

1982

Utility Shareholder Association of Utah et al v.
Public Service Commission of Utah et al :
Answering Brief of Mountain Fuel Supply
Company and Wexpro Company

Utah Supreme Court

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Recommended Citation

Reply Brief, *Utility Shareholder Association of Utah v. Public Service Commission of Utah*, No. 18286 (Utah Supreme Court, 1982).
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IN THE SUPREME COURT OF THE STATE OF UTAH

UTAH UTILITY SHAREHOLDERS ASSOCIA- :
TION, ALEX OBLAD and HAROLD BURTON; :
UTAH DEPARTMENT OF ADMINISTRATIVE :
SERVICES; UTAH COALITION OF SENIOR :
CITIZENS, :

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

Defendants/Intervenor- :
Respondents. :

FILED

ANSWERING BRIEF OF
MOUNTAIN FUEL SUPPLY COMPANY

JUL 30 1982

AND

Clerk, Supreme Court, Utah

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MITTEE OF CONSUMER SERVICES, :

Defendants/Intervenor- :
Respondents. :

ANSWERING BRIEF OF
MOUNTAIN FUEL SUPPLY COMPANY

AND

WEXPRO COMPANY

NATURE OF THE CASE

This Case arises out of proceedings before the Public Service Commission of Utah, in part on remand from an Opinion of this Court of May 10, 1979,^{1/} in which a Stipulation and Agreement of the

^{1/} In Committee of Consumer Services v. Public Service Commission, 595 P.2d 871 (Utah 1979), generically referred to as the "Wexpro Case", this Court reversed and remanded the matter to the Utah Commission for further proceedings in accordance with the holding of the Opinion. In the course of those proceedings, the Commission addressed the larger issues of the Mountain Fuel exploration and development program, and after a hearing on a Motion for approval of a settlement Agreement, a remedy was fashioned and Order entered by the Commission that ran to the entire MFS exploration and development operations.

adversary parties in the earlier case with regard to the manner, method and accounting of the operation and development of Mountain Fuel's oil, gas and wildcat properties were comprehensively reviewed and then approved by the Commission in its Order of December 31, 1981. For the convenience of the Court, there is filed as a separate Attachment to this Brief true copies of the Stipulation and the Agreement together with a copy of the December 31, 1981 Order of the Commission approving the settlement.

PARTIES BEFORE THE UTAH COMMISSION

The public parties before the Commission (Utah PSC or Commission) in the proceedings below were the Utah Division of Public Utilities (Division) and the Utah Committee of Consumer Services (Committee) represented by the Attorney General and his Assistants.^{2/} Mountain Fuel Supply Company (MFS) and Wexpro Company (Wexpro) were investor owned private companies whose properties and interests were directly affected. The Utility Shareholders Association (Shareholders) appeared as an intervenor as did the Utah Coalition of Senior Citizens (Coalition) and each fully participated in the Commission proceedings below. The Utah Department of Administrative Services (Administrative Services), while not participating in the principal proceedings before the Commission, filed a petition for rehearing to the Commission Order of December 31, 1981.

DISPOSITION OF CASE BY THE COMMISSION

The Commission initially set the case down for hearing on remand, as to whether a transfer to Wexpro of the historically

^{2/} The Division of Public Utilities and Committee of Consumer Services were the appellants in the initial appeal before this Court.

classified non-utility oil properties by MFS was in the public interest and otherwise consistent with the holding of this Court. The scope of the hearing was later expanded to include numerous additional issues relating to the entire exploration program. After several continuances granted because of pending negotiations, the Division, Committee, Mountain Fuel and Wexpro submitted a proposed Stipulation and Agreement of settlement of all issues to the Commission for its review and approval. Because the Stipulation and Agreement were between the parties to the initial controversy and included the public agencies acting in behalf of the ratepayers, the Commission ordered a hearing and review of all aspects of the Stipulation and Agreement as to whether they were, in fact, consistent with regulatory policy and in the public interest and whether such were in conformance with the holding of this Court. After eight days of testimony, substantial argument and written briefs, the matter was submitted to the Commission after which it issued its Order and Report, including Findings of Fact and Conclusions of Law, on December 31, 1981.

From that Order, the Shareholders, the Coalition, and the Administrative Services filed separate petitions for rehearing which were denied by the Commission on February 9, 1982. Individual petitions for certiorari were thereafter filed with this Court by each of said interests seeking review of the December 31, 1981 Order. The certiorari appeals were consolidated for briefing, argument and disposition.

ISSUES ON CERTIORARI APPEALS

The questions presented for review by this Court by the appeals of the Shareholders, Administrative Services, and the Coalition are:

1. Did the Commission have jurisdiction to accept the Stipulation and Agreement of the parties and determine that such Stipulation and Agreement should be accepted?
2. Are the Findings and Conclusions that the Stipulation and Agreement settling the Wexpro case were in the public interest supported by competent evidence?
3. Did the Commission err in law in accepting and adopting the Stipulation and Agreement which settled the Wexpro litigation?
4. Does the Commission Report and Order sufficiently define and approve the settlement, including the transfers of property to Wexpro and Celsius, as to be afforded the finality of res judicata?
5. Did the Commission err in not ordering an appraisal to determine the value in dollars of all the properties involved in the settlement?

SUMMARY OF MFS AND WEXPRO POSITION

The Report and Order of the Commission in this Case should be affirmed. This Court, in Committee of Consumer Services, supra remanded the case to the Commission with directions to conduct further proceedings (595 P.2d at 871). The Commission did just that.

Extensive hearings were held and the Stipulation and the Agreement of the parties were submitted only after intense, lengthy and extremely difficult negotiations. The overwhelming and

competent evidence supports the Findings of the Commission that the Stipulation and Agreement were in the public interest, in the interest of the ratepayer and implement the regulatory policy of this State. Such Findings, being supported by competent, uncontroverted evidence, are thus, by statute, not open to challenge or review before this Court. The Commission Order observed and the Stipulation and Agreement incorporated the principles set forth by this Court in the initial Wexpro decision.

The method of valuation of the properties transferred was also correctly determined, was consistent with industry standards, resulted in a transfer for fair market consideration and was in the public interest.

The Report and Order of the Commission deal with the transfer of properties to Wexpro and Celsius^{3/} and with the allocation of benefits from the producing properties with finality with the doctrine of res judicata applicable to property transfers and other provisions of the Report and Order.

STATEMENT OF FACTS

The presentations of the facts in the record made in the opening Briefs of Appellants are incomplete. Administrative Services essentially ignores the record in this proceeding and, instead, devotes 65 pages in an emotional and erroneous translation of the original record in the first Wexpro case, as though that matter

^{3/} Celsius Energy Company (Celsius) a wholly controlled affiliate of MFS was established for the purpose of holding the exploration acreage and of conducting the oil and gas exploration activities, all as contemplated by the Stipulation and Agreement of settlement. (Tr. 961, 1409-10; Stipulation § 17.4)

was again before the Court. The record and issues in the original Wexpro case are completely different from the record and issues in the instant appeal.^{4/} This Case and its record relate to the approval of the Stipulation and Agreement of settlement and in no sense constitute a rehearing of Wexpro. Accordingly, the Statement of Administrative Services is of very little assistance.

On the other hand, the factual statement of the Shareholders is accurate but incomplete to an analysis of all of the issues on appeal. Therefore, MFS and Wexpro set forth their statement of Facts in accordance with Rule 75(p)(2) U.R.C.P.

1. Mountain Fuel Exploration and Development Program. John Crawford, Jr., Executive Vice-President and Chief Financial Officer of MFS, testified that the Company was organized in 1935 through the consolidation of several companies, including an oil company, and maintained from its inception an exploration and development program including ownership of and rights to certain oil properties. The oil operations of Mountain Fuel were, from the beginning of

^{4/} In Wexpro the PSC ordered that it did not have jurisdiction over or to approve or disapprove the transfer of certain oil properties historically (pursuant to prior Commission orders) classified in a non-utility oil account of MFS. It also approved an Amended Agreement of Purchase and Sale and an Amended Joint Exploration Agreement (J.E.A.) between MFS and Wexpro. This Court reversed the PSC Order and indicated that with regard to Commission jurisdiction, the elements of classification of the oil properties as non-utility should be re-examined (albeit retroactively). The settlement bears no relationship to the Amended Agreement of Purchase and Sale and the program provided for therein bears no similarity to the J.E.A. The appeal now before the Court does not involve any such jurisdictional or classification issue, because the Stipulation and Agreement of settlement assumes that the PSC has jurisdiction over all oil and gas properties, whether previously classified as non-utility or utility.

the Commission regulation in 1940, excluded from utility regulation.^{5/} Beginning in 1947, the Commission utilized a method of accounting for the classification of gas properties as utility assets and oil properties as non-utility assets and over the years, approved, if not mandated, such classification system for MFS. (Tr. 1374-86) Repeated attempts were made over the years of regulation to have the Commission order MFS to include oil revenues in its utility accounts to reduce gas rates, but such attempts were specifically denied. (Tr. 1378-1383) For example, the exact method used in classifying oil wells and gas wells, which this Court disapproved in 1979, was expressly adopted by the Commission in a 1959 Order. (Tr. 1380)^{6/}

As the exploration and development program of MFS was carried out over the years, both the utility and non-utility accounts made contributions to its functions. (Tr. 1376-1379) Even though all of the capital costs of leasehold acquisition of oil and gas exploration acreage, all of the capital costs of oil exploration and drilling, and a proportionate share of unsuccessful dry hole expenses were paid from the MFS non-utility accounts (Tr. 1376-81), the inclusion of a portion of unsuccessful drilling costs as an expense in setting gas rates and the existence of the non-utility oil properties continued to cause contention. (Tr. 1377) In 1974, the Commission proposed to use oil revenues to reduce gas

^{5/} In 1940, the Commission issued an order eliminating oil wells from utility rate base accounts as not being used and useful in the sale of natural gas. (Tr. 1374)

^{6/} PSC Case No. 4797.

rates (Tr. 1382), but backed-off in the face of the suspension of trading and a disastrous market decline in the value of MFS' stock on the New York Stock Exchange. (Tr. 1382-3)

In the Spring of 1976, MFS faced a proxy battle to remove present management because of the continuing problem with the separated, unregulated oil properties. (Tr. 1388-9) In late 1976 MFS created Wexpro, a wholly-owned subsidiary, and transferred to it the oil properties, then held in a long established non-utility account. Wexpro was also to have conducted a joint drilling program with Mountain Fuel under the J.E.A. The Commission, after requiring some amendments and concluding that it did not possess jurisdiction over the transfer of the non-utility oil properties from MFS to Wexpro, approved on April 11, 1978 the Purchase and Sale Agreement and the J.E.A. between MFS and Wexpro. The Division and the Committee, by certiorari, appealed that Order to this Court.

2. Holding of Supreme Court on Appeal. This Court, under Opinion dated May 10, 1979, reversed the Report and Order of the Commission and decided that until there was an evidentiary hearing to determine whether the transferred oil properties were, in fact, non-utility assets, there was not an adequate basis to determine whether the Commission's subject matter jurisdiction reached the transfer. The Court also reversed the Order of the PSC approving the Amended Agreement of Purchase and Sale.^{7/}

The majority Opinion authored by Maughan, C. J., went on to observe that the traditional concepts of public utility law,

^{7/} See 595 P.2d at 873, 877..

viz., that the investor supplies risk capital and sustains the loss of a speculative venture, may have been modified over the years in the MFS exploration program through an exploration expense for unsuccessful well drilling being reflected in utility rates. The Maughan Opinion stated that such charges were, in effect, a capital contribution by customers to a speculative venture.

The majority Opinion also observed that exploration or development properties should be transferred by Mountain Fuel only for fair market consideration so that an "appropriate" benefit could be realized by customers and then only after the Commission has determined whether the transaction is detrimental to the ratepayer and in the public interest.^{8/}

The majority Opinion also commented on the question of whether the arrangement between Wexpro and Mountain Fuel, regarding the sale of natural gas at market price on developed acreage other than that transferred under the Agreement, violated the "no-profits-to-affiliates" rule. The Opinion suggested that such a sale would so do.

