr. 286.

Under the JEA, Wexpro was granted the right jointly to explore all of Mountain Fuel's oil and gas acreage. Tr. 134, 462-63, 588, 1521; SLC-1 at 12. All of the 2.9 million acres were carried in Mountain Fuel's "utility" accounts. MFS-5; Tr. 2085, 462-63, 588, 691-92, 701. The initial costs of this acreage were included as costs of property held for future use and the ratepayers of Mountain Fuel paid a rate of return on those costs. Tr. 701. Virtually all of the exploration and development expense with regard to this acreage had been paid by Mountain Fuel's "utility" accounts and charged to the ratepayers. Tr. 691-92, 2083.

The right granted to Wexpro jointly to explore this wildcat acreage unquestionably was very valuable. During the hearings preceding this Court's decision, Mountain Fuel's vice-president for exploration, Mr. Cash, testified that the Rocky Mountain region, the region in which Mountain Fuel's wildcat acreage was located, was the hottest onshore area in the U.S. for oil and gas exploration, Tr. 439-441, 444, and "the competition for acreage and for exploration and processing of acreage is extreme." Tr. 439-40. At the same hearings, Dr. Bass confirmed Mr. Cash's judgment. Tr. 886, 892. Dr. Bass testified that Mountain Fuel's wildcat acreage was of great value, Tr. 892, and that the Amended JEA was fundamentally unfair because Wexpro had done nothing to earn the right to participate in its joint exploration. Tr. 885, 942.

D. The April 11, 1978 Report And Order Allowed The Shareholders Their Unregulated Oil Company.

On April 11, 1978, the Commission issued a Report and Order on Rehearing approving the Amended P&S Agreement and the Amended JEA. The Commission resolved "every significant issue of fact and law in the proceeding." Ord. 4/11/78 at ¶ 100.

The Commission ruled against the Division's contentions (1) that the Commission had jurisdiction over the oil and gas properties held in Mountain Fuel's "non-utility"

accounts; (2) that such properties were utility properties; and (3) that the proceeds from those properties should be rolled into or included in Mountain Fuel's utility accounts for ratemaking purposes.

The Report and Order on Rehearing covered the entire range of the controversy and adopted in total (and verbatim) the positions of Mountain Fuel and Wexpro. The Commission reaffirmed the non-utility status of the oil operations and its lack of jurisdiction over them. Id. at ¶ 11. The Commission held that it would not indulge in fund-tracing and that the origin of funds used for exploration was not relevant to the validity of the program. Id. at ¶ 13. The Commission also held that cost-of-service gas was a sufficient return for inclusion of exploration expense in the rate base, and that the shareholders should be allowed an unregulated return from the oil-producing properties. Id. at ¶¶ 16, 18, 26, 46.

The Commission in the Report and Order on Rehearing expressly rejected the theory proposed by the Division and other protestants that any gain from operations should be realized by those who bear the risk and therefore gas rates should be reduced by oil profits. Id. at ¶¶ 30, 32, 34, 35 and 38. The Commission expressly rejected the notion that a utility bears a trust relationship toward its customers, citing Board of Public Utility Commissioners v. New York

Telephone Co., 271 U.S. 23 (1925). Ord. 4/11/78 at ¶ 37.

The Commission also expressly rejected the contention of the Committee that the transfer of properties to Wexpro should be for fair market value instead of depreciated book value. Id. at ¶¶ 82-84.

The Commission approved a provision in the Amended Agreement of Purchase and Sale which allowed Wexpro to charge Mountain Fuel market price rather than cost of service for gas produced from acreage acquired by Wexpro other than transferred acreage and that which came to it under the JEA. Id. at ¶ 104(2)(vii). 595 P.2d at 875.

E. This Court's Decision And Mandate In The Wexpro Case Held That Properties Explored And Developed With Ratepayer Funds Are Utility Assets; Held That The Benefits From Such Properties Must Be Allocated According To The Principle "Gain Follows Risk," And Remanded The Case For A Hearing To Classify The Assets And Give The Ratepayers Their Due.

Mountain Fuel itself explained to the Supreme Court of the United States this Court's decision in the Wexpro case. According to Mountain Fuel, this Court held that the "non-utility" oil properties transferred by Mountain Fuel to Wexpro had always been and are utility assets, and that these properties and the oil revenues generated therefrom should be applied to reduce the cost of gas to the Utah utility customer. Mountain Fuel Petition for Certiorari at 13.

According to Mountain Fuel, this Court held that Mountain Fuel stood in a trust relationship when it sold natural gas to its utility customers, Mountain Fuel Petition for Certiorari at 14; that sales of gas by Wexpro to Mountain Fuel must be at cost-of-service prices for ratemaking purposes; and that Wexpro is itself a public utility. Mountain Fuel stated to the United States Supreme Court that this Court's decision leaves "no room for Mountain Fuel or Wexpro to conduct a non-utility business in oil and gas, subject[s] Wexpro to Utah regulation as a public utility, and require[s] Wexpro to sell gas to Mountain Fuel at cheap prices." Petition for Certiorari at 14. Mountain Fuel's characterization of the decision is correct.

Specifically, this Court held that the order approving the Amended P&S Agreement and Amended JEA was predicated on two erroneous conclusions: the validity of Mountain Fuel's classification system for determining utility versus non-utility assets, and the conclusion that the Commission had no jurisdiction over the "non-utility" assets and the transfer of those assets to a non-utility corporate entity. This Court quoted with approval, as a key to the defect in the Commission's order, the dissent of Commissioner Rigtrup:

I would conclude that the exploration acreage held by Mountain Fuel over the years was used or useful in its natural gas utility business, and should have always been classified as utility assets. The fact that revenues from "oil" or other liquid hydrocarbons have become very significant during the last few years does not change the basic character of those assets. However, it appears that the shareholders of Mountain Fuel have come to expect an unregulated return from oil properties, for which the risk capital was largely derived in rates charged its customers as ordered by the Commission. . . . 595 P.2d at 873.

This Court held that the provisions under the Amended P&S Agreement whereby Mountain Fuel would purchase at market price, rather than cost-of-service price, the gas discovered on properties acquired by Wexpro, violates the no-profits-to-affiliates rule. Id. at 875.

This Court held that by the activities performed by Wexpro in joint activity with Mountain Fuel, particularly upon the properties transferred by the P&S Agreement, Wexpro itself becomes a public utility subject to the jurisdiction and regulation of the Commission. Wexpro is facilitating the production of natural gas and delivering natural gas to its parent, each of which constitutes Wexpro a public utility. Id. at 878.

This Court held that the Amended JEA contained "certain infirmities", since it allowed Mountain Fuel's system of oil and gas classification to determine utility

versus non-utility properties and the allocation of benefits therefrom. Id. at 879.

This Court reversed the Commission's Order approving the transactions and remanded for a "hearing in accordance with the principles set forth" in its opinion. Id. at 873.

The principles in accordance with which the hearing on remand was to be held were:

1. Oil production facilities explored and developed by a public utility in the search for hydrocarbons with funds paid by ratepayers cannot be considered a separate non-utility operation, but are incidental to natural gas exploration and are a part of utility operations, and must be treated and regarded as such for ratemaking and accounting purposes. Id. at 879.

2. "There is . . . posed the serious issue of whether it is in the public interest for Mountain Fuel to divide its utility function between it and a subsidiary." Id. at 878, n.8.

3. When the expenses to develop utility properties are included in rate base, the ratepayers are entitled to share in the benefit by having the net proceeds on the oil and gas and other hydrocarbon substances sold by Mountain Fuel to others applied to reduce the cost of gas. Id. at 876.

4. It is the duty of a public utility to operate in such a manner as to give the consumers the most favorable rate reasonably possible, which stems from the trust relationship the utility bears to its customers. Id. at 874.

5. Under the no-profits-to-affiliates rule, any amount paid as a profit by a utility to any other company with which it is directly or indirectly in a control relationship cannot properly be included in the rate base. Id.

This Court required a hearing:

The order approving the amended purchase and sale agreement must be reversed, and there must be an evidentiary hearing. The Commission must reassess the transfer and determine whether the properties were utility assets. The following is the criteria by which the properties should be classified:

(1) Was the property, while undeveloped, held in the utility capital account (Account #105), upon which a rate of return was paid by the ratepayers?

(2) Were any funds from the utility exploration and development expense accounts (Accounts #795, #796, #797, and #798) applied to the development of the acreage?

(3) Has any natural gas or natural gas liquids been produced from the acreage?

If the answer to any of these is in the affirmative, the assets are utility property.

Any transfer of a utility asset should be for fair market value so an appropriate benefit therefrom will redound to the credit of the ratepayers. Furthermore, before approving the transfer of a utility asset, the Commission should determine whether the transaction is detrimental to the ratepayer, and whether it is in the public interest. 595 P.2d at 878.

The record is uncontroverted that virtually every property transferred to Wexpro was, and is, under the tests, utility property.

F. The Shareholder Interests, Unwilling To Live With This Court's Decision, Decided Not To Operate Within The Decision's Boundaries But Rather To Inform The Commission They Would Not Operate A Regulated Oil And Gas Exploration And Development Program; Presented The Commission With A Deregulated Oil Company As A Fait Accompli; And Attacked This Court's Decision In All Available Forums.

1. The Fait Accompli.

There was never an evidentiary hearing to classify assets, to reduce rates, or to determine whether the public interest could or would be served by Mountain Fuel's ownership of an unregulated oil company. After this Court's decision and the denial of certiorari by the United States Supreme Court, Wexpro explored the properties conveyed to it under the P&S Agreement, and acted in all respects under the P&S Agreement, as if this Court had not rendered its decision. Stipulation ¶ 1.14, R. 3548-49. The JEA was can-

celled, and further drilling on utility leases was done by Wexpro first under an informal agreement and subsequently under a stipulation filed in Case No. 81-057-04 and approved by the Commission. Mountain Fuel also discontinued all exploration and development activities on the properties subject to the JEA. Stipulation ¶ 1.16, R. 3549.

At the hearings on the Stipulation and Agreement, Mountain Fuel's officers and shareholders stated the position that:

Under the conditions as they exist under the Supreme Court decision, and on the properties that are involved . . . the company is . . . not only unwilling, but probably unable to continue exploring in the utility.

Testimony of Crawford, R. 1523.

The general feeling was someone in Utah did something which was very bad for the investors in Mountain Fuel.

Testimony of Harmon, R. 1265.

There was no one in Washington who stood up and said "This is a horrendous decision that has been reached for free enterprise and for our national policy . . ." and I would say, well it wasn't the commissioners doing it. It was the Supreme Court of Utah that made that decision.

Id. at 1265-66.

[The company] felt the decision of the Supreme Court was improper and totally inconsistent with the practices that have been carried on by the company throughout its history.

Testimony of Crawford, R. 1525.

Therefore, counsel for Mountain Fuel stated:

We are fully aware of what the Supreme Court said about Wexpro and that is one of the reasons we want this initial transfer of the exploration program to go to Celsius. Wexpro as the operator may or may not be regulated. We'll just have to see what happens in the future on that, but we want the exploration part of the program as free of utility-type regulation as is possible to get it. That was probably as important as any other single element of anything we negotiated. R. 1651.

The management of Mountain Fuel expressed to the Commission in writing that it "cannot and will not, as a regulated public utility in Utah, utilize retained earnings or other shareholder monies for an exploration program" under the circumstances facing the company. Objection of Mountain Fuel Supply Company to Division and Committee Motion for Temporary Restraining Order and for Preliminary Injunction, R. 2696 at 2701. Mountain Fuel informed the Commission that leases would be lost through expiration because it would not explore for hydrocarbons. Id. at 2700-01.

Mountain Fuel also informed the Commission that, without seeking Commission approval, it was transferring wildcat acreage to Celsius and that Celsius was willing to commence drilling to prevent the lapsing of leases. Id. at 2698, 2702-03. If the assets were not transferred to Celsius, Mountain Fuel stated, the leasehold interests would expire. Id. at 2703. "Unless the wells are drilled on the affected acreage by Celsius, under the jurisdiction of

FERC, they will not be drilled at all and all interests will be losers." Id. at 2704. Mountain Fuel took the position that no damage would be sustained by any party pursuant to this transfer, even though it acknowledged to the Commission that any gas purchased by the utility from Celsius would be at market price. Id. at 2703.

At the hearing prior to the entry of the Stipulation and Agreement, Mountain Fuel's counsel, rather than petition the Commission, simply told the Commission that Mountain Fuel was not going to continue with an exploration program on any properties transferred back to Mountain Fuel under the Supreme Court opinion. R. 30, 116, 1053-54. Mountain Fuel took the position that participation by the ratepayers in an exploration and development program with management was "impossible." R. 984.

A Mountain Fuel shareholder testified that Mountain Fuel shareholders were not interested in a regulated exploration and development program. Testimony of Harmon, R. 1211-12.

Put simply, the utility interests made it crystal clear to the Commission that their exploration for hydrocarbons would not be regulated by the Commission under any circumstances.

2. The Shareholder Interests' Litigative Attack On This Court's Decision.

The shareholder interests "mounted an extraordinary attack on the determination of [this] Court" in three separate forums: before the Commission, before the United States District Court for the District of Utah, and before the Federal Energy Regulatory Commission (FERC), in an attempt to continue to litigate the Wexpro case, a case which it had already lost. Petition for the Establishment of a Fund for Attorneys' and Expert Witness Fees for the Division of Public Utilities, R. 2506 at 2507.

(a) The FERC Applications.

Mountain Fuel and Wexpro filed a Joint Application for Abandonment and Accounting Authorization and for Acquisition and Certificate and Sales Authorization by Celsius Energy Company, In the Matter of Mountain Fuel Supply Company, Wexpro Company, Celsius Energy Company, before the FERC. R. 2506.

Mountain Fuel and Mountain Fuel Resources filed a Joint Application for the Issuance of Authorizations, pursuant to Section 7 of the Natural Gas Act, for (1) the Abandonment of Certain Interstate Transmission Facilities, Gas Purchase Agreements, Sales, and Service by Mountain Fuel Supply Company, and (2) the Acquisition, Operation and Continuation of such by Mountain Fuel Resources, Inc., In the

Matter of Mountain Fuel Supply Company, Mountain Fuel Resources, Inc., before the FERC. R. 2506-7.

Mountain Fuel attempted to obtain FERC approval of a transfer of the exploratory leaseholds held in its 105 account--its wildcat acreage--to Celsius, even though this Court had required that any transfer of utility assets should be determined by the Commission after a hearing on whether the transfer is for fair market value and in the public interest. The property sought to be transferred to Celsius was, as a matter of law, utility property under the tests announced by this Court. Mountain Fuel did not inform the Commission or the Division of the FERC applications. Rather, staff of the Division in attendance at a meeting between Mountain Fuel and FERC gained knowledge that agreements were being prepared to transfer utility leaseholds to Celsius. Motion for Temporary Restraining Order and for Preliminary Injunction, R. 2622-26. The Division moved for a temporary restraining order and preliminary injunction in Case No. 76-057-14, to restrain the transfer of 105 account leaseholds to Celsius. Id. The Commission denied the Division's motion in 76-057-14, but established the 81-057-04 docket, and entered the motion for temporary restraining order in the new docket. R. 2794-95. The Division took the position that Mountain Fuel's applications before FERC were

an attempt by Mountain Fuel to avoid continued cost of service pricing for its produced gas [and] an attempt to avoid giving the Company's ratepayers proper credit for their contribution to the Company's producing oil properties, as required by the Utah Supreme Court.

Motion of Utah State Division of Public Utilities and Utah State Committee of Consumer Services to Dismiss Applications, R. 2709 at 2710. As the Division informed FERC, by the applications

Mountain Fuel now invites [FERC] to relitigate these issues, in hopes of setting aside the result of the Utah Supreme Court's opinion and the policy embodied in the Utah Commission's 1974 Report and Order. Id. at 2716.

In short, the FERC application and Mountain Fuel's failure to apply to the Commission for permission to transfer properties to Celsius were attempts to divest the Commission of jurisdiction over the properties and to obtain market prices on the gas developed from those properties.

(b) Mountain Fuel Supply Company, et al. V. Public Service Commission of Utah, et al., Civil No. C-80-0710-J, In The United States District Court For The District Of Utah, Central Division.

In this action, Mountain Fuel and the shareholder interests sought declaratory and injunctive relief under

various provisions of the federal constitution and federal statutes, claiming that regulation of Mountain Fuel's non-utility properties would violate its constitutional rights, all of which issues had been previously litigated and foreclosed.

(c) Mountain Fuel's Opposition to the Fund for Attorneys' and Expert Witness Fees.

The effect of the actions in federal district court, FERC and before the Public Service Commission, and the use by Mountain Fuel and Wexpro of four major law firms and in-house legal counsel, spread the issues in the Wexpro case across multiple forums and stretched the Division representation thin. See, Reply of the Division of Public Utilities and Committee of Consumer Services to Mountain Fuel and Wexpro Objection to Motion for Continuance, R. 2858-60; see also, Motion for Continuance of Hearing and Time for Filing of Prefiled Testimony, R. 2836 at 2837-38.

Mountain Fuels's litigation strategy led the Division to petition the Commission to establish a fund for attorneys' and expert witness fees, as necessary so that the Commission could exercise its power and jurisdiction and to secure compliance with Utah statutes because of the attack on this Court's determination. The Division noted that, even

should the federal court and FERC actions be dismissed summarily, the three-front war launched by Mountain Fuel would involve an enormous amount of expense, and noted the irony that Mountain Fuel was incurring enormous fees and costs and charging them off to ratepayers, while the ratepayer interests were in severe danger of being unrepresented. Petition for the Establishment of a Fund for Attorneys' and Expert Witness Fees for the Division of Public Utilities. R. 2506-09.

Mountain Fuel not only opposed the fund for attorneys' fees, but based on purported Commission contacts with legislators concerning appropriations for the Wexpro litigation, moved to disqualify the Commission from adjudicating the Motion.

G. The Positions Taken By The Shareholder Interests Before The Commission On Remand Contradicted Their Positions Before The United States Supreme Court.

On remand, in a complete turn about from the positions taken before the United States Supreme Court as to the meaning of this Court's decision, the shareholder interests took some extraordinary positions before the Commission. The Utility Shareholders Association of Utah (Shareholders Association), an organization funded by the utilities of this state, R. 4345, noted that this Court's

decision "is viewed by the petitioner as adversely affecting vested interests of shareholders acquired in reliance upon past Commission actions," Application to Intervene, R. 2129 at 2133. It in effect urged the Commission to ignore this Court's opinion. It urged the Commission to "give recognition to the long standing separation of the utility and non-utility functions of the Company upon which the shareholders have relied." Id. at 2132.

The Shareholders Association expressly asked the Commission to ignore the Court's decision that gain follows risk and to reaffirm in effect the findings and conclusions in the April 11, 1978 Report and Order rejected by this Court. The Shareholders Association asked the Commission to recognize

that customers pay for service, not for the property used to render it, so as to avoid an unconstitutional taking of the shareholders' property rights.

Id. at 2135. The Shareholders Association further ignored this Court's express determination that its decision did nothing unconstitutional, by asking the Commission to "recognize its responsibilities to the Company's existing investors not to confiscate properties squarely acquired by non-utility operations by their own funds." Id. (emphasis added).

Mountain Fuel also attempted to litigate the issue whether the Commission's enforcement of this Court's mandate would involve an unconstitutional taking of property from Mountain Fuel and its shareholders, Objection to Order on Prehearing Conference, R. 2194-95, and Wexpro took the same position. Id. at 2196-97. Mountain Fuel, attempting to convince the Commission that a number of "comments" by this Court are dicta, seemingly flip-flopped the hierarchy between this Court and the Commission:

All of the functions of regulating a public utility are vested by statute in this Commission--not the Court. . . .

