

1982

Utility Shareholder Association of Utah et al v.
Public Service Commission of Utah et al : Joint
Brief of Utah Department of Business Regulation,
Division of Public Utilities and Utah Committee of
Consumer Services

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

UTAH DEPARTMENT OF ADMINISTRATIVE :
SERVICES, UTAH COALITION OF SENIOR :
CITIZENS, UTAH UTILITY SHAREHOLDERS :
ASSOCIATION, ALEX OBLAD and HAROLD :
BURTON, :

Plaintiffs/Appellants, :

v. :

PUBLIC SERVICE COMMISSION OF UTAH; :
MILLY O. BERNARD, Chairman; DAVID :
IRVINE, Commissioner; and BRENT :
CAMERON, Commissioner, :

Case Nos. 18286, 18303, 18304

Respondents, :

MOUNTAIN FUEL SUPPLY COMPANY, a Utah :
Corporation; WEXPRO COMPANY, a Utah :
corporation; UTAH DEPARTMENT OF BUSI- :
NESS REGULATION, DIVISION OF PUBLIC :
UTILITIES; and UTAH COMMITTEE OF :
CONSUMER SERVICES, :

Defendants/Intervenor- :
Respondents. :

JOINT BRIEF OF UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES, ("THE DIVISION") AND
UTAH COMMITTEE OF CONSUMER SERVICES ("THE COMMITTEE")

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STATEMENT OF THE CASE

In 1978, the Public Service Commission ("the Commission"), as a part of the original "Wexpro" hearing, concluded in its 1978 Order that because certain properties, which were primarily oil producing, were not "used and useful" in the gas utility business, they were not "utility property" and therefore no jurisdiction existed in the Commission to examine the terms of Mountain Fuel Supply Company's ("MFS") proposed transfer of such properties to Wexpro Company ("Wexpro"). The Division of Public Utilities ("the Division") and the Committee of Consumer Services ("the Committee") appealed that Order to this Court, asserting legal error in that jurisdictional holding.

In Committee of Consumer Services v. Public Service Commission, 595 P.2d 871 (Utah 1979) (hereafter "the Wexpro Case"), this Court rejected the classification of properties as utility or non-utility based on whether the properties primarily produced gas or oil and remanded the case to the Commission to examine the proposed transfer of properties using a proper and specified jurisdiction test. 595 P.2d at 878. The Appeal in the Wexpro Case did not raise, and thus the Court's opinion did not decide, numerous questions concerning the proper sharing of benefits from the oil and gas properties owned by MFS and its affiliates or the power of the Commission to force MFS to conduct a ratepayer supported exploration program.

Taking this Court's decision in the Wexpro Case as direction and guidance, the Division and the Committee negotiated with MFS and Wexpro to settle the property transfer issues dividing the parties. The resulting Stipulation ("the Stipulation") and Agreement ("the Agreement") assumed that all of the affected properties were utility properties based on this Court's definitions. (Hereafter, the Stipulation and the Agreement may be collectively referred to as "the Settlement".)

On August 3, 1981, MFS, Wexpro, the Division and the Committee presented the Commission with a summary of the Stipulation and Agreement, and their motion for approval of, the Settlement. The Commission set the matter for hearing on October 14, 1981, at which time the Utility Shareholders' Association ("Shareholders") and the Coalition of Senior Citizens ("the Coalition") entered their appearances. The proponents of the Settlement presented evidence and argument during the course of hearings held on October 14, 15, 16, 19 and 20, 1981, and November 23, 24 and 25, 1981. Prior notice of the hearings and the opportunity for the public to participate was published in a newspaper of statewide distribution for two consecutive days. The news media provided extensive coverage of the hearings and of the opportunity for public comment. (Ord. at 4 and 5.)

After considering the extensive expert testimony, public comment, and argument and explanations by counsel, the Commission

issued its Report and Order on December 31, 1981, approving the Settlement. On January 18, 1982, the Shareholders made application for rehearing. The Coalition and Utah Department of Administrative Services ("Administrative Services") also filed applications for rehearing dated January 20, 1982. All applications were denied by the Commission on February 9, 1982.

ISSUES ON APPEAL

The Committee and Division believe that the voluminous pages of "questions" presented for review by Appellants can fairly be reduced to the following:

1. Could The Wexpro Litigation Be Settled?
2. Does The Settlement Comply With The Law As Declared by This Court?
3. Did The Commission Surrender Its Statutory Jurisdiction By Approving The Settlement?
4. Does The Order Clearly Express The Commission's Intent As To Its Finality?

SUMMARY OF DIVISION AND COMMITTEE POSITION

Based on the clear power given it by statute and the clear legislative purpose of encouraging settlement of controversies, the Commission acted lawfully and properly in approving the Settlement. Based on the overwhelming and unanimous expert testimony below, the

Settlement was in the public interest and its terms complied with the law as declared by this Court in its Wexpro decision. In essence, the Settlement resolves the dispute between MFS and its ratepayers by the mechanism of selling the ratepayers' interest in the disputed properties to the shareholders in exchange for a retained interest in the oil and gas produced from the properties. While this solution results in the properties being transferred out of MFS's utility accounts and thus presumptively out of the Commission's jurisdiction, it does not affect the statutory scope of the Commission. By submitting the Settlement to the Commission for approval and a determination that the transfers are in the public interest and for fair market value, the parties recognized the Commission's authority to regulate the terms of such transfers. Finally, as made eminently clear by the Commission's language in its Conclusion of Law #6, the Order was intended to be final as to those properties treated by the Settlement.

In short, no grounds exist for criticizing the Commission Order approving the Settlement; rather, the Commission's action should not only be upheld on appeal but applauded as a responsible and considered step to resolve a veritable Pandora's Box of litigation.

I. STATEMENT OF FACTS

A. BACKGROUND

The Brief of MFS and Wexpro contains a satisfactory outline of the testimony presented at the hearing below. The Division and the Committee hereby adopt that discussion and incorporate it by this reference.

The material found at pages 16 - 29 and at pages 38 - 45 of Administrative Services Brief provides a largely irrelevant but adequate summary of the history of the Wexpro controversy and what the Division and the Committee would have argued had there been no Settlement. Because this material may be useful background to the Court, it is hereby incorporated by this reference with the caution that it does not address the issues before this Court on appeal, to wit: whether the Commission's Order approving the Agreement is supported by law and the factual record made during the Commission's hearings on the Settlement.

B. INACCURACIES IN APPELLANTS' FACTUAL STATEMENTS

The Administrative Services' and the Coalition's statement of the terms of the Settlement is so colored with argument that the Division and the Committee find it necessary to provide its own outline of the Settlement. First, however, the Division and Committee must correct certain misstatements and erroneous conclusions contained in the Briefs of Administrative Services and the Coalition:

Inaccuracy #1: "There Was No Determination Below of the Public Interest." (Admin. Serv. Br. at 1)

For eight days, the Commission heard testimony and argument on whether the terms of the Settlement were in the public interest. The Commission explicitly found that the Settlement was in the public interest. (Order at Findings of Fact #8, #9, and #11; Conclusions of Law #4 and #5).

Inaccuracy #2: "The Commission Took No Evidence and Made No Finding as to the Fair Market Value of the Properties Transferred Under the Agreement." (Admin. Serv. Br. at 1)

The record below is replete with expert testimony from highly respected oil and gas experts that the Agreement passed to the ratepayers, fair market value consideration for the ratepayers' interest in properties transferred under the Agreement. (Tr. 1024, 1025, 1045, 1155-56, 1165, 1173, 1249, 1251, 1261, 1263, 1328, 1353, 1487 and 1711.) Based upon this unambiguous record, the Commission specifically found that fair market value consideration had been passed in the transfers effectuated by the Agreement. (Order at Findings of Fact #10 and #11; Conclusion of Law #5).

Inaccuracy #3: "It Was the Division's Position That All Profits From Oil Operations Were to Reduce Natural Gas Prices." (Admin. Serv. Br. at 7)

Neither in the Wexpro Case (Case No. 15835) nor in the 1977 hearings before the Commission has the Division argued that all

MFS oil profits should reduce natural gas rates. (See Tr. 674-75, 707, 743-44; Joint Brief of Petitioners in Case No. 15835 at 85 (1978)).¹ It was always the law, as well as the understanding of the Division and the Committee, that a portion of the oil profits would be retained by the shareholders to compensate for that risk of development assumed by the shareholders and to provide a return on the shareholder capital investment in the properties. This Court did not, in its Wexpro opinion, dictate how the oil profits would be divided between the shareholders and the ratepayers, leaving that issue to the expert discretion of the Commission.