The decision also declared that Wexpro had the option of withdrawing from the Joint Exploration Agreement.^{9/}

3. Case on Remand Before Commission. Soon after the issuance of the majority Opinion, Wexpro availed itself of the option and terminated the Joint Exploration Agreement (Tr. 1479, Stipulation §§ 1.14, 1.16), thus making moot the question of whether the

^{8/} See 595 P.2d at 878.

^{9/} See 595 P.2d at 879.

1976 transfer and proposed exploration program were detrimental to the MFS customer, in the public interest, or for market value.

The Case, upon remand to the Commission, was set down to determine whether any exploration and development properties of Mountain Fuel and particularly the classified non-utility oil properties, should be transferred to Wexpro as consonant with the public interest, whether such would be detrimental to the customers of MFS, and if a transfer were proposed, what conditions should be attached to benefit the customers and to satisfy the public interest.

The parties before the Commission on remand were those before the Supreme Court in the original Wexpro appeal, namely, the Division, the Committee, MFS, Wexpro and the individual shareholders Oblad and Burton. In addition, the Coalition and the Shareholders Association sought and were granted permission to intervene. The preliminary motions and pre-trial proceedings before the Commission were vigorously contested between the parties, with MFS and Wexpro raising a number of Federal and State constitutional questions. In addition, litigation had been initiated by MFS and Wexpro against the Division, the Committee, and the Commission before the United States Court for Utah raising constitutional questions stemming from the May 10, 1979 Opinion of this Court,^{10/} and reorganization proceedings

^{10/} Mountain Fuel Supply Company v. Public Service Commission of Utah, et al., U.S. District Court No. C-80-0710J. While said complaint was dismissed as premature in July of 1981, the dismissal was without prejudice to refile upon completion of the pending proceedings before the Commission.

had been initiated by MFS before the Federal Energy Regulatory Commission in Washington, D.C.^{11/}

4. Stipulation and Settlement of Case. During the pendency of the Case before the Commission on remand, numerous problems and practical considerations required MFS to make certain business decisions and to advise the Commission that the sweep of the majority Opinion of the Supreme Court in Wexpro had made it virtually impossible for the Company to conduct a utility exploration and development program or to raise new investment capital for that purpose. MFS was experiencing great difficulty raising investment capital and retaining its exploration personnel. Shareholders of MFS were unwilling to invest further monies until it was determined the manner in which risk capital for exploration and development would be treated and accounted for by MFS and Wexpro. (Tr. 1137-43, 1475-79)

The expert witnesses testified that: the drilling program in the future was going to require investment of about \$200 million (Tr. 1056); the required funds could not be generated internally (Tr. 1529); the shareholders would not support a joint program with customers and it would be extremely difficult, if not impossible, to raise outside capital; the exploration program was at a standstill (Tr. 1039-40); leases were expiring (Tr. 1479); the Company was experiencing great difficulty retaining skilled explor-

^{11/} FERC Docket Nos. CP80-274, CP80-275 and CI80-233.

ation personnel; the proceedings and litigation were diverting inordinate amounts of time of corporate management of MFS (Tr. 1480); the Company had every reason, under the circumstances, to "hold back" on the exploration program (Tr. 1040).

The exploration program was, thus, on "hold" by 1980 because of the unresolved litigation (Tr. 1039-1040); there was concern on the part of all parties that leases on wildcat acreage were expiring, commitments to drill should be made as part of an on-going exploration program and that unless the Commission proceedings (which had been pending since late 1976) were resolved quickly and the pending litigation finally terminated, the exploration and development program of MFS would be irreparably damaged, regardless of who prevailed, to the injury of ratepayers, stockholders, and the Company. (Tr. 943, 944-45, 1520-21, 1529)

For the better part of six months in the Spring and Summer 1981, intensive negotiations were conducted between legal counsel for the Division and Committee on the one hand, and Mountain Fuel and Wexpro, on the other hand. Expert economic and petroleum industry consultants also attended and participated. The negotiations were "very tough, and hard nosed", conducted at "arms-length", with impasse being reached at several points. (Tr. 899-900, 1015) As one legal counsel put it to the Commission, the negotiations were the most complex, involved, and difficult in a long career of legal practice. (Tr. 891-92) Counsel for the Coalition was invited to attend any negotiating sessions and although such invitation was declined, the Coalition was apprised of general developments taking place. (Tr. 952-53) During the

negotiations, one of the principal concerns was that any stipulation or settlement reached be generally consistent with the observations and holdings of this Court in the Wexpro Opinion.

In late August 1981, a settlement, subject to final drafting, was reached among the Division, Committee, Mountain Fuel, and Wexpro with regard to the allocation of benefits from the producing reservoirs, the conduct and operation of exploration and development, the transfer of properties, the credits to utility accounts for the benefit of customers, the preservation of cost-of-service gas, the recognition of capital investment, and other relevant factors. The settlement took the form of a Stipulation between counsel for the principal parties and an Agreement between the parties which were laid before the Commission under a Joint Petition for approval.

The Commission thereupon held hearings in October and November 1981 on the questions of whether the Stipulation and Agreement were detrimental to ratepayers, whether they were in the public interest, and whether such should be approved or rejected as consistent with the regulatory policy of the Commission and the prior Opinion of this Court.

5. Terms of Stipulation and Settlement Agreement. The Stipulation and Agreement are comprehensive regarding the exploration and development of Mountain Fuel properties held in both the utility and non-utility accounts. They are complex, lengthy and detailed.

A summary of the Stipulation and Agreement has been set out both in the Answering Brief of the Division and the Committee (pages 12-18) and the opening Brief of the Shareholders (pages 9-15) here-

in. Apart from editorial comments in the Division and Committee Brief, the factual summaries in both Briefs are accurate, are adopted by MFS and Wexpro for purposes of this Brief, and the Court is referred to such summaries.

6. Commission Proceedings on Stipulation and Agreement of Settlement.

For eight days, the Commission took testimony from expert economists, accountants, petroleum engineers, energy and utility rate consultants, petroleum geologists, security analysts, shareholders, officers of MFS and Wexpro, an Assistant Attorney General, and public witnesses regarding the factual and legal policy surrounding the Stipulation and Agreement. The following is a capsule summary of the evidence:

Herman G. Roseman. Engaged by the Division, Roseman is an economist and regulatory consultant of national standing with substantial experience as an employee of the Federal Power Commission (FPC) in the regulation of utility and oil and gas companies. (Tr. 1009-13) Roseman was retained by the Division as an expert witness to testify in what was expected to be a sharply contested trial, but when settlement talks developed, he assisted the Division in negotiations.

As to a fully litigated contest between MFS on one side and the Division and Committee on the other, Roseman was not sure which would be worse for the consumer -- a win by MFS or a win by the customers. Both "appeared to be disastrous outcomes". (Tr. 1017) A customer win causing a complete roll-in of the previously designated non-utility oil properties into the utility gas accounts for rate making would severely curtail and perhaps

even eliminate the MFS exploration program. (Tr. 1017) Roseman further testified that if a roll-in were to occur, all MFS would receive from future exploration would be the possibility of earning a utility rate of return for cost-of-service gas, as reduced by oil revenues. Such would not attract new capital and investors who needed the prospects of unregulated returns to invest in high risk oil and gas exploration. (Tr. 1031-33) Roseman further believed that a roll-in would have a major and adverse financial impact on MFS, making it extremely difficult for the Company to raise either common equity or debt capital on reasonable terms. (Tr. 1040-4)

Roseman was also of the judgment that a complete roll-in of the oil properties and revenues would have a very negative impact upon MFS personnel and would probably result in a much less aggressive program. In response to a Commission inquiry, Roseman stated that a higher regulated rate of return on the rolled-in properties would not solve the fundamental economic realities. (Tr. 1042)

Roseman strongly supported the settlement Agreement before the Commission, testifying that it provided incentives for the development of oil and gas acreage while protecting the interests of the customers of MFS in cost-of-service gas and future reserves. (Tr. 1023, 1029-30) Beyond that, Roseman testified that while the customers had a claim on a substantial fraction of the oil profits, he was "never persuaded that the share was 100%." The 54% share arrived at in the settlement Agreement was slightly better than he had hoped to achieve as a minimum in the litigation, particularly in light of other aspects of the Agreement. (Tr. 1024)

Roseman was of the view that oil and gas exploration and development has not proved successful as a regulated public utility function. (Tr. 1022) Apart from the many other problems, it was difficult for a regulatory commission to cover the Company in the "down side risk" of successive dry holes. (Tr. 1033, 1042) The formation of joint ventures to share the risk of deep and difficult drilling is common in the Rocky Mountain area, but Roseman testified that exploration companies do, in fact, shy away from being a "joint venturer with a regulated utility", because the venture may subject the operator to regulation. (Tr. 1032, 1034)

Roseman testified that under the settlement, the utility receives the benefit of customers substantial overriding royalty interest of 7% on undeveloped wildcat acreage which he characterized as "a fairly high figure as overriding royalties in the oil business go". (Tr. 1026) Also all contributions from customers are eliminated, both with regard to carrying charges on undeveloped acreage or dry hole costs. In short, the customer bears no risk in wildcat drilling or otherwise under the Agreement. (Tr. 1024, 1028)

As to the no-profit-to-affiliate rule, Roseman stated that in his experience with the Federal Power Commission in the regulation of natural gas public utilities, the theory has not been applied so as to eliminate all profit between affiliated companies, but only excessive profits that may come through either self dealing or a monopoly position brought about by regulation. (Tr. 1038) Reasonable profit between affiliated companies should be allowed. (Tr. 1038) Even in the case of cost-of-service gas from the production of MFS, itself, the Commission has always recognized the

element of profit for return on capital. (Tr. 1039) Roseman knew of no instance in which cost-of-service gas prices do not include a reasonable return on capital.

Roseman emphasized that the entire settlement and all of its various constituent parts were: "interrelated." (Tr. 1015, 1045) The settlement must be viewed in its entirety (Tr. 1021) in order to properly assess the consideration which flowed to the benefit of customers. (Tr. 1023-25) The individual aspects of the negotiations and settlement should not be isolated when examining the totality of the bargain. The consideration and benefits received by the customers for the settlement are for fair market value and in the public interest. (Tr. 1029-30)

Roseman pointed out that if the settlement had not been reached, there was a great risk that customers would lose the benefit of cost-of-service gas as a result of federal regulation. He characterized this possibility as "the greatest single risk" of litigating the case in an adversarial atmosphere. (Tr. 1018) The settlement removes this risk from the customer and assures continued availability of cost-of-service gas.

Richard Walker. Mr. Walker, a CPA with 35 years experience and senior partner of Arthur Andersen & Co. in Chicago, specializes in utility regulation. He has performed work for a substantial number of natural gas and oil companies, including natural gas transportation and distribution utilities. Walker was retained by MFS to review the terms of the Stipulation and Agreement.