We are not urging the Commission to undertake to overrule the Utah Supreme Court on any issue, but we do urge the Commission to assert its primary authority to make the judgment decisions and to in effect regulate where the issue has not been foreclosed by the Court.

Memorandum of Mountain Fuel Supply Company in Support of Objection to Prehearing Order, R. 2237 at 2245-46.

Notwithstanding Mountain Fuel's statement to the United States Supreme Court that "nothing remained to be done except the implementation of the judgment by the Utah utilities commission," Mountain Fuel Petition for Certiorari, at 17, n.7, and that "the federal questions have been resolved with finality, the regulation and taking are certain and all that remains is an accounting proceeding," Id. at 17-18, n.7, Mountain Fuel informed the Commission on remand

that there were many issues to be decided. Memorandum of Mountain Fuel, supra.

The Shareholders Association urged the Commission to "exercise the discretion and latitude implicit in the opinion of the Supreme Court." Memorandum in Support of Motion for Reconsideration of Order on Prehearing Conference, R. 2330 at 2338, and itself went on to reargue all of the issues already foreclosed by this Court's decision. The Shareholders Association went so far as to tell the Commission:

While it is important to consider the advice and philosophies set forth in the Supreme Court's opinion on whether any transferred assets should be transferred at fair market value, the Commission must recognize that it is only after a full hearing as mandated by the Supreme Court that any such determination of what is in the public interest can in fact be made. Id. at 2337-38.

In short, the Commission was urged by the shareholder interests to ignore this Court's opinion, and to "sustain [the Commission's rulings] that the beneficial interest in those assets that have traditionally been classified as non-utility assets must continue to be unregulated property." Id. at 2343.

H. The Agreement And Stipulation Violate This Court's Decision And Mandate.

1. The Agreement

(a) The Property Transferred to Wexpro and Celsius.

The Agreement, R. 3575, effectuates the retention by Wexpro of Mountain Fuel's oil and gas properties transferred to Wexpro under the Amended P&S Agreement. The Agreement expressly supersedes and terminates the P&S Agreement and recognizes that the properties subject to the Agreement which were transferred from Mountain Fuel to Wexpro under the P&S Agreement "have been held, operated and owned by Wexpro since the effective date of [The P&S] Agreement," and will be and remain the sole and exclusive property of Wexpro. Agreement, ¶¶ VII-2, VII-3. Mountain Fuel's and the Commission's total disregard of this Court's reversal of the April 11, 1978 order approving the P&S Agreement is thus perpetuated.

The Agreement also provides for the transfer to Celsius of all Mountain Fuel's wildcat acreage held in utility account 105, formerly the subject of the JEA.

The Agreement thus went beyond transferring the properties the shareholders obtained under the Amended P&S Agreement and Amended JEA rejected by this Court. For not only does this Agreement perpetuate the infirmities of the P&S Agreement, but it goes on to transfer with few exceptions virtually all of the utility's oil and gas properties to wholly-owned subsidiaries, Wexpro and Celsius.

First, properties already deemed by the Agreement to be in Wexpro's possession pursuant to the P&S Agreement are under the Agreement to remain Wexpro's sole and exclusive property and all oil, natural gas liquids and natural gas produced from such properties are the property of and to be sold or otherwise disposed of by Wexpro. Agreement

¶¶ II-1 to II-3.²

Second, Mountain Fuel transfers to Wexpro all 101 and 105 account leaseholds and operating rights held by Mountain Fuel and accounted for in its utility gas plant (101) account as of July 31, 1981, subject to a retention by Mountain Fuel of the ownership of oil, natural gas liquids and other minerals produced from "productive gas reservoirs" underlying those leaseholds. Agreement ¶ III. Productive gas reservoirs are reservoirs classified as such under Mountain Fuel's rejected system of classification. These account 101 properties transferred to Wexpro are defined by the Agreement itself as "gas plant owned and used by a utility entity in its natural gas operations." Agreement, ¶ I-30. Thus, except for hydrocarbons from productive gas reservoirs, Mountain Fuel gives up its ownership of all hydrocarbons,

²Wexpro's properties in ¶ II of the Agreement are referred to as "productive oil reservoirs" and "prior Wexpro wells." These designations are based on Mountain Fuel's classification system previously rejected by this Court.

including gas, from gas plant used in Mountain Fuel's natural gas operations. While "prior company wells" and hydrocarbons produced from "productive gas reservoirs" remain the property of Mountain Fuel, everything else goes to Wexpro; and to add insult to injury, 46% of the net profits from any oil from commercial wells completed after July 31, 1981 in productive gas reservoirs is to be shared by Wexpro, according to a formula to be described below. Agreement §§ III-3, III-9.

Third, Mountain Fuel transfers to Celsius all its valuable wildcat acreage. Agreement, § IV. Even under the Amended JEA, found infirm by this Court, Mountain Fuel continued to hold the wildcat acreage as gas plant used and useful in its utility 105 account. The Agreement, however, transfers all this wildcat acreage to Celsius. This valuable wildcat acreage is now transferred from utility accounts to an independent hydrocarbon exploration subsidiary free of Commission regulation.

All of the properties transferred above would by the very definitions in the Agreement be utility properties under the three tests enunciated by this Court. Yet no hearing was held to classify them and no attempt was made, despite a motion by the Coalition of Senior Citizens, to determine their fair market value.

Fourth, the Agreement transfers to Wexpro or Celsius certain properties acquired by Wexpro after the P&S Agreement was executed from sources the Agreement states are independent from Mountain Fuel. Agreement ¶ V. In the initial stage of the post-remand proceedings, a dispute arose as to whether these "after-acquired properties" would be classified as utility or non-utility, with the Division taking the position that they were utility assets. Utah Department of Business Regulation, Division of Public Utilities' Hearing Brief on Remand, R. 2482 at 2487-88. Yet, the Agreement transfers those properties to Wexpro without any decision on classification.

Fifth, the Agreement transfers "non-utility" properties said by the Agreement never to have been in utility accounts.

(b) Allocation Of Benefits From The Transferred Properties.

The allocation of benefits from the transferred properties depends on the type of property transferred. For example, the Agreement treats differently the consideration given to the utility for productive oil reservoirs and oil wells (P&S acreage) than it does the consideration given the utility for the wildcat acreage. Again, these different types of properties are defined by the same classification system which this Court rejected as a

principle of jurisdiction or allocation. 595 P.2d at 877-79.³

(1) "Productive Oil Reservoirs" And
"Prior Wexpro Wells"

With respect to what the Agreement calls "productive oil reservoirs" and "prior Wexpro wells," all oil, natural gas liquids and natural gas produced therefrom are to be the property of Wexpro. Agreement ¶ II-3. The proceeds from the sale of oil and natural gas liquids are subject to a "54-46" formula. Agreement, ¶ II-4.

This "54-46" formula subjects the proceeds to the following provisions: First, the proceeds are used to pay Wexpro's costs and expenses of holding and operating prior Wexpro wells and productive oil reservoirs. Agreement ¶ II-4. Second, after deduction of expenses and royalties, Wexpro is then allowed to receive from the proceeds a return sufficient to provide a return on Wexpro's investment allocated to oil and natural gas liquids production. Agreement ¶ II-4(e). The "base rate of return" is, for the first year of operation 16%, subject to certain adjustments. Agreement ¶ I-44.

³ Whether a reservoir is "oil" or "gas" is determined in the Agreement by whether a well drilled in a reservoir was held at the time of the Agreement by Mountain Fuel or Wexpro, which is in turn determined by whether or not the P&S Agreement had transferred that well based on Mountain Fuel's classification system.

For example, if development oil drilling is done into a productive oil reservoir, the investment of Wexpro includes the investment in any commercial well and the base rate of return is set at $R+5\%$, i.e., at least 21%. Agreement ¶ II-8(b).

Out of any remaining Wexpro oil and natural gas liquids, Mountain Fuel receives 54% of the net revenues to be placed in an account used to reduce natural gas rates, and Wexpro receives 46%. Agreement ¶ II-4.

Natural gas produced by Wexpro from oil wells or productive oil reservoirs is to be sold to the utility at cost of service. That cost of service price includes the base rate of return plus certain adjustments, Agreement ¶ I-44 and Exhibit "A", and the rate of return will be unregulated by the Commission.

(2) "Productive Gas Reservoirs" and
"Prior Company Wells"

While Mountain Fuel retains the ownership of oil, natural gas liquids, natural gas and other minerals produced from productive gas reservoirs underlying any leaseholds in the 101 account, Agreement III-2(a), Wexpro under the Agreement owns all the operating rights and will be the operator of all facilities related to such leaseholds. Agreement ¶ III-2(b). Proceeds from the sale of oil and natural gas from Mountain Fuel's gas wells and productive gas

reservoirs, as defined by Mountain Fuel, are accounted for as utility revenues, Agreement ¶ III-3, with one critical exception--i.e., any oil from commercial wells drilled after July 31, 1981 in productive gas reservoirs will be sold by Wexpro and Wexpro will receive revenues under the "54-46" formula. Agreement ¶¶ III-3, III-9. Moreover, in calculating Wexpro's proceeds on this "new oil" under the "54-46" formula, the rate of return applied to Wexpro's investment in development gas wells from which such oil is produced entitles Wexpro to a "5% risk premium," Agreement ¶ III-9(c), or a rate of return of 21% in the first year, in addition to its 46% of net revenues from "new oil".

Wexpro, as operator, will bill Mountain Fuel an "operator service fee" in producing Mountain Fuel's hydrocarbons from gas wells and productive gas reservoirs. Agreement ¶ III-5. The Agreement does not provide that the utility may bargain with third parties to obtain an operator, but locks the utility into using Wexpro as the operator. Billing will be on a cost-of-service basis, including a return on investment for post-July 1981 facilities at the base rate of return with an additional 8% rate of return (24% in the first year) on investment in commercial development wells. Agreement ¶ III-5(c). The rate of return to be included in the service operator fee is set by the Agreement,

Agreement ¶ III-5(c) and Exhibit "E", and will be unregulated by the Commission.

Wexpro is required by the Agreement to spend or invest at least \$40 million for development drilling in productive gas reservoirs. Agreement ¶ III-8(c). If development gas wells become commercial, they will be capitalized as Wexpro investment. Wexpro is expected under the Agreement to exercise prudent judgment "as if it were owner of the productive gas reservoirs in determining the desirability and necessity of development gas drilling. . . ." Agreement ¶ III-8(a). While Wexpro is committed to invest at least \$40 million in development gas drilling, it receives two major benefits for this investment: first, it obtains its service operator fee with its rate of return on investment in commercial development wells in productive gas reservoirs; second, it receives 46% of the net profits from "new oil" from productive gas reservoirs after deducting its costs and expenses on drilling wells, and a healthy rate of return on investment.

(3) Exploratory Properties

All the leaseholds and operating rights with respect to the 1.4 million acres of wildcat acreage are transferred to Celsius⁴ under the Agreement. All such acreage

⁴The Stipulation provides that Celsius rather than

and unexplored formations underlying 101 account leaseholds transferred by the Agreement are to be explored by Celsius. Mountain Fuel retains a 7% overriding royalty interest on all natural gas, oil and natural gas liquids produced from these "exploratory properties."⁵ The 7% overriding royalty continues until expiration or surrender of the leases to which the overriding royalty is applicable. Agreement ¶ IV. The Agreement leaves open the possibility that Celsius could trade leases so as to avoid the overriding royalty and there is no safeguard established to prevent reciprocal dealing which could avoid the 7% royalty.

Mountain Fuel has a 30-day call on any gas produced from these exploratory properties, but at market prices rather than cost-of-service prices.

The wildcat acreage is the same class of acreage to which the Amended JEA applied. Under the Amended JEA, Mountain Fuel would have obtained the gas produced from the properties transferred to Wexpro and all gas discovered under

(⁴ cont'd)

Wexpro may receive properties under the Agreement, Stipulation § 17.4. In fact, the wildcat acreage was all transferred to Celsius. Testimony of Crawford, R. 1516.

⁵Exploratory properties are defined as "Formations underlying Account 101/105 leaseholds or transferred leaseholds into which exploratory drilling is conducted. . . ." Agreement, ¶ I-29.

the JEA at cost of service. MFS-4, 5; Tr. 68-69. Yet under the Agreement Mountain Fuel's 30-day call on gas from exploratory property is at market price. Moreover, any agency which disallows any portion of the market price in rates does so at the risk of the utility's gas supply--the Agreement provides that if any regulatory agency with ratemaking jurisdiction over Mountain Fuel disallows in rates any portion of the market price paid to Wexpro, the price will be reduced to equal the amount that Mountain Fuel is allowed to recover, but Wexpro may then elect to be released of its obligation to sell further gas subject to that price reduction. Agreement ¶ IV-6(c).

(4) "After-Acquired" Properties

With respect to the after-acquired properties, Wexpro grants Mountain Fuel a 2.5% overriding royalty interest on all production. Agreement ¶ V-3. It also grants Mountain Fuel a 30-day call at market prices on the same terms as the call on gas from exploratory properties.

(5) \$250,000 Per Year Credit

Wexpro agrees to pay Mountain Fuel \$250,000 per year for twelve consecutive years to be credited to its utility account. Agreement ¶ VIII-16.

(6) \$21,000,000 Reduction In Rates.

The Stipulation provides a temporary reduction in the company's cost of service reflected in a reduction of

retail distribution rates in the pre-tax sum of \$21 million, 90% of which reduction applies to Utah customers.

Stipulation ¶ 3.3.10.

2. The Stipulation

(a) The Stipulation Divests The Commission Of Its Jurisdiction And Divests The Division Of Its Statutory Powers.

The Stipulation, R. 3544, was executed by the Division, the Committee, Mountain Fuel and Wexpro to resolve all issues in all the above-captioned cases except the rate design issue in Case No. 81-057-01. Mountain Fuel and Wexpro also entered into a similar stipulation with the staff of the Wyoming Public Service Commission. The Stipulation in part calls for the parties to enter into the Agreement and be bound by it. Stipulation ¶ 5.

The parties stipulate at paragraph 2.4 that Wexpro and Celsius will be independent hydrocarbon exploration and development companies not subject to state public utility regulation and which legally own and operate Mountain Fuel's oil and gas properties. Thus, the Stipulation, in direct contravention of this Court's opinion, divests the Commission of jurisdiction over Wexpro and Celsius.

The parties stipulate at paragraph 5.2 that the Division and Committee will not challenge any action taken by

Mountain Fuel, Wexpro or Celsius other than through arbitration procedures set forth in the Stipulation.

The Stipulation provides that in the event any party claims default under the Stipulation or the Agreement, arbitration will be the sole remedy. Stipulation ¶ 9. The decision of the arbitrators will be binding upon the parties except with respect to matters covered by Utah Code Ann. §§ 78-31-16 and 78-31-17, and other claims of improprieties or irregularities in the arbitration proceedings. Any form of rescission is specifically excluded as a remedy in arbitration. The Division and Committee agree to make no claim that Mountain Fuel or its customers have any right in any property owned by Wexpro or Celsius except as provided in the Stipulation and Agreement. Stipulation ¶ 11.1

The Division and Committee further agree not to claim that any of Wexpro's or Celsius' properties are subject to the public utility regulation of any state and agree to cooperate to obtain legal rulings or statutes so providing. Stipulation ¶ 11.2

The Stipulation provides that no party will assert any claim to any reimbursement for any cost previously paid by it to them. No party will claim any entitlement to any revenues previously received by others as a result of any aspect of the exploration and development program, the ownership or classification of the properties, or rates

previously in effect, except as expressly provided in the Stipulation and Agreement. Stipulation ¶ 13.

The Stipulation provides that no benefit or burden created in the company, and ultimately its retail distribution customers, by the Stipulation or the Agreement" will be used in any way as a basis for future rate relief to the company except under exigent circumstances as otherwise directed by the agency having jurisdiction." Stipulation ¶ 7.6.

The Stipulation strips the Commission of jurisdiction over the natural gas sold by Celsius to Mountain Fuel at market prices and nonjurisdictionalizes the 101 and 105 leaseholds. It strips the Commission of jurisdiction to regulate the rate of return on capital in the cost of service for gas from productive oil reservoirs, and in the operator service fee on gas from productive gas wells. The arbitration provision strips the Commission of its statutory jurisdiction and powers.

The Division divests itself of its statutory powers in agreeing not to challenge actions of Mountain Fuel, Wexpro or Celsius other than through arbitration, in agreeing to make no claim to any right in property transferred to Wexpro or Celsius, and in agreeing not to file with any regulatory body for modification of the Agreement.

(b) The Stipulation Flies In The Face Of The
Division's Successful Position Before The United States
Supreme Court.

The Stipulation states:

By reason of the Company's decision not to conduct exploration activities as a utility, in order to exploit the Properties adequately, Wexpro must own the fee title or be the lessee of record and must be the operator of all the Properties. Stipulation ¶ 1.22.

The Division also stipulates that all issues are resolved in Case No. 76-057-14 "in a manner consistent with the public interest and in accordance with the holding of the Utah Supreme Court in Committee of Consumer Services."

Stipulation ¶ 13.1. The Stipulation also provides that this Court's decision was limited to jurisdictional grounds. Stipulation ¶ 13.

The Division and Committee in the Stipulation contradict the position they took before the United States Supreme Court, a position which was successful. That position was that this Court's decision with regard to the oil and gas properties held in Mountain Fuel's "non-utility" accounts was (1) such properties were utility properties and (2) such properties should be included in Mountain Fuel's utility accounts for ratemaking purposes. Brief of the Division and Committee in Opposition to Mountain Fuel's

Petition for Certiorari (Brief in Opposition), attached hereto as Appendix "B", at 14. The Division and Committee also stated to the United States Supreme Court:

The bottom line of the Utah Supreme Court's decision was that the net profits from Mountain Fuel's oil properties beyond all costs associated with their production, including the cost of capital, should be applied to the benefit of Utah ratepayers through a reduction in their future rates. . . .

The Supreme Court of Utah, in light of these past practices, adopted a "no-profits-to-affiliates" rule which prohibited such intra-company profits from being included in consumer rates, and applied that rule to the Mountain Fuel-Wexpro option so as to prevent any profit realized by Wexpro under that option from being passed on to Mountain Fuel's ratepayers. The Utah Supreme Court also held that Wexpro, by reason of its relationship as a wholly-owned subsidiary of Mountain Fuel and the unique relationship between Mountain Fuel and Wexpro created under the Purchase and Sale Agreement and the Joint Exploration Agreement, was, under Utah law, a public utility. Brief in Opposition at 14-16.

I. The Settling Parties Admitted The Stipulation

And Agreement Are Not Consistent With This Court's Decision.

Counsel for Mountain Fuel stated:

[I]t also frees this [exploration and development] program that in the past has been highly successful. It's a program that I don't believe and the consultants that have advised me don't believe and the company doesn't believe that could be conducted under the ground rules which the Supreme Court said must apply for the future. R. 980.

* * *

Participation by the customer under the ground rules of the Supreme Court opinion is in my

opinion and in the opinion of management impossible. R. 984.

* * *

There is an enormous capital requirement [for drilling] that we foresaw then and foresee now being difficult to meet. We think we can do it under the settlement agreement . . . and we think we would have had some difficulty doing so under the ground rules set forth by the Utah Supreme Court. R. 1032.