Inaccuracy #4: "The Division Gave Up Its Right to Represent the Public Interest Before the Commission."

(Admin. Serv. Br. at 10)

Although this is not a factual issue, and hence will be dealt with, infra at Section C, no place in the Stipulation or the Agreement does the Division waive any right it might have to contest MFS's or Wexpro's performance under the Stipulation or the Agreement or to contest any other action or non-action by these entities as it relates to their operations under the jurisdiction of the Commission. If anything, the Agreement and Stipulation expand the power of the

¹The cited transcripts indicate that Mr. Berman (with whom Administrative Services' counsel was associated at the time) expressly represented that the Division did not advocate that all of the oil profits should be utilized to reduce gas rates.

Division, because it will monitor and contest matters thereunder which it otherwise legally believes are non-utility in nature.

Inaccuracy #5: "The Commission Failed to Hold a Hearing as Ordered by This Court." (Admin. Serv. Br. at 11)

This Court ordered as part of the Wexpro Case that the Commission hold a hearing to determine whether any of the oil properties proposed to be transferred to Wexpro were utility properties and thus subject to the Commission's jurisdiction. Because the Settlement implicitly assumes all properties transferred were "utility properties", the "hearing" yearned for by Administrative Services was unnecessary. The Court should note that for eight days in October, November and December, 1981, the Commission took testimony from factual, expert, and public witnesses for the express purpose of determining whether the Settlement was in harmony with this Court's opinion in the Wexpro Case. (Order at Conclusions of Law #1; Tr. 931, 932-33.) The nearly one thousand pages of transcript in the designated record on appeal bear strong testimony that indeed an appropriate hearing resulted from this Court's remand.

Inaccuracy #6: "MFS's Exploration Program Ended When the Settlement Was Approved." (Admin. Serv. Br. at 12)

The MFS exploration program ended when MFS terminated the Joint Exploration Agreement in 1980. MFS thereafter gave notice of its intention not to acquire additional unexplored acreage into

MFS utility accounts for future exploration, and to cease developmental and exploratory drilling on all leases then in MFS. Far from stopping an ongoing drilling program, the Settlement ensures that an energetic exploration and development drilling program will continue to exist to the benefit of the ratepayers of this state. (Tr. 1018, 1019, 1023, 1030, 1143, 1158, 1226, 1232, 1244, 1252, 1272, 1273, 1280, 1320, 1398, 1485, 1688.)

C. LITIGATION RESOLVED BY THE SETTLEMENT

During the pendency of Case No. 76-057-14 (the Wexpro Case), MFS received general rate increases in Case Nos. 77-057-03, 79-057-03, 80-057-01 and 81-057-01. The Orders establishing the overall increase in rates entered in each of those cases has been in some way connected to the outcome of the Wexpro Case.

Wexpro issues were raised by the Wyoming Public Service Commission in Docket No. 9192 Sub 68 in 1980 and 1981.²

In 1980, MFS, Wexpro, Mountain Fuel Resources, Inc. (Resources)³ and Celsius Energy Company (Celsius) filed Applications with the Federal Energy Regulatory Commission (FERC) in

²The Settlement attempts to deal with all issues for both Utah and Wyoming. The Wyoming Public Service Commission approved the Settlement, and its Order has now become final and unappealable by the passage of time.

³Mountain Fuel Resources, Inc. and Celsius Energy Company are subsidiaries of Mountain Fuel Supply Company.

FERC Docket Nos. CP80-274, CP80-275 and CI80-233 seeking authorization for the transfer of the properties subject to the Agreement from MFS and Wexpro to Celsius, a subsidiary of Entrada Industries, a subsidiary of MFS. Resolution of these Applications in favor of MFS, absent the Settlement, could have resulted in the end of cost-of-service gas in Utah. Mid-Louisiana Gas Co. v. F.E.R.C., 664 F.2d 530, 538 (5th Cir. 1981).

Also in 1980, MFS, Wexpro and certain shareholders of MFS filed a Complaint in the United States District Court for the District of Utah in Mountain Fuel Supply Co. v. Public Service Commission of Utah, Civil No. C-80-0710J. The Complaints, as amended and supplemented, claimed that the regulation of MFS properties by the Commission violated various provisions of the Constitution of the United States. The District Court entered an Order dismissing the Complaint, but without prejudice to refiling after the Commission and this Court had acted.

In 1981, MFS attempted to transfer properties to Celsius without FERC or Commission approval. Upon challenge of these transfers by the Division and the Committee, a preliminary restraining order issued from the Commission pending further hearings on the propriety of the proposed transfers. This litigation was designated Case No. 81-057-04.

The FERC, Commission, Wyoming PSC, and federal court litigation as well as the remand case and rate cases here on appeal

were part of a protracted, time-consuming, expensive and disruptive battle which has cost the people of Utah over Four Million Dollars (\$4,000,000.00) in legal fees alone since January 1, 1977. (Tr. 940, 1149, 1480).

D. THE SETTLEMENT

The Court has before it in the designated record the full Agreement and the Stipulation which attempts to put to rest all of the litigation described above. It should be understood that the Settlement attempts to resolve many points of controversy which were not before this Court in the Wexpro Case. Because of the scope of the litigation which the Settlement seeks to resolve and the somewhat arcane nature of the oil and gas business, the Stipulation and Agreement are not light reading. Consequently, the Division and the Committee provides below what they hope and believe is a fair and readable summary of the most significant aspects of the Settlement.

1. Productive Gas Reservoirs.⁴

The depreciated book investment in currently gas-producing leases, wells and appurtenant facilities (which primarily produce

⁴Administrative Services and the Coalition attempt to find an "issue" when they accuse the Settlement of partaking of the "discredited MFS classification system." While for clarity and precision reservoirs were classified as "gas" or "oil" in the Settlement, that classification served no jurisdictional purpose and hence is not violative of the Wexpro Case.

cost-of-service natural gas, together with some natural gas liquids and oil) have historically been accounted for in the MFS rate-base account 101, upon which MFS earned a rate of return.⁵ All investment and ownership of these wells and appurtenant facilities, and the rights to production from these wells (but not the leases) will be retained by MFS. All natural gas, natural gas liquids and oil produced from these reservoirs will belong to the utility and regulated by the Commission. Wexpro will operate these wells and facilities on a service contract basis, but will make no profit for that service. The terms of the service contract were approved by the Commission as part of the Settlement.

Because many of these reservoirs are not perforated by a sufficient number of wells to adequately produce all available gas, future developmental drilling will be required. The Agreement requires Wexpro to perform all necessary developmental drilling at its sole risk and expense, and specifically requires Wexpro to expend a minimum of Forty Million Dollars (\$40,000,000) within the first five (5) years of the Agreement's term for developmental

⁵These wells and the reservoirs from which they produce, along with any appurtenant facilities, are to be distinguished from the lease which, for any particular surface area, governs legal rights to all strata below the surface, some of which may be above and some below the reservoirs which are currently being produced by the wells and facilities in the MFS 101 account.

drilling. When and if Wexpro achieves a successful developmental well in these reservoirs, it will capitalize that investment in a special account similar to a rate-base account, and will add to its service fee billings an amount equal to the base-rate of return (to compensate for the cost of money)⁶ plus eight percent (8%) (to compensate for the risk inherent in developmental drilling) on that investment. All natural gas produced from developmental drilling will belong to the utility and be delivered at cost-of-service. However, because of the risk involved in drilling developmental wells, and because Wexpro will bear that risk solely and entirely, the natural gas liquids and any oil which may be produced from a successful developmental well will not belong to the utility solely, but will be shared, with the ratepayers getting fifty-four percent (54%) of the net profits, as described in subsection 2, infra. Provisions are made in the Agreement for close monitoring to assure that all wells which are successful developmental wells are so declared and provide cost-of-service gas to the utility.

2. Productive Oil Reservoirs.

The Settlement properties called "Productive Oil Reservoirs" are essentially those that were the focus of the Court in the Wexpro Case. Because ratepayers had borne a large part of

⁶A floating rate based on returns to a group of unrelated regulated utilities, initially, sixteen percent (16%).

the risk of exploring these properties, it was implicitly assumed by the parties that these were "utility properties" and that a significant portion of the profits from these properties should be applied to reduce gas rates. This philosophy is implemented as follows:

(a) after expenses and a base rate of return⁷ are achieved by Wexpro from these properties, the ratepayers will receive fifty-four percent (54%) of all profits from the sale of oil and natural gas liquids from these properties whether produced from existing wells or developmental wells drilled in the future.