Mr. Walker testified that one of the oldest problems in utility regulation is keeping the role of the investor and the

customer clear. (Tr. 1193) The investor supplies the risk capital and needs to know what that risk will be and what he can expect as a reward. The operating expenses of a utility company are recovered in the price of the services and products sold to the customer. Investment capital is provided by shareholders and bondholders. The customer should not become an involuntary supplier of capital. (Tr. 1194) Walker testified that, by and large, unsuccessful exploration and development expenses, including nonproductive dry hole operations, are viewed in this country as an item of current operating expense in fixing utility gas rates. However, the Supreme Court of Utah, in the Wexpro decision, seemed to say that such current operating expenses were, in reality, capital contributions. With that finding, the roles of the investor and the customer were reversed and confused. (Tr. 1207) Whether the comment of the Utah Court to this effect was either central or gratuitous to its opinion in Wexpro, Mr. Walker stated that under the Agreement of settlement, the roles of the investor and the customer are clearly separated with exploration and development costs, including the risk of dry holes, placed with the investor. This is "very desirable". (Tr. 1195)

Turning to the no-profit-to-affiliate rule, Walker stated that American utility law, as he understands it, permits a fair profit in affiliated transactions. (Tr. 1199-1200) Mr. Walker

had reviewed the actual records in two cases cited by the Utah Court in its Wexpro decision on the no-profit-to-affiliate rule. He testified that in both cases, the affiliate was permitted, by the final court decision, to earn a reasonable return on capital invested. (Tr. 1199-1200)

As to the provisions in the settlement Agreement relating to sales of natural gas between MFS-Wexpro and MFS-Celsius, the no-profit-to-affiliate principal has no application in any event, because the bargaining parties were not MFS and Wexpro or Celsius, but were MFS and Wexpro on one side of the table and the Division and the Committee on the other side. (Tr. 1201)

Walker testified that oil and gas exploration is not well suited to utility regulation because of the high risks and great uncertainty in the value of discoveries in relation to expenditures. (Tr. 1202-3) Walker was opposed to conscripting or labeling as investment capital the payments made by customers in purchasing natural gas. (Tr. 1204) Of the many pipeline and distribution utilities having exploration programs which Mr. Walker represents, none of them have exploration and development on-going in a regulated entity other than those properties which are just living out their lives. (Tr. 1205) Further, exploration companies in the field are not anxious to conduct joint explorations or operations with regulated utilities. (Tr. 1205)

Mr. Walker stated that a joint program between investor and utility customer would not work since the investor would be an unwilling partner and could receive a substantially different return than the customer, the latter of whom may take his return off the top in a regulated operation. (Tr. 1213-4)

John F. O'Leary. Mr. O'Leary, called by the Shareholders, was formerly Deputy Secretary of the U.S. Department of Energy, Administrator of the Federal Energy Administration, Chief Energy Officer of the State of New Mexico, Director of Licensing of the U.S. Atomic Energy Commission, Director of the U.S. Bureau of Minerals, Chief of the Bureau of Natural Gas of the Federal Power Commission, and Deputy Asst. Secretary of the U.S. Department of Interior responsible for energy matters. (Tr. 1216)

O'Leary testified that in his experience, natural gas exploration in the various states is generally carried out as a non-utility function with the gas being transferred to the utility at market price. (Tr. 1218) Federal regulation, as well, of exploration by regulated pipeline companies was changed to a non-utility activity in 1969. (Tr. 1218-23) O'Leary stated that an involuntary drilling program forced on the Company would not be successful and would cause good personnel to leave MFS employment. (Tr. 1226-8) A joint program between the customer and the shareholder will not work. (Tr. 1230)

Contrary to the assumption that Administrative Services and the Shareholders make in their Brief, pricing gas at cost-of-service does not assure a price below market. High risk and unsuccessful drilling over a period of time, even though exploration was aggressively pursued, would place gas customers in a position where they paid more for internally generated production than would be paid in the open market. A regulatory commission, in his experience, would be very hard pressed to permit an unsuccessful utility exploration program to continue for any length of time. (Tr. 1230-1)

O'Leary studied the settlement Agreement and found that it places dry hole risks entirely on the investor, that the utility gas customer was served very well, and that if anything, the Agreement does not make a fair distribution from the exploration program to MFS shareholders. (Tr. 1226, 1232-3)

As to the no-profit-to-affiliate rule, O'Leary testified that in all of his regulatory experience, he understood it to foreclose only abusive profits and not profits which would be normally earned in a competitive market. (Tr. 1233-4) On cross-examination, he stated emphatically that a call on the gas in behalf of MFS from wildcat acreage at market price did not violate the no-profit-to-affiliate rule. (Tr. 1238-40)

Mr. O'Leary stated that in all events, it was extremely important that the settlement Agreement and Stipulation, if accepted by the Commission, be final and binding in the future and as to future parties, so that property transferred, capital committed, benefits received, and properties developed in reliance upon the Agreement and the Commission Order could not be undone or retroactively unraveled to their detriment four to five years in the future.

Howard Ritzma. Ritzma, called by the Division and Committee, is a petroleum geologist with vast experience with oil and gas activities in the Rocky Mountains. He is the Assistant Director and Chief of the Petroleum Section of the Utah Geological and Mineral Survey. Ritzma testified that with regard to aggressive

exploration companies, they have not wanted to explore jointly with MFS because of the utility regulation of the Company. (Tr. 1267-8) Further, Ritzma said that in high risk wildcat exploration, it would be very difficult for MFS to obtain either exploration partners or investors without the prospect of "the big strike" which utility regulation cannot provide. (Tr. 1270)

As to the settlement Agreement, Ritzma had been consulted by the Division and Committee in the settlement negotiations as a State of Utah employee. Ritzma had written a letter to the Commission recommending approval of the settlement Agreement as both a State employee and as an expert consultant. The Utah Director of Natural Resources had also approved the letter. (Tr. 1272)

In the view of Ritzma, the settlement Agreement offers better advantages to the utility customer of MFS than the prior Joint Exploration Agreement between MFS and Wexpro. (Tr. 1273)

James A. Harmon. Mr. Harmon, an investment banker and general partner of Wertheim and Co. of New York City who works with large institutional investors trading significant blocks of MFS stock, is a member of the MFS Board of Directors. (Tr. 1105-10) Harmon has assisted MFS in much of its capital financing and has talked with many large shareholders with regard to their view on the discontinuance of a utility exploration and development program. Mr. Harmon testified that the majority of MFS shareholders would not support any further exploration or development program out of the utility and that in his judgment, new capital could not be raised for such purpose. (Tr. 1137-9)

The financial community regards oil and gas exploration as one of the highest risk businesses with possible high returns whereas the utility business is regarded as one of minimal risk with a lower, regulated return. The two concepts are not compatible, because the Commission, while it might allow a higher return for the higher risk, could never guarantee it and the equity investor will never swap the potential of a large return for a fixed rate of return. (TR. 1119, 1122, 1130-1)

If Mountain Fuel were to further explore as a utility in the future, the Company could not raise capital for the program. Looking at the settlement Agreement, even though it is complex, Harmon concluded that new capital could be raised to finance exploration through the unregulated operations of Wexpro and Celsius. (Tr. 1151)

R. Don Cash. MFS called Mr. Cash, President of the Company. Cash has a significant background in oil and gas exploration in several areas of the United States, and especially in the Rocky Mountains. Mr. Cash testified that the Wexpro decision and the pending litigation between MFS and Wexpro and the public agencies had adversely affected the morale of exploration employees of the Company. Exploration engineers, geologists, and landmen are in high demand and are extremely valuable. Those employees do not like their work subject to retroactive review when the program is under utility regulation. (Tr. 1475-6)

Cash stated that operators in the oil and gas industry shy away from arrangements with regulated utility companies because it is difficult to keep information confidential. (Tr. 1477-8)

Immediately after the issuance of the Wexpro Opinion by the Utah Supreme Court, MFS suspended its exploration program with the exception of those activities that were necessary to preserve properties and meet contractual commitments. The Company had no other choice in the matter, because the shareholders had no further interest in the previously conducted program. (Tr. 1479) The exploration program of MFS continued to suffer after issuance of the Wexpro Opinion and during the pendency of significant litigation.

Mr. Cash stated that wildcat exploration is high risk business, but even development drilling (in already discovered reservoirs) is not a "sure" bet, because much of the development drilling will be on the rim or edge of the reservoir. (Tr. 1480)

Mr. Cash stated that under the settlement Agreement, the Utility Division of MFS did not surrender any cost-of-service gas; those reserves were retained with a supply-life of about 12 years. (Tr. 1483, 1496, 1507) Although the settlement Agreement concedes more to customers than MFS believed it should, the Agreement is in the public interest. Mr. Cash detailed the reasons. (Tr. 1486)

Ralph M. Kirsch. Wexpro called as its witness Mr. Kirsch, President and CEO of Wexpro. A lawyer by training with extensive experience in oil and gas exploration and negotiations, Kirsch testified that his direct experience with MFS over many years was that it cannot carry on a successful exploration program as a regulated utility. (Tr. 1511-14) Mr. Kirsch went on to say that

while the additional allowance of 5% and 8% on capital investment for development drilling of oil and gas reservoirs was reasonably necessary in the Agreement to cover unsuccessful drilling costs in said reservoirs, the allowance would not be adequate to cover wildcat exploration risks. (Tr. 1118) Of the wildcat acreage, 56.2% of the leases will expire in four years, with 10.6% expiring in 1982, 21.1% in 1983, 8.9% in 1984 and 15.6% in 1985. (Tr. 1520) Under the Agreement Wexpro has an obligation to expend \$40 million in development drilling but there are no internally generated funds with which to accomplish that drilling. (Tr. 1529)

Mr. Kirsch also explained how the 7% overriding royalty on the unexplored acreage works. An override is computed on the gross value of production and does not share in any exploration, development or production expenses. As a consequence, the value of the gross production is usually many times that of the net value of production after costs and expenses. Accordingly, Mr. Kirsch testified, a 7% override could be more valuable than a 50, 60 or even 70% equity interest. (Tr. 1523)

Mr. Kirsch stated that everything being considered, the settlement Agreement providing for an unregulated exploration program, was fair to all interests.^{12/} He emphasized that the settlement must be viewed as a "whole". If an attempt were made to change one portion, then some other part of the settlement would be impacted. (Tr. 1515)

^{12/} During the course of the Kirsch examination, legal counsel for the Division and Committee as well as MFS and Wexpro expressed to the Commission that the Agreement reflected an attempt to free the exploration program, to the extent possible, from utility type regulation. (Tr. 1543, 1573)

Lyle Hale. Mr. Hale was called as an expert petroleum geologist by the Division and Committee. He was familiar with MFS exploration properties, having worked in exploration for MFS from 1951 through 1974. Hale testified that in his opinion, the settlement Agreement was in the public interest and in particular, in the interest of the utility gas customer and that the consideration to the utility for properties transferred to Wexpro and Celsius represented fair market value. (Tr. 1331)

Merrill R. Norman. Mr. Norman, a CPA who testified in opposition to the MFS-Wexpro agreements in 1977, testified that the settlement Agreement is in the best interest of the customer. (Tr 1279-80) Gas from both oil and gas producing properties will go to the utility at cost-of-service prices. (Tr. 1298) In Norman's opinion, the Agreement is "far better" than the program proposed in the original Wexpro proceedings of 1977.

Richard B. Rosenberg. The only witness called by the Coalition, Mr. Rosenberg is a recently employed staff attorney of the California Public Utilities Commission. While explaining the functions of an exploration program in California, he expressly took no position on the merits of the Stipulation or Agreement before the Commission. The Commission expressly so found. (See p. 5 of the Report and Order)

With the exception of Mr. Rosenberg, who took no position, all of the witnesses testified that the settlement was in the public interest.

7. Transfer of Exploration Acreage for Market Value. The Coalition maintained that the wildcat exploration acreage to be transferred from Mountain Fuel to Celsius under the Agreement should be appraised on a dollar value basis in the traditional sense and monies transferred for the benefit of the MFS utility customers. The Coalition failed to produce a shred of testimony that the wildcat acreage could be meaningfully appraised by establishing a fixed dollar amount. The overwhelming weight of the testimony is that it is neither customary nor appropriate to appraise such properties in that manner.