* * *

The [Utah Supreme Court] decision from the standpoint of management was a disaster. If all of the fruits of the program had to be rolled in, . . . the disaster was of such dimensions to the shareholders of the company that it felt it had to go forward with massive litigation, and it did so. R. 2002-03.

J. The Division Settled The Cases Because Of The Expense And Time The Litigation Would Take And The "Threat" FERC Would Deprive Ratepayers Of Cost-Of-Service Gas.

The Division expressed as the primary motivation for settlement, not the settlement's compliance with this Court's mandate or the public interest, but the expense and time the litigation would take. R. 974, 967. To the Division, the expense of the litigation was the "most significant element" that motivated a negotiated settlement. R. 1025-27. See also, R. 1028-29. Moreover, the Division was extremely concerned with the "threat" posed by the FERC applications which could cause the ratepayers to lose all

cost-of-service gas R. 2055.⁶

K. The Commission, Rather Than Carry Out The Court's Mandate, Found Itself "In A Box" And Approved The Settlement.

The Report and Order approving the Stipulation and Agreement is replete with express statements that the Commission was concerned with the utility's refusal to explore, its threat to have all gas priced at market through its FERC applications, and the expense and time of the litigation.

The Commission noted several critical regards in which it found Mountain Fuel's conduct lacking. The Commission noted that "the decision by [Mountain Fuel] to abandon exploration as a utility undertaking has been implemented unilaterally and without Commission sanction." Report and Order at 9.

The Commission expressly noted that the decision to create Celsius was not brought before it, and that any such proposal whereby Mountain Fuel would be allowed to earn an

⁶The Division's position that its concerns with the loss of cost-of-service gas is the basis for the settlement is puzzling in light of the Division's concession that in the Agreement gas from all the wildcat acreage transferred to Celsius will be purchased at market prices.

unregulated rate of return on its "non-utility" investments should be presented in advance. Report and Order at 9.

With respect to Mountain Fuel's FERC applications, the Commission stated:

[The] Commission is extremely concerned that the Utah customers of MFS are not well-served by the Federal Energy Regulatory Commission's (FERC) taking jurisdiction over any of MFS's operations and by MFS's attempt to supplant State regulation with Federal regulation and pricing policies which could make natural gas significantly more costly to Utah customers. The thrust of the FERC applications has been to avoid Utah policies favoring cost-of-service gas pricing (rather than sharply rising "market" pricing favored by the Federal Congress as an incentive for producers to search for new gas supplies) on old as well as new gas. The applications have evoked a classic, and ironic, confrontation between company interests seeking higher profits through an expansion of federal regulation, and regulators seeking to preserve State prerogatives to regulate utility affairs in the interest of keeping costs to customers as low as practicable while allowing a reasonable rate of return to investors. While the Commission will not condition this order on the withdrawal of MFS and its subsidiaries of pending FERC applications, the Commission feels a more appropriate procedure and a showing of good faith by MFS and its subsidiaries would be to voluntarily continue said applications until the Commission has been fully apprised of the effect of such applications. Id. at 9 (emphasis added).

In addition, the Commission expressly noted that "the testimony of management and members of the board of

directors is that MFS investors will not support a regulated exploration program on these properties." Id. at 13.

Yet, despite its express reservations, the Commission approved the Report and Order. In doing so, the Commission stated:

Litigation has already cost the parties substantial amounts in direct costs and has involved proceedings in multiple agencies and courts. If the litigation, which to date has cost a total of approximately \$4,000,000, is not resolved by settlement, it is possible that it will proceed for several years in several forums with costs to the parties of additional millions of dollars. Id. at 13.

One of the Commissioners noted during argument that estimates of litigation costs in the future were in the neighborhood of \$7 million. R. 1423.

That the Commission was concerned with expense and threats rather than with a thorough examination of the issues is in part attested to by Finding 6 wherein the Commission stated that:

The Commission is not entirely persuaded that under attractive circumstances investors will not support a regulated exploration and development program, or that such a program will cause problems with partners in the field or with the ability of MFS to keep employees. However, the Commission finds that it is unnecessary to make a final determination on this matter for the purpose of this proceeding. Id. at 18.

The Commission had great concern about and expressed great frustration with Mountain Fuel's adamant

refusal to agree to conduct any future utility exploration and development, as evidenced by the following comments made during closing argument on the Stipulation and Agreement:

COM. CAMERON: So if we start over and we divide it up 80/20, or whatever figure you want to say, and the ratepayer puts up its fair share under an order up to a certain amount of money, the company goes out and apportions whatever it does, I don't understand for the life of me why the company is going to do a worse job than they would if all the money came from stockholders, number one. Number two, I can't understand if this Commission is willing after hearing about it to go ahead and authorize such a program why it would be in the company's interest not to pursue that. R. 2010-11.

After an interplay with counsel, Commissioner Cameron went on to indicate the impact that the fait accompli and threats by the shareholder interests had:

COM. CAMERON: I frankly am not worried too much about these properties or the stipulation insofar as it treats these properties. I think that's been covered. I think I can make a decision based on that. I'm worried about and have concern about an attitude by the management of Mountain Fuel . . . but I am very concerned about that management absolutely throwing down the gauntlet to this Commission saying we are not doing that, we won't, this is the only way we'll look at this, you know, and it seems to be nonsense. They're going to have to go out and raise the money somewhere in the future and it just seems nonsense. R. 2011-12 (emphasis added).

Commissioner Cameron later in the same hearing stated:

COM. CAMERON: That's my basic question, is that what we're addressing, just these properties? You know, I seem to think

and it seems to me every statement that's been made here is the Commission accept this, you've made your bed and it isn't going to get changed, and I agree you don't expect--you know, the law is the law and jurisdiction is jurisdiction and all that gobbledygook, but we're trying to be, or, we're being put into a box which we can't get out of either. R. 2018 (emphasis added).

ARGUMENT

I. THE COMMISSION ERRED IN DIVESTING ITSELF OF JURISDICTION OVER PUBLIC UTILITIES AND PUBLIC UTILITY PROPERTIES.

Fundamentally, the Stipulation and Agreement divests the Commission of jurisdiction. It sanctions the deregulation of at least three classes of assets which are as a matter of law utility properties: (1) the properties transferred by the P&S Agreement to Wexpro, virtually all of which originally were in the utility capital account; (2) leaseholds in the utility 101 account containing productive gas reservoirs; and (3) the assets transferred to Celsius from the utility 105 account. Notwithstanding this Court's holding that these types of properties are utility properties, all of these properties are, under the Report and Order, immune from regulation. Moreover, the Stipulation seeks to assure this divestiture of jurisdiction over the properties by stating that:

None of the parties will claim that the Properties owned by Wexpro are subject to the public utility regulation of any state, and all parties will cooperate to obtain legal rulings and, if necessary, statutes so

providing. It is acknowledged that the Company's rights with respect to the Properties or benefits from them may be subject to appropriate regulation for ratemaking purposes. However, that fact will in no way be claimed by any party as a basis for state public utility regulation of Wexpro in any of its activities with respect to the Properties. If Wexpro's activities with respect to the Properties are claimed by the parties to be or are successfully subjected to state public utility regulation, Wexpro will be released from its obligations under the Agreement with respect to the Properties which subject it to regulation. Stipulation, ¶ 11.2

Not only does the Report and Order divest the Commission of jurisdiction over utility properties, but it approves the Stipulation that Wexpro and Celsius will be outside the Commission's jurisdiction and not subject to public utility regulation. This is absolutely at variance with the statutes of this state and with this Court's decision that by the activities performed by Wexpro it becomes a public utility subject to the jurisdiction and regulation of the Commission. 595 P.2d at 878. Wexpro has never ceased owning and operating the gas plant it obtained by the unlawful P&S Agreement. The activities which this Court found made Wexpro a public utility do not change under the Agreement. Yet by approval of the Stipulation, the Commission has in effect reversed this Court's determination that Wexpro, as a matter of law, is a public utility. Celsius, by engaging in the same types of activities which

caused this Court to proclaim Wexpro a public utility, is likewise as a matter of law a public utility under the terms of the Agreement. Yet the Commission acquiesces in the plainly unlawful terms of the Stipulation and disclaims jurisdiction over Celsius.

The Stipulation and Agreement go so far as to strip the Commission of jurisdiction over sales of natural gas by Celsius to Mountain Fuel. Plainly, the Commission has power to regulate all of the business of every public utility. This Court declared in the Wexpro case that oil and gas exploration is a utility business. It also prohibited sales of gas between affiliates at market prices because such sales were violative of the no-profits-to-affiliates rule. Moreover, the Commission has jurisdiction over any contract with respect to any expenditure diverting directly or indirectly the funds of any utility to any of its shareholders or to any corporation in which they are interested, § 54-5-26, Utah Code Ann. Yet under the Stipulation approved by the Commission, the Commission will be unable to regulate purchases of gas by Mountain Fuel from Celsius or the price at which such gas is purchased--a price which could be of severe detriment to ratepayers whether or not the full price paid is allowed to be passed on in rates.

The Stipulation in effect divests the Commission of the power to determine "the serious issue of whether it is in

the public interest for Mountain Fuel to divide its utility function between itself and a subsidiary." 595 P.2d at 878, n.8. Since the Stipulation will prevent any party from ever challenging Wexpro's and Celsius' independence from regulation, the Commission will be permanently barred from determining that question, a question which, in light of Mountain Fuel's decision to continue Wexpro's ownership of the properties, should have been determined on remand.

The Commission divested itself of its ratemaking jurisdiction by allowing the parties to fix in the Agreement the rate of return in the operator service fee and cost of service paid Wexpro for its operations on 101 properties.

Finally, the Stipulation does away with virtually all of the hearing provisions under the Commission's grant of statutory authority by providing that parties claiming default under the Stipulation are limited solely to the remedy of arbitration.

The statutes of this state, and not the Stipulation and Agreement, must define the jurisdiction of the Commission. See, §§ 54-1-2; 54-2-1(30); 54-4-1 to 54-4-7; 54-4-26, U.C.A. 1953. Notwithstanding the several disclaimers in the Commission's Report and Order that the Commission is not giving up any jurisdiction, there is no way to square the Commission's wholesale divestiture of jurisdiction with those disclaimers.

II. THE DIVISION OF PUBLIC UTILITIES DIVESTS
ITSELF OF THE STATUTORY POWERS TO ACT AS A
PARTY IN LITIGATION BEFORE THE PUBLIC SER-
VICE COMMISSION.

During the pre-Supreme Court decision stage of Case No. 76-057-14, this Court decided that the Division was empowered to act as a party and represent the public interest before the Commission. The Report and Order divests the Division of this power in several important respects.

The Division gives up its power to act before the Commission, to litigate before the Commission, and agrees not to challenge any action taken by Mountain Fuel, Wexpro or Celsius in accordance with the terms of the Agreement, other than through arbitration. Stipulation ¶ 5.2. The arbitration provision further hogties the Division in monitoring performance under the Agreement by prohibiting the Division from using professionals retained by the Division or Committee within twelve months preceding the Agreement. This eliminates any expertise the Division's experts have obtained over the last twelve months in these complex matters.

The Division agrees not to make any claims that the utility or its customers have any right or interest in any property owned by Wexpro or hereafter acquired by Wexpro except as provided in the Stipulation and Agreement. The Division agrees not to claim that the properties owned by Wexpro are subject to state public utility regulation.

Stipulation ¶ 11.2. The Division gives up its right to claim certain Wexpro properties are subject to any company interest. Stipulation, ¶ 12. The Division agrees not to file with any regulatory body for the modification or abrogation of any terms of the Stipulation and Agreement except in exigent circumstances. Stipulation, ¶ 15.4.

The legislature of this state is the only entity with authority to limit the Department of Business Regulation's and the Division's powers. Neither the Commission, Mountain Fuel, Wexpro, Celsius, nor the Division itself has any statutory authority to modify the Division's powers. Yet the Division did so in the Stipulation and Agreement.

III. THE APPROVAL OF THE STIPULATION AND AGREEMENT WAS IN WHOLESALE VIOLATION OF THIS COURT'S MANDATE IN CASE NO. 76-057-14.

The Order in Case No. 76-057-14 was reversed and the matter was "remanded for a hearing in accordance with the principles set forth in [this Court's] opinion." 595 P.2d at 873. See, Part E. at pp. 29-34, supra. This Court expressly ordered that the Commission must reassess the transfer and determine whether the properties were utility assets in accordance with the tests set forth by this Court. Any transfer was to be for fair market value, not detrimental to ratepayers, and in the public interest. Proceeds from oil operations on utility properties were to offset rates. If Wexpro were to continue its operations, it was to be subject

to regulation and the Commission was to decide if Mountain Fuel could divide its utility operations with a subsidiary.

Nothing was done in accordance with the mandate. There was never a hearing on classification. There was never a hearing on valuation of the assets or on whether the transfers were in the public interest. There was never a valuation of any of the assets. There was merely a wholesale release of utility assets from Commission jurisdiction, and the only hearing was on the Stipulation and Agreement.

The Commission ignored and violated this Court's express mandate that the ratepayers were entitled to have rates reduced by all the oil profits from properties explored and developed at the ratepayers' risk. 595 P.2d at 876. Instead, the Commission approved a stipulation that the Division and the Committee would not assert any claim to any part of the revenues previously received or retained as a result of the exploration and development program or the ownership or classification of properties, except as provided in the Stipulation and Agreement. Stipulation, ¶ 13. There was never any hearing for the purpose of reducing rates to the extent of the oil profits from utility properties.

In perhaps the most glaring and critical violation of the mandate, the Report and Order allows Mountain Fuel's shareholders to operate two unregulated oil companies as wholly-owned subsidiaries. Footnote 8 of this Court's

decision forecloses such acquiescence by the Commission in the shareholders' successful attempt to avoid regulation of utility functions. The failure to determine pursuant to this Court's order the "serious issue" of whether Mountain Fuel could, consistent with the public interest, divide its utility oil and gas exploration and development function between itself and a subsidiary, is unthinkable.

By their statements to the United States Supreme Court, the stipulating parties are estopped to argue that the Report and Order follow the mandate.

A lower tribunal or administrative agency is bound to follow an order or mandate of this Court, Powerine Co. v. Zion's Sav. Bank & Trust Co., 148 P.2d 807 (Utah 1944); see, Ithaca College v. National Labor Relations Board, 623 F.2d 224 (2d Cir. 1980); City of Cleveland, Ohio v. Federal Power Commission, 561 F.2d 344 (D.C. Cir. 1977); Vetter v. Wagner, 576 P.2d 979 (Ak. 1978); Tovrea v. Superior Court, 419 P.2d 79 (Ariz. 1966); and has no power or authority to deviate from the mandate issued by this Court. Briggs v. Pennsylvania R. Co., 334 U.S. 304 (1948). Once a higher court issues its decree or mandate, an administrative agency has no authority, by stipulation or otherwise, to circumscribe the power of that court to see that its mandate is carried out. No entity other than an appellate court which issues the mandate has authority to alter or modify its man-

date. United States v. E.I. duPont deNemours and Co., 366 U.S. 316 (1961); Cascade Natural Gas Corp. v. El Paso Natural Gas Co., 386 U.S. 129 (1967). An administrative agency may not knuckle under to utility interests and settle litigation in a manner inconsistent with an appellate court's mandate. Id. at 141.

In Cascade Natural Gas, supra, the Supreme Court of the United States set aside a consent decree which did not comport with a Supreme Court mandate. After the district court issued a new decree on remand, the Supreme Court in Utah Public Service Commission v. El Paso Natural Gas Co., 395 U.S. 464 (1969) vacated the lower court's decree a second time as not in compliance with the mandate. In Utah Public Service Commission, the Court held that a decree of a lower court must conform with the purpose of the mandate as well as its letter. Id. at 469. The lower court may not simply do "the best that might be" done without quite complying with the mandate. Id. at 471.

And perhaps most pertinent to the issue before this Court where the public interest is at stake, "the pinch on private interests is not relevant" to fashioning a decree. Id. at 472.

The Commission did not comply with the mandate of this Court. Nor did the Commission comply with this Court's purpose in issuing the mandate. This Court's purpose was to

put a stop to a fundamental abdication by the Commission of its statutory responsibility to protect the public interest, 595 P.2d at 873, and prevent a "regulatory outrage" which allowed the transfer to an unregulated company of well over \$150 million worth of assets discovered and developed with funds provided by Utah ratepayers. Id. This Court's purpose was to ensure that ratepayers obtain their rightful benefits from the huge oil profits Mountain Fuel was expropriating for its shareholders. This Court's purpose was to prevent the use of intracompany transactions to create an inflated price to be charged consumers. Id. at 874-75.

The Stipulation and Agreement disserve those purposes. Assets discovered and developed with ratepayer funds are transferred to unregulated companies. The shareholders have received Commission sanction for their unregulated return from oil properties. Ratepayers will pay market prices to Celsius for gas from utility acreage. Except for a one-time, temporary reduction in cost-of-service gas, the ratepayers will not share in the benefits by having the net proceeds from all oil reduce the cost of gas. The purpose of the mandate, as well as the letter, is dashed by the Report and Order.

IV. THE REPORT AND ORDER APPROVING THE
STIPULATION AND AGREEMENT VIOLATES THE
LAW OF UTAH AS EXPRESSED BY THIS COURT.

This Court in the Wexpro case put flesh on the public interest standard administered by the Commission. In several important respects, even aside from the violation of the mandate, that standard is violated by the Report and Order. The sale of gas obtained from utility properties from Celsius to Mountain Fuel at market prices, and Wexpro's entitlement to 46% of net profits on "new oil" from gas reservoirs, violate the no-profits-to-affiliates rule.

The Report and Order, as a matter of law, violates the trust relationship whereby Mountain Fuel has a duty to provide the most favorable rates reasonably possible. 595 P.2d at 874. There was substantial testimony that the market price of gas over the coming years will increase sharply. See, e.g., R. 1145-46. The record is uncontroverted that, when the 101 account gas fields are depleted, cost-of-service gas will no longer exist. See, e.g., R. 1060. The Stipulation and Agreement means there will be no more exploration and development of hydrocarbons by the utility. These uncontroverted facts combine to mean--not cheap gas--but very expensive gas in the future for Mountain Fuel's ratepayers.

The parties paid lip-service throughout the hearing to the ratepayers' concern for maintaining cost-of-service gas supplies. For example, Mountain Fuel's counsel stated:

I think [the settlement agreement] will give the customer the thing the customer ought to be interested in and is, and that's the maximum amount of gas at cost-of-service prices and the best reserves that these properties are able to provide. R. 982-83.

Counsel for the Division and Committee echoed that "We wanted above all to preserve cost-of-service gas to the ratepayers of the State of Utah." R. 1038. See also, R. 1901, 1965, 2009, 2054-55 and 2080-83.

Despite this lip-service to cost-of-service gas, the fact is that when the supplies of cost-of-service gas available from the 101 account properties are exhausted, Mountain Fuel will have no more cost-of-service gas. The uncontroverted evidence from the stipulating parties' own witness establishes that the market price of gas will increase dramatically during the 1980's. R. 1145-46. The adverse impact on ratepayers may well be devastating.