(b) all natural gas produced from these properties will be sold by Wexpro to the utility at a cost-of-service price specified in the Agreement and approved by the Commission; (because these are primarily oil-producing properties to be owned by Wexpro, this cost-of-service price is contractually guaranteed, as opposed to Commission-set as with Productive Oil Reservoirs, supra.)

(c) the profit element in the Agreement's cost-of-service calculations is a base-rate of return of sixteen percent (16%),⁸ which will fluctuate annually (up or down) based on an index of unrelated regulated companies;

⁷See note 6, supra.

⁸This corresponds to the rate of return currently allowed by the Commission in equity investment.

(d) all expenditures for enhancement of oil recovery and/or development drilling on these properties will be at the sole risk and expense of Wexpro;⁹

(e) MFS will retain all of the common stock of Wexpro.

3. Exploratory Properties Held by MFS.

Exploratory properties are unexplored formations underlying a lease which may or may not already have production from another formation. Hence, there are exploratory properties underlying the MFS 101 account leases (producing gas leases), underlying the MFS 105 account leases (totally unexplored leases), and underlying the Wexpro oil properties. The Agreement provides that all leases will be transferred from MFS's 101 and 105 accounts to Wexpro. Wexpro or Wexpro's assignee will explore these properties at its sole and entire risk and expense.¹⁰ Anything that is produced in the

⁹To the extent that development drilling is successful, a five percent (5%) premium will be allowed in addition to the base rate of return on investment in successful wells to compensate for the risk of developmental drilling. Further, in the event the total profitability of Wexpro sinks below a certain minimal level, a two-point incentive rate of return may also be collected by Wexpro on new investment in enhanced recovery procedures.

¹⁰The Settlement does not attempt to resolve the issue of whether Wexpro is a utility. The Division and Committee note, however, that the requirement for fair market value consideration for the transferred properties is inconsistent to its being a utility inasmuch as transfers between utilities of property must always be at book value so as to avoid an inflated rate base burdening ratepayers. Further, with Wexpro bearing all the risk and expense of exploration, it is in a classic non-utility posture. City of El Dorado v. Arkansas Pub. Serv. Comm., 362 S.W.2d 680 (Ar. 1962).

future from these unexplored formations, whether oil, natural gas liquids, natural gas, or other minerals, will be sold and the ratepayers will receive seven percent (7%) of the gross revenues from any such production or the utility may take its seven percent (7%) royalty in kind.¹¹ Further, MFS will have the first right to purchase at market for its ratepayers any natural gas which is discovered in the future on any of these exploratory properties, thus assuring, to some degree, future supplies of natural gas to Utah ratepayers. The seven percent (7%) royalty assures that gas from these properties will always come net to the ratepayer at below market prices.

4. Exploratory Properties Never Held by MFS.

There are some properties dealt with by the Settlement which have never been held in an MFS utility account. Some of these properties are producing properties which were never capitalized into the rate base. There are also unexplored properties which Wexpro acquired directly into its accounts after January, 1977 ("After-Acquired Properties"). The Agreement provides that the utility obtains no interest of any kind either in producing properties

¹¹Provisions are made in the Agreement to assure that, in the event Wexpro needs to use farm-out or other joint venture arrangements to adequately explore these properties, the utility's royalty interest will be preserved or improved, contrary to the bald and baseless assertion by the Appellants that room for mischief exists. (Admin. Serv. Br. at 54)

acquired directly into a non-utility account, or in exploratory properties acquired directly into Wexpro after 1977, with two very valuable exceptions:

(a) On approximately one hundred twenty-eight thousand (128,000) acres of unexplored property acquired by Wexpro after 1977 but before May 10, 1979, the utility is granted a two and one-half percent (2.5%) gross royalty, similar in operation to the seven percent (7%) royalty described in subsection C-3, above.

(b) On certain acreage in the San Juan County, Utah, area known as the "Bug Field," the utility is also given a two and one-half percent (2.5%) gross royalty even though this acreage was acquired after May 10, 1979, or was acquired through farm-in arrangements where Wexpro bore the entire risk of exploration. From all the acreage affected by the exceptions, MFS has a first right to purchase all natural gas, which, by virtue of the royalty, will always come net to the utility at below-market prices.

5. Other Consideration.

The Agreement gives the ratepayers Twenty-One Million Dollars (\$21,000,000.00) to reduce rates in the first year of the Settlement in addition to the proceeds of the various properties. Also, each year for twelve (12) years, the ratepayers get an additional Two Hundred Fifty Thousand Dollars (\$250,000.00) rate reduction.

E. BENEFITS OF THE SETTLEMENT

Any attempt to quantify the benefits which flow to the ratepayers by reason of the Settlement must of necessity be based on assumptions concerning rates of production, future market price of gas and oil and levels of success in developmental and exploratory drilling. Consequently, the following estimates are very gross attempts to quantify the benefits accruing to the ratepayer as the result of the Settlement.

1. Cost-of-Service Gas is Preserved.

The Agreement assures that the Utah ratepayer will continue to receive cost-of-service gas from the existing productive oil and gas reservoirs. Witness Roseman, a nationally respected expert (Tr. 1009-14), testified that the preservation of this cost-of-service gas was the greatest single benefit of the Agreement. (Tr. 1017-19.) By protecting this gas from the FERC's NGPA pricing,¹² the

¹²The Agreement was carefully drafted with an eye to the pending MFS applications before the FERC. Protection of low-cost gas against the imposition of significantly higher NGPA prices by the FERC in the Agreement and Stipulation was a hard-won and important concession to the ratepayer.

The Agreement intentionally provides that the utility will retain ownership of all the currently producing gas properties. (Agreement at III-5.) The statutory and case law is clear that without a sale to MFS there can be no federal jurisdiction of this transaction under the Natural Gas Act. United Gas Pipeline Co. v. McCombs, 442 U.S. 529, 531 (1979). FPC v. Trans-continental Pipeline Co., 365 U.S. 1, 8, 23-24 (1961); Wessely Energy Corp. v. Arkla Gas Co., 593 F.2d 917, 920 (10th Cir. 1979).

ratepayers are benefited nearly Two Billion Dollars (\$2,000,000,000) over the next twenty (20) years. (Exhibit S-2)

2. Ratepayers Will Get the Majority Share of Net Oil Benefits.

The Agreement provides an immediate flow to the ratepayer of fifty-four (54%) of the net profits from the oil properties. Witness Roseman, an important participant in the Settlement negotiations and a nationally prominent consultant on natural gas

¹²Continued: Gas produced on the currently productive properties transferred to Wexpro will belong to Wexpro, but it is all dedicated to MFS at cost-of-service. The Agreement contractually guarantees both the price (Commission-approved cost-of-service) and supply (all to MFS) of this gas. (Agreement at II-5.) If FERC exercises jurisdiction over this gas, the contract price (cost-of-service) will be applied and the MFS parties will fully cooperate with the Division and the Committee to obtain this end. (Stipulation at 15.5.) See United Gas Pipeline Co. v. Mobile Gas Corp., 350 U.S. 332, 338 (1956); MCI Telecommunications Corp. v. F.C.C., 665 F.2d 1300, 1303 (D.C. Cir. 1981); Mississippi Valley Gas Co. v. Federal Energy Regulatory Commission, 659 F.2d 488, 498 (5th Cir. 1981).

Pursuant to the Stipulation (15.1), MFS has amended its FERC Applications to reflect the Settlement and has withdrawn the request for FERC jurisdiction over most of the subject properties. If this Court strikes down the Agreement, MFS would undoubtedly return its FERC Applications to their prior, highly dangerous state, which would be its legal right.