Indeed, virtually every experienced witness who took the stand, testified unequivocally that not only would a dollar value appraisal be unavailing and futile, but that the 7% overriding royalty with a call on the gas constituted market value for the transfer of the exploration acreage. For example, Howard Ritzma, testifying for the Division and Committee, with vast experience in exploration activities, testified that the 7% gross overriding royalty and a first call on the gas at market constituted fair market consideration for the transfer to Celsius of the wildcat acreage (Tr. 1250), and the 2½% royalty on the Wexpro after-acquired property is "generous" to the utility customer and reflects fair market value. (Tr. 1251-2) The 7% overriding royalty on the wildcat acreage was, actually, higher than usual. (Tr. 1254) Ritzma, stated, unequivocally, that it is not reliable to fix the values in money of unexplored acreage and that trying to estimate the volume of oil and gas in wildcat acreage is "an exercise in futility." (Tr. 1263)

Mr. Hale, a consulting petroleum geologist, testified that the 7% overriding royalty and the first call on gas at market is a fair consideration for the transfer of the wildcat acreage and that trying to place an appraised value, in the traditional sense, on the properties would be "very speculative" -- ten different geologists would give ten different answers -- a dollar value would remain speculative until the property had been drilled and produced. (Tr. 1333-5)

Mr. Roseman for the Division and Committee stated that in his experience, transfers of interests in exploration acreage in exchange for royalties is generally understood and accepted in the industry. (Tr. 1047) Further, he testified that any attempt to place a fixed dollar value, per acre, on the wildcat acreage would be "very much a guess" and that what the Division and Committee did was to estimate "what the market would require in the way of royalties" for a transfer of the acreage. (Tr. 1045) Roseman stated that in his experience, transfer of oil and gas properties would, in the great bulk of cases, be best valued on a royalty percentage, that being "more or less traditional in the industry". (Tr. 1046) Mr. Roseman estimated the 7% overriding royalty on the wildcat acreage to be worth something like \$7 million dollars per year to the utility gas customer. (Tr. 1055)

Ralph M. Kirsch, with years of experience in dealing with wildcat acreage, testified that the 7% overriding royalty with a call on the gas could be more valuable, in the market, than a 50%, 60%, or 70% equity interest in wildcat acreage. (Tr. 1523)

The Commission expressly found in its Report and Order that the properties, including the wildcat acreage, were transferred "for fair market value as that value is typically determined in the industry", and that "adequate benefits from the Settlement redound to the benefit of customers of MFS". (Finding #10 of R. and O. p. 19)

8. Report and Order, Findings and Conclusions of the Commission.

Throughout the days of testimony, the Commission evidenced considerable interest in and concern over various aspects of the Stipulation and Agreement. Much questioning occurred both of witness and counsel.

In its Report and Order, the Commission noted that the pending litigation was extremely difficult and had impaired the benefits of the exploration program to MFS customers as well as the public interest, generally. (R. and O. pp. 13, 14) It was noted that although the settlement Agreement was to be viewed in total and not in separable units, the uncontested testimony manifested that the individual properties had been transferred for fair market value. (R. and O. p. 16, ¶16)

The Commission expressly found as fact that the settlement Agreement and Stipulation were just and reasonable, in the public interest, and that the customers of MFS will be served by approval. (Finding #11 p. 19 R. and O.) The Commission concluded it had jurisdiction to resolve the controversy and various cases before it, that resolution of the contested issues under the Stipulation and Agreement was in the public interest, that the Commission had jurisdiction to review the transfer of the subject properties between MFS and its subsidiaries and that such transfers were for market value and in the public interest. (Conclusion #5, R. and O. p. 21)

In paragraph six of the Conclusions, the Commission stated that the order was final and necessarily so:

because to insure 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. (Conclusion 6, R. and O. pp. 21, 22)

As part of the Order MFS was required to reflect in its utility rates an annualized reduction of \$21 million dollars commencing January 30, 1982. (R. and O. ¶5, p. 23) That portion, as well as other facets of the Order were implemented by MFS.

A R G U M E N T

POINT I

THE PUBLIC SERVICE COMMISSION OF UTAH,
ALONE, IS AUTHORIZED TO ESTABLISH
THE REGULATORY POLICY AND PUBLIC INTEREST
OF THIS STATE REGARDING THE FUNCTION OF
A PUBLIC UTILITY AND SUCH POLICY IS CONCLUSIVE,
UNLESS CLEARLY CONTRARY TO LAW.

The argument of Administrative Services and the Coalition by Brief appears to be that this Court is authorized or entitled to define the public interest and public policy of Utah with regard to the regulation of a public utility. The apparent theory is that this Court should review the Findings and Conclusions of the Report and Order of the Commission de novo, as to what is and is not in the public interest of the public utility regulation of MFS and further, that the decision of this Court in Committee of Consumer Services (Wexpro Case), supra, somehow constitutes a judicial decree mandating that the oil and gas exploration program and properties of MFS be regulated and conducted in a specific manner. (See Administrative Services Br. p. 14, 15, 29, 46, 62 and 71) It is, they suggest, as though this Court must assume the clearly delineated legislative functions expressly delegated to the PSC. They would have this Court abandon its judicial duties and assume the legislative (if not social) functions of the Commission by undertaking the plenary review and second-guessing of every utility policy and public interest determination of the Commission.

The fundamental flaws in the argument of Administrative Services and Coalition are obvious. First, this Court does not lay down the regulatory and public policy of Utah with regard to public utilities, generally, or MFS, in particular. These are tasks delegated by the legislature to the PSC. Second, this Court did not carve out a judicial edict in Committee of Consumer Services (Wexpro Case) that required a specific implementation of a plan for the conduct or transfer of the MFS exploration program and properties.^{13/} The jurisdiction of this Court to review on certiorari an order of the Public Service Commission is defined and limited by Statute. Section 54-7-16 of the Utah Code Annotated (Repl. vol. 1974) provides:

The review shall not be extended further than to determine whether the commission has regularly pursued its authority, including a determination of whether the order or decision under review violates any right of the petitioner under the Constitution of the United States or of the state of Utah. The findings and conclusions of the commission on questions of fact shall be final and shall not be subject to review. Such questions of fact shall include ultimate facts and the findings and conclusions of the commission on reasonableness and discrimination. (Emphasis added.)

In recognition of that limited scope of review, this Court has long held that it should not involve itself in determinations of the policy supporting or the wisdom behind a Commission deter-

^{13/} The scope and meaning of the decision of the Court in Committee of Consumer Services (Wexpro Case), supra, has been the subject of extended and wide-ranging debate in this Case and otherwise. Whether the holding of the Case was one squarely on the jurisdiction of the Commission over the classified non-utility oil properties with the balance of the opinion being dicta, or whether the many statements of the majority Opinion were all central and primary to the reversal of the Commission Order, it is clear that the Opinion does not mandate specific regulatory conduct and continued supervision of MFS oil and gas exploration and development.

mination. In Mulcahy v. Public Service Comm'n, 101 Utah 245, 117 P.2d 298 (1941), this Court noted:

What policy should be pursued, or what conclusions should be drawn from disputed facts is not a law question for the judiciary to decide.

In Lewis v. Wycoff Co., 18 Utah 2d 255, 420 P.2d 264 (1966) this Court reaffirmed the principles annunciated in Mulcahy as follows:

It is not our prerogative to pass upon the wisdom of the Commission's decision. It is charged with the responsibility of general supervision and regulation of the common carriers of this state and of seeing that the public receives the most efficient and economical service possible.

See also, Union Pac. R. Co. v. Public Service Comm'n, 103 Utah 459, 135 P.2d 915 (1943).

So long as the decision of the Public Service Commission is in conformance with the law, this Court's review is addressed to a determination of whether there is reasonably competent evidence in the record to support the findings of fact and declarations of policy and public interest made by the Commission. See, Williams v. Public Service Comm'n, 29 Utah 2d 9, 504 P.2d 34 (1972); Ashworth Transfer Co. v. Public Service Comm'n, 2 Utah 2d 23, 268 P.2d 990 (1954).

The lip service that Administrative Services and the Coalition pay to this plainly stated case law is outweighed by their insistent request that this Court set the regulatory policy for the Commission regarding oil and gas exploration of MFS and that the earlier Wexpro decision be transformed from a judicial opinion to a legislative decree. This Court's opinion, invalidating the prior J.E.A., did not even purport to design a program for the

future exploration and development of the properties, but correctly left the designing of a new one for the parties and the Commission. That is all that has been done in the instant case.

All parties did agree that the past exploration program had resulted in the acquisition of valuable properties and that it was in the public interest to explore and develop the properties in order to enhance gas supplies for the utility. But the Court, in Wexpro, did not (and could not for that matter) dictate how the properties were to be developed.

This Court was correct in refusing to attempt to usurp the powers of the Commission by fashioning legislative policy and dictating the method of conducting an oil and gas exploration program. Why Administrative Services and the Coalition now argue from the record in the old case and urge this Court to make a decision establishing public policy based on the record in that case, is a mystery.

The facts, issues, and record established before the Commission in this matter are not those of the earlier Case, and although the language of the 1979 Opinion has been observed in the Stipulation and Agreement reached by the parties in this Case, the instant record and issues stand on their own feet. The established statutory and case law are controlling.

POINT II

SETTLEMENT OF DISPUTES ARE FAVORED BY STATUTE IN UTAH AND IN THE LAW GENERALLY

1. The Law Generally.

Administrative Services is sharply critical of the parties for having resolved and settled this long running and complex Wexpro dispute. It implies that the compromise of contested litigation is in some way sinister, if not immoral, and that the Commission somehow lacked the authority or power to approve the settlement. The law is to the contrary. Compromise and settlement are encouraged. The policy behind the fostering of settlements of disputed litigation has been well stated by the Kansas Supreme Court in International Motor Rebuilding v. United Motor Exchange, Inc., 193 Kan. 497, 393 P.2d 992 (1964). At 393 P.2d 995, the Court put it this way:

The law favors the amicable settlement of disputes. Compromise as a mode of adjusting claims should be encouraged by the courts. It would be against public policy to prevent compromise of claims by compelling all controversies to be adjusted by litigation.
[citations omitted]

A compromise does not anticipate that the rights of the parties have been settled with exact nicety. Courts should not be concerned with the exactness of the accounting between the parties in considering the validity of a compromise.

For similar holdings, see, e.g., Shell Oil Co. v. Christie, 125 Ariz. 38, 607 P.2d 21 (1980); Wheeler v. McNett, 281 Ore. 485, 575 P.2d 649 (1978).

Moreover, the party challenging the relief has the burden of proof, by clear and convincing evidence and only for the strongest

reasons, that the settlement should be set aside by the Court. Lomas & Nettleton Co. v. Tiger Enterprises, 99 Idaho 539, 585 P.2d 949 (1978). The foregoing principles apply with equal force to the settlement of contested proceedings before administrative agencies. Continental Oil Co. v. Federal Power Comm'n, 373 F.2d 96 (10th Cir. 1967); Texas Eastern Transmission Corp. v. Federal Power Comm'n, 306 F.2d 345 (5th Cir. 1962).

2. The Commission is Expressly Authorized by Utah Statute to Accept Settlements of the Parties.

Not only are settlements of disputes pending before administrative agencies favored by the courts, settlements of disputes before the Utah PSC have been expressly authorized and recognized by the Utah Legislature as being in the public interest. In the recently enacted Amendment to Section 54-7-10(1) Utah Code Ann. (Supp. 1981), the legislature declared:

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. (Emphasis added.)

The Commission was unquestionably acting within its statutorily delegated authority and in the declared public interest when it examined and in its discretion, approved after full hearing, the Stipulation and Agreement.

As will be discussed hereinafter, the Stipulation and Agreement in this case satisfy the concerns expressed by this Court in its earlier Wexpro Opinion, result in long term benefits

to MFS, its customers and its shareholders, saves the Company exploration program and is in the public interest. Administrative Services and the Coalition have simply failed to meet their burden in challenging this Settlement, and the Order of the PSC approving and implementing the same should be sustained on this appeal.

3. The Claim of Appellants is Specious.

Administrative Services and the Coalition argue that the Opinion of this Court in Wexpro constituted a judicial mandate to the PSC to collapse all the oil properties into the utility accounts in establishing rates of MFS and to force MFS to explore. (Adm. Serv. Br. 73-4, Coalition Br. 10)

Whatever might be said about the range of the Wexpro Opinion, no one can reasonably argue that the decision was a decree and mandate to implement a judicially fashioned remedy of utility regulation. That simply isn't the business of this Court. Under all the authority of this Court, utility policy and regulation lies solely with the Commission. The citation by Appellants of the Antitrust divestiture decree of the U.S. Supreme Court in Utah Public Service Comm'n v. El Paso Natural Gas Co., 395 U.S. 464 (1969) ^{14/} reflects the desperation of their position. The federal courts are specifically charged by Congress with enforcement of the Sherman and Clayton Antitrust Acts, 15 USC §§1 et seq. Remedial relief is indeed fashioned by federal judges in federal antitrust litigation. But the Utah Supreme Court can hardly be said to be in the same position

^{14/} Significantly, El Paso did not involve any proceedings before or appeal from the Utah Commission. The PSC was only an amicus curiae.

in enforcement of utility regulation in Utah. The attempt to use El Paso and other similar cases as an analogy here is specious.