For example, Mountain Fuel is producing currently about 50 million Mcf of gas a year at an average cost of service of about \$1.00 an Mcf. R. 1105. In a very few years, the same gas, if unregulated, might have a market price of \$5.00 an Mcf. R. 1105. Depleting and not replacing

this amount of cost-of-service gas will ultimately cost ratepayers a minimum of several hundred million dollars a year in increased gas costs. Testimony of Roseman, R. 1105. If the 105 account properties will ultimately produce gas in amounts equal to that now being produced by Mountain Fuel (i.e., 50 million Mcf a year) and Mountain Fuel buys that gas, that gas will be charged to consumers at the then prevailing market price (e.g., \$5.00 an Mcf) rather than at the then prevailing cost-of-service (e.g., \$2.00 an Mcf). This means an additional charge of \$150 million dollars a year to the ratepayers. Testimony of Roseman at R. 1145.

A California gas utility estimated the difference to ratepayers between cost-of-service-gas and market-price gas over the life of the production of reserves from similar properties in the Rocky Mountain region; the utility estimated that providing the gas at cost of service would result in a "net savings of \$543,000,000 from the market price of the gas. . ." R. 1814.

In other words, the Commission's approval of the settlement agreement may well be a half billion dollar mistake. In any event, the failure to require cost-of-service gas from the 105 account properties clearly is contrary to the public interest, is extremely detrimental to rate payers, and is violative of the trust duty

considerations enumerated by this Court in the Wexpro opinion. 595 P.2d 874.

Finally, despite some conclusory evidence in the record that the transfers were for fair market value, and despite a stipulation by less than all the parties that the transfers were for fair market value, there is no substantial evidence in the record to support any such finding. In fact, a motion by the Coalition of Senior Citizens for valuation of the assets was denied by the Commission. Counsel for the Committee stipulated that the 54% Mountain Fuel receives from net proceeds from oil on productive gas reservoirs is not fair market value. R. 1377. While there was testimony that a 7% overriding royalty is fair market value in arm's length transactions, there was no evidence that it was fair market value for Celsius to give Mountain Fuel a 7% overriding royalty interest but to charge market prices for gas from those properties. There is no reasoned explanation in the record why 54% of net oil revenues beyond Wexpro's return on investment constitutes fair market value with respect to productive oil reservoirs, whereas a 7% overriding royalty constitutes fair market value for extremely valuable wildcat acreage. Nor is there any evidence to support the difference between requiring cost-of-service gas from explored properties but allowing market-price gas from wildcat properties.

The record as a whole is devoid of substantial evidence to make a finding that the properties were transferred for fair market value. On the contrary, the record is clear, based on statements of witnesses and counsel for the stipulating parties, that the Stipulation and Agreement was the result not of reasoned determinations on issues, but of compromise--pure and simple.

V. THE REPORT AND ORDER IS ARBITRARY AND CAPRICIOUS AND HOSTILE TO ITS FINDINGS AND CONCLUSIONS.

A. The Report and Order is hostile to its own findings and conclusions because while it states that customers will benefit from cost-of-service gas, it sanctions the end of cost-of-service gas and the purchase by Mountain Fuel from Celsius of market-price gas. Four times in the Report and Order the Commission emphasizes the importance of cost-of-service gas. Report and Order, at 10, 11, 15, 17. Yet the Report and Order will lead to the end of cost-of-service gas because, when the 101 account gas fields are depleted, all gas purchased by Mountain Fuel will be at market prices. Even before those fields are depleted, all the gas to be purchased by the utility from Celsius from wildcat acreage and from unexplored formations under explored acreage is to be purchased at market prices.

B. The Report and Order is hostile to its own findings and conclusions because it leaves Wexpro and Celsius unregulated. The Commission states that the no-profit-to-affiliates rule and potential conflicts of interest or sweetheart relationships between Mountain Fuel and its subsidiaries require continued and ongoing scrutiny by the Commission of Mountain Fuel and its subsidiaries, whether or not they are subject to a regulated rate of return. Id. at 8. Yet the Report and Order allows Wexpro and Celsius to be unregulated and in fact prevents the Division from ever challenging that lack of regulation.

C. The Report and Order is hostile to its findings and conclusions because the Commission states that Mountain Fuel should continue utility exploration and development. The Report and Order states that exploration and development of energy resources are an appropriate activity for Mountain Fuel, both as part of its regulated activities and those which are not regulated. The Commission states it believes that Mountain Fuel should continue utility exploration and development in the future, and that the decision by Mountain Fuel to abandon exploration as a utility "has been implemented unilaterally and without Commission sanction." Despite this express statement of the importance of Mountain Fuel's utility exploration and development for hydrocarbons, the Commission allows Wexpro and Celsius to go

unregulated and "for the purpose of this settlement [The Commission] finds it unnecessary to determine if Mountain Fuel's activities should include an exploration and development program." Id. at 9.

D. The Report and Order is internally inconsistent because the Commission on the one hand states that Mountain Fuel's non-utility activities must enhance and not jeopardize utility operations, Id. at 8, but, on the other hand, allows Celsius to be an unregulated oil company and to sell gas from utility property to Mountain Fuel at market prices.

E. The Report and Order is arbitrary and capricious in allowing Celsius to be an unregulated oil company based not on an application by Celsius or Mountain Fuel, but on the Commission's "trust" that Mountain Fuel will make such an application. Id. at 9.

F. The Report and Order is arbitrary and capricious in that the Commission notes its "extreme concern with the FERC applications," but fails to condition the approval of the Stipulation and Agreement on withdrawal by Mountain Fuel and its subsidiaries of those FERC applications, and rather awaits a showing of "good faith" by Mountain Fuel and its subsidiaries concerning those applications. Id. at 10.

G. The Report and Order is arbitrary and capricious because the Commission accepts Mountain Fuel's fait

accompli, but the Commission "is not entirely persuaded that under attractive circumstances investors will not support a regulated exploration and development program or that such a program will cause problems with partners in the field or with the ability of Mountain Fuel to keep employees." Id., Finding 18.

In short, the Commission's Order is not supported by its findings and is in fact hostile to them. The irreconcilability of findings and the Order is fatal. See, e.g., Parowan Pumpers Association v. Public Service Commission, 586 P.2d 407 at 409 (Utah 1978). Moreover, the Commission's action is so unreasonable that it must be deemed arbitrary and capricious and it must not be sustained. See, e.g., Williams v. Public Service Commission, 504 P.2d 34 (Utah 1972).

CONCLUSION

Much more is at stake here than the Commission's failure to comply with this Court's mandate in this case, however important this case is. What is at stake here is the very integrity of the judicial process and the maintenance in the community of respect for this Court's decisions. If well-heeled interests perceive they can successfully avoid this Court's decisions by waging all-out war on them, respect for the law cannot be sustained. If this Court allows lower tribunals and administrative agencies to honor settlements

which fly in the face of not just the law, but of an express mandate, then this Court will encourage endless litigation rather than the resolution of disputes. The shareholders interests' thus-far successful refusal to comply with this Court's mandate is an affront to the integrity of the Commission, of this Court and the law. Reversal of the Commission's Report and Order has import far beyond the protection of the public interest in fair and equitable utility regulation. It has fundamental import to the promotion of a fair and equitable legal system, and most important to promoting respect for the law.

The Report and Order should be reversed and the cases remanded with instructions to comply with the mandate in the Wexpro case and the law.

DATED this 10th day of June, 1982.

Respectfully submitted,

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A handwritten signature in black ink, reading "Jay D. Lumsden". The signature is written in a cursive style with a horizontal line underneath the name.

A P P E N D I X "A"

**In the Supreme Court of the
United States**

OCTOBER TERM, 1979

No.

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, and
ALEX OBLAD, HAROLD BURTON, and
CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE
SUPREME COURT OF THE STATE OF UTAH

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UTAH COMMITTEE OF CONSUMER SERVICES and
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE
SUPREME COURT OF THE STATE OF UTAH

The petitioners, Mountain Fuel Supply Company, Wexpro Company, and Alex Oblad, Harold Burton and Carlyle Harmon, major representative Mountain Fuel shareholders, respectfully pray that a writ of certiorari issue to the Supreme Court of the State of Utah to review the judgment and opinion of this court entered in this proceeding on May 10, 1979.

OPINION BELOW

The opinion of the Utah Supreme Court, Appeal No. 15835, has been reported at 595 P.2d 871 (Utah 1979) and a copy of the same is attached as Appendix A.¹

JURISDICTION

From the opinion of the Utah Supreme Court on May 10, 1979, timely petitions for rehearing were filed by petitioners and denied without comment on July 18, 1979. The Utah Supreme Court has stayed its remittitur of the case pending disposition of this petition for certiorari. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

- I. Whether Utah regulation and taxation of interstate production and sale of crude oil and natural gas, so severe that the interstate commerce may be terminated, constitute an impermissible interference with and burden upon interstate commerce.
- II. Whether Utah regulation of the price of interstate natural gas sales, which sales are subject to comprehensive pricing regulations by Congress and the Federal Energy Regulatory Commission, is preempted by federal regulation.
- III. Whether Utah regulation of the economic return to the producer upon sales of oil in interstate commerce is preempted by comprehensive price regulations of the United States Department of Energy which produce, in accord-

¹ The advance sheets of the Pacific Reporter erroneously set forth counsel appearances for the parties. The Utah Public Service Commission was *without any legal counsel at any time before the Utah Supreme Court to urge the validity and public policy of its order of April 14, 1978. That assignment consequently fell on the petitioners.* Also, Calvin L. Rampton, Esq. was, at all times below, counsel for Wexpro Company.

ance with Congress' intention, a far higher economic return.

- IV. Whether Utah's retroactive reclassification of oil and gas properties as utility assets, which depresses their value by tens of millions of dollars, constitutes an uncompensated taking of the property of shareholders and bondholders contrary to their investment-backed reliance upon a Utah statute, its practical construction for over forty years, and previous final adjudications that these same properties were not utility assets.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED²

Article I, Section 8 of the Constitution.

Article VI of the Constitution.

Fifth Amendment to the Constitution.

Fourteenth Amendment, Section 1 to the Constitution.

Natural Gas Act, 15 U.S.C. § 717(b) (1976).

Emergency Petroleum Allocation Act, 15 U.S.C. §§ 751 & 753 (1976).

Energy Policy and Conservation Act, 15 U.S.C. §§ 757 & 760g and 42 U.S.C. § 6201 (1976 & Supp. 1979).

Natural Gas Policy Act, 15 U.S.C. § 3301(21) (Supp. 1979).

Utah Public Utilities Act, Utah Code Ann. § 54-2-1(30) (1974).

STATEMENT OF THE CASE

1. *The Nature of the Dispute.* This controversy concerns the State of Utah's constitutional power to regulate interstate com-

² Copies of the relevant portions of the constitutional and statutory provisions of the State of Utah are available from the Utah State Library.

merce in oil and gas, a commerce already regulated by the United States, and to do so by a retroactive reclassification of non-utility oil and gas properties as utility assets. Issues argued below included preemption by federal regulation, undue burden on interstate commerce, and the taking of property without just compensation.

For almost 40 years, petitioner Mountain Fuel Supply Company ("Mountain Fuel"), which operates a natural gas distribution utility, has also conducted one of the most successful oil and gas exploration and development programs in the Intermountain West. It has done so with the full knowledge and express support of the Utah Public Service Commission ("Utilities Commission"). Gas found was placed in a utility account and dedicated to the distribution utility at a cost-of-service price far below the interstate and intrastate market price. Oil found was placed in a non-utility account and sold at market price.

The Utilities Commission required this segregation into utility and non-utility accounts and, in a series of contested, final, and unappealed orders, has repeatedly held that the oil properties, most of which are in Wyoming and states other than Utah, were non-utility and not subject to Utah regulation. Every piece of property at issue here was involved in one or more hearings and was classified as a non-utility asset by a final order.

The capital costs of joint exploration and development for both oil and gas were financed by Mountain Fuel's shareholders and by the sale of debt securities. Portions of some expenses (primarily for drilling that resulted in dry holes) were allocated to the utility accounts in a manner approved by the Utilities Commission. From 1960 to 1972, the non-

utility oil accounts paid a share of dry hole expenses in proportion to their share of revenues and thereafter have paid more than that proportion.

This case arose in late 1976 when Mountain Fuel transferred its non-utility oil properties and operations to a wholly-owned subsidiary, petitioner Wexpro Company ("Wexpro"). The Utilities Commission, after exhaustive hearings, approved the arrangements between Mountain Fuel and Wexpro after modification, adhering to the position, relied upon by Mountain Fuel's stockholders and bondholders, that the properties transferred were non-utility. That position was based upon the Commission's long-standing construction of the pertinent Utah statutes and specific findings of fact in contested hearings with respect to the properties.

The Utah Supreme Court reversed. It fashioned a test under which virtually all of the non-utility properties must be reclassified as utility properties and the profits on Wexpro's sales of oil and gas from Wyoming and other states must be subjected to Utah regulation to subsidize yet lower rates to Utah natural gas ratepayers who already pay the lowest metropolitan area rates in the nation.

Certain consequences stemming from the new interpretation of the Utah statutes by the Utah court are undeniable and were not controverted below.

First, shareholders and bondholders, who relied upon previous final orders of the Utilities Commission applying the Utah statutes that the oil properties were not subject to regulation, have retroactively lost tens of millions of dollars of their property and of the security for their debentures.

Second, the conversion of a high-risk, free market business into a high-risk, low-return utility operation means that petitioners will almost certainly be forced to close down, as now unprofitable and impossible to finance, one of the nation's most successful energy exploration and development programs. The energy program which will be shut down is in the Intermountain West, one of the most prolific on-shore areas in the country for new discoveries of oil and gas.

Third, Utah, a consuming state, has undertaken to regulate oil and gas production and sales in the producing states of Wyoming, Colorado and other states, with the effect of impeding interstate commerce.

Fourth, the price of interstate sales of gas, regulated nationally by Congress and the Federal Energy Regulatory Commission, will now be fixed at lower levels by Utah in order to benefit local, Utah consumers.

Fifth, the return to the producer on interstate sales of oil, controlled by price regulations of the United States Department of Energy to encourage new production, will now be greatly depressed by Utah in order to subsidize local natural gas consumers.

The dispute between the parties concerns the constitutional power of Utah to accomplish these results in the way it did.

2. *Origin and Functions of Mountain Fuel.* Mountain Fuel was created by a 1935 merger of five companies, one of which produced oil. (R. 4394, 4945, 5512-13) For decades, Mountain Fuel has operated separate utility gas and non-utility oil businesses. (R. 4393-94) Its distribution of natural gas sub-

jects it to public utility regulation in Utah and Wyoming, while its production and transmission functions are under federal and other state regulation. Mountain Fuel's independent, non-utility businesses include the production and sale of oil and the production of gas as well as the manufacture and sale of brick, ceramics, and other building materials, none of which has ever been subject to state utility regulation. *Re: Mountain Fuel Supply Co.*, 33 P.U.R. (N.S.) 3 (Utah 1940); *Utah P.S.C. Case No. 6369* (1972) (R. 5728, 5734-36); (R. 226, 3800 [17])

3. *The Exploration and Development Program.* For many years, the Company's utility and non-utility divisions carried on a vigorous joint exploration and development program. Mountain Fuel investors have always borne the capital costs of land acquisition for both utility and non-utility exploration. (R. 4392) If the program produced a successful well, it was classified as either oil or gas, depending upon which had the greater "value of production" at the wellhead. (R. 4722-23) If a gas formation was discovered, all associated costs were capitalized in the utility accounts and reflected in the rates. In the event of an oil well discovery, the entire cost was capitalized in the Company's non-utility oil accounts and was, therefore, not taken into account in establishing natural gas rates. (R. 5614, 5706)

Dry holes, which produce neither gas nor oil, are necessarily treated differently. In the early years, when most wells were gas, dry hole expenses were principally reflected in the utility accounts. Even then, the non-utility oil division paid a larger proportion of drilling expense than its proportion of total Company oil and gas revenues. (R. 3792[8], 3800[24], 5723) As oil became a significant contributor to Mountain Fuel revenues, its share of joint exploration expense rose and

since 1975, has stood at half. *Utah P.S.C. Case No. 7113* (1975) (R. 5817-18) The share allocated to the utility gas accounts affects natural gas rates. The share paid by non-utility oil accounts does not.

The Utilities Commission has always *required* Mountain Fuel to segregate non-utility oil properties from utility gas properties and operations. The Commission *forbade* Mountain Fuel to include oil properties in the utility rate base upon which an authorized rate of return on plant was allowed. This was done in seven separate rate orders from 1940 to 1978.³ These seven proceedings were all contested and all went to final orders from which no appeals were taken. During these years the joint exploration and development program was carried on with the express approval of the Commission as to the utility division's participation.

Mountain Fuel also has historically conducted joint exploration and development with other independent producers who, upon discovering gas, sold the gas at market price to Mountain Fuel in interstate commerce for delivery and consumption in Utah.

4. *Ratepayer Benefits from the Program.* Mountain Fuel has always found substantially more gas (better than 1.5 trillion cubic feet between 1950-1976) than oil. (R. 3666, 5033, 5636) Its cost-of-service gas (actual production cost plus a utility rate of return) has always been priced well below market. In 1977, for example, Mountain Fuel customers paid \$.40 per Mcf for Company cost-of-service gas as compared with a

³ Re: *Mountain Fuel Supply Company*, 33 P.U.R. (N.S.) 3 (1940); *Utah P.S.C. Case No. 3972* (1953) (R. 5502-03); *Utah P.S.C. Case No. 4392* (1957) (R. 5621); *Utah P.S.C. Case No. 4797* (1960) (R. 5636); *Utah P.S.C. Case No. 5007* (1968) (R. 5706-07); *Utah P.S.C. Case No. 6369* (1972) (R. 5728); *Utah P.S.C. Case No. 4668* (1974) (R. 5803).

field price of \$1.17 and a pipeline price of \$1.48. (R. 5031) Mountain Fuel's gas transmission system, built only because of its exploration and development program, enabled the Company to purchase an additional one trillion cubic feet between 1960-1976 (R. 3666), giving Mountain Fuel a reserve life index of between 14 and 15 years, compared with the national average of nine years. (R. 2030) In 1979, over 30 percent of Mountain Fuel's utility gas requirements are being supplied from its own wells, a result unmatched by any other comparable gas distribution utility

In the period 1960-1976, rates were reduced \$123 million by lower gas prices due to the exploration and development program. (R. 2391) Rates were reduced an additional \$93.8 million due to tax deductions generated by the program (R. 3638), for a total benefit to the ratepayers of \$216.8 million. As a consequence, Mountain Fuel has the lowest metropolitan area natural gas rates in the nation. (R. 389)

5. *The Ratepayer Risk Issue* The Utah Supreme Court held that Mountain Fuel's non-utility oil properties must be taken to subsidize its utility ratepayers. This holding was based on the assumption that the ratepayers took the risks of the program by paying certain exploration expenses in their rates. (App. A8-9) The court dedicated the oil properties to the ratepayers on this money-at-risk notion. Although a misnomer, "ratepayer contribution" to the program was much smaller than shareholder contribution. In the period 1960-1976, a recovery of \$44.9 million was authorized in the rates. (R. 3638) In that same period, investors contributed \$87.7 million to capital costs associated with utility gas exploration (R. 3639) and \$42.9 million for costs associated with oil (R. 4439), making a total contribution of \$130.6 million.

Investors thus contributed nearly three times as much as rate-payers "contributed."

Moreover, whatever the comparative contributions of investor and ratepayer, the magnitude of the contributions had nothing to do with risk. All of the investor contribution was at risk while none of the so-called "ratepayer contribution" was. (R. 2452, 2514-15, 2523, 2746) That is manifest from the fact that the Utilities Commission ruled in three cases—in 1960, 1968 and 1978⁴—that it would allow a reasonable exploration expense in the gas utility rates only so long as the cost-of-service of developing new supplies of Company production was lower than the average cost of purchased gas. The ratepayers could not lose; the shareholders and bondholders could.