Before December 1981, the Division and the Committee had a "backstop" position at FERC: high NGPA pricing had not been allowed by FERC to similar gas. In FERC Orders 57 and 98 (issued in 1980), FERC declined to treat sales of a jurisdictional company's own gas to itself, even from a subsidiary, as "first sales" under the NGPA, thus maintaining cost-of-service prices. In December 1981, the Fifth Circuit Court of Appeals struck down these Orders and required FERC to apply NGPA pricing to intracorporate transfers of gas. Mid-Louisiana Gas Co. v. Federal Energy Reg. Com'n., 664 F.2d 530, 538 (5th Cir. 1981). The Agreement thus remains the only sure means by which cost-of-service pricing can be preserved for the customers of MFS.

regulation, indicated that the Division and Committee were well justified in accepting less than one hundred percent (100%) of the profits from the oil in light of the equities and the other terms of the Agreement. In fact, the fifty-four percent (54%) figure actually achieved was better than what Roseman had established in his mind as an appropriate figure. (Tr. 1024.) This item could yield over Two Hundred Fifty Million Dollars (\$250,000,000.00) to the ratepayers over twenty (20) years based on 1981 results.

3. Vigorous Exploration Is Provided.

The Agreement has mechanisms whereby the benefits to the consumer are combined with incentives to Wexpro to encourage vigorous development of existing oil and gas reservoirs and to exploration for additional reservoirs. In contrast to the hiatus in exploratory and developmental drilling that existed before the Settlement, the Agreement provides a framework of incentives for vigorous exploration and development of oil, natural gas and natural gas liquids. (Tr. 1024A, 1514-15.) The record shows that by designing the consideration for the exploratory properties on an overriding royalty basis, the "lure of the big strike" will be an incentive to the vigorous and energetic exploration of these properties which would not exist were the product to be priced at cost-of-service. (Tr. 1143, 1149-52, 1226, 1397.) This is an important step in assuring future supplies of gas for Utah ratepayers. (Tr. 1273.)

4. Ratepayers Are Given a Stake in Future Success on
Exploratory Acreage, but Bear No Risk of Future Failure.

The entire risk of failure on the exploratory properties will be borne by MFS shareholders. This is a complete redirection from the past whereby MFS was allowed to expense exploratory risk through its rates. The result of the former program was often near-market "cost-of-service" gas and no share of the oil. Under the Agreement, the shareholders bear the total risk and the ratepayers get below-market gas through a seven percent (7%) royalty. This royalty comes "off the top" (Tr. 1523) and, because of the high cost of today's exploration, it is by no means a fact that the seven percent (7%) gross royalty will provide less benefits to the ratepayer than would cost-of-service gas from these properties, with the ratepayers bearing the expenses and risk of exploration. (Tr. 1057, 1231, 1455.)¹³ Assuming the success

¹³Witness Roseman considered the seven percent (7%) royalty not only "reasonable" but "fairly high" and indeed a "generous slice." (Tr. 1026.) Moreover, the first right to purchase natural gas from the exploratory properties, which would belong to the utility under the Agreement, is a very valuable benefit. As witness Kirsch indicated:

At the present time there is enough gas being produced in this area to meet demand by additional connections which are continually being added to MFS's system and additional supply will be more difficult to acquire. Three (3) years ago there was a shortage of gas and the right to call upon production at market price was of great value. When in a world where all energy is in short supply, this call on gas is of significant importance.

(Tr. 1524.)

level on new exploration on this property that was historically experienced by MFS, ratepayers could obtain another Two Hundred Million Dollars (\$200,000,000.00) in benefits over twenty years. In addition, the elimination of exploratory costs from MFS retail gas rates will save the ratepayers at least an additional \$3 million dollars annually.

5. Rates Are Further Reduced by a Variety of Other Settlement Provisions.

The reduction of rates by the various elements of the Settlement are multiple and continuing. The removal of all leases from the MFS rate-base accounts yields immediate rate reductions of approximately \$2 million annually. During the first twelve (12) months of the Agreement's operation, Twenty-One Million Dollars (\$21,000,000.00) in rate reductions will immediately flow through to reduce rates, and the continuing Two Hundred Fifty Thousand Dollar (\$250,000.00) annual cash payment will further reduce rates. Thus, in sum, the Agreement sets the groundwork for continued low-cost gas for the MFS customers.

6. Litigation is Ended.

There is no justification for litigation unless an important principle needs to be vindicated or a sure economic benefit awaits the winner. In this case, the principle (jurisdiction) was won in this Court in the original Wexpro decision, but the ultimate financial benefit to the ratepayers was in limbo.

Barring settlement, any financial benefit of the Wexpro Case would be postponed for many years pending the outcome of interminable litigation. In 1980, the parties found themselves in a position where politically and economically, in the absence of compromise, the only solution was increasingly vigorous litigation in every forum available. The estimates by counsel as to the costs of this litigation since 1977 yielded a frightening figure in excess of Four Million Dollars (\$4,000,000.00) which the ratepayer in Utah has paid through both taxes and MFS rates. However, even this Four Million Dollar (\$4,000,000.00) figure is deceptively small. Because of the increased tempo of litigation and inflation, fully one-third of that figure was incurred during 1981 alone. The projection of future costs of litigation from this point forward, should the settlement not be affirmed, conservatively reaches an additional Seven Million Dollars (\$7,000,000.00). This would be money down the proverbial rat hole. The record is clear that after five (5) to seven (7) more years of litigation, if and when the ultimate consumer position eventually triumphed in all the administrative agencies and all courts, what was left of cost-of-service gas, the oil profits and unexplored properties might not be enough to justify what had been expended in the litigation.

II. ARGUMENT

A. ON REMAND FROM THIS COURT, THE PARTIES WERE NOT PRECLUDED FROM SETTLING THE ISSUES COVERED IN THE STIPULATION AND AGREEMENT

1. The Commission Is Statutorily Empowered to Approve Settlements of any Case Before It.

The statutory powers of the Commission were significantly expanded in 1981 with the amendment of § 54-7-10(1), U.C.A. as follows:

At any time before or during a hearing or proceeding before the Commission, the parties between themselves or with the Commission or any Commissioner, may engage in settlement conferences and negotiations. The Commission may at its sole discretion adopt any settlement proposal of the parties and enter an order based upon such proposal if it deems such action proper.

It is apparent from the clear language of the statute that the Legislature intended for the Commission to be able to act as it did in this case to avoid wasteful and disruptive litigation.¹⁴

¹⁴Settlements are encouraged and supported by reviewing courts in the energy regulatory context, even when not all parties agree with the settlement. Penn. Gas & Water Co. v. FPC, 463 F.2d 1242 (D.C. Cir. 1972); Cities of Lexington, et al. v. E.P.C., 295 F.2d 109 (4th Cir. 1961). The Coalition attempts to dismiss the statute by saying the Commission could not approve a settlement contrary to law, citing Gorgoza, Inc. v. State Road Comm'n, 553 P.2d 413 (Utah 1976). Neither the case nor the Coalition's logic apply. First, Gorgoza dealt with an agreement without specific statutory authority. Second, while we agree the Commission may not approve unlawful terms regardless of the power to approve settlements in general, the terms of the Agreement and Stipulation are lawful, as amply shown in Section B, infra.

2. This Court's Wexpro Decision Did Not -- Indeed Cannot -- Bind the Commission's Regulatory Discretion -- Nor Did It Preclude Settlement.

Both the Coalition and Administrative Services attempt to cast the Wexpro Case as a twin to United States v. El Paso Natural Gas Co., 376 U.S. 651, 662 (1964), and thereby entice this Court to reverse to assert its reviewing authority. The El Paso case has no relevance to this appeal.

That both El Paso and the Wexpro Case ordered remands is the sole point of congruity. In El Paso, the order was directed to a lower court and explicitly ordered total divestiture. The lower court in El Paso, bound by the Supreme Court's detailed directive, had no remaining discretion. Naturally, when subsequent appeals showed that total divestiture was not accomplished, the Supreme Court reversed. Cascade Natural Gas Corp. v. El Paso Natural Gas Co., 386 U.S. 129 (1967); and then Utah Pub. Serv. Comm's v. El Paso Natural Gas Co., 394 U.S. 1009 (1969).

This Court's holding in the Wexpro Case declared jurisdictional law, but directed no specific plan or result. The Commission was to factually determine whether properties were "utility" or "non-utility" and thereafter to use its expertise and discretion to deal with these properties and their benefits. As a remand to an administrative agency, the Wexpro decision could properly declare legal principles to be utilized in determining

which properties were utility properties but could not bind the Commission's discretion to formulate an appropriate regulatory treatment to be accorded such properties.