POINT III

THE VARIOUS CONCEPTS OF LAW
IDENTIFIED IN THE WEXPRO APPEAL
WERE RECOGNIZED BY THE PSC ON REHEARING
AND INCORPORATED IN THE STIPULATION
AND AGREEMENT OF SETTLEMENT

A. The PSC Was Free to Fashion a New Remedy Which Met the
Legal Requirements Enunciated in the Wexpro Decision.

Administrative Services and the Coalition would have this Court limit the discretion of the PSC on remand to the mere implementation of a very specific and pre-determined remedy fashioned largely out of their own boot strapping arguments intermingled with occasional dicta from the majority Wexpro Opinion. The part of the PSC cannot, under applicable case law, be so limited; it is free, within the law, to fashion a new and different solution to the problem.

The watershed case on this issue is F.C.C. v. Pottsville Broadcasting, 309 U.S. 134(1940). In that case, a broadcasting company sought a permit from the F.C.C. for the construction of a broadcasting station. The Commission denied the application, finding that the respondent was financially disqualified. The Company appealed, and the Circuit Court reversed and remanded, holding that the Commission's conclusion regarding the respondent's lack of financial qualification was based on an erroneous understanding of Pennsylvania law.

Following the remand, the Commission set the Company's application for argument along with two rival applications which had been filed subsequent to the Company's. Pottsville at this stage sought and obtained from the Court of Appeals a writ of mandamus commanding the Commission to first hear and reconsider the Company's prior application "on the basis of the record as originally made".

On appeal, the U.S. Supreme Court reversed the determination of the Circuit Court that the Commission had failed to follow the Court's mandate. In that regard, the Supreme Court said:

This was not a mandate from court to court but from a court to an administrative agency A review by a federal court of the action of a lower court is only one phase of a single unified process. But to the extent that a federal court is authorized to review an administrative act, there is superimposed upon the enforcement of the legislative policy through administrative control a different process from that out of which the administrative action under review ensued.

On review, the court may thus correct errors of law and on remand the Commission is bound to act upon the correction. Federal Power Comm'n v. Pacific Co., 307 U.S. 156. . . . But an administrative determination in which is embedded a legal question open to judicial review does not impliedly foreclose the administrative agency, after its error has been corrected, from enforcing the legislative policy committed to its charge. Cf. Ford Motor Co. v. National Labor Relations Board, 305 U.S. 364

The Commission's responsibility at all times is to measure applications by the standard of 'public convenience, interest, or necessity' The fact that in its first disposition the Commission had committed a legal error did not create rights of priority in the respondent, as against the later applicants, which it would not have otherwise possessed. (Emphasis added.) (309 U.S. at 141, 145-46)

The decision in Pottsville has been repeatedly followed by the U.S. Supreme Court in support of the proposition that an administrative agency may examine a matter after remand on a new record and make a decision based on new considerations. See, e.g., Securities and Exchange Comm'n v. Chenery Corp., 332 U.S. 194 (1947); F.P.C. v. Idaho Power Co., 344 U.S. 17 (1952). In the most recent Supreme Court case, N.L.R.B. v. Food Store Emoloyees Union, 417 U.S. 1 (1973), the Court stated:

It is a guiding principle of administrative law, long recognized by this Court, "that an administrative determination in which is embedded a legal question open to judicial review does not impliedly foreclose the administrative agency, after its error has been corrected, from enforcing the legislative policy committed to its charge" . . . Application of that general principle in this case best respects the congressional scheme investing the Board and not the courts with broad powers to fashion remedies that will effectuate national labor policy. (417 U.S. at 9-11)

See also Tennessee Gas Pipeline Co. v. Federal Energy Regulatory Comm'n, 606 F.2d 1094 (D.C. Cir. 1979), and Empire Electric Ass'n v. Public Service Comm'n, 604 P.2d 930 (Utah 1979).

Thus on the remand from this Court, the PSC had the authority and discretion to take a fresh and new approach, within the legal bounds of the law, to the questions surrounding the exploration and development program of MFS. That is precisely what the Commission did.

The Coalition, in three of the four points in its Brief, asserts that the PSC erred in not following some imagined all-encompassing mandate of this Court. The case law cited by the

Coalition in support of this position, however, is fully consistent with and relies upon the United States Supreme Court cases cited hereinabove. All that is required by those cases is that the Commission on remand fashion a remedy which is consistent with the law as declared by the Court. As will be demonstrated hereinafter, the Commission did just that.

B. The Order of the PSC Recognizes and Meets the Requirements of the Wexpro Decision.

It is clear that the PSC did not act outside of the discretion committed to it in approving the remedy fashioned by the parties in the Stipulation and Agreement of Settlement. That Stipulation and Agreement, and the order of the PSC approving same, clearly meet both the strict legal requirements of the Wexpro decision, as well as the more general observations of the Court therein.

1. Jurisdiction of the PSC Over Transfer to Wexpro. The fundamental issue in the Wexpro appeal was the determination by the PSC that it did not have jurisdiction over the transfer to Wexpro of the historically classified non-utility oil properties of MFS. The settlement Agreement moots the issue of jurisdiction by simply recognizing, for settlement purposes, the Commission's jurisdiction over all properties included in the transaction.

2. The Transfers to Wexpro as Approved by the Settlement Agreement Are In the Public Interest. The determination of the public interest requires a balancing between the interests of utility customers in having reasonable rates and reliable service with those of utility shareholders in obtaining an adequate

return on their investment. See Utah Power & Light Co. v. Public Service Comm'n, 107 Utah 155, 152 P.2d 542 (1944). Without exception, each industry expert who testified before the Commission in the remand proceedings agreed that the settlement Agreement and Stipulation were in the public interest and in the interest of the ratepayer, the shareholder, and MFS itself.

The interest of the utility customers in having reasonable rates is protected by the settlement Agreement in insuring that natural gas produced in conjunction with existing oil and gas reservoirs will come to the utility at cost of service. (Stipulation §§ 3.3.2 and 3.3.6) In addition, the utility is given a valuable first call on natural gas located and produced in the unexplored wildcat acreage at third-party market prices. (Stipulation §3.3.5) The utility will also receive a 7% overriding royalty interest on all oil and gas produced from the wildcat acreage (Stipulation §3.3.4), which will assuredly result in net gas costs at substantially below market prices.

The interests of the utility customers in a continued reliable source of supply of natural gas, which has been repeatedly recognized by the PSC as a critical factor in determining the public interest, ^{15/} is also recognized in the settlement. The Agreement provides the necessary incentives to attract the new investment capital required to continue the exploration and development program (Tr. 1023, 1029-30) which should supply MFS with a secure supply of gas for years to come. The settlement in

^{15/} The Utah Public Service Commission expressly recognized the importance of securing future supplies of natural gas as a primary factor in assessing the public interest in orders issued in PSC Case Nos. 6329, 5907, 4797, 4392, and 3650.

turn recognizes the interest of the shareholders to an adequate return on their investment by providing for an unregulated rate of return on high risk investment capital. Lastly, the public is served generally by providing incentives for the discovery and development of domestic oil and gas supplies.

Thus, it is clear that the settlement Agreement balances the interests of the utility shareholders and customers, as well as the public. The Agreement is not tilted in favor of the shareholders of MFS (indeed, against them if anything, under the testimony of Roseman and Harmon) and the Commission did not err in finding that the Settlement met the public interest.

3. The Transfers to Wexpro Were for Fair Market Consideration. Again, without exception, those expert witnesses who spoke to the issue in testimony before the PSC stated that both the traditional and preferable method of setting market value for the transfer of interests in oil and gas properties is through the use of royalty or profit interests expressed in terms of a percentage of gross or net revenues. The concept is quite simple. The more oil and gas that is found, the more valuable is the property and the greater will be the consideration secured for its sale or transfer. The less oil and gas discovered, the smaller is the value of the property and the smaller will be the consideration returned to the seller. The only question that remains is what is a fair percentage.

The testimony was without contradiction that the percentage of oil revenues allocated to the utility for the benefit of its customers from producing oil properties and the percentage royalty on the unexplored acreage were fair and perhaps even above what

could have been expected in the litigation. (Tr. 1024-29, 1254, 1325-31, 1502, 1523) The consideration given thus complies with the requirements of this Court in the prior Wexpro decision.

In contending that the transfers were not for fair market value, Administrative Services and Coalition overlook or deliberately ignore the other salient factors which were taken into consideration by the parties in determining whether the properties were transferred for fair market value. The Stipulation provides in pertinent part:

The Stipulation and Agreement are an integrated whole and each part is dependent on all other parts The totality of the consideration flowing to the Company [for the benefit of customers] under the Agreement is agreed, by the parties, in view of all the circumstances, to be the equivalent of fair market value for all assets transferred from the Company to Wexpro

(Stipulation §§3.1 and 3.2) By their failure to recognize the integrated nature of the settlement provisions and their interdependency upon each other, Administrative Services and Coalition present a very misleading and incomplete picture of the issue of fair consideration.

4. Benefits to Ratepayers. This Court expressed concern in the Wexpro decision that under the earlier arrangements, the gas customers of MFS had not been given enough benefit for the inclusion in rates of some operating expenses incurred in connection with the exploration program, and that such benefit should have been reflected by some sort of an interest in the acquisition and development of the oil properties which MFS had been histori-

cally required to classify in its non-utility account. The settlement Agreement clearly meets and satisfies this concern.

MFS retains ownership of the gas from existing gas producing reservoirs and brings into its system all gas produced currently or in the future, from such existing gas reservoirs at cost of service, and gets full credit for the value of all existing oil production from such reservoirs. Such arrangement assures continued supplies of low cost gas for the benefit of the customers. The Agreement now also allocates to MFS all gas at cost of service currently being produced or developed in the future from the existing oil properties transferred to Wexpro. In addition, 54 percent of the net revenues from the sale of oil produced from said oil properties comes to the MFS utility account for the benefit of its customers. This is over and above the \$21 million one time reduction in utility rates of MFS. As to the unexplored wildcat acreage, MFS is entitled to a 7 percent overriding royalty interest on all hydrocarbons produced, as well as first call on the gas and Wexpro and Celsius assume all the costs and risks of such production. In each of the above described situations, the consideration flows directly to the ratepayer in the form of reduced gas rates.

Additional benefits to customers as a result of the settlement include: all risk and expense of development drilling in producing gas reservoirs is to be borne by Wexpro; a 2-1/2% overriding royalty interest on approximately 128,000 acres of exploration properties acquired independently by Wexpro; a 2-1/2% overriding royalty on certain producing acreage

independently acquired by Wexpro; reduction in utility rate base by removal of all leaseholds from rate base accounts, thereby reducing utility revenue requirements; elimination of all unsuccessful exploration and development expenses from ratemaking consideration resulting in reduced utility rates; productive gas reservoirs; and, an agreement by Wexpro to pay to the Utility for the purpose of reducing rates to customers, the amount of \$250,000 per year for each of the next 12 years. (See Stipulation §3)

The settlement Agreement unquestionably meets all of the criteria discussed by the Wexpro Opinion.

5. Ratepayers Do Not Contribute to the Exploration and Development Program. The majority opinion in Wexpro expressed concern that the traditional roles of investor and customer had, to some extent, been reversed. Rather than simply paying for the cost of services rendered, this Court suggested that MFS ratepayers had made a "capital contribution to a speculative venture for the purpose of developing oil and gas sources." (Wexpro decision at p. 876) While MFS does not concede that the customer ever made a capital payment to exploration prior to the 1979 Opinion, it is clear that any concern over the matter has been completely removed under the settlement Agreement as approved by the PSC. All the costs of exploration and development of both developmental wells in known oil and gas reservoirs, as well as wildcat drilling on the unexplored acreage will be borne by Wexpro/Celsius, and thus by the share-

holders. The risk capital is provided solely by the investor and the shareholder and ratepayer of MFS are each re-established in their traditional roles.