6. *Interstate Commerce.* Virtually all of the non-utility oil properties transferred to Wexpro on January 1, 1977, were outside Utah, the principal producing properties being in Wyoming, Colorado, and Nevada. (See Appendix C) All of Wexpro's oil operations and substantially all of Mountain Fuel's gas operations involve interstate commerce. Crude oil is sold in interstate commerce to refineries or other producers in many states at prices subject to federal regulation. (R. 970-71) Natural gas sales at the wellhead, in intrastate as well as interstate transactions, are also subject to comprehensive federal regulation.

Mountain Fuel has constructed an interstate transmission system from Colorado through Wyoming to Utah along with

⁴ Utah P.S.C. Case No. 4797 (1960) (R. 5639); Utah P.S.C. Case No. 5907 (1968) (R. 5663); Utah P.S.C. Case No. 76-057-14 (1978) (R. 3393, 3395). In the 1968 case, the Utilities Commission said:

[A] vigorous exploration and development program should be continued so long as the costs incurred in developing new supplies of gas are lower than the average cost of purchased gas. (R. 5663)

a major gathering network, compressor stations, and allied capital facilities. These facilities are under federal regulation. (R. 4570) They are shown on Appendix D. Because of its exploration and development program, Mountain Fuel was able to supply natural gas to northwestern, southwestern and midwestern consuming states during the harsh winter of 1976-1977. (R. 5504[3])

7. *Investor Reliance.* Capital contributions by investors for both oil and gas were made in reliance upon the segregation of the non-utility oil from the utility gas. (R. 5149-51) Shareholders purchased Mountain Fuel stock, which is traded on the New York Stock Exchange, in reliance upon the Utility Commission's repeated final and unappealed but contested decisions that the Company's oil properties are unregulated, non-utility assets. Bondholders, as well, purchased in reliance upon the non-utility character of the oil properties. As a result, the Company has raised debt capital at low costs to utility ratepayers. *Utah P.S.C. Case No. 7113 (1975)* (R. 5822)

8. *Formation and Transfer to Wexpro.* The non-utility oil properties were transferred by Mountain Fuel in return for all outstanding Wexpro stock. (R. 346-47, 5340) Wexpro was created to encourage and expand oil and gas exploration and development activities. The market value of the non-utility oil properties transferred was estimated to be in excess of \$150 million, the entire cost of which had been paid by shareholders from earnings or the sale of securities. No part of these costs was ever recovered in utility rates. (R. 4393, 4406)

Wexpro and Mountain Fuel also entered into a 1977 Joint Exploration Agreement ("JEA"), approved by the Commission. Each agreed to advance one-

half of annual exploration expenses, with Mountain Fuel capitalizing and receiving any gas discoveries and Wexpro capitalizing and receiving any oil discoveries. It was anticipated that Wexpro would also explore and develop independently of Mountain Fuel, raising its own capital to do so. (R. 250, 277)

9. *Position of Respondents.* Respondents did not contend before the Utilities Commission that the non-utility assets should be rolled into or merged with the utility gas accounts for rate-making purposes. They expressly disclaimed that argument and instead asked the Commission to attach certain conditions to the Wexpro transfer. (R. 674, 3785-91) On appeal, respondents for the first time argued that the ratepayer should receive, along with low-priced cost-of-service gas and high reserves, all of the oil assets and profits above a regulated utility rate of return.

10. *Utilities Commission Holding.* On April 11, 1978, the Utilities Commission approved the JEA and found that non-utility oil properties transferred to Wexpro were not subject to regulation. It cited the precedent of 38 years of final adjudications and orders of the Utilities Commission as to the non-utility character of the oil assets and that an exploration expense would be allowed in the rates only so long as the costs of that program reflected in the rates were lower than the average price of purchased gas.³ (App. B11-15, 17-18, 28-30, 32, 35, 44)

It further found that Mountain Fuel shareholders and bondholders had relied upon the final orders of the Utilities Commission and its regulatory policy on the oil and gas exploration and development program in investing in the Com-

³ The Report and Order of the Utilities Commission of April 11, 1978 is attached as Appendix B.

pany (App. B17-18, 22, 39-40) and that the program had been in the public interest and should be continued in the future under the JEA with Wexpro. (App. B39-40, 85-86)

11. *Utah Supreme Court Holding.* Upon direct appeal, the Utah Supreme Court, in a divided opinion, held that the non-utility oil properties had always been and are utility assets,⁶ and that these properties and the oil revenues generated from them should be "applied, to reduce the cost of gas" to the Utah utility customer. (App. A8-9) The court majority did not mention the separation of utility gas and non-utility oil required by the Commission for almost 40 years, or the seven previous, separate final orders of the Commission adjudicating the oil properties of Mountain Fuel to be non-utility, unregulated assets.

The Utah Supreme Court majority did not cite nor discuss that portion of the Utah statute providing that regulation of a utility by the Commission shall not extend to any non-utility business conducted by the utility. Utah Code Ann. § 54-2-1 (30) (1974). The court held that the Commission's conclusions were "premised on the erroneous assumption there was no correlation or connection between the contributions by the ratepayers, through an annual exploration and development expense included in the rate base, and the ensuing benefits from the program." (App. A2)

⁶ The Utah court wrote out a three-pronged economic test to determine whether the non-utility oil properties were utility assets, viz., (1) was the property, while undeveloped wildcat acreage, ever reflected, even momentarily, in a utility account earning a rate of return, (2) were any utility exploration expense funds applied to develop that acreage or (3) have natural gas or gas liquids ever been produced from the acreage, regardless of amount. (App. A13-14) Petitioners acknowledge that under this new test, substantially all of the non-utility oil properties would fall within the sweeping contours of what the Utah court has now announced to be "utility assets."

Ignoring the fact that the Commission had precisely recognized that connection and explained its relevance, the court majority, on the basis of a new theory that Mountain Fuel stood in a "trust relationship" when it sold natural gas to its utility customers (App. A4, 8), held that (i) sales of interstate gas by Wexpro to Mountain Fuel must be at the cost-of-service price rather than the federal ceiling price, even when the gas comes from acreage independently developed by Wexpro (App. A5-6), and (ii) Wexpro, along with any other company in interstate commerce that sells jointly developed gas to Mountain Fuel, is itself a public utility subject to Utah regulation. The Utah court stated:

A review of the provisions of the two agreements as modified by the Commission clearly indicates that, by the activities performed by Wexpro, it becomes a public utility subject to the jurisdiction and regulation of the Commission under Sec. 54-2-1(30). *Wexpro, by its joint activities with Mountain Fuel, particularly upon the transferred properties is both performing a service, viz., facilitating the production of natural gas, and delivering natural gas to its parent, both of which constitute Wexpro a public utility.* (App. A13) (Emphasis added)

These concepts, taken together, leave no room for Mountain Fuel or Wexpro to conduct a non-utility business in oil or gas, subject Wexpro to Utah regulation as a public utility, and require Wexpro to sell gas to Mountain Fuel at cheap prices (App. A5-6), far below the federal ceiling level for comparable vintage supply. Further, under the statutory interpretation of the Utah court, any other independent producer which explores "jointly" with and delivers gas to Mountain Fuel, whether in interstate commerce or not, "facilitat[es] the production of natural gas" and is, as well, subject to Utah regulation.

Justice Wilkins, in dissent, concluded that the majority's ruling was contrary to the Utah statutes and to the many final decisions of the Utilities Commission, that the Utah court had ignored decisions of this Court under the Fourteenth Amendment, and that the decision constituted a "massive appropriation of the property rights of Mountain Fuel's shareholders." (App. A52-56) The dissent noted that the remand to the Utilities Commission would be a mere mechanical accounting procedure because the Commission had found facts and the court majority had stated conclusions that required the reclassification of the properties in question from non-utility to utility. (App. A41-42, 53)

12. *Termination of Mountain Fuel Exploration and Development.* The evidence shows, and it has never been denied, that if the non-utility oil properties were folded into the gas utility accounts for ratemaking, the 43-year-old exploration and development program of Mountain Fuel would end. (R. 2006, 5028, 5033) Mountain Fuel competes for capital funds against oil and gas companies who receive the highest interstate price for both crude oil and natural gas, even though such companies also recover an exploration expense in their rates and prices. (R. 4175, 4410-11) The subsidization of Utah gas consumers with oil profits, and the requirement that Wexpro sell gas independently discovered in other states to Mountain Fuel at low, cost-of-service prices, will make it impossible to raise risk capital for the program. (R. 155-56, 350, 385-89)

REASONS FOR GRANTING THE WRIT

Utah will now regulate both the price of natural gas moving in interstate commerce and the rate of return on interstate sales of oil. The State has also taken tens of millions of dollars of public funds to subsidize Mountain Fuel's gas, and to petitioners in order to

give a one-time windfall to Utah gas utility customers through temporarily lowered rates. These actions by Utah raise serious constitutional issues of interference with interstate commerce, state regulation of subjects preempted by federal law, and the uncompensated taking of private property.

This case is one of great public importance and widespread significance, particularly at a time when energy shortages present an urgent problem for solution at national and international levels. Utah has attempted to appropriate energy resources in interstate commerce, much of which does not even touch Utah's borders, for purely local benefit. This is not the first time in our history, nor will it be the last, that this Court has been asked to preserve the federal plan against local incursion. In times of economic difficulty, states are under strong temptation to prefer local and short-term interests to national and long-term goals. Utah has succumbed to that temptation. If its attempt succeeds and the decision below stands, other states and localities will be encouraged to similar attempts, if only in self-defense. Further litigation of this kind is a certainty.

The issues here do not turn upon Utah's utility laws but on principles of federal constitutional law. It could not be more clear that petitioners do not invite this Court to determine the wisdom or propriety of the "no-profit-to-affiliate" concept or the three-pronged utility test under the Utah court opinion. Nor do petitioners request in any sense that this Court enter upon or become enmeshed in an accounting or classification proceeding as to the non-utility or utility character of the oil properties. There is no issue presented involving the classification of oil or gas assets. Rather, petitioners complain only of the resulting impact of the Utah opinion upon

the production and sale of oil and gas in interstate commerce, upon preemptive federal law and policy, and upon constitutionally protected property rights. This petition is so confined.

That Utah has acted in the guise of regulating a distribution utility neither justifies its action nor narrows the scope of the precedent. Hence, Utah's announced rationale for interfering with interstate commerce and federal regulation — that its utility ratepayers bore the risk of out-of-state exploration and development — does not, even if it were true, empower Utah to fix oil profits and gas prices it is constitutionally barred from regulating.

The controlling constitutional rules should be authoritatively stated now.⁷ With Utah's action as precedent, other

⁷ The federal constitutional questions asserted by this petition were raised below and decided against petitioners. The decision is subject to no further review in Utah. Nothing remains to be done except the implementation of the judgment by the Utah Utilities Commission. Justice Wilkins, in his dissent below, characterized the remand to the Commission as "demonstrably needless" because the criteria framed by the Utah court had appropriated all Wexpro's assets under the Commission's undisputed findings. (App. A41-42, 53)

In response to the petitions for rehearing below, respondents adopted the opinion of Justice Wilkins on the nature of the remand, arguing that all of Wexpro's oil profits and properties were to be utilized to lower Mountain Fuel natural gas rates. Petitioners, however, urged on rehearing that the Utah court judgment could be interpreted as resulting in a roll-in of less than all of the oil profits and properties. The Utah court did not respond.

Under any interpretation, there is no question that on remand Utah will regulate interstate commerce contrary to the Constitution and Congressional preemption and that petitioners will suffer an immense loss in property values and profits of at least tens of millions of dollars and perhaps as much as \$150 million. The sole reason these results have not already occurred is that the Utah Supreme Court stayed its remittitur of the matter to the Commission so that petitioners could seek review in this Court of the substantial federal questions presented.

This case is mature for review by this Court because the federal

(Note continued on next page)

states and local units of government will attempt to seize non-utility assets of other shareholders and bondholders to subsidize local consumers at the expense of national interests in energy development, thus obstructing vital and comprehensive federal energy policies.

I.

UTAH'S EXTRATERRITORIAL REGULATION IS AN IMPERMISSIBLE INTERFERENCE WITH AND BURDEN UPON INTERSTATE COMMERCE.

Utah has obstructed interstate commerce in three ways:

1. By appropriating Wexpro's profits on sales of Wyoming, Colorado, and Nevada oil in order to subsidize natural gas prices charged Utah ratepayers by the parent, Mountain Fuel;⁶

2. By requiring Wexpro to lower the price of interstate natural gas sales to Mountain Fuel by approximately 68 per-

⁷ Continued

questions have been resolved with finality, the regulation and taking are certain and all that remains is an accounting proceeding. *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975); *Radio Station WOW, Inc. v. Johnson*, 326 U.S. 120 (1945).

Review at this time is essential to preserve petitioners' rights. Continuation of the gas and oil exploration and development program depends upon the continuing commitment of risk capital and the retention of highly skilled management and technical personnel. Neither of these is possible if Utah's action is likely to stay in effect. Complex and high risk undertakings of this sort cannot be stopped and started at will. Hence, later review, after extended proceedings before the Commission, would in all probability come too late, no matter what the outcome, to save petitioners' exploration and development program and operations.

⁶ If the non-utility oil properties are folded into the utility gas accounts for ratemaking purposes, Mountain Fuel's cost-of-service production would come to Utah customers at \$.16/Mcf rather than the already low 1977 average price of \$.40/Mcf.

cent from the federal ceiling price of \$1.17/Mcf to the state regulated price of \$.40/Mcf;⁹ and

3. By subjecting to Utah utility regulation the wellhead price and sales of other producers who jointly produce natural gas with Mountain Fuel outside of Utah and sell that gas to Mountain Fuel for interstate transmission to Utah.

There is no doubt on this record, or indeed, in common sense, what the results of Utah regulation will be. Wexpro and Mountain Fuel will in all probability have no other option than to cease efforts to find new discoveries of and to develop oil and gas. Neither Wexpro nor Mountain Fuel can attract risk capital for oil and gas exploration when the best that can be expected is a low distribution utility rate of return.

Three lines of authority condemn Utah's extraterritorial regulation of natural gas and oil sales.

First, Utah's regulation of oil and gas is invalidated by the Commerce Clause under *Pennsylvania v. West Virginia*, 262 U.S. 581 (1923); *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963); *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525 (1949); and *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

Pennsylvania v. West Virginia, *supra*, held unconstitutional a West Virginia statute requiring producers and distributors to satisfy local consumers before shipping to Ohio and Pennsylvania. This Court stated:

Natural gas is a lawful article of commerce, and its transmission from one state to another for sale and

⁹ Based on a comparison of Mountain Fuel's average cost-of-service price for its own gas with its average field producer price for the year 1977. (R-5031)

consumption in the latter is interstate commerce. A state law, whether of the state where the gas is produced or that where it is to be sold, which by its necessary operation prevents, obstructs, or burdens such transmission, is a regulation of interstate commerce,—a prohibited interference. 262 U.S. at 596-97.

This Court has frequently reaffirmed the fundamental principle of *Pennsylvania v. West Virginia* which prevents a state from impeding the channels of interstate commerce or erecting anti-competitive barriers to the free flow of goods for the benefit of local consumers. *H. P. Hood & Sons, Inc. v. Du Mond*, *supra*; *Toomer v. Witsell*, 334 U.S. 385 (1948); *Baldwin v. Seelig, Inc.*, 294 U.S. 511 (1935); *Foster-Fountain Packing Co. v. Haydel*, 278 U.S. 1 (1928). *Baldwin* held unconstitutional a New York law prohibiting the importation of milk unless it had been purchased in the producing state at prices no lower than New York required its producers be paid.

Utah's statutes, as now interpreted, require that natural gas, produced and sold in Wyoming in interstate commerce, but destined for Utah, be sold at a regulated Utah price well below applicable federal prices for the benefit of Utah consumers. As a consuming state, Utah has interfered with interstate commerce to protect local consumers, as in *Pennsylvania v. West Virginia*. Utah has also extended its regulatory arm into the producing state of Wyoming, as in *Baldwin*, when its only basis for utility jurisdiction is the retail distribution of natural gas in Utah.

Moreover, the Utah scheme reaches even further beyond constitutional limits when it subsidizes its Utah customers by exporting its state regulation to millions of dollars of Wexpro profits for the sale of oil in interstate commerce in Wyom-

ing and Colorado when that oil is not even destined for use in the consuming state.

The State of Wyoming was so concerned with the application of the Utah regulation to Wyoming producers that it filed a brief *amicus curiae* in connection with the petitions for rehearing below. Wyoming noted that the Utah statute was interpreted to apply to all interstate producers selling gas to Mountain Fuel and asked:

[D]oes the Court's application of the Utah statute mean that a producer of natural gas in Wyoming may be held subject to the jurisdiction of the Utah Public Service Commission as a public utility if it sells gas to Mountain Fuel?

The Utah court had already given a clear affirmative answer to the Wyoming question in its opinion and did not trouble to reanswer the question on rehearing.

Second, decisions of this Court beginning with *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924) and culminating in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), establish the principle that the wellhead price of natural gas sold for transportation or resale across state lines is itself a transaction in interstate commerce and so not subject to state regulation. Wexpro in this case stands in precisely that position. *Phillips* invalidates Utah's regulation of interstate gas sales to Mountain Fuel by Wexpro and other producers.

Third, whatever label is used, Utah's appropriation for local ratepayers of Wexpro's profits on oil sales in Wyoming, Colorado, and Nevada is analogous to, and indeed indistinguishable from, a tax upon those interstate sales. Any profit

Wexpro makes above a fixed utility rate of return on a sale of regulated oil, is to be taken and redistributed to Mountain Fuel's consumers in the form of cheap gas rates. The fact that the local consumer-beneficiaries are less than all of the citizens of Utah does not make the exaction any less a tax, for numerous taxes are levied for the benefit of particular classes.

The controlling law on state taxation of interstate commerce is stated in *General Motors Corp. v. Washington*, 377 U.S. 436, 441 (1964):

[T]he decisive issue turns on the operating incidence of the tax. In other words, the question is whether the State has exerted its power in proper proportion to appellant's activities within the State and to appellant's consequent enjoyment of the opportunities and protections which the State has afforded.

All of the cases hold that there must be *some* nexus between the commerce and the state taxing it and *some* fair proportionality between the tax and the company's activities within the state. See, e.g., *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Here there is neither. Utah is taxing interstate commerce in oil which does not even touch its borders. Petitioners have found no case with a tax like this one because no other state has attempted such a bold and rapacious charge on interstate commerce.

Moreover, there exists the prospect of multiple taxation. Mountain Fuel operates as a gas distribution utility under local regulation in Wyoming as well as in Utah. If Utah may tax Wexpro's Wyoming, Colorado and Nevada oil sales because Mountain Fuel is a distribution utility in Utah, certainly Wyoming may also tax Wyoming oil sales and Wexpro's oil sales in Utah, Colorado and Nevada as well.

What has really happened here is this: Utah, without any nexus to the interstate commerce and having no taxable incidence of Wexpro's oil business or profits, has nonetheless undertaken to tax that oil commerce so severely that it will end — and it has done so under a rationale that will permit other states to levy similar taxes on the same commerce.

Under all relevant authority, Utah has interfered with interstate sales and movements of oil and natural gas in a manner rendered impermissible by the Commerce Clause of the Constitution.

II.

UTAH'S REGULATION IS PREEMPTED BY FEDERAL REGULATION OF OIL AND NATURAL GAS SALES.