As a body rich with the expertise to regulate the natural gas utilities of this State, the Commission received a remand which was thus properly restrained. The law regarding the role of the court on the one hand (to establish the law) and the role of the Commission (to regulate the industry) is clear and settled. An administrative agency is entrusted by statute with specified regulatory authority. On review, this Court determines the law, but once the Court has declared the law, the Commission fashions the relief. The agency is free, within the declared law, to take a totally new approach to the problem. NLRB v. Food Store Employees Union, 417 U.S. 1 (1974); SEC v. Chenery Corp., 332 U.S. 194 (1947); FCC v. Pottsville Broadcasting, 309 U.S. 134 (1940). City of Cleveland v. FPC, 561 F.2d 344 (D.C. Cir. 1977) and C. & N.W. Transp. Co. v. U.S., 574 F.2d 926 (7th Cir. 1978), cases cited by the Coalition, are not to the contrary.

This allocation of responsibilities is clearly provided for in Utah's statutory scheme of utility regulation. The Commission is broadly empowered to "regulate and supervise all of the business" of a public utility, § 54-4-1, U.C.A., and to establish "just and reasonable" rates, § 54-4-2 U.C.A. In contrast, this Court's review is limited to determining whether the

Commission acted constitutionally and within the scope of its statutory authority. Section 54-7-16, U.C.A. Thus, this Court is without authority to prescribe appropriate rates of return for regulated utilities or fix prices to be paid by ratepayers for utility services.

Directly contrary to the allegations of the Appellants (Admin. Serv. Br. at 42-44, 60), numerous factual, policy and legal issues were left by this Court for possible decision by the Commission on remand. The following is a small list of some of the issues confronting the Commission for resolution after this Court's Wexpro decision:

- What could Wexpro or Celsius charge for gas supplied to MFS without violating the "no-profit-to affiliates rule"? (595 P.2d at 874)
- What would the Commission determine to be the proper return on investment if it declared the oil properties to be utility properties? (595 P.2d at 874)
- How much risk capital would the Commission recognize as having been contributed by MFS shareholders to the exploration program and how would that impact on the Commission's division of benefits from the oil and gas properties? (595 P.2d at 874, 880)

- Which specific properties were "utility" properties within the guidelines of this Court? Were properties acquired by Wexpro directly from third parties' "utility" properties? (595 P.2d at 877)
- What consideration would the Commission recognize as fair market value for the ratepayers' interest in the oil properties? (595 P.2d at 878)
- What would be the "appropriate benefit" to the ratepayers after a fair market value sale of property? (Id.)
- What split of Joint Exploration Agreement properties and benefits should occur? (595 P.2d at 880)

3. Judicial Precedent Supports the Commission's Approval of the Settlement.

Federal courts have developed a uniform approach when examining settlements involving the interest of the public. While the United States Supreme Court's principal decision, Protective Committee for Independent Stockholders of TMT Tracker Ferry, Inc. v. Anderson, 390 U.S. 414 (1968), involved judicial approval of a compromise in a Chapter X bankruptcy proceeding, the principles announced there have been applied to various proceedings where court approval of settlement litigation tinged with public interest were involved. See, e.g., Karson v. American Brands, Inc., 450 U.S. 79 (1981) (civil rights action); McDonald v. Chicago Milwaukee

Corp., 565 F.2d 416 (7th Cir. 1977) (class action settlement); Newman v. Stein, 464 F.2d 689 (2d Cir. 1972) cert. denied, 409 U.S. 1039 (1973) (stockholder's derivative action); State of West Virginia v. Charles Pfizer & Co., 314 F. Supp. 710 (S.D.N.Y. 1970), aff'd 440 F.2d 1079 (2d Cir 1971) (class action settlement). These principles, and their satisfaction by the Commission below, can be summarized as follows:

(a) Is the Settlement a Fair and Reasonable Compromise of the Public's Claim?

The trial court in Pfizer explained that "[w]hether to approve [a] compromise involves an exercise of discretion." 314 F. Supp. at 740. See also, § 54-7-10(1) U.C.A. A settlement should be approved if it is "fair, reasonable, and adequate". Obviously, as noted in Pfizer, "these terms are general and cannot be measured scientifically." 314 F. Supp. at 740.

The Pfizer Appellate Court further explained:

It appears to be well settled that in reviewing the appropriateness of the settlement approval, the appellate court should only intervene upon a clear showing that the trial court was guilty of an abuse of discretion.

440 F.2d at 1085. In Newman v. Stein, 464 F.2d at 693, the Second Circuit explained the discretion involved in making a decision as to the reasonableness of a settlement:

. . . [I]n any case there is a range of reasonableness with respect to a settlement - a range which recognizes the uncertainties of law

and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion - and the judge will not be reversed if the appellate court concludes that the settlement lies within that range.

See also In Re Prudence Co., Inc., 98 F.2d 559, 560 (2d Cir. 1938). The Commission, utilizing its special expertise and competence, found the Settlement to be fair and reasonable and in the public interest. (Order at Findings of Fact #8 and #10.)

(b) The Court Should Not Try the Controversy in the Course of Approving the Settlement.

Any virtue which may reside in a settlement is based on doing away with the effect of such a decision.

Pfizer, 314 F. Supp. at 741. (Citing In Re Riggi Bros. Co., Inc., 42 F.2d 174, 176 (2nd Cir. 1930)).

. . . [T]he very uncertainties of outcome in litigation as well as the avoidance of wasteful litigation and expense, lay behind the Congressional infusion of a power to compromise. This is a recognition of the policy of the law generally to encourage settlement. This could hardly be achieved if the test on hearing for approval meant establishing success or failure to a certainty.

Pfizer, 440 F.2d at 1085, 1086 (emphasis added) (quoting from Florida Trailer & Equipment Co. v. Deal, 284 F.2d 567, 571 (5th Cir. 1960)). The Commission specifically applied this standard, as shown in its Conclusion of Law #3.

(c) Does the Judgment of Experienced Counsel Support the Settlement?

The ability and competence of counsel representing the parties is of great weight. Pfizer, 314 F. Supp. at 741. The record shows the prevailing view of the participants that competent and experienced counsel represented the parties. (Tr. 1158, 1232) The Commission so noted below. (Order at Finding of Fact #12.) All counsel for MFS, Wexpro, the Shareholders, the Committee and the Division recommended the Settlement.

(d) The Settlement Should Be the Result of Good Faith Arm's Length Bargaining.

The Court must also be satisfied that a settlement is the result of "good faith bargaining at arm's length." Pfizer, 314 F. Supp. at 741. In the present case, the tough adversarial nature of the negotiations leading up to the settlement was noted to be the most vigorous and difficult in the memory of the participants (Tr. 1015, 1115, 1179.), giving the Commission that assurance of the fairness of the Settlement. (Order at Finding of Fact #7.)

(e) Did Bi-Partisan Support Exist for the Settlement?

In Pfizer, the strong support of most, though not all, of the parties was persuasive to the trial court in approving the Settlement, 314 F. Supp. at 743. In this case, witness after witness with decades of regulatory experience (Tr. 1009-14, 1095-1100, 1190-92, 1216, 1245-46, 1324-25, 1466-67) testified that

the Settlement was fair, reasonable and adequate. (Tr. 1030, 1149-51, 1195-96, 1232, 1252, 1279-80, 1330-31, 1397-98, 1385, 96, 1525-26.) There was no credible evidence to the contrary.¹⁵ The Division and Committee, the parties charged by law with representing the interests of the customers of MFS in this State, along with the management of MFS and Wexpro unanimously and without qualification supported the Settlement. It is important to note the Division and the Committee were the first to challenge the Wexpro issues in 1976 and successfully fought the 1978 appeal in the Wexpro Case. Their support for the Settlement is significant evidence of its fairness.

B. THE SETTLEMENT IS LAWFUL, CONFORMING TO THE HOLDING AND GUIDANCE OF THIS COURT

1. The Commission's Factual Findings and Conclusions Supporting the Settlement Are Presumptively Correct.

The only real question raised by the Coalition and Administrative Services is not did the Settlement and the Commission's Order comply with this Court's directives - they did. Their Complaint goes to the findings of the Commission that fair market value was received for the properties and that the public

¹⁵Some public witnesses, out of an established ignorance of the scope and terms of the Settlement, testified against the Settlement. No expert qualified before the Commission supported their position, however.

and ratepayer interest is served by the Agreement. (Order, Findings of Fact #8, #9, #10 and #11.) Those Findings are presumptively correct¹⁶ and are due great deference in the face of the merely conclusory attacks by Appellants, who had plenty of opportunity to present persuasive contrary evidence below but did not. The "straw man" of noncompliance with this Court's Opinion is baseless.