6. The Agreement Does Not Violate the No-Profits-to-Affiliates Rule. This Court's reference in the Wexpro Opinion to the no-profit-to-affiliates rule is general in its treatment and makes no attempt to specifically define the scope of the rule. An examination of the case law relied upon by the Court, as well as other authorities, does add some definition to the rule and as so defined, it is clear that the settlement does not violate the rule.

The no-profit-to-affiliates rule originated early in the history of utility regulation. It is based upon the principle that a utility, by creating an affiliate to perform a service or provide a product, cannot use that captive supplier as a ruse to make inordinately high profits at the expense of its customers. The rule has never stood for the principle, however, that the affiliate would be limited to charging its bare costs with no return on its invested capital.

In the recent case of Central Telephone v. State Corporation Comm'n, 252 S.E.2d 575 (Va. 1979), the Virginia Commission reduced expenses claimed by the utility for certain services and products furnished by an affiliate because the payment of those expenses would yield to the affiliate a greater return on capital than the utility was permitted to earn. On appeal, the Virginia Supreme Court reversed and remanded, holding that the price paid by the utility to the affiliate was not unreasonable under the circumstances. The Court said:

We are unwilling to approve this action of the Commission. While it is the duty of the Commission to scrutinize prices paid by a utility to an affiliated supplier, we find no evidence in this case that the expenses incurred by Central in the purchase of its supplies were exorbitant, unnecessary, wasteful, extravagant, or incurred in the abuse of discretion or in bad faith. [citations omitted] On the contrary, there is affirmative evidence that the prices paid by Central were as reasonable as it could have obtained elsewhere

We observe that there is no evidence of any advantage taken by Central of its affiliated relationship with Service Company to the detriment of Central and its customers. Neither is there any evidence that Service Company, in its affiliated relationship with Central, enjoys a unique position of market power which renders a comparison of prices and profits with those of other suppliers inadequate as a measure of reasonableness. (Emphasis added.) (252 S.E. 2d at 585)

In the Wexpro decision, this Court quoted a short section from Florida Gas Transmission Co. v. Federal Power Comm'n, 362 F.2d 331 (5th Cir. 1966), which merely states the no-profit-to-affiliates rule in the most general of terms. The Fifth Circuit had no reason to address the rule in any greater detail, since it held the rule was not applicable to the facts of that case. The so-called subsidiary was not actually under the control of the "parent" and as a consequence, the prices set were the result of arms length negotiations. The rule should similarly be inapplicable here since, as the accountant Walker noted, the terms of this settlement, including the price of gas coming from Wexpro, were not fixed by MFS and its affiliate, but were the result of

arm's-length negotiations with the Division and the Committee (Tr. 1200).

This Court, in Wexpro, also cited Utah Power & Light Co. v. Public Service Comm'n, 107 Utah 155, 152 P.2d 542 (1944). The fact situation there was again quite different from this case. Utah Power & Light (UP&L) and the Phoenix Companies, which had constructed a plant for UP&L, were subsidiaries of Electric Bond & Share. The Commission disallowed in UP&L's rate base any cost for the plant in excess of the reasonable costs that Phoenix expended in the construction. The Phoenix mark-up, referred to as the "Phoenix-fees," were rejected because Phoenix appeared to be merely a shell company without assets or employees and rendering no service to anyone. It merely acted as a conduit to facilitate the marking up of costs by Electric Bond & Share which had effectively done all the work. In sustaining the PSC, this Court noted:

The Commission held and the evidence discloses that the Phoenix Companies had no assets of their own. The Phoenix Utility Company, successor to other Phoenix companies, had only nominal capitalization and substantially no direct overhead costs or administrative organization distinct from that of Electric Bond & Share Company . . . In view of the evidence showing that every service rendered by Electric Bond & Share Company was billed as an item of cost; that all employees were compensated by the Company; that part of the overhead expense of the New York offices was allocated to the Utah construction; and the further fact that there were no assets or employees of Electric Bond & Share that were shown to have been devoted to or employed in connection with the construction for the Company which were not paid for by the Company, we cannot hold that the Commission was arbitrary in refusing to include in the rate base an additional amount representing additional payments to Electric Bond & Share Company in connection with this construction. (107 Utah at 194).

This Court went on to point out that the rule there applied was limited to the particular facts of the case. The Court specifically noted that it was not faced with

the situation under which the subsidiary corporation has substantial separate assets of its own, for as will be subsequently noted, the Phoenix companies had no assets. (107 Utah at 193)

The facts of the Utah Power & Light case are simply inapposite to the case at bar. Wexpro is not merely a shell corporation. It maintains its own separate offices and employees, including a professional oil and gas exploration staff, and owns substantial oil and gas properties, including properties and interests acquired independently of MFS. Wexpro is separately managed and financed. In short, the facts under which this Court applied the no-profit-to-affiliates rule in Utah Power & Light are totally different from those extant in the instant case.

Finally, Cities Service Gas Co. v. Federal Power Comm'n, 424 F.2d 411 (10th Cir. 1969), cited by this Court, does not require rejection of the settlement. There the Circuit Court upheld the Federal Power Commission's requirement that the utility pay the cost of service, rather than the contract price, for gas obtained from the subsidiary. The cost of service applied by the FPC however, included a return on capital to the subsidiary; the allowance was not confined to merely out-of-pocket costs.

More importantly, however, the Cities Service case is simply out of date. In more recent time, the FPC, its successor the Federal Energy Regulatory Commission (FERC) and Congress have, in order to encourage exploration and development activities, specifically recognized the right of exploration subsidiaries of jurisdictional pipeline companies to be paid market prices for gas sold

to their parent. Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301 (21) and 3431(b)(1)(E); FPC Opinion No. 770, 10 Fed. Power Service 5-293 (FPC 1976); FPC Opinion No. 699-H, 52 F.P.C. 1604 (1974); Opinion No. 568, 42 F.P.C. 38 (1969). In fact, even where the pipeline company itself is conducting exploration, FERC allows the pipeline market prices in its rate. Order No. 98, Dkt. No. RM 80-6, 21 Fed. Power Service 5-199 (FPC 1980). This pricing policy has been determined to be in the national public interest.

The practical experience in the oil and gas industry as related by the expert witnesses is also supportive of a limited application of the no-profit-to-affiliates rule. Mr. Roseman testified that in his experience the rule is applied where the affiliate has a captive market in the utility customer because the product cannot be acquired by the utility elsewhere. The rule is then applied to avoid excessive profits to the affiliate. (Tr. 1037-38)

Mr. Walker testified that the rule was designed to prevent excessive profits resulting from a price set other than on an arm's length basis. He said this settlement would not violate the rule since the prices used in the Agreement were agreed to by the Division and Committee in tough, arm's-length negotiations. (Tr. 1200-01) Mr. O'Leary, testifying for the shareholders, stated that in his experience the rule is designed to insure that prices paid to an affiliate are not in excess of a competitive value. The settlement in the instant case clearly meets each of the real

life criteria set by said expert witnesses.

Under the Agreement, MFS will be obtaining gas in four different situations involving an affiliate.

First, gas from established gas reservoirs will continue to belong to MFS and will be priced at cost of service. Wexpro will operate the fields and will receive its costs, including a "utility" indexed return, for any future capital investment associated with its services. No possible violation of the no-profit-to-affiliates rule is involved.

Second, MFS will purchase from Wexpro at cost of service, gas produced from the established oil reservoirs. Again, the no-profit-to-affiliates rule is not violated.

Third, MFS has a 7% overriding royalty interest on all hydrocarbon production, plus first right to purchase at market prices, all gas produced from unexplored properties which are being transferred to Celsius. The market prices will be determined on the basis of third-party standards and will be the same price at which MFS could acquire the gas from other producers. Recovery of the royalty payment will assuredly result in net gas prices that are below market prices. (Tr. 1457-8) Even assuming arguendo that the purchases violate the no-profit-to-affiliate rule, the first right would then be void and the rule would not be violated since there would be no sale.

Finally, MFS has a first right to purchase at market prices gas produced by Wexpro from certain of its independently acquired properties. If these purchase are determined to violate the

no-profit-to-affiliates rule, the first right will be void. No sale will take place and the rule will not otherwise be violated.

POINT IV

THE OBJECTIONS OF ADMINISTRATIVE SERVICES AND COALITION TO THE SETTLEMENT ARE NOT WELL TAKEN

A great many of the arguments of the Administrative Services and Coalition are answered both directly and implicitly in other sections of this Brief. There are, however, several particular statements regarding the settlement made by these Appellants, which are so out of harmony with the evidence that they merit special attention.

1. MFS Could Not do All Development and Wildcat Drilling on These "Joint" Properties at an Assured Cost of Service Price Which Would be Less Than Market. Administrative Services makes the bald assumption that the utility could do the exploratory drilling and development of the wildcat properties with resulting cost-of-service prices for any gas discovered that would assuredly be below the prevailing market price. This assumption has no evidentiary base whatsoever.

To the contrary, the evidence shows that MFS would have a difficult, if not impossible, time raising the capital to drill as a utility. (Tr. 1026, 1043, 1060, 1230, 1512) In that regard, the Company had made the determination for legitimate business reasons that it could not and would not conduct a regu-

lated exploration program. Any attempt to force an involuntary drilling program by order of the Commission would not likely be successful. (Tr. 1073, 1203, 1227) A successful drilling program is dependent on highly trained and skilled personnel and a forced and regulated drilling program would have little chance in a competitive world of keeping these personnel. Moreover, many of these properties are in deep-drilling areas (Tr. 1457) where it is desirable to share the risk and industry people are reluctant to join in a venture with a regulated company. (Ritzma Tr. 1267, Roseman Tr. 1034, Cash Tr. 1477, Kirsch Tr. 1513)

Even if, for the sake of sheer argument, it were assumed that the utility could somehow be forced to drill, there is no guarantee that it would be successful, or that cost of service would be below market. O'Leary testified that cost of service could exceed market if there were a series of unsuccessful wells (Tr. 1231), and Crawford stated that it is impossible to know beforehand whether cost-of-service gas prices will be more or less than market prices, especially when the benefits to customers of the 7% overriding royalty interest are taken into account. (Tr. 1457) It was his opinion that the settlement resulted in greater benefits for customers than did the traditional "straight line" cost of service approach used in past years. (Tr. 1458) Mr. Kirsch testified that the 7% overriding royalty interest on all hydrocarbons produced on the exploratory properties could well be worth more than a 50%, 60%, or 70% equity interest in the acreage. (Tr. 1523) Accordingly, the

supposition that the utility would assuredly come out better if it drilled and developed the wildcat acreage is pure speculation.

Moreover, any program which would insure cost-of-service gas on the wildcat acreage necessarily would involve ratepayer participation because, as already noted, it would be extremely unlikely that investors would fund such a program. Yet such ratepayer participation would again result in the reversal of traditional roles between customer and investor earlier condemned by this Court. In contrast, under the settlement there is no customer participation in the capital costs and dry hole expenses associated with either the exploration and development of new acreage, or with the drilling of development wells in established gas and oil reservoirs. These costs fall solely on the shoulders of the shareholders.

Clearly, the unsupported assertion of Administrative Services that the approval of the Agreement may have cost the ratepayers \$500 million is fictional sensationalism that serves no useful function in resolving this complicated litigation.

2. The Agreement Pays More Than "Lip Service" to Cost-of-Service Gas. Rather than paying mere lip service to the concept of cost-of-service gas, as Administrative Services argues, the Agreement takes great pains to secure gas at the lowest rates reasonably possible for the customers of MFS. If there is one thing that is abundantly clear from the record before the Commission it is that the exploration and development program, as it has been operated since the inception of MFS, is finished. That program had included so-called joint proper-

ties, consisting of producing oil and gas reservoirs and wildcat acreage held for further development. In the producing reservoirs, discovery wells have been completed, but not all of the development wells necessary to define the limits of the reservoirs and economically produce the fields have been fully drilled. The wildcat acreage is, of course, undrilled and untested.