Utah has regulated both oil and gas in conflict with federal statutes and policy.¹⁰

A. *General Framework of Preemptive Federal Oil and Natural Gas Regulation.*

Production and sale of natural gas and crude oil has been a field of intense federal concern and comprehensive, detailed federal regulation for decades. Commencing with the passage of the Natural Gas Act of 1938, continuing with the Emergency Petroleum Allocation Act of 1973, and culminating in a

¹⁰ The doctrine of federal preemption extends not only to state laws or actions that conflict with particular federal statutes, but also to state actions which attempt to operate in a field already occupied by Congress or which frustrate the achievement of federal policy. *Burbank v. Lockheed Air Terminal*, 411 U.S. 624 (1973); *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963).

series of energy enactments in 1978,¹¹ Congress has completely occupied the field. State regulation of interstate production and sales of oil and gas has been ousted and national policies established in direct conflict with what Utah has done here. The national government has taken the more recent of these actions in response to the worst energy crisis in the history of this country. Its policy is to develop national markets for oil and gas with uniform prices, to stimulate new exploration and development through price incentives, and ultimately to phase out regulation in favor of competitive pricing.¹²

So complete is the federal domination of this field that even the traditional area of state regulation, natural monopoly distribution, has been subjected to federal standards in control of wasteful practices, rate design, incremental pricing and the

¹¹ Natural Gas Act, 15 U.S.C. §§ 717-717w (1976 & Supp. 1979); Emergency Petroleum Allocation Act of 1973, Pub. L. 93-159, 87 Stat. 627; Energy Policy and Conservation Act, Pub. L. 94-173, 89 Stat. 871; Natural Gas Policy of 1978, 15 U.S.C. §§ 3301-3432 and 42 U.S.C. § 7255 (Supp. 1979); Public Utility Regulatory Policy Act of 1978, Pub. L. 95-617, 92 Stat. 3117; Energy Tax Act of 1978, Pub. L. 95-618, 92 Stat. 3174; National Energy Conservation Policy Act, Pub. L. 95-619, 92 Stat. 3206; Power Plant and Industrial Fuel Use Act of 1978, Pub. L. 95-620, 92 Stat. 3289.

¹² The statutory declarations and legislative history leave no room for argument that a national policy for the uniform pricing of oil and gas in or affecting interstate commerce and for providing price incentives for new production is plainly intended by the Congress. See, 15 U.S.C. §§ 751 & 3201 (1976 & Supp. 1979), 16 U.S.C. § 2601 (1976) and 42 U.S.C. § 6201 (1976). Public Utility Regulatory Policy Act of 1978, H.R. Rep. No. 95-543, p. 10, states:

The natural gas pricing policy adopted by the [Conference] Committee establishes a single, uniform price for natural gas produced in the United States.

See also, Natural Gas Policy Act of 1978, H.R. Rep. No. 95-1752 and Energy Tax Act of 1978, S.R. No. 95-436, p. 20, where the Senate Committee on Energy and Natural Resources stated:

The Administration is proposing a system under which price controls would be made more consistent with national policies. Producers would be given adequate price incentives for development of new fields.

production and sale of intrastate oil and gas. In short, federal regulation has been extended to completely eclipse state regulation in this field.¹³

B. Federal Preemption of Natural Gas.

Against the background of the comprehensive federal framework just examined, the invalidity of Utah's regulation of both gas and oil is clear.

With respect to gas, the Natural Gas Act preserves for exclusive federal jurisdiction "the sale in interstate commerce of natural gas for resale for ultimate public consumption . . . and [sales] to natural-gas companies engaged in such transportation or sale . . ." Natural Gas Act, 15 U.S.C. § 717(b) (1976). See also, Natural Gas Policy Act, 15 U.S.C. § 3301(21) (Supp. 1979).

In *Phillips Petroleum Co. v. Wisconsin*, *supra*, this Court held:

[T]he legislative history [of the Natural Gas Act] indicates a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company. 347 U.S. at 682.

Utah's regulation here is not a regulation of transactions between a Utah utility and its Utah customers. It is, rather, a regulation of interstate sales of natural gas for resale as defined by the Natural Gas Act. The regulated sales are also

¹³ A state may not regulate any price of oil even though produced and consumed intrastate. 15 U.S.C. § 757 (1976). It may still regulate the sales price of gas produced and consumed wholly intrastate, provided however that the price in all events does not exceed the federal maximum ceiling for comparable vintaged gas. 15 U.S.C. § 3432(a) (Supp. 1979).

transactions by a "natural-gas company" within the Act's coverage as settled by *Phillips*. Under that decision, regulation of sales by an independent natural-gas producer is the same as regulation of sales "by an affiliate of an interstate pipeline company." 347 U.S. at 685. Thus, sales from Wexpro and others to Mountain Fuel are "first sales" in interstate commerce and immune from state regulation.

C. Federal Preemption of Oil.

With respect to oil (as well as natural gas), one of the central objectives of the comprehensive energy legislation, as set out in the Energy Policy and Conservation Act, is "to increase the supply of fossil fuels in the United States through price incentives and production requirements." 42 U.S.C. § 6201(3) (1976) (Emphasis added.) See also, Emergency Petroleum Allocation Act, 15 U.S.C. § 751(a)(1) (1976).

The Utah regulation completely and effectively frustrates this federal policy. The uncontroverted fact is that as a result of the Utah scheme, one of the nation's most successful exploration and development programs will be compelled to phase out and end. The precise reason is that Utah has taken away the "price incentives" that Congress intended. By requiring that profits from oil sales be used to subsidize natural gas rates, the consuming State of Utah has eliminated all incentive and economic capacity for Mountain Fuel shareholders to continue to bear the risk and expense of further exploration and development. This form of oil regulation is an open invitation to other consuming states to regulate by seizing the profits from oil production and collapsing those profits into local gas distribution utility rates.

The fact that Utah's regulation is by way of seizing profits on Wexpro's oil sales, and not regulation of the sales price,

does not lessen the frustration of federal preemptive policy. Requiring Wexpro to dedicate its oil profits to lower Utah utility gas rates is destructive of the federal objectives of price incentive and new production and thus has exactly the same impact as state regulation of the price itself. That regulation is in conflict with and condemned under the seminal authority of *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963). Although *Northern Natural* dealt with the Natural Gas Act, the analogy here is direct:

The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, [citation omitted] or for state regulations which would indirectly achieve the same result. These state orders necessarily deal with matters which directly affect the ability of the Federal Power Commission [now FERC] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. They therefore invalidly invade the federal agency's exclusive domain. 372 U.S. at 91-92. (Emphasis added)

In *Federal Power Commission v. Oklahoma Corporation Commission*, 362 F. Supp. 522 (1973), *summ. aff.* 415 U.S. 961 (1974), Oklahoma attempted, in the name of local conservation, to "shut-in" wells dedicated to interstate commerce having a cheap casinghead price for the benefit of Oklahoma producers and consumers. A three judge federal court invalidated the state regulation as inconsistent with the preemptive authority of the Federal Power Commission and also as an intolerable burden upon commerce. This Court summarily affirmed.¹⁴

¹⁴ The dissents of Justices Rehnquist, Stewart and Powell were not "from any disagreement with the substantive holding of the District Court," but ran to the standing of the FPC to prosecute the action. 415 U.S. at 903.

Federal preemption of the regulation here follows, *a fortiori*, from the *Oklahoma Corporation Commission* holding. There, the announced purpose of the regulation was energy conservation which is also a federal policy. The Utah regulation results in lower production of oil (because of decreased profits) and higher consumption of gas (because of artificially lower rates), each of which runs squarely counter to federal energy policy:

Government policy . . . should provide for prices that encourage development of new wells through a more effective distribution of production incentives [and] should also promote conservation by confronting [consumers] with the real cost of oil and gas in the energy marketplace. Energy Tax Act of 1978, S.R. No. 95-436, p. 20.

If allowed to spread to other states, Utah's conflicting regulation will not only balkanize the national oil and gas markets, it will destroy the development of a comprehensive and uniform federal energy policy during an era of critical energy shortage. The burden on commerce of the attempted Utah regulation is patent; its conflict with comprehensive federal policy is startling; and the invitation to other state regulatory bodies to do likewise is undeniable.

III.

UTAH HAS UNCONSTITUTIONALLY CONFISCATED PETITIONERS' OIL PROPERTIES WITHOUT COMPENSATION.

From the beginning of its corporate existence in 1935 until 1977 when it transferred them to Wexpro, Mountain Fuel owned non-utility oil properties. It did so pursuant to the Utah Utility Code, Utah Code Ann. § 54-2-1(30) (1974).

that permits a company to own and operate both utility and non-utility businesses and provides that the latter shall not be regulated. The capital costs of acquiring, drilling and developing non-utility oil properties were paid by Mountain Fuel shareholders from capital contributions, retained earnings, and the sale of debt securities. Shareholders purchased stock and bondholders lent their credit in express reliance upon the non-utility oil functions of the Company. Mountain Fuel sold oil at the market price and realized competitive profits. So operated, the oil properties had a market value in excess of \$150 million.

Mountain Fuel's shareholders owned these non-utility oil properties for 43 years, to May 9, 1979. They own them no more. On May 10, 1979, the Utah Supreme Court gave most of the value of the oil properties to Mountain Fuel's natural gas utility ratepayers. The court did so by declaring the oil assets to be "utility properties." (App. A12) Thus, Wexpro and its owner, Mountain Fuel, are now entitled only to a low utility gas rate of return, the oil profits being given to the gas customers to lower their rates further.

By subjecting virtually all of the oil properties to its regulation, Utah has taken from Mountain Fuel and its shareholders substantial oil profits and capital values of the oil properties. The bondholders have lost substantial security for the debentures they purchased.

The Utah decision is an uncompensated confiscation of petitioners' property in violation of the Fifth Amendment, made applicable to the states by the Fourteenth Amendment, under the principles enunciated by this Court in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978) and *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922),

as well as, by close analogy, *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978) and *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977).¹⁵ The central inquiry of those cases is whether state action has interfered with or demoralized the distinct investment-backed expectation of property owners resulting in substantial loss or the devaluation of property interests.

Additional factors stressed by those cases as showing an unconstitutional taking are present here. The property values taken are substantial and the taking is retroactive. There are no alternative valuable uses for the property. Petitioners have received no compensating benefit. There is no public emergency in Utah and no strong public interest relating to these properties — other than the desire to appropriate most of their value. Legitimate, investment-backed expectations of petitioners, the shareholders, and the bondholders have been destroyed.

It is unquestioned that the shareholders and bondholders acted in justifiable reliance upon Utah law. Pursuant to the Utah Utility Code, Utah Code Ann. § 54-2-1(30) (1974), petitioners' oil business, carried on in other states, was no more a gas utility business than was Mountain Fuel's ceramic and brick business. In fact, petitioners, if anything, were more justified in their dependence upon the non-utility status of the oil business than any other, for they had not only the Utah utility statute and 43 years of practical construction upon which to rely, but also a series of final orders of the Utilities

¹⁵ *Allied Structural Steel* and *United States Trust Co.* involve the impairment of the obligation of contracts, but both decisions are directly relevant because the two concepts, impairment of contractual obligation and the taking of property without just compensation, are closely parallel and in some respects conceptually identical.

Commission. The Commission decisions not only announced the principles of the segregated, non-utility character of the oil properties, but adjudicated the non-utility status of these specific properties now retroactively declared to be utility assets.

The seizure of Mountain Fuel oil properties floats, under the Utah opinion, on two theories, each patently fallacious. The first premise is that "the ratepayers [were] the primary source of risk capital throughout the years" (App. A8), because a share of the dry hole expenses proportionate to revenues was allocated to utility accounts and reflected in the rates. The defect of the argument has already been demonstrated — by a policy announced in advance, no dry hole expense would be reflected in the rates unless the exploration program resulted in gas for ratepayers at less than the cost of purchasing the same gas in the market. There was no prospect that a gas customer in paying his bill would contribute to an unsuccessful exploration and development program and, therefore, there was no risk to the ratepayer, only to Mountain Fuel and its shareholders.

Mountain Fuel was not required to explore and develop gas fields; it could have simply purchased pipeline or field produced gas. The share of dry hole expense reflected in the utility rates was a *quid pro quo* for cost-of-service gas and would continue only so long as exploration resulted in lower rates. All of this was known in advance and constituted the announced rules under which the Mountain Fuel program went forward. The ratepayer risk theory is, beyond quibble, a sham.

The second premise of the Utah court is that a utility stands in a "trust relationship to its customers" (App. A4, 8) and must undertake all steps to sell gas at the cheapest rate

to consumers, including the dedication of profits from a non-utility business. This trust-relationship notion is in square conflict with this Court's constitutional holding in *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926). The New York Commission attempted to employ in a rate case an excess depreciation reserve created by the telephone company in prior years to off-set future year deficiencies in telephone revenues. The Court held that the New York Commission could not reach back and retroactively utilize assets of prior years to offset prospective revenue deficiencies. To do so would be a confiscation of investor assets in violation of the Fourteenth Amendment.

With respect to the trust-relationship notion, the Court in *New York Telephone* said:

The customers are entitled to demand service and the company must comply. The company is entitled to just compensation and, to have the service, the customers must pay for it. *The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary.* 271 U.S. at 31. (Emphasis added)

The Court also rejected the novel theory adopted by the Utah court here that a customer acquires an interest in the assets of a seller when he pays a purchase price that covers some or all of the seller's expenses:

Customers pay for service, not for the property used to render it. . . . By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of money received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock. 271 U.S. at 32. (Emphasis added)

In the American economy, there is nothing remarkable about any business, utility or otherwise, recovering all of its expenses plus a profit in the price it charges for the product or service it sells — all without the customer participating in the business profits or the assets that produced those profits.

The facts in this case are much more extreme than those which were indicted as a "taking" in *New York Telephone*. In the latter, the assets and accounts which were sought to be taken by the New York Commission *were and always had been* utility properties. The oil properties of Mountain Fuel never have been.

Had Utah made a prospective decision that utilities could not own non-utility assets, this case would be very different. But Utah did not do that. The judgment below holds that the State may consistently — by express statute, by consistent practice, and by specific adjudication for over four decades — assure the investor that its policy is not to regulate oil properties, invite investment on that basis, and then, only after significant oil discoveries had been made and the world price of oil had sharply risen, deliberately break its promise and appropriate the value of the investments made.

Not only will the Utah decision blunt and demoralize the investment-backed expectations of bondholders and shareholders in the capital markets of the nation in similar instances, it will, if permitted to stand, serve as an incentive for other states to seize corporate properties to ease the economic condition of voting consumers.¹⁶

¹⁶ As Mr. Justice Holmes wrote for the Court in *Pennsylvania Coal Co. v. Mahon*, *supra*:

We are in danger of forgetting that a strong public desire to improve the public condition [in this case by lowering local natural gas rates] is not enough to warrant achieving the desire by a shorter cut than the constitutional way of doing for the chance.

CONCLUSION

The non-utility oil properties of Mountain Fuel have been seized and expropriated by Utah without compensation in contravention of the Fifth and Fourteenth Amendments to the Constitution. In so doing, Utah has burdened interstate commerce by attempting to regulate the sale and production of gas and oil, fields which are federally preempted under the Supremacy Clause.

This petition for certiorari should be granted.

Respectfully submitted,

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United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, and
ALEX OBLAD, HAROLD BURTON, and
CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER
SERVICES and UTAH DEPARTMENT
OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF
THE STATE OF UTAH

BRIEF IN OPPOSITION

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ON PETITION FOR A WRIT OF CERTIORARI
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BRIEF IN OPPOSITION

INTRODUCTION

The Utah Division of Public Utilities and the Utah Committee of Consumer Services ("Utah") file this Brief in opposition to the petition for certiorari of Utah's principal natural gas utility, Mountain Fuel, and its af-

affiliated petitioners ("Mountain Fuel").¹ Mountain Fuel seeks federal review of a Utah Supreme Court decision determining a gross consumer fraud on Utah's citizens as a fraud the Utah court aptly characterized as a "regulatory outrage", in a manner wholly consonant with Utah's regulatory mandate and public policy without the remotest interference, let alone violation of any federal constitutional prescription.

QUESTIONS PRESENTED

1. Does the fourteenth amendment, the commerce clause or federal preemption prohibit Utah from treating Mountain Fuel's oil and gas properties located in Utah, Colorado and Wyoming as utility properties for rate-making purposes when those properties were explored and developed as utility properties pursuant to a utility exploration program at the risk of Utah's ratepayers?

2. Under the property guarantees of the fourteenth amendment does Mountain Fuel have the constitutional right to conduct an oil and gas exploration program as a utility activity, charge all of the risk of exploration to Utah ratepayers, and keep all the profits from oil discoveries for the sole benefit of Mountain Fuel's stockholders?

3. Does the fourteenth amendment require Utah to grant Mountain Fuel the best of both possible worlds,

¹ The amicus Mountain States Legal Foundation, which purports to present to the Court a "studied reflection" on this case, is financially supported by Mountain Fuel and has on its Board of Directors Wexpro's counsel.

that is, to treat the risk of oil and gas exploration as a utility activity to be borne solely by Utah's ratepayers, but the profits of successful oil discovery as the fruits of free enterprise to be enjoyed exclusively by Mountain Fuel's stockholders?

4. Was Utah constitutionally compelled to accept Mountain Fuel's totally unique "oil and gas method of classification" as the controlling principle for allocating the benefits from Mountain Fuel's oil and gas properties between ratepayer and stockholder interest?

5. Does federal preemption or the commerce clause deprive Utah of regulatory authority over a utility's oil and gas exploration program conducted in Utah and other states as a Utah utility activity at the sole risk of Utah's ratepayers upon the discovery of oil?

6. Is Utah's decision to apply the well-established principle of utility law—gain follows risk—in the allocation of benefits arising from utility activity between ratepayer and stockholder interest to Mountain Fuel's oil and gas properties barred by federal preemption or the commerce clause when those properties whether located in Utah or adjacent states were explored and developed as a Utah utility activity at the sole risk of Utah's ratepayers?

STATEMENT OF THE CASE

The sweeping questions Mountain Fuel attempts to present are contrary to the uncontroverted facts. Mountain Fuel's argument is fundamentally premised on three false factual assertions.

(1) Mountain Fuel claims Mountain Fuel conducted its oil and gas exploration program as a free enterprise, non-regulated activity. On the contrary, Mountain Fuel at all times conducted its exploration program as a utility activity.

(2) Mountain Fuel claims Mountain Fuel's shareholders bore the risk of its exploration for oil and gas. On the contrary, the ratepayers bore all the risk of Mountain Fuel's exploration for oil and gas.

(3) Mountain Fuel claims the decision of the Utah Supreme Court amounts to retroactive reclassification, whatever that is. On the contrary, the Utah decision does not recapture one dime of oil profits taken by Mountain Fuel's shareholders before the initiation of these proceedings, and only classifies as utility properties for future rate-making purposes, properties that always were and should have been so classified.