2. The Settlement's Implicit Classification of Properties Pursuant to the Wexpro Case Criteria Recognized Commission Jurisdiction and Negated the Requirement of a Remand Hearing.

By the Settlement, all properties transferred from MFS to Wexpro under the Agreement were transferred for fair market value

16". . . The Findings and Conclusions of the Commission on questions of fact shall be final and shall not be subject to review . . ." (§ 54-7-16 U.C.A) This Court will not disturb findings of the Public Service Commission which are supported by competent evidence.

[I]t is not required that the facts found by the Commission be conclusively established, nor even that they be shown by a preponderance of the evidence. If there is in the record competent evidence from which a reasonable mind could believe or conclude that a certain fact existed, a finding of such fact finds justification in the evidence, and this Court cannot disturb it.

PBI Freight Service v. Public Service Commission of Utah, 598 P.2d 1352, 1355 (Utah 1979). See, also, Empire Electric Association, Inc. v. Public Service Commission, 604 P.2d 930 (Utah 1979); Utah Parks Co. v. Kent Frost Canyonland Tours, 19 Utah 2d 252, 430 P.2d 171 (1967); Utah Gas Service Co. v. Mountain Fuel Supply Co., 18 Utah 2d 310, 422 P.2d 530 (1967); Lewis v. Wycoff Co., 18 Utah 2d 255, 420 P.2d 264 (1966); Milne Truck Lines, Inc. v. Public Service Commission, 13 Utah 2d 72, 368 P.2d 590 (1962).

nd after a Commission finding that the transfer was in the public interest. 595 P.2d at 878. The submission of the Agreement to the Commission tacitly recognized the Commission's jurisdiction over the transfer. (Stipulation at § 1.25; Order at Conclusions of Law #1 and #3.) Thus, the hearing mandated by this Court's Order of Remand, to determine whether the properties were utility properties would have served no useful purpose, since the parties effectively conceded for purposes of the Settlement that all of the transferred properties were utility properties.

3. Ratepayers Now Share in the Profits from the Oil-Producing Properties.

In the Wexpro Case, this Court recognized that the ratepayers had borne much of the risk of exploration of the oil properties and were entitled to share in the profits produced from these properties. 595 P.2d at 873, 878-79. The Agreement gives to ratepayers the majority of net profits from the oil production (Agreement, § II.) and the natural gas produced from oil-producing wells is committed to the MFS utility system at cost-of-service. (Id.)

4. Gas is Provided at as Favorable a Rate as Reasonably Possible.

This Court recognized a "duty" on the part of MFS to "give to the consumers the most favorable rate reasonably possible." 595 P.2d at 874. Nowhere in the Wexpro Case is MFS

charged simply to provide the lowest possible rate. This Court was careful only to require the "most favorable rate reasonably possible." The unanimous expert opinion in this record is that the Agreement is in the best interest of both the shareholders and the customers, (e.g., Tr. 940, 943, 1017, 1149, 1267, 1480), and the negotiations were tough and frequently threatened to end in failure. The rate reductions which will be achieved under the Settlement can logically be said to be the most favorable rates reasonably possible.

In a colloquy between Chairman Bernard and Witness Ritzma, the Associate Director of the Utah Geological Survey, the following exchange occurred:

Q. Mr. Ritzma, you were involved in the last case, or, the first part of this case. What is your opinion regarding the order that the Commission entered into in that case and the stipulation? Which is more advantageous to the ratepayer and the general public?

A. Oh, I think the present stipulation is a much better solution to the . . . problem. It provides a vehicle for Wexpro to get back into active exploration and the -- let's say the existence of an active exploratory arm of the public utility here I think is vital to the interests of the people in the State of Utah so that they can be provided with -- continue to be provided with gas at a reasonable rate.

Q. (Com. Cameron:) Well now, did your answer refer to the order of the Commission and the overruling of that order by the Supreme Court, or was it just the order of the Commission prior to it going to the Supreme Court?

A. I was comparing the state of affairs prior to -- let's say, prior to the proposal that the Commission made prior to the decision of the Supreme Court and to the present settlement. The present settlement is much to be preferred and provides a solution.

(Tr. 1272-1273.)

5. No Risk Capital Will be Provided by Ratepayers.

This Court criticized the provision of "risk capital" by ratepayers. 595 P.2d at 874. The Agreement resolves this "problem" by requiring that all development and exploration risk be borne by shareholders. (Stipulation § 1.23; Agreement, § II - 8, IV - 5.) No expense will be allowed in any rate paid by MFS customers which is traceable to exploration or development expense. Further, no increments to either the MFS rate base or the investment base of Wexpro are allowed which represent unsuccessful exploration expenses. Thus, under the Agreement, the entire risk of exploration is shifted to the shareholders and away from the customers.

6. "No Profit-to-Affiliates Rule" Is Met.

The charge by Administrative Services and the Coalition that potential sales of gas from currently unexplored properties to MFS at market prices, and the retention by Wexpro of 46% of the net profit from oil operations, violate the "no-profit-to-affiliates rule", and hence the Wexpro decision, 595 P.2d at 875, is without substance. The only aspect of the prior arrangement which this Court found violative of the rule was that

Wexpro was permitted to charge market prices for gas from properties for which it paid book value consideration. 515 P.2d at 875. Necessarily, no such arrangement exists in the Settlement.

While a literal and extreme interpretation of the term "no-profit-to-affiliates" would require that NO profit, not even a return on investment, be paid by a utility to an affiliated company, this reading is not consistent with the authorities on which the Court relied in discussing the rule in the Wexpro opinion.¹⁷

When applied to purchases of goods or services by utilities from affiliates, which will not be included in the rate base but rather in the cost of service, courts use the "no profit-to-affiliates" rule as a regulatory tool to ensure, on a case by

¹⁷Only in cases dealing with construction of utility plant by a subsidiary does "no profit" really mean no profit. In Florida Gas Transmission Co. v. Federal Power Commission, 362 F.2d 331, 334 (5th Cir. 1966), the Fifth Circuit noted that the "no profit-to-affiliates" rule began in the Federal Power Commission case of Alabama Power Co., 1 FPC 25 (1932). There, the FPC refused to allow a utility to pay a profit to a subsidiary for construction work which would ultimately be included in Alabama Power's rate base and upon which cost Alabama Power would earn a rate of return.

It is this rule which this Court applied in Utah Power and Light Co. v. Public Service Commission, 152 P.2d 542 (Utah 1944). There, certain affiliates known as the "Phoenix Companies" did construction work for Utah Power & Light Co. Finding that the Phoenix Companies were nothing more than a department of UP&L without independent assets or business purpose, this Court disallowed profits paid to the Phoenix Companies from the UP&L rate base.

case basis, that a utility does not use "sweetheart" relationships with its affiliates to inflate profits to inappropriate levels. Under the majority rule, an affiliate is allowed to receive a "reasonable profit" if market forces or a similar independent factor determines profit. See Washington Water Power v. Idaho Public Utility, 617 P.2d 1242, 1248-49 (Ida. 1980) and cases collected there. The Tenth Circuit in Cities Service Gas Company v. Federal Power Commission, 424 F.2d 411 (10th Cir. 1969) noted the real problem:

Intra-company transactions cannot be used to create an artificial or inflated price to be charged consumers

424 F.2d at 416 (Emphasis added) (cited at 595 P.2d at 874-75).

Because Cities Service shareholders had received the total \$21,450,000 in profit realized by the utility on the sale of gas producing property, additional profit through market price sales of gas back from that property were improper. However, it should be noted that in Cities Service cost-of-service pricing which included an element of profit in the form of return on investment was permitted.

In the present case, since the Settlement provides consideration directly to the ratepayer (as opposed to the shareholder) in the form of 7% gross royalty on the production from unexplored properties at no risk, true market price sale of gas back to the utility does not violate the rule. Similarly, the retention of 46% of the net profits of oil and liquid gas sales is an

appropriate owner's share after paying the ratepayers fair market value for their interest in the property.

Finally, the participation by the Division and Committee in the negotiation of the Agreement ipso facto removes the abusive "sweetheart" characteristics necessary for the application of the "no-profit-to-affiliates" rule. See, generally, Central Telephone Co. of Va. v. Va. State Corp. Commission, 252 S.E.2d 575 (Va. 1979). The terms of the Settlement were negotiated at arm's length (often an "arm plus a baseball bat" Tr. 1015), and thus the Commission could properly conclude that the Settlement does not violate the "no-profit-to-affiliates rule".