All of the gas currently produced from these so-called joint properties, as well as gas produced from development wells in known producing reservoirs, goes to the utility at cost of service. This is certainly more than "lip service." There is a significant difference between the cost-of-service gas from wells drilled in the past and today's market price. The present wells which are now producing gas were drilled at various times over the past decade or so. The drilling costs and the investment in these presently producing gas wells is known. The operating expenses are foreseeable. The cost of service to produce the gas from these presently producing wells drilled years ago is below the market price. The market price of "old" gas of similar vintage or age is going steadily upward as the federal government allows producers to increase prices in order to stimulate more production and to compete with world energy prices.

As the market price continues to go up with deregulation of gas or for other reasons, the spread between cost-of-service gas from presently existing wells drilled years ago and market prices will increase. There is, thus, a known and specific benefit to the customer in getting all of the gas from all of the presently producing wells at cost-of-service prices.

The settlement Agreement also takes a giant step toward ensuring that the development drilling will provide cost-of-service gas at less than market prices. If, for example, Wexpro or Celsius drill 17 consecutive dry holes, (as actually happened to another company Tr. 1033), the heavy expense of such failure will not be passed on to the customer under the Agreement. If they find new gas, an incremental incentive allowance (8% on successful, commercial gas wells and 5% on successful oil wells) is provided for (Agreement §§II-8, III-5) to help compensate for these costs and the dry hole risks. There is, thus, a lid fixed by the Agreement and, if there should be a run of bad luck, those costs cannot be passed on to the ratepayer in cost-of-service gas or otherwise.

On all of the 1.4 million wildcat acres, MFS has a call on the gas at market prices, but it is absolutely certain that it will not result in the customer paying full market prices because there is an offsetting 7% overriding royalty on all production. Thus, if a wildcat well is drilled on the exploratory acreage and it is dry, the loss is totally Celsius. If some gas or oil is discovered, Celsius pays the 7% royalty to MFS and all of the costs, even if it is a marginal well. There is no evidence that the price to the customer would be lower under some other program. In fact, there was some concern that the deep and expensive drilling MFS may be required to do could result in cost-of-service exceeding market prices. (Tr. 1231, 1457) As a result of the costs associated with the deep drilling required to explore the wildcat acreage, the 7% royalty might

well be more valuable to the utility than cost-of-service gas.
(Tr. 1457)

The Settlement Agreement has been carefully drafted to secure for the customers of MFS gas at the lowest reasonable rates. The concept of cost-of-service gas is the very foundation of that low cost gas. It clearly receives more than lip service in the settlement.

3. Although Title to the Producing Oil Reservoirs Was Left With Wexpro, The Statement on p. 47 of the Brief of Administrative Services to the Effect That These Remain Wexpro's Sole and Exclusive Property is Wrong. Title to the property must, of course, reside somewhere. While who has naked title is of little legal significance, in this case, placing title with the driller does have significant operating advantages and does simplify the obtaining of permits, the negotiation of farm out and unit agreements, and reduces costs. What is important in the context of the settlement, however, is what happens to the benefits from those properties.

The Agreement (§II-5, p.19) expressly provides that the gas which is produced in association with the oil from producing oil reservoirs will be sold to the utility at cost-of-service computed in the same way the Commission presently computes it; under prior programs, such gas was sold at field prices. The Agreement also contemplates that the oil revenue, after deduction of the operating expenses and the agreed return on capital, is divided 54% to the utility and 46% to Wexpro. (Agreement, §II-4, pp. 17-18) The Settlement expressly requires that the utility's share of the oil revenues will be used to reduce rates. (Stipulation, §2.1,

p.9) As a consequence, MFS retains a very real and beneficial interest in the subject properties.

4. The 5% Incentive Allowance for Successful Development Oil Drilling and 8% Incentive Allowance for Successful Development Gas Drilling Does Not Provide a 21% and 24% Return. Administrative Services asserts (p.52 of its Brief) that the allowance of 5% incentive return on investment for successful development oil drilling and 8% on successful development gas drilling allows MFS's affiliate Wexpro a 21% and 24% return on invested capital, respectively. The claim is absolutely false.

It must be noted, as the Certified Public Accountant witness Walker testified, a development and exploration program at some point must recover at least its costs. If it does not, the program will eventually go broke. (Tr. 1207-1211) The cost of acquiring property, paying the annual rent, doing seismic and other work and the cost of unsuccessful drilling are all costs which must be recovered for a program to remain viable. Under the Agreement of Settlement, the cost of future unsuccessful development drilling efforts on producing oil and gas reservoirs will be borne exclusively by Wexpro. It is undisputed that in this development drilling there will be significant edge drilling near the rim of the reservoir. In edge drilling, the risk of a dry hole is substantially increased. (Tr. 1480-81) Mr. Roseman testified that the incentives for this risk to the Company were "not very substantial". (Tr 1020)

Even where oil and gas are located, some of those wells will be marginal where the production would not be enough to permit the operator to recoup the cost of drilling the well,

plus the cost of production. Nevertheless, if the Division and the Committee want the marginal gas delivered to MFS even though it is more expensive, the costs of the well will be capitalized by Wexpro/Celsius. If they do not want the gas and it does not measure up to the criteria set forth in the Agreement, the excess cost has to be absorbed by Wexpro/Celsius and they get the gas. (Agreement, §§I-19-20, II-8[d], III-8[d])

The 5% and 8% incentive allowance on invested capital are to cover these dry hole and marginal well risks. ^{16/} Therefore, the assertion that this allowance constitutes some sort of hidden increase in the "rate of return" earned by Wexpro is a misstatement of the record.

POINT V

THE SETTLEMENT IN NO WAY DIMISHES THE JURISDICTION OF THE COMMISSION

Contrary to the contention of Administrative Services, the Commission does not, under the settlement, surrender any of its statutory powers or jurisdiction. The Commission has not been asked to prejudge whether Celsius or Wexpro will be regulated as utilities because of the way they operate in the future.

It is the position of the parties under the settlement that an oil business in Utah is not regulated as a utility. It is in-

^{16/} The parties to the settlement acknowledged that the higher risks of development well drilling must be recognized. In Section 2.2 of the Stipulation it was agreed that "Wexpro should have sufficient legal and economic incentive that it, in its own self interest, will prudently and energetically exploit the properties to their full potential for the benefit of the Company's customers and its shareholders." Administrative Services also loses sight of the fact that the \$40 million commitment of Wexpro is very much at risk. (Tr. 1256)

tended to have Wexpro become the operator of the producing properties and to have Celsius operate as an oil company. (Tr. 1528) None of this has in any way foreclosed the exercise of any jurisdictional power by the PSC. One of the principal issues before this Court in Wexpro was the jurisdiction of the Commission over the transfer of oil properties. That jurisdiction was expressly recognized in the settlement. The transfers to Wexpro and Celsius were submitted to the jurisdiction of the Commission for approval.

It is true that if the settlement is affirmed the Commission will lose jurisdiction over the transferred property. Such loss of jurisdiction after the transfer was intended by the parties in order to permit the development of a vigorous and unregulated oil and gas exploration program. (Stipulation §§ 1.21, 1.23, 2.2, 2.4) There should be nothing startling about such a loss of jurisdiction. Utility companies frequently, for a variety of reasons, dispose of property which had been used and useful in the utility business. The PSC can and does exercise its jurisdiction to approve the sale of the property. After the sale is closed, however, the Commission cannot, at some future date, assert jurisdiction over the property and undo that which has already been done. Such a limitation clearly recognizes and in no way diminishes the PSC jurisdiction.

Finally, the stipulation of the Division and Committee, that they will not assert that the activities of Wexpro or Celsius

under the Agreement result in their being subject to public utility regulation (Stipulation §§11.1, 11.2) takes nothing away from the Commission's jurisdiction and power. If the Commission has jurisdiction, the stipulation cannot change that fact. The Commission itself recognized that the settlement did not diminish its jurisdiction. In the Conclusions of Law of its December 31, 1981 Order, the PSC stated "By adopting and approving this Stipulation, the Commission does not relinquish or limit any jurisdiction or statutory authority it possesses". (Order, p.22)

This concern of Administrative Services is invalid for two reasons. First, it was erroneously contended in the proceedings before the Commission in this case that the stipulation between the Division and Mountain Fuel could bind the Commission, since the Division acted as the staff of the Commission. Under the present case law, however, it is clear that the Division does not serve in a staff role to the Commission. Utah Department of Business Regulation, Division of Public Utilities v. Public Service Comm'n, 614 P.2d 1242 Utah (1980). Second, even if the Division is the staff of the Commission or becomes the staff of the Commission under some future statutory scheme or court opinion, it is accepted that an agreement or stipulation of the staff of an administrative agency is not binding on the agency. Kixmiller v. Securities and Exchange Comm'n, 492 F.2d 641 (D.C. Cir. 1974); Utah Hotel Co. v. Industrial Comm'n, 107 Utah 24, 151 P.2d 467 (1944).

The concerns that the settlement adversely impacts the jurisdiction of the Commission are plainly unfounded.

POINT VI

THE COMMISSION ORDER IS FINAL
AND BINDING ON THE PARTIES AND ON THE COMMISSION
UNDER THE PRINCIPLES OF RES JUDICATA

The Shareholders have asserted that the Commission did not go far enough in its December 31, 1981 Findings, Conclusions and Order in confirming the finality of the distribution of the property and the allocation of the benefits. The facts and applicable law necessarily lead to an opposite conclusion.

The Commission found that it had jurisdiction to review the transfer of property between MFS and its affiliates, as contemplated by the Agreement, and to determine whether the transfer was in the public interest and for fair market value. The Commission then entered its Conclusion No. 6, as follows:

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. (Emphasis added.)

The Commission was correct in its conclusion that the Order was final and that such finality is necessary to ensure the proper development of the properties.

Historically, there was a reluctance on the part of the courts to afford res judicata effect to the decision of administrative agencies. For example, see Pearson v. Williams, 202 U.S. 281 (1906) and Warburton v. Warkentin, 345 P.2d 992 (Kan. 1959). However, a dramatic change in the attitude of the courts occurred in 1966 with the decision of the U.S. Supreme Court, in United States v. Utah Construction & Mining Co., 384 U.S. 394 (1966). The Court there held:

Occasionally courts have used language to the effect that res judicata principles do not apply to administrative proceedings, [citations omitted] but such language is certainly too broad. When an administrative agency is acting in a judicial capacity and resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate, the courts have not hesitated to apply res judicata to enforce repose. (384 U.S. at 421-2)

As a result of this decision, both federal and state courts have widely extended the doctrine of res judicata to decisions of administrative agencies in appropriate cases. In Philadelphia Electric Co. v. Borough of Lansdale, 424 A.2d 514, 521 (Pa. 1981) the Court expressed the application of the doctrine of res judicata to administrative proceedings as follows:

Plaintiff further argues, however, than [sic] an administrative decision has no res judicata effect upon a subsequent action to determine an issue within the jurisdiction of the administrative agency However, the application of res judicata principles is not precluded merely because administrative proceedings are involved and where an administrative agency is acting in a judicial capacity and resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate the courts will not hesitate to apply res judicata principles.

For similar holdings, see Painters Dist. Council No. 38 v. Edgewood Contracting Co., 416 F.2d 1081, 1084 (5th Cir. 1969);

Jeffries v. Glacier State Tel. Co., 604 P.2d 4 (Alaska 1979);
Campbell v. Superior Court, 18 Ariz. App. 287, 501 P.2d 463
(1972); Cooper v. United States, 546 F.2d 870 (10th Cir. 1976).

The sister doctrine of collateral estoppel is also equally applicable to administrative proceedings. In Superior's Brand Meats, Inc. v. Lindley, 403 N.E.2d 996, 999 (Ohio 1980) the Court made the following pertinent comments:

The doctrine of collateral estoppel is an important element of our legal system. It provides a necessary degree of finality to decisions rendered by our courts. Finality is a desirable objective in administrative proceedings, as well.