1. *Mountain Fuel always conducted its oil and gas exploration program as a utility activity.*

From the inception, Mountain Fuel conducted its oil and gas exploration program as a Utah utility activity. Unlike major oil companies, independent producers, or indeed other utilities, Mountain Fuel did not put up its shareholders' money and take its chances. Mountain Fuel let Utah ratepayers put up their money and take the chance of finding oil or gas. All of the wildcat acreage Mountain Fuel explored was acquired

by Mountain Fuel in its utility accounts and included in Mountain Fuel's rate base on which Mountain Fuel's ratepayers paid a regulated rate of return. (R. 700.)² If leases proved unsuccessful and were cancelled, the loss on such cancellation was charged to Mountain Fuel's ratepayers. (R. 687-88.) All preliminary exploratory work was charged as an expense in Mountain Fuel's rates. Most important of all, every single dry hole was charged to Mountain Fuel's Utah ratepayers. (Utah P.S.C. Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; R. 312-14, 687-89, 691, 701, 2394.) From 1947 until 1974 Mountain Fuel recovered all of its expense for the exploration and development of oil and gas through charges in its rates to Utah ratepayers and in fact the amount recovered actually exceeded the amount of expense incurred by Mountain Fuel in its exploration activities. (Utah P.S.C. Case Nos. 6668 and 6791 (1974); R. 694.)³ Mountain Fuel did conduct its exploration program in states other than Utah, but the uncontroverted facts were that that exploration program, wherever conducted—in Utah, Wyoming, or Colorado—was con

² The following abbreviations are used for the purpose of citation in this brief: (1) "R." refers to the transcript page numbers from evidentiary hearings before the Public Service Commission; (2) "Ord." by date and without case number refers to the orders of the Public Service Commission in this case; (3) orders by case number and date only refer to Commission orders in the cited case, and (4) citations to exhibits are to the exhibit number used in this proceeding; Mountain Fuel exhibits are referred to as MFS—; Division of Public Utilities exhibits are referred to as DIV—; and Salt Lake County exhibits are referred to as SLC—.

³ For accounting purposes, the costs of unsuccessful exploration are expensed and the costs of successful exploration are capitalized. Mountain Fuel's shareholders only put their money up after exploration proved to be successful.

ducted as a Utah utility activity, and Mountain Fuel only attempted to transform its exploration program from a utility to a non-utility classification after oil and gas were discovered.

2. *It was only after the successful discovery of oil that Mountain Fuel attempted to reclassify its oil properties as non-utility properties under Mountain Fuel's wholly-unique oil and gas method of classification.*

While Mountain Fuel explored for oil and gas as a utility activity, it attempted to transform successful oil discoveries into non-utility properties beyond regulatory control under its wholly-unique oil and gas method of classification. (R. 1030-31.) Under Mountain Fuel's oil and gas method of classification, a successful exploration was classified as an oil or gas well based on the type of hydrocarbon discovered. (MFS-5; R. 71-72, 422, 455, 559, 1030-31.) If a commercial discovery produced pipeline quality gas, the well and related properties were capitalized in Mountain Fuel's utility accounts and the gas distributed to Mountain Fuel's ratepayers as cost-of-service gas, which included, of course, a profit or rate of return on Mountain Fuel's capital investment. (MFS-5; R. 61.) All other hydrocarbons, whether crude oil, condensate, or natural gas liquids were classified by Mountain Fuel as oil properties and capitalized by Mountain Fuel in its non-utility accounts. (R. 1030-31; 1045.) Mountain Fuel kept all of the profits from these oil properties exclusively for Mountain Fuel's shareholders. (SLC-1 at 8; R. 1030-31.)

Mountain Fuel's oil and gas method of classification was thus used by Mountain Fuel for two purposes. First, it was used by Mountain Fuel as a test of Utah's regulatory jurisdiction. That is, under Mountain Fuel's oil-and-gas method of classification, Mountain Fuel claimed Utah lost regulatory jurisdiction upon Mountain Fuel's discovery of hydrocarbons other than pipeline gas. (Ord. 4/11/78 at ¶¶ 11, 52, 108.) Mountain Fuel also used its oil and gas method of classification as a principle of allocating the benefits of its exploration program between ratepayer and stockholder interests. (SLC-1 at 8; R. 1030-31.) Although all of Mountain Fuel's exploration program for oil and gas was conducted as a unitary utility activity, Mountain Fuel's ratepayers only benefited upon the discovery of gas.⁴ The ratepayers benefited upon gas discoveries by having such gas included in their rates at a cost-of-service price rather than field or market prices. The cost-of-service price, of course, included a profit for Mountain Fuel's stockholders. Although Mountain Fuel conducted its exploration as a utility activity under its oil and gas method of classification, it kept all oil discoveries

⁴ Utah did not argue that Mountain Fuel's exploration program had failed to benefit Utah ratepayers. Utah's argument was that Mountain Fuel's shareholders, under Mountain Fuel's oil and gas method of classification, realized huge oil profits to which they were not entitled. Mountain Fuel, moreover, in its petition, grossly overstates the benefits received by Utah's ratepayers. Mountain Fuel, in its petition, for instance, claims that Utah ratepayers received some \$93.8 million in tax deductions from Mountain Fuel's exploration program. (Petition at 9.) But the \$93.8 million includes all of Mountain Fuel's costs of unsuccessful exploration that were, in turn, charged to Utah's ratepayers to the tune of \$57 million. Simply, Mountain Fuel claims that it was to the ratepayers' benefit to pay for the cost of drilling dry holes.

for the sole benefit of Mountain Fuel's stockholders. In short, Mountain Fuel used its oil and gas method of classification to achieve the best of both possible worlds. When it was involved in the high-risk business of exploring for oil and gas, it conducted that business as a utility activity and charged those risks to Utah's ratepayers. When the risk of exploration was eliminated and it had discovered oil, Mountain Fuel attempted to convert its oil wells to non-utility properties and to keep the benefits or profits from those properties as the fruits of free enterprise exclusively for its stockholders. To look at the consequences of Mountain Fuel's oil and gas method of classification in the harsh light of economic reality, it was Mountain Fuel's position that Mountain Fuel was able to develop over \$250 million in oil reserves for the sole benefit of Mountain Fuel's stockholders without drilling a single dry hole.

Mountain Fuel's claim that its oil and gas method of classification was required by utility regulation and that its rejection will have economic and litigation repercussions beyond this one proceeding are wholly false. Mountain Fuel's oil and gas method of classification was not required by any rule or regulation. (R. 230, 231, 1029.) Indeed it was only after the initiation of these proceedings in 1977 that Mountain Fuel's oil and gas method of classification was ever reduced to writing. (Ord. 4/11/78 at ¶ 22; MFS-4, 5; R. 286.) Mountain Fuel's own chief executive officer acknowledged that while Mountain Fuel was required under standard utility regulation to keep separate utility and non-utility accounts, there was no rule or regulation that required

the division of Mountain Fuel's oil and gas properties between such accounts on the basis of Mountain Fuel's oil and gas method of classification. (R.231.) The reason there was no such accepted rule or regulation is because Mountain Fuel's oil and gas method of classification was wholly unique not only to the gas utility industry but to the entire oil and gas industry. No other company in the United States has ever used Mountain Fuel's oil and gas method of classification as a test of regulatory jurisdiction or as a principle for allocating benefits between ratepayer and shareholder interests. (R. 295-96; 459-61; 870-71; 2707.) The uniqueness of Mountain Fuel's oil and gas method of classification now belies Mountain Fuel's claim that Utah's rejection of that method of classification raises constitutional questions of substance for this Court's consideration or to put the issue in different perspective, belies Mountain Fuel's necessary position that the consequences of its oil and gas method of classification were compelled under the United States Constitution

3. Utah's ratepayers bore all of the risk of Mountain Fuel's exploration for oil and gas.

The risk of exploration for oil and gas is the risk of not finding oil or gas. All of the risk of oil and gas exploration is reflected in the cost of unsuccessful exploration and all of the cost of unsuccessful exploration by Mountain Fuel was charged by Mountain Fuel in its rates to Utah ratepayers. From 1947 until 1972 Utah ratepayers did not merely pay Mountain Fuel for the gas they used but also paid all of Mountain Fuel's cost for unsuccessful exploration—every single dry hole.

(Utah P.S.C. Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; R. 312-14, 687-89, 691, 1011, 2394.)

Mountain Fuel's shareholders or non-utility accounts were not required to pay one single dime toward Mountain Fuel's cost of unsuccessful exploration until 1972. In 1972, the Utah Public Service Commission for the first time required Mountain Fuel's non-utility accounts, representing the interest of Mountain Fuel's shareholders, to pay \$300,000 a year toward Mountain Fuel's cost of unsuccessful exploration. (Utah P.S.C. Case No. 6369 (1972); R. 688.) In 1974 Mountain Fuel's non-utility accounts were required to pay 1/3 of such cost (Utah P.S.C. Case No. 6668 (1974)) and finally in 1976, only one year before the Wexpro transactions, Mountain Fuel's stockholders were required to bear 50% of Mountain Fuel's risk of exploration. (Utah P.S.C. Case No. 7113 (1975); R. 688-89.)

From 1947 through 1974 the amount charged in Mountain Fuel's rates to Utah's ratepayers for the cost of unsuccessful exploration exceeded by over \$3 million the amount Mountain Fuel actually spent or incurred for unsuccessful exploration. (Utah P.S.C. Case Nos. 6668, 6791 (1974); R. 694.) In short, through 1974, Utah ratepayers bore all of Mountain Fuel's risk of exploration for oil and gas. By 1974 Mountain Fuel had already completed its major oil and gas discoveries. (Ord. 4/11/78 at ¶¶ 27-29.) Of the \$250 million in oil and gas reserves that Mountain Fuel attempted to transfer from its non-utility accounts to Wexpro in December

of 1976, over 96% of those reserves had been discovered by 1974. (Ord. 4/11/78 at ¶¶ 27-29; DIV-2; R. 1012, 1025.)

It is true that in 1972 Mountain Fuel's non-utility accounts were required to commence making token contributions to Mountain Fuel's exploration risk and that from 1972 through 1976 Mountain Fuel's shareholders, through its non-utility accounts, finally paid over \$8 million toward Mountain Fuel's risk of exploration. (DIV-1.) In the same 1972-1976 period, however, Mountain Fuel's ratepayers paid \$17 million toward Mountain Fuel's cost of unsuccessful exploration (*Id.*) and from 1947 through 1976 the ratepayers paid over \$57 million. (Utah P.S.C. Case Nos. 2906 (1947), 3275 (1948), 3511 (1950), 3650 (1951), 3972 (1953), 4392 (1957), 4797 (1960) and 5907 (1968); DIV-1; MFS-8.) More importantly, the shareholders' contribution that was finally required was only paid out of the enormous profits from oil properties that had been discovered at ratepayer risk. In 1972 Mountain Fuel had net profits from its non-utility oil properties of \$1.6 million; in 1973, \$2.3 million; in 1974, \$7.2 million; in 1975, \$14.4 million; and in 1976, the year before Wexpro, \$24 million. (SLC-1 at 8.) In the period, 1972-1976, when Mountain Fuel was finally required to pay \$8 million toward Mountain Fuel's cost of unsuccessful exploration it realized over \$47 million in net profits from the oil properties that had been developed at the sole risk of Mountain Fuel's ratepayers. Mountain Fuel's costs of unsuccessful exploration were, thus, either directly paid by Utah ratepayers or paid from the prof-

its of oil properties that had been developed at the sole risk of Utah ratepayers. The total risk, therefore, of Mountain Fuel's exploration and development of oil and gas was in economic reality borne by the Utah ratepayers of Mountain Fuel. It was this consumer fraud that was terminated by the Utah decision that Mountain Fuel now claims warrants review of this Court.

Mountain Fuel's claim, a claim made for the first time in this Court, that the risk of exploration charged to ratepayers was conditioned on the requirement that Mountain Fuel discover and produce cheap gas, is wholly false. The ratepayers' obligation to pay all of Mountain Fuel's cost of unsuccessful exploration was not conditioned in any way. If Mountain Fuel had not discovered a single cubic foot of gas, Mountain Fuel and its stockholders would not have had to reimburse or defray any of the burden placed on Utah's ratepayers. The record is wholly devoid of any such administrative requirement. There was simply no money-back guarantee.

4. *The Wexpro transactions.*

Effective January 1, 1977, Mountain Fuel attempted to once and for all remove the oil and gas properties held in its non-utility accounts from what it perceived as the jeopardy of Utah regulation. Mountain Fuel created a wholly-owned subsidiary, Wexpro, and attempted to transfer all of the oil and gas reserves held in its non-utility oil accounts with a market value in excess of \$250 million to Wexpro. Mountain Fuel also at-

tempted to have Wexpro enter into a joint exploration arrangement with Mountain Fuel to explore over 2.9 million acres of oil and gas leases held in Mountain Fuel's utility accounts. The transfer of Mountain Fuel's oil and gas properties to Wexpro at book value in exchange for all of Wexpro's outstanding stock was reflected in a Purchase and Sale Agreement. (MFS-1.) The Purchase and Sale Agreement, as amended, required Wexpro to resell all of the gas produced from the transferred properties to Mountain Fuel at cost-of-service prices. (MFS-4.) The Purchase and Sale Agreement also gave Mountain Fuel an option to purchase gas produced by Wexpro on new acreage at market prices. The joint exploration arrangement was reflected in a Joint Exploration Agreement between Mountain Fuel and Wexpro. (MFS-2, 5.)

The respondents initiated the proceedings below to attack the Wexpro transactions. Utah claimed that the Commission had jurisdiction over the oil and gas properties held in Mountain Fuel's non-utility accounts, that such properties were utility properties, and that they should be rolled in or included in Mountain Fuel's utility accounts for rate-making purposes. The Public Service Commission, in a 2-1 decision,⁵ ruled against respondents, and they appealed to the Utah Supreme Court.

⁵ The Commission Report & Order set forth at pages 1 to 95 of Appendix B to Mountain Fuel's petition does not represent the independent product of the Public Service Commission but was adopted verbatim from the order proposed by Mountain Fuel an adjudicatory practice previously critized by this Court. *U.S. v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

5. *The decision of the Utah Supreme Court.*

The Utah Supreme Court reversed the Utah Public Service Commission. The holdings of the Utah Supreme Court below can be divided for the purpose of the petition for certiorari between holdings addressed to issues relating to the oil and gas properties held in Mountain Fuel's non-utility accounts and holdings addressed to the option of Mountain Fuel to purchase gas produced by Wexpro from newly-acquired acreage at market prices and Wexpro's regulatory status. The holdings of the Utah Supreme Court addressed to the oil and gas properties were by far the most important and were the focus of the court's decision. These holdings were clear and final.

The Utah Supreme Court held with regard to the oil and gas properties held in Mountain Fuel's non-utility accounts (1) such properties were utility properties (App. A12),⁶ and (2) such properties should be included in Mountain Fuel's utility accounts for rate-making purposes (App. A8, 9). The Supreme Court of Utah categorically rejected Mountain Fuel's oil and gas method of classification as a proper test of Utah regulatory jurisdiction or as a proper principle for the allocation of benefits arising from Mountain Fuel's oil and gas exploration program between ratepayer and shareholder interest. The bottom line of the Utah Supreme Court's decision was that the net profits from Mountain Fuel's oil properties beyond all costs associated with their pro-

⁶ The citation "App. A" refers to the Utah Supreme Court's decision set forth in Appendix A to Mountain Fuel's Petition for a Writ of Certiorari.

duction, including the cost of capital, should be applied to the benefit of Utah ratepayers through a reduction in their future rates (App. A8, 9). The court held the ratepayers were to receive those net profits because the ratepayers and not Mountain Fuel's shareholders had assumed the risk of exploration for oil and gas (App. A8). The Utah court reached the same result as Michigan and California, *Re Michigan Consolidated Gas Co.*, 78 P.U.R.3d 321 (Mich. Pub. Serv. Comm'n 1968); *Re Pacific Gas & Electric Co.*, 97 P.U.R.3d 321 (Cal. Pub. Serv. Comm'n 1972), and implicitly followed the thoughtful decision of the Circuit Court of Appeals for the District of Columbia in *Democratic Central Committee v. Washington Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974).

The Utah Supreme Court's holding with regard to Mountain Fuel's option to purchase gas from Wexpro at market prices was occasioned by the past practices of Mountain Fuel. When gas reserves wound up in Mountain Fuel's non-utility accounts as a result of Mountain Fuel's oil and gas method of classification, Mountain Fuel added insult to injury by reselling that gas to Mountain Fuel's utility accounts at market prices, and then passing on those market prices as an expense in its rates to Utah ratepayers. The Supreme Court of Utah, in light of these past practices, adopted a "no-profit-to-affiliates" rule which prohibited such intra-company profits from being included in consumer rates, and applied that rule to the Mountain Fuel-Wexpro option so as to prevent any profit realized by Wexpro

under that option from being passed on to Mountain Fuel's ratepayers. The Utah Supreme Court also held that Wexpro, by reason of its relationship as a wholly-owned subsidiary of Mountain Fuel and the unique relationship between Mountain Fuel and Wexpro created under the Purchase and Sale Agreement and the Joint Exploration Agreement, was, under Utah law, a public utility.

While the Supreme Court's holding with regard to the Mountain Fuel-Wexpro option and Wexpro's status as a public utility are clear, their finality for the purpose of certiorari is less certain. The Supreme Court not only set aside the Purchase and Sale Agreement and the Joint Exploration Agreement, the Supreme Court of Utah left open the question of whether Wexpro is to exist at all. Specifically, in footnote 8, the Utah court said:

There is further posed the serious issue of whether it is in the public interest for Mountain Fuel to divide its utility function between itself and a subsidiary. Relevant factors to be considered in this inquiry include any potential administrative inconvenience caused by the necessity of regulating two corporate entities performing, in essence, a singular utility function; and additional costs and expenses affecting the rate base.

Simply put, the question of whether there is going to be a Wexpro remains a Utah regulatory issue.

6. *The decision of the Utah Supreme Court does not confiscate any property of Mountain Fuel or its shareholders, interfere with interstate commerce or conflict with federal energy policy.*

Mountain Fuel's attempt to concoct "substantial Federal questions" out of the decision below is premised on fundamental mischaracterization of the court's decision. The Utah Supreme Court's decision did not confiscate anything. The Utah Supreme Court merely held that oil and gas properties that had been developed under a utility program at the risk of Utah ratepayers were utility properties on which Mountain Fuel was only entitled to a regulated rate of return, and that net profits beyond that regulated rate of return should be credited to Mountain Fuel's ratepayers to reduce rates. What Mountain Fuel's shareholders are entitled to have constitutionally protected and what will be protected under the decision of the Utah Supreme Court is their capital investment in Mountain Fuel's utility oil properties.

The decision below does not "retroactively reclassify" anything. Mountain Fuel's attempt to inject the slogan "retroactive reclassification" to support its "confiscation" argument is sophistry. Nothing in the Utah court's holding will affect anything prior to the institution of the *Wexpro* proceeding. There is no impact on rates received or revenues realized under any prior Commission order. Mountain Fuel will keep every dime of the \$57 million it received for the cost of unsuccessful exploration. It will keep every dime of oil profits it received through the end of 1976—profits amounting to over \$47 million. The court's decision will only affect rates and revenues after the initiation of the *Wexpro* case.

The Utah decision did not regulate the price, pro-

duction or profits of oil and gas sold in interstate commerce. The Utah decision did not remotely attempt to regulate the price at which oil or gas is sold by Mountain Fuel or Wexpro to others, nor does it even regulate the price at which Wexpro sells gas to Mountain Fuel under the Mountain Fuel-Wexpro option. All that the Utah Supreme Court held with regard to the Wexpro-Mountain Fuel sales is that any profits realized by Wexpro could not be included as charges in Mountain Fuel's rates to Mountain Fuel's customers under the "no-profit-to-affiliates" rule.