7. Undeveloped Acreage Is Recognized as Utility Acreage.

This Court's Opinion recognized that "the undeveloped acreage may properly be deemed an asset of the gas plant . . .". 595 P.2d at 875. The Agreement assumed that the unexplored acreage was "utility" property. This acreage, including the unexplored portion of producing properties, were transferred for a fair market value consideration and (subject to the approval of the Commission) in accordance with the requirements of this Court.

8. All Property Transfers Were For Fair Market Value.

(a) Fair Market Value Requires a Split of That Value Between Shareholders and Ratepayers. To assure ratepayers of an "appropriate benefit" from the transfers of MFS property to Wexpro,

this Court indicated, that such transfers be for fair market value. 595 P.2d at 878. The Agreement achieves this objective. It is important here to recognize that neither the shareholders nor ratepayers own one hundred percent (100%) of the interest in any utility property. The relative interests of the shareholders and ratepayers in any disposition of property are determined, on a case by case basis, largely by the doctrine of "gain follows risk." This determination of interests was settled and the benefits divided accordingly by the Settlement.

The "gain follows risk" rule does not dictate that all gain goes to the ratepayers. As the D.C. Circuit emphasized in Democratic Central Committee v. Washington Metro Area Transit Commission, 485 F.2d 786, 846 (D.C. Cir. 1973):

The ratemaking process involves fundamentally 'a balancing of the investor and the consumer interests'. . . . In terms of property value appreciations, the balance is best struck at the point at which the interests of both groups receive maximum accommodation. . . .

Accord: Michigan Consol. Gas Co., 78 P.U.R.3d 321, 324 (Mich. 1968), part of oil revenues to shareholders as rate of return); Casco Bay Lines, 11 P.U.R. 4th 172 (Maine 1975) (shareholders allowed to retain ten percent (10%) of the gross revenue from sale of utility property); Kansas Power & Light Co. v. Corporation Commission, 620 P.2d 329, 341 (Kan. 1980) (reversed P.S.C. order

granting all the profit from the sale of a utility asset to the ratepayers, ordering sharing with shareholders). Certainly, nowhere in the Wexpro Case did this Court mandate a fixed formula for sharing of revenues from the property transfer examined there, leaving to the Commission the expert determination of "an appropriate benefit" to the ratepayers. 595 P.2d at 878.

(b) Production-Based Consideration is Fair Market Value. All property transfers made by the Agreement are in return for a percentage of revenues¹⁸ from actual future oil and gas production, not for hypothetical and arbitrary dollar values estimated at the time of transfer. These streams of revenue will be received without the ratepayer paying one dime of the expense or risk of exploration.

Both Administrative Services and the Coalition assume that because no dollar "value" for these properties was established, ipso facto the properties were not purchased for fair value. This assertion ignores common sense, industry practice, and the voluminous record below. The value of oil and gas properties depends upon the size of the hydrocarbon deposits

¹⁸Such a percentage is either realized in the form of receipt of product at below market prices (as in cost of service gas) or directly paid to ratepayer through the 191 Account.

existing on the properties, how quickly they can be produced, market prices pertaining to the product less the cost of production and treatment of the product. None of the elements can accurately be predicted in advance. Even the best statistical tools available for estimating the values of producing properties yield only highly speculative results. (Tr. 1155-56, 1261, 1488, 1490.)¹⁹ This is axiomatic with respect to unexplored properties, because there is no reliable means of determining the conditions which prevail thousands of feet below the surface of the land without drilling a well. Hence, any dollar value appraisal of such properties is necessarily imprecise and naturally leads to the practice of trading oil and gas properties based on a retained percentage of production rather than a dollar value appraisal. (Tr. 1045, 1487-88). Percentage of production consideration is a practice recognized by government

¹⁹Counsel is aware of one well not involved in the MFS/Wexpro matter which produced at only a few barrels per day for a year, yielding a certified estimate of reserves based on that production rate. In just the last sixty (60) days, through no extra effort by the operator, the well has begun producing hundreds of barrels per day, rendering yesterday's expert appraisal worthless. Had a "fair market" dollar value been used to sell the property before the unforeseen increase in production, the seller would have been poorly served. Conversely, counsel is also aware of a field estimated last year, based on production at that time, to have a certified reserve figure of 60,000+ barrels of oil. Suddenly production fell and now an estimate gives only a 13,000 barrel reserve. Any dollar value previously fixed would be challenged for fraud by the disappointed buyer.

as well as industry. A principal goal of the 1978 Amendments to the Outer Continental Shelf Lands Act of 1953, 43 U.S.C. § 1331 et seq. (1976 ed., Suppl. III), was to assure receipt of fair market value for potentially oil-rich offshore tracts leased by the Federal Government. The Act specifies that the consideration will be in terms of a retained percentage of production. Additionally, the U.S. Supreme Court recently held that the Secretary of the Interior acted properly in awarding offshore leases in return for percentage of production consideration. Watt v. Energy Action Educational Foundation, 50 U.S.L.W. 4031 (December 1, 1981).

(c) The Record Below Supports the Commission's Finding of Fair Market Value. The Commission heard from highly qualified experts on the economic aspects of the oil and gas industry including: Howard Ritzma, Associate Director of the Utah Geological Survey; Lyle Hale, former Vice-President of Exploration for Mountain Fuel and now an independent consulting geologist; Herman Roseman, a nationally respected expert in natural gas regulation; Ralph Kirsch, a twenty-year veteran of oil and gas exploration and President of Wexpro; and James Harmon, a New York investment banker with extensive familiarity with the oil and gas industry. All gave their expert opinion that the consideration transferred to the ratepayers for their interest in the transferred properties was fair market

value.²⁰ (Tr. 1025, 1029, 1045, 1165, 1173, 1249-51, and 1328.)

This testimony was in the record for over a month while the Coalition and other parties were given time to gather evidence against it. When the hearing reconvened, not one qualified witness

²⁰In the context of challenging the Commission's finding that fair market value was passed for the property transfers, the Coalition argues that because of the massive pending litigation that the Division, Committee and Commission were bludgeoned into approving an exchange of properties for less than fair market value consideration. (Brief at 18-19). This conclusion is difficult to understand. The Division and the Committee had won at every turn: the Federal District Court case was dismissed, MFS's FERC applications were stymied by Division action, and based on preliminary rulings before the Commission, the prospects of a favorable result by the Division and Committee before the Commission in the remand hearing were great. Surely, the pressures on MFS to settle were just as great as they were on the consumer side.

Witness Harmon, a member of MFS' Board of Directors stated:

. . . I mean I can't help but say whoever represented the State -- and I include the lawyers here and their experts -- did a phenomenal job on behalf of you all, or the ratepayer, whoever you want to say. I don't think -- I think it was too expensive and I don't think it was fair for the shareholder but I think we should do it. Someone, if this thing ever gets resolved, did a very good job on that side. I hope they're on my side some day. (Tr. 1158).

Witness John O'Leary, former Deputy U.S. Secretary of Energy, agreed:

With regard to the customers, I think that they're very well served by the agreement. I marvel at the negotiating skills of the people who represented them. (Tr. 1232).

disputed the prior expert testimony concerning receipt of fair market value for the properties.²¹

9. The Settlement is in the Public Interest.

This Court required that any sale of utility property be both for fair market value and in the public interest. 595 P.2d at 878. The Commission found the Settlement in the public interest. (Order at Findings of Fact #8, #9 and #11). It must be understood that the public interest is not necessarily equivalent to gas now at the cheapest price possible. It is in the public's long-term interest first to assure future supplies of gas, and second, to get it at the most favorable price possible. The only way to assure future supplies of gas is to provide incentives for energetic and vigorous exploration and development of potential gas-bearing properties. It is also in the public interest to obtain the immediate flow of Agreement-provided benefits to the consumer to cushion the inevitable rise in gas prices rather than continuing a

²¹Richard Rosenberg testified, on behalf of the Coalition, concerning Pacific Gas & Electric's exploration program. It is instructive to note that PG&E's utility exploration subsidiary acquired similar exploratory properties from a shareholder subsidiary, not for a monetary consideration, but rather for production-based consideration: alternating a six and one quarter percent (6.25%) overriding royalty or a percentage of the net profits. (This compares with the 7% royalty obtained by the ratepayers base.) DeGolyer & McNaughton, the respected oil and gas geology firm, pronounced this fair market value. (Tr. 1754.)