We recognize the need for flexibility in applying the doctrine of collateral estoppel to administrative decision-making process; however, because of the need for finality, we hold that ordinarily, where an administrative proceeding is of a judicial nature and where the parties have had an adequate opportunity to litigate the issues involved in the proceeding, the doctrine of collateral estoppel may be used to bar litigation of the issues in a second administrative proceeding.

In Bowen v. United States, 570 F.2d 1311 (7th Cir. 1978), the court was faced with whether the State of Indiana, whose state court decisions had been silent on the subject, would extend the doctrines of res judicata and collateral estoppel to proceedings before administrative agencies. After outlining the history of the development of the application of those doctrines in state administrative proceedings, the court went on to review cases from some 14 separate state court jurisdictions in which the doctrines of res judicata and collateral estoppel had been applied to administrative proceedings.

Utah unquestionably follows this modern trend. This Court was applying principles of res judicata to administrative

hearings long before the U.S. Supreme Court decision in Utah Construction, supra. For example, in Mulcahy v. Public Service Comm'n, 101 Utah 245, 117 P.2d 298 (1941), this Court expressly said that the rule which forbids the reopening of a matter once judicially determined by competent authority "applies as well to judicial and quasi-judicial acts" of administrative boards. In North Salt Lake v. St. Joseph Water & Irr. Co., 118 Utah 602, 223 P.2d 577(1950) this Court held that an Order of the PSC which had not been appealed from had the same effect as a judgment and could not be collaterally attacked.

Finally, in Bowen Trucking, Inc. v. Public Service Comm'n 559 P.2d 954, 957 (Utah 1977), the Court made the following pertinent observations:

[I]f the fact situation and the legal issues are exactly the same, I see no reason why a decision of the Commission should not be res adjudicata as to such facts and issues, the same as in any other legal proceeding; and there are good and sufficient reasons why the parties should not be permitted another, and what could be indefinitely repeated other trips on a merry-go-round of the same litigation.

The common thread running through all of these cases is that in order for a prior decision to be given res judicata effect, the administrative agency must be acting within its jurisdiction and the prior proceeding must have afforded the parties a full opportunity to be heard, including an opportunity to seek court review from any adverse holding. All of the required factors are clearly present here.

The Commission's Order recites the notice that was given and the opportunity offered for all to be heard. The proceedings

were conducted in a judicial format, with the witnesses being sworn and then being examined and cross-examined on the record. All interested parties were afforded an opportunity to argue the matter orally and to submit written memoranda. The Commission then entered formal findings of fact and conclusions of law and a decision. As is evidenced by this Appeal, there is a right of court review.

There is also a critical need for finality. The record clearly demonstrates that millions of dollars will be required to do the exploratory and development drilling; that the funds cannot be generated internally and that those asked to provide the money through equity or debt financing will require security of expectations. (Tr. 1523) The Settlement requires that Wexpro expend not less than \$40 million over the next five year period for development gas well drilling alone. This amount of capital cannot be raised unless investors have assurance that the program they invest in and the benefits they can realize, will not be changed by some future PSC decision.

Common sense, as well as the uncontroverted testimony dictates that people cannot be induced to invest in wildcat oil drilling if after the "big strike" the Commission can renoteice these very same issues for hearing, set aside or modify the Stipulation and Agreement and Order and reverse the transfer of property and/or change the allocation of the benefits.

The fact that the Commission has continuing jurisdiction to regulate the distribution system and to regulate MFS as a utility, does not change the res judicata finality of this Order.

Factual determinations are and must be final. The transfers to Wexpro are and must be final. Such finality of past determination while the agency maintains a continuing jurisdiction is not unique or even unusual.

Administrative agencies consistently maintain a continuing jurisdiction even though res judicata effect is given to prior administrative decisions. For example, the Industrial Commission has jurisdiction over industrial injuries and retains continuing jurisdiction over future medical expenses, the extent of disability and similar matters. When an employee claims compensation and there is a hearing and the right of appeal, the decision reached therein is final and even though the Commission exercises jurisdiction later on over some other phase of the problem. The Commission never readjudicates, however, the earlier determination that an injury was or was not compensable. See §35-1-78 Utah Code Ann. (Supp. 1981) and Salt Lake City v. Industrial Comm'n, 61 Utah 514, 215 P. 1047 (1923); Kennecott Copper Corp. v. Industrial Comm'n, 19 Utah 2d 158, 427 P.2d 952 (1967).

Likewise, the State Engineer enters orders and by sections 73-3-14 and 15, Utah Code Ann. (Repl. vol. 1980) there is a right of court review. While he keeps jurisdiction for a variety of reasons, he is not permitted to relitigate an issue which he has already fully heard, decided and on which the appeal time has run. See Provo City v. Lambert, 545 P.2d 185 (Utah 1976); and Glenwood Irr. Co. v. Meyers, 24 Utah 2d 78, 465 P.2d 1013 (1970).

The order of the Utah PSC in the instant case clearly falls within the scope of the foregoing rule. The transfer of the properties and the allocation of benefits from the consideration given for such transfers are final and entitled to the applications of the doctrines of res judicata and collateral estoppel.

POINT VII

THE COMMISSION DID NOT ERR IN DECLINING TO ORDER AN ACREAGE OR MONETARY APPRAISAL OF THE PROPERTY

The Coalition asserts at page 19 of its Brief that if any of the utility property was to be transferred it was necessary to express that consideration in dollars. In Wexpro, this Court noted that book value was not necessarily market value and that a transfer of utility assets had to be made at market value so that an "appropriate" benefit will redound to the credit of customers. Quite correctly, the Court itself made no attempt in the Wexpro Opinion to define or set that market value or determine how it was to be done.

The settlement Agreement does not contemplate a transfer for a dollar consideration. Instead, the unexplored wildcat acreage is transferred in return for an overriding royalty interest. As already set out in detail at pages 27-29 of the Statement of Facts, each of the witnesses who testified on the subject stated that an overriding royalty on the unexplored wildcat acreage was the standard method of fixing the value of the unexplored oil and gas properties and that the 7% override was fair consideration

for transfer of the specific properties subject to the settlement. (Roseman Tr. 1026-29; Ritzma Tr. 1250-54; Cash Tr. 1502; Kirsch Tr. 1520; Hale Tr. 1331) Ritzma further indicated that the 2-1/2% override on the future acquired property was "generous". (Tr. 1252)

When asked if a dollar value appraisal was a viable alternative for fixing the value of the unexplored acreage, the witnesses uniformly rejected such a fixed value appraisal as "speculative" and "futile". (Roseman Tr. 1045-46; Ritzma Tr. 1263, 1274; Hale Tr. 1333-35, Harmon Tr. 1155)

Clearly, the correct valuation method and that agreed upon by the adversary parties in this case is to follow the plainly understood market and standard industry practice. The 7% overriding royalty interest assures "appropriate" benefits no matter what value the property turns out to have. Customers receive the benefit of any production of hydrocarbons, no matter how great or how little. There is no need to guess and speculate as to the possible future value of production from undrilled acreage.

The Coalition ignores this consideration and returns to the arguments already resolved by the earlier appeal. It asserts, for example that the property has a fair market value and that the value is likely to be far in excess of depreciated book value. So what? There is no longer any proposal before this

Court to transfer the property only at depreciated book value. ^{17/} The value of the property is now expressed in terms of an overriding royalty, and percentage interest, which the uncontroverted testimony explained was the traditional method of expressing market value in the oil and gas industry.

In short, the overwhelming weight of the evidence is to the effect that properties are traditionally traded by buyers and sellers in arm's-length transactions on the basis of percentage interests in the property; that on unexplored acreage, it is neither useful nor the practice to make estimates on the value of the property or the reserves and, even if they are put on the market, knowledgable oil companies ascribe widely differing values to the property; that a dollar value could be established by trying to sell the property on the open market for a specific dollar amount, but it would not be in the interest of the public, the Company or the consumer for those properties to be sold since all would lose the continuing benefits from the development of the properties which are secured under the Stipulation and Agreement.

There is no error in this regard and the Commission Order should be affirmed.

^{17/} The mechanics of transfer of the wildcat acreage involves the conveyance of title or working interests in the property as well as normal accounting entries. The value of the properties as recorded on the books of the Company (acquisition cost or investment) is removed from rate base in the utility accounts. The properties are then recorded on the books of Celsius at that value. The investment of MFS in Celsius then equals the value of the acreage. The removal of the properties from the rate base accounts of the utility benefits customers in that investment upon which a rate of return is calculated is reduced, thereby reducing the revenue requirements of the utility and the rates to the customer.

C O N C L U S I O N

The Report and Order of the Commission in this matter requires affirmance. It brought to an end, sharply contested and expensive litigation spanning five years of time involving the exploration and development properties of MFS. The impact and uncertainty of that litigation had effectively paralyzed MFS exploration and a further continuance of the proceedings could have been, in the words of Roseman for the Division and the Committee, a "disaster" regardless of who prevailed.

The record is replete with elements of risk and jeopardy which further proceedings would have presented to the utility gas customers, to corporate shareholders and to the essential integrity of the MFS exploration and development program. While all aspects of the record below are important, the "Stipulated Facts", "Objectives", "Consideration" and the "Agreement" at pages 3-17 of the Stipulation are required reading to a comprehension of the issues and they are commended in particular, to the Court.

Those who would claim that the Stipulation and Agreement of settlement were a "soft", "sweetheart" arrangement, abuse the English language. The settlement and Stipulation were struck after difficult, sometimes bitter, arms-length bargaining with impasse reached on several occasions. Settlement remained in doubt even through the drafting of the Stipulation and Agreement, after an understanding in principal had been already hammered out.

However, the significance of the Stipulation and Agreement, does not rest only upon achieving the settlement of complex litigation. The Agreement reached provides far-reaching benefits to the utility customers (in the form of low cost-of-service gas and strengthened future gas reserves) and is in the public interest in the broadest context of that term.

The Commission had authority to adopt and did not err in approving the Stipulation and Agreement of settlement. The findings are sustained by practically all of the competent and admissible evidence, from the testimony of economists, geologists, security analysts, petroleum engineers and accountants from both sides of the controversy.

The argument of Administrative Services and Coalition that the 1979 Wexpro opinion of this Court constituted a judicial mandate compelling the Commission to implement specific regulatory policy as to MFS exploration and development is fatally flawed. It misconceives or ignores the fundamental, appellate function of this Court. Regulatory policy is the function of the Commission, alone. The role of this Court on review is to determine if an error in law exists or if the order is sustained by competent evidence. Whether all of the language in the Wexpro decision was central or dicta to the principal holding, notwithstanding, it cannot be gainsaid that the Stipulation and Agreement satisfy the holding and observations made by the majority Opinion in Wexpro in all regards.

The uncontradicted competent evidence is that the transfer of exploration and development properties (all of which were assumed to be in the Commission's regulatory jurisdiction) under

the Stipulation and settlement were, at the very least, for fair consideration and value. In fact, there is no competent evidence in the record to the contrary.

The appeal of the Shareholders is not well taken. While it is acknowledged that the Report and Order of the Commission must have the finality of res judicata with regard to the transferred properties, the Report and Order, at page 21 paragraph 6 in particular, accomplishes finality with the effect of res judicata. The Commission, MFS, Wexpro, Celsius, and gas customers are assured under the Report and Order as well as the controlling case law, that the properties subject to the Stipulation and Agreement may not be attacked or questioned in the future.

The Report and Order concluding this massive controversy and approving the Stipulation and Agreement of settlement should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

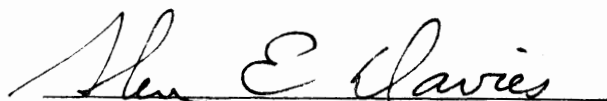
I hereby certify that on the 30th day of July, 1982, the required number of copies of the foregoing Answering Brief of Mountain Fuel Supply Company and Wexpro Company were hand delivered to:

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A handwritten signature in cursive script, reading "Allen E. Davies", is written over a horizontal line.