By holding that the unique relationship between Mountain Fuel and Wexpro resulted in Wexpro being classified as a public utility, the Utah Supreme Court did not hold and did not even state that independent parties other than Wexpro would be classified as public utilities by reason of their normal business relationships with Mountain Fuel. The Utah Supreme Court did not attempt to regulate the price of natural gas sold to Mountain Fuel for resale by independent parties or to classify such independent suppliers as public utilities. Indeed, Utah has a statute that expressly exempts such independent suppliers from classification as a public utility. Thus, section 54-2-1(30) provides in material part:

Such person, company, corporation or association selling or exchanging such surplus product under such authorized contract shall not thereby become a public utility within the meaning of this act, nor shall it be subject to the jurisdiction of the commission. . . . § 54-2-1 (30), U.C.A. 1953.

And finally, the Utah Supreme Court's decision does not prevent any independent party from engaging in joint exploration with Mountain Fuel under the penalty of being classified as a public utility. Wexpro was not an independent party. Wexpro was created as a wholly-owned subsidiary of Mountain Fuel for the sole business purpose of receiving all of the oil and gas properties held in Mountain Fuel's non-utility accounts and to explore with Mountain Fuel the valuable wildcat acreage held in Mountain Fuel's utility accounts. It was intimately involved in an attempt to secure with finality hundreds of millions of dollars of oil and gas reserves that had been developed at ratepayer risk for the benefit of Mountain Fuel's shareholders, and to grab enormously valuable exploration rights on over 2.9 million acres of oil and gas leases held in Mountain Fuel's utility accounts. There was nothing independent about Wexpro, and there is nothing in the *Wexpro* decision by the Utah Supreme Court that regulates, threatens or interferes with independent producers or sellers.

REASONS FOR DENYING THE WRIT

1. *The Utah Supreme Court's decision does not raise any issue of constitutional confiscation.*

Mountain Fuel's claim of constitutional confiscation amounts to a claim that Mountain Fuel is constitutionally entitled in its exploration program to the best of both possible worlds—the worlds of utility regulation and private enterprise. Mountain Fuel under its "oil" and "gas" method of classification asked to be treated

as a utility when it was engaged in the risk of exploration. It wanted to be treated as a utility by having its wildcat acreage capitalized in its utility accounts as property held for future use, when it incurred losses on wildcat acreage by including as a charge in its rates the expenses of cancelled leases, when it did geophysical and seismic work preparatory to exploration, and when exploration was unsuccessful and resulted in dry holes. But Mountain Fuel wanted its exploration to be transformed into a private enterprise as soon as oil was discovered. It wanted to be treated as a private enterprise under its "oil" and "gas" method of classification where the benefits of profits of its oil properties were concerned.

The simple answer to Mountain Fuel's claim of constitutional confiscation is that the constitution does not guarantee a utility the best of both possible worlds. The constitution does not guarantee a utility can charge its ratepayers the cost of service for the gas they receive, in addition can charge its ratepayers for all the cost of unsuccessful exploration, and then keep the unregulated return from oil properties discovered through such exploration solely for the benefit of stockholders.

Under the Utah Supreme Court's decision Mountain Fuel and Mountain Fuel's stockholders receive the constitutional protection to which they are entitled. What Mountain Fuel's stockholders are entitled to have protected, and what will be protected under the Utah Supreme Court's decision, is their capital investment. *Federal Power Commission v. Hope Natural Gas Co.*,

320 U.S. 591 (1944); *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934); see also, *Nebbia v. People of the State of New York*, 291 U.S. 502 (1934). The roll-in of Mountain Fuel's utility oil properties and associated revenues and expenses under the Utah Supreme Court's decision will result in the full protection of Mountain Fuel's stockholders' capital investment in utility oil properties. All the costs associated with the operation and production of Mountain Fuel's utility oil properties, including a rate of return or profit on the stockholders' capital investment, will inure to the benefit of Mountain Fuel's stockholders. That is the protection required by the constitution and that is the protection that Mountain Fuel's stockholders will receive under the court's decision. What the stockholders will not receive are the net profits of Mountain Fuel's utility oil properties beyond all costs associated with their production. Beyond such costs those profits will be allocated to its ratepayers under the Utah Supreme Court's decision, for those profits are profits attributable to the risks of exploration, the risks that were exclusively borne by Mountain Fuel's ratepayers.

This Court has squarely held that there is no constitutional right to non-regulation and certainly there is no constitutional right to the continued acceptance of Mountain Fuel's oil and gas method of classification that arbitrarily and improperly removed utility properties from the jurisdiction of the Commission. *Federal Power Commission v. Natural Gas Pipeline*, 315 U.S. 575 (1942); *Nebbia v. People of the State of New York*, *supra*; *Cottonwood Mall Shopping Center v. Uta*

Power & Light Co., 440 F.2d 36 (10th Cir. 1971). The argument that Mountain Fuel makes was precisely the constitutional attack made against the Natural Gas Act of 1938 which for the first time placed natural gas pipelines under federal regulation and made such pipelines subject to a regulated rate of return. The Court made short shrift of that argument and stated, "[T]he business . . . is not any the less subject to regulation now because the government has not seen fit to regulate it in the past." *Federal Power Commission v. Natural Gas Pipeline*, *supra*, at 583.

The roll-in of oil properties, revenues and expenses is not confiscation at all, but is an application by the Utah Supreme Court of the controlling principle uniformly followed by courts and commissions in allocating benefits arising from utility activities between ratepayer and stockholder—gain follows risk. *Democratic Central Committee v. Washington Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974); *Bebchick v. Washington Transit Commission*, 485 F.2d 858 (D.C. Cir. 1973); *New York Water Service Corp. v. Public Service Commission*, 12 App. Div.2d 122, 208 N.Y.S.2d 857 (1960); *El Paso Natural Gas Co.*, Docket No. CP75-362 (FERC 1977); *Re Michigan Consolidated Gas Co.*, 78 P.U.R.3d 321 (Mich. Pub. Serv. Comm'n 1968); *Re Wyoming Gas Co.*, 40 P.U.R.3d 509 (Wyo. Pub. Serv. Comm'n 1961). The principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom, *Democratic Central Committee*, *supra*, at 806, does not raise an issue of con-

fiscation, but is valid regulation of public utility activity in the public interest. This principle of allocation has been adopted without exception by every single judicial and administrative decision in every jurisdiction which has ever addressed the question. *Bebchick v. Washington Transit Commission*, *supra*; *New York Water Service Corp. v. Public Service Commission*, *supra*; *El Paso Natural Gas Co.*, *supra*; *Re Michigan Consolidated Gas Co.*, *supra*; *Re Wyoming Gas Co.*, *supra*. The claim of "confiscation" is a red herring.

2. *The Utah Supreme Court's decision does not raise any issue of undue burden or obstruction of interstate commerce.*

Mountain Fuel's claim the Utah Supreme Court decision burdens or obstructs interstate commerce is wholly without merit.

(a) Mountain Fuel attempts to argue that the Utah Supreme Court's holding addressed to the Mountain Fuel-Wexpro option obstructs commerce by regulating the price of interstate sales of gas from Wexpro to Mountain Fuel.⁷ The decision below does nothing of the sort. Rather, the Utah Supreme Court requires the Public Service Commission to allow in retail rates only the cost of service on gas sold by Wexpro to Mountain Fuel. The court does so under the "no-profit-to-affiliates" rule, applying the well-established principle that

⁷ While the question whether Wexpro is to exist at all is still open, see § 5, *supra*, there is no commerce clause issue raised by this case whether Wexpro exists or not. For the purpose of respondents' argument respondents assume that Wexpro will be in business.

shareholders should not be able to make a profit at the expense of ratepayers on transactions between affiliated companies where there is no arm's-length bargaining. Regardless of whether or not Wexpro's gas comes from inside or outside Utah, this holding is fully in line with constitutional doctrine established by this Court. This Court has consistently held a state, in retail ratemaking, may determine a reasonable charge on interstate sales of natural gas between affiliates without violating the commerce clause. In *Lone Star Gas Co. v. Texas*, 304 U.S. 224 (1938), this Court expressly rejected the argument that a determination by the Texas commission of a reasonable rate for gas sold interstate to a utility by an affiliated pipeline company was invalid under the commerce clause. *Lone Star Gas* was consistent with and followed the rule laid down in *Dayton Power & Light Co. v. Public Utilities Commission of Ohio*, 292 U.S. 290 (1934) and *Western Distributing Co. v. Public Service Commission of Kansas*, 285 U.S. 119 (1932). In *Western Distributing*, the Court explained why a state inquiry into the reasonableness of a charge by an affiliate for gas sold interstate does not circumvent paramount federal authority over interstate commerce:

Those in control of the situation have combined the interstate carriage of the commodity with its local distribution in what is in practical effect one organization. There is an absence of arm's length bargaining between the two corporate entities involved, and of all the elements which ordinarily go to fix market value. The opportunity exists for one member of the combination to charge the other an unreasonable rate for the gas fur-

nished and thus to make such unfair charge in part the basis of the retail rate. The state authority whose powers are invoked to fix a reasonable rate is certainly entitled to be informed whether advantage has been taken of the situation to put an unreasonable burden upon the distributing company, and the mere fact that the charge is made for an interstate service does not constrain the Commission to desist from all inquiry as to its fairness. Any other rule would make possible the gravest injustice, and would tie the hands of the state authority in such fashion that it could not effectively regulate the intrastate service which unquestionably lies within its jurisdiction. *Western Distributing Co.*, *supra*, at 124-25.

The Utah Supreme Court's holding on this point was especially sound in this case in light of the fact that in the past Mountain Fuel has actually been selling gas from its non-utility accounts to its utility accounts at market prices, and then passing on those market prices as an expense in rates to Utah ratepayers. The commerce clause under this Court's doctrine does not proscribe a state from putting a stop to that kind of practice.

(b) Mountain Fuel's argument that the roll-in of oil properties and profits obstructs commerce is based on a fundamental misstatement of the Utah Supreme Court's decision. Mountain Fuel misrepresents the court's holding by arguing that it regulates production, prices and profits on interstate sales of crude oil developed in states other than Utah. That is false. On the contrary, all the Utah Supreme Court held with regard to Mountain Fuel's oil profits is that net profits

beyond all costs associated with production, including the cost of capital, from oil developed as a utility activity at the sole risk of ratepayers, should benefit Utah's ratepayers. This is rate-making, not regulation of production, price or profit.

Mountain Fuel's contention that the roll-in of oil properties and profits violates the commerce clause because oil is developed and sold outside Utah is again contrary to the doctrine of this Court. This Court has squarely held that the commerce clause does not prohibit a state, in establishing utility rates, from classifying as utility properties for rate-making purposes properties located in other states. In *Lone Star Gas Co. v. Texas*, *supra*, this Court upheld, without requiring segregation of out-of-state properties from the rate base or segregation of revenues and expenses associated with those properties, an order of the Texas Railroad Commission reducing natural gas rates charged by a Texas utility.

This was not a case where the segregation of properties and business was essential in order to confine the exercise of state power to its own proper province [citation omitted]. Here, as we have seen, the Commission in its method of dealing with the property and business of appellant as an integrated operating system did not transcend the limits of the state's jurisdiction or apply an improper criterion in its determinations. *Lone Star Gas Co.*, *supra*, at 241.

Cf. Capital Transit Co. v. Public Utilities Commission of D.C., 213 F.2d 176, 179-81. (D.C. Cir. 1953).

Not only is Mountain Fuel's argument wrong as a matter of this Court's doctrine, but it flies in the face of

regulatory reality. It is both necessary and common for public utilities throughout this country to utilize out-of-state properties to provide services to consumers in their state of service. For example, Pacific Gas & Electric Company, in serving energy to California consumers, explores and develops oil and gas properties in Alaska.⁸ Mountain Fuel itself explores for and develops hydrocarbons in Wyoming and Colorado for the purpose of providing natural gas to ratepayers in Utah. Because out-of-state properties are necessary to provide utility services, state public utility commissions have to include these properties in rate base and calculate rates on the basis of revenues and expenses from them. Mountain Fuel's commerce clause argument would have the effect of handicapping utilities in developing adequate sources of power to serve their consumers, and would handicap utility commissions in exercising the regulatory powers they need to set rates. Therefore, not only is Mountain Fuel's argument contrary to this Court's doctrine, but it would have the effect of stripping public commissions of power they use as a matter of course on a day-to-day basis. Mountain Fuel's position that this common practice violates the commerce clause is constitutional nonsense.

(c) Mountain Fuel's final claim the decision below burdens interstate commerce is based on the totally false premise that the holding of the Utah Supreme Court will regulate as public utilities independent

⁸ See, e.g., *Re Pacific Gas & Electric Co.*, 97 P.U.R.3d 321 (Cal. Pub. Serv. Comm'n. 1972), where the California Commission gave ratepayers the benefits in rates of profits on oil discovered by the utility in Alaska.

parties jointly exploring with Mountain Fuel and will regulate interstate gas sales between independent parties and Mountain Fuel. These premises are categorically false and are a misstatement of the Utah Supreme Court's holding. The issues in this case solely concern Mountain Fuel and its wholly-owned subsidiary, Wexpro, and the court's decision makes no holding and has absolutely no ramifications with respect to independent parties.

3. *The Utah Supreme Court's decision does not raise any issue of preemption.*

Mountain Fuel's claim that the Utah Supreme Court decision regulates both oil and gas in conflict with federal statutes and policy is also nonsense. Mountain Fuel attacks both the court's decision prohibiting Wexpro to make a profit on its sales of gas to Mountain Fuel at ratepayer expense, and the holding benefiting ratepayers by rolling in oil profits on utility properties explored and developed at ratepayer risk. Neither of these holdings is remotely preempted by any federal statute, regulation or policy.

Mountain Fuel claims the Natural Gas Act preempts the Utah Supreme Court's holding preventing Mountain Fuel from passing on in rates any more than the cost of service on natural gas it obtains from Wexpro. In making this argument, Mountain Fuel misanalyzes the Utah Supreme Court's decision. The decision does not regulate wholesale prices, but prohibits profits on wholesale sales between Mountain Fuel and its wholly-owned subsidiary, Wexpro, from being

charged to ratepayers in the retail price of gas. This action is fully consistent with this Court's holdings on this very point. Contrary to Mountain Fuel's position, the Natural Gas Act left it to the states to do exactly what the court below mandated. Prior to the passage of the Natural Gas Act, this Court held consistently and squarely the states had constitutional power to regulate charges in retail rates for natural gas purchased from affiliates, regardless of whether or not the gas was purchased from the affiliate in an interstate transaction. *Western Distributing Co., supra*; *Dayton Power & Light Co., supra*; *Lone Star Gas Co., supra*. The Natural Gas Act had no effect on that authority. *Panhandle Eastern Pipeline Co. v. Michigan Public Service Commission*, 341 U.S. 329 (1951); *Panhandle Eastern Pipeline Co. v. Public Service Commission of Indiana*, 332 U.S. 507 (1947). The Natural Gas Act "had no purpose or effect to cut down state power." *Panhandle v. Indiana, supra*, at 517. The Natural Gas Act was not intended and could not have been intended by Congress to render states helpless to protect consumers against affiliated companies' price manipulations, when the Court prior to the Act had held the states had clear power to provide consumers such protection. This Court stated in *Panhandle v. Indiana, supra*, with respect to the Act:

[P]erhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions. The Act was drawn with meticulous re-

gard for the continued exercise of state power, not to handicap or dilute it in any way.

* * * *

It would be an exceedingly incongruous result if a statute so motivated, designed and shaped to bring about more effective regulation, and particularly more effective state regulation, were construed in the teeth of those objects, and the import of its wording as well, to cut down regulatory power and to do so in a manner making the states less capable of regulation than before the statute's adoption. *Id.* at 517-19.

Therefore, Mountain Fuel's argument that Utah is constitutionally required to allow its natural gas public utility's stockholders to make a profit at ratepayer expense on gas "purchased" from its wholly-owned subsidiary is simply wrong.

Mountain Fuel argues that the entire decision of the Utah Supreme Court is preempted by "federal regulation [which] has been extended to completely eclipse state regulation in this field." (Petition at 25.) Mountain Fuel cites a string of federal statutes, including the Natural Gas Act, in support of this fatuous proposition (Petition at 24, n. 11). But federal statutes have not eclipsed the field and "ousted" state regulation. The very statutes cited by Mountain Fuel belie that proposition. Congress has expressly recognized in these statutes the traditional powers of the states over oil and gas matters. The absurdity of Mountain Fuel's position is seen, for example, in the Public Utility Regulatory Policy Act of 1978, 15 U.S.C. §§ 3201, *et seq.* (1978). That statute expressly provides:

Nothing in this chapter prohibits any State regulatory authority or nonregulated gas utility from adopting, pursuant to State law, any standard or rule affecting gas utilities which is different from any standard established by this chapter. 15 U.S.C. §3208.⁹

There is no pattern of Congressional law "eclipsing the field." In fact, Congress has demonstrated its intent not to do so. Nor is there any conflict between any federal policy, statute or regulation and the holding of the Utah Supreme Court. The Utah Supreme Court does not in any way regulate production, price or profit of oil or gas. It rather articulated and implemented uniformly accepted principles of ratemaking. Allocation of profits according to the principle gain follows risk is not regulation of production, price or profit. Mountain Fuel necessarily misstates the holdings because it realizes an accurate reading of the decision raises no federal issue of any sort.

Once again, Mountain Fuel's position flies in the face of regulatory reality. Mountain Fuel would have this Court eliminate all classes of state regulation over any aspect of the oil and gas business. It would eliminate state regulation preventing waste of oil and gas. It would eliminate state regulation promoting conservation. It would eliminate state boards with the juris-

⁹ See also the Federal Energy Petroleum Allocation Act, cited by Mountain Fuel, which again demonstrates Congress' recognition that federal regulation has not "completely eclipsed" the field. This Act, by its express terms, preempts only state regulation over allocation of refined petroleum products which are in actual conflict with regulations promulgated pursuant to it. 15 U.S.C. §755(b).

diction and authority necessary to promote conservation. It would eliminate state laws requiring well permits and the spacing of wells.¹⁰ The argument is simply untenable.

Mountain Fuel states that the Utah Supreme Court's decision frustrates federal policy by "siezing profits" on Wexpro's oil sales because Mountain Fuel's "exploration and development program will be compelled to phase out and end." (Petition at 26.) This is nothing more than a thinly-veiled temper tantrum by Mountain Fuel's stockholders who threaten to end their exploration program if they do not get their own way. But a temper tantrum does not produce a federal constitutional issue. Mountain Fuel's contention the decision eliminates price incentives in violation of federal policy is wholly inaccurate. Price incentives are not eliminated by the decision. Mountain Fuel has always been free, and still is free, to engage in a free-enterprise oil and gas exploration program of its own. Mountain Fuel has the same price incentives as any other company. All it needs to do is put its stockholders' money at risk, rather than use the profits generated by its exploration program to foster the enterprise. Nor is the decision at all to end the program credible, because this temper tantrum cannot limit Mountain Fuel's obligations under federal law to serve as a public utility under Utah's regulatory authority.

¹⁰ See, e.g., §§ 40-6-1, et seq., U.C.A. (1953).

Finally, the claim that this decision will invite other states to "sieze profits" from utilities rings hollow. The Utah Supreme Court was faced with a wholly-unique problem. No other utility in this country ever developed this unique system of classification to give its shareholders the best of both worlds in its exploration and development of oil and gas at the expense of ratepayers. Mountain Fuel's conduct was unique and the decision will not have the ramifications claimed by Mountain Fuel. Mountain Fuel's claim that this abuse of Utah consumers rises to the level of constitutional principle warrants no consideration by this Court.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

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Respectfully submitted,

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