8. The Settlement is an agreement between the parties, and approval thereof by the Commission does not modify or in any way limit the jurisdiction of the Commission to require information from the parties and to investigate transactions under the Settlement in which the parties are involved.

9. By adopting and approving the Stipulation, the Commission does not relinquish or limit any jurisdiction or statutory authority it possesses.

While the scope of the Commission's statutory jurisdiction was not affected by the Settlement, properties sold at fair market value out of the utility (whether a used truck or a gas property) do individually become unregulated if they are thereafter used in a non-utility manner. This diminution of jurisdiction (if it can accurately be characterized as such) is an obvious consequence of the utility being an operating business and not a museum and is tacitly recognized by this Court's Wexpro opinion when it indicated that such transfers could take place for fair market value, 595 P.2d at 878.

2. The Division and Committee Have Authority to Execute and Function Under the Agreement.

No serious question should arise as to the legal capacity of the Committee either to enter into the Agreement or perform thereunder. That is legislatively settled. § 54-10-1, et seq., U.C.A. The question of the authority of the Division to act as a party is judicially settled. In Utah Department of Business Regulation, Division of Public Utilities v. Public Service Comm'n,

litigious quest for the "last dime" of benefits, or the absolute vindication of a litigation position. The Settlement is in the public interest because while it recognizes the victory of the Division and the Committee before this Court in the Wexpro Case on the issue of the ratepayer having an interest in the oil properties, it also provides a mechanism to yield continuing benefits long into the future in the form of assured supplies of gas committed to the state at prices which will be among the lowest in the nation. (Tr. 1018, 1019, 1023, 1030, 1158, 1226, 1232, 1252, 1272, 1273, 1280, 1319-20, 1398, 1485 and 1688).

C. BY ITS ORDER, THE COMMISSION DID NOT WAIVE OTHERWISE LEGAL JURISDICTION

1. Commission Approval of the Agreement Could Not Result in the Relinquishing of Any Jurisdiction Over Any Entity.

Administrative Services spends a great deal of effort belaboring the "straw man" that the Commission and the Division somehow relinquished jurisdiction or abandoned legal duties through the provisions of the Agreement, Stipulation, and Order. This is a position which is impossible to support. First, this Court found in Wexpro, as a matter of law, that state agencies cannot relinquish or waive their statutory jurisdiction. See also Utah Hotel Co. v. Industrial Commission, 151 P.2d 467 (1944). Second, the Commission explicitly stated in the Order that it was not relinquishing its statutory jurisdiction as a matter of law:

614 P.2d 1242 (Utah 1980), this Court clearly interpreted the Division as "an advocate" represented by the Attorney General, the independently empowered legal officer of the State. 614 P.2d at 1252. The Division functioned in good faith reliance on this Court's recognition of it as a party advocate, empowered by 54-7-10(1) U.C.A. to negotiate the Settlement subject to Commission approval.

The only purpose of the Stipulation was to provide a commonly agreed to legal and factual basis for the Commission's approval of the Agreement. The Agreement is nothing more than a contract for the transfer of properties and money which provides a self-policing mechanism for internal monitoring and enforcement. At item 11.2 of the Stipulation, the Committee and the Division agreed not to argue that the properties transferred to Wexpro under the Agreement were thereafter subject to utility regulation because the Division and the Committee believe they are not. The Division and the Committee may at some future time be proven wrong when and if the issue is brought before the Commission. But nowhere in the Division's or the Committee's statutory mandate is the requirement to take any particular position on an issue. That is the freedom of an advocate.

The Division was given the contractual role under the Agreement to monitor MFS and Wexpro compliance, with the Committee joining in the enforcement mechanisms. Because of the statutory

role of the Division and the technical expertise available to it, it is eminently suited to monitor compliance with the Agreement.²²

3. Arbitration Outside of the Decision-Making Body Is Lawful and Consistent with Public Policy.

Contrary to Administrative Services' charge (Admin. Serv. Br. at 69), the arbitration clause of the Agreement in no way "does away with" the Commission's jurisdiction or authority (Br. at 69). As stated earlier, the Agreement and Stipulation, which are contracts, were intended by the parties to be self-enforcing once the Commission found the terms to be just and reasonable. Thus, internal monitoring and arbitration remedies were initially employed. However, the Agreement affirmatively requires that enforcement of an arbitration order dealing with utility questions be by the Commission, with non-utility orders enforceable by a

²² In this regard, Administrative Services again evidences an inability to understand the Settlement when it states that the Division is "prohibited" from using experts who have previously assisted it in the Wexpro matter, for monitoring of MFS and Wexpro performance. (Br. at 70). In fact, the Division may use any person it chooses to assist in monitoring, and has the continuing power to require MFS and Wexpro to produce information concerning their activities for Division investigation. (Agreement at VIII-4.) The only constriction is in regard to special funding provided in the Agreement, which covers the first several thousand dollars of expenses for one accountant and one petroleum engineer to specifically help monitor the Agreement. Only this internal funding is restricted against those who actively represented the Division and assisted in negotiating the Agreement. (Stipulation at ¶ 8.2.) The Division certainly, as in the past, may hire whomever it wishes from its own budget funds.

competent court, such a court being fully able to decline jurisdiction at the request of the Division or Committee if it found itself faced with a utility question.

An agreement to arbitrate a dispute which arises under a contract is both valid and favored by the law. Latter v. Holsum Bread Co., 160 P.2d 421 (Utah 1945) (dissent of Wolfe, J.) Section 78-31-1, U.C.A. as amended in 1977, expressly authorizes parties to agree "to submit to arbitration . . . any controversy which may arise in the future." By allowing for arbitration, the Legislature certainly did not constrict the jurisdiction of the courts, nor the Commission. Additionally, it should be noted that the Agreement and Stipulation are only contracts between the parties. The Commission is not a party to or bound by the Agreement or Stipulation, and may investigate and enforce such orders as it deems appropriate.

§§ 54-4-1, 2 U.C.A.

D. THE CLEAR HOLDING OF THE COMMISSION'S ORDER RENDERS IT FINAL AND BINDING.

The shareholders purport to be concerned that the Commission's Order does not clearly express the intent that the Order be a final, res judicata resolution of the issues covered by the Settlement. It is difficult to take this concern seriously in view of paragraph 6 of the Commission's Conclusions of Law:

The Commission's findings and conclusions with regard to the transfer of properties and the allocation of benefits contemplated by the

Settlement, including the findings and conclusions that the transfer of properties and the allocation of benefits are reasonable and for market value and are in the public interest, are intended by the Commission to be final and not subject to future change (except through an appropriate and timely petition for rehearing or judicial review). The Commission so concludes because to ensure the proper development of said properties, the parties must be able to rely on the finality of the findings and conclusions in regard to the transfer of properties and apportionment of benefits. The Commission also is entitled to rely on the finality of its order.

It is hard to imagine a clearer expression of the intent that the Order be a final resolution of the issues settled by the Agreement, Stipulation and Order and have res judicata effect. In view of this language, one suspects that the shareholders have raised the issue only for the purpose of obtaining the added comfort of this Court's holding that the Order is final and res judicata. Certainly, the Division and Committee have no objection to this Court giving the shareholders such further comfort with respect to the disposition of the properties, funds and benefits covered by the Agreement. However, portions of the shareholders' brief seem intended to tempt this Court to go further and to rule that the Commission has finally resolved issues which the Commission clearly indicated it did not intend to resolve. For example:

1. Can MFS restructure its business without a determination of the Commission that it is in the public interest? (Order at pp. 8-9).

2. Can MFS or its subsidiaries divest the Commission of jurisdiction to regulate MFS activities through FERC Applications? (Order at p. 10).

3. Which activities or subsidiaries of MFS are subject to Commission regulation? (Order at p. 5).

4. Can the Commission order MFS as a utility to engage in an oil and gas exploration program involving properties not covered by the Settlement? (Order at p. 9).

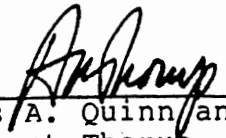
The Division and Committee do not at this point express any opinion as to how these issues should be resolved. The only purpose in mentioning these issues is to indicate that the Settlement and Order did not and were not intended to resolve these issues, and their resolution is not necessary to upholding the finality and res judicata effect of the Order Approving the Settlement.

CONCLUSION

Based upon the record testimony and the reasons set forth above, the Commission's Order Approving the Settlement should be affirmed.

Respectfully submitted this 14th day of July, 1982.

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