1982

S. H. Bennion v. Shell Oil Company : Reply Brief of Appellant

Utah Supreme Court

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IN THE SUPREME COURT

OF THE STATE OF UTAH

S. H. BENNION,	:	
Plaintiff-Appellant	:	
vs.	:	
		Case No. 18345
SHELL OIL COMPANY, a Delaware corporation,	:	
Defendant-Respondent.	:	
and	:	
UTAH STATE BOARD OF OIL, GAS & MINING,	:	
Defendant.	:	

REPLY BRIEF OF APPELLANT

Appeal From the Judgment of the

Third Judicial District Court in and for Salt Lake County

Honorable James S. Sawaya, Judge

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REPLY BRIEF OF APPELLANT

STATEMENT OF FACTS

The Statement of Facts in appellee's Brief is misleading and ignores certain crucial facts.

A. Mr. Bennion's Status as a Nonconsenting Owner.

At the time that the drilling unit was formed, most of the proposed 7 working interest owners in the unit were major oil companies. (Shell Ex. 7 Operator's Agreement, pp. 12-13) There were also 54 other interest owners in the unit that did not pay any production costs. (Shell Ex. 7 Oil Division Order) Although it may have been more convenient for Shell if Mr. Bennion became

a working interest owner at Shell's invitation, there was no legal obligation imposed upon Mr. Bennion to consent to become a working interest owner or to directly pay any production costs. There was also no legal requirement that he sign an operator's agreement. He eventually was treated similarly as the other 54 interest owners in the unit who also did not risk their capital for the drilling of the well.

Prior to drilling, Section 1 had been unitized by the Utah Board of Oil, Gas & Mining. There was no legal necessity for Mr. Bennion to consent because upon entry of the spacing order Mr. Bennion became entitled by law to a landowner's royalty and to receive his proportionate share of the production from the unit after deducting his proportionate share of the costs of drilling the well and paying his proportionate share of the expense of producing any oil and gas.[1] Shell fails to enlighten this Court in its Statement of Facts that at no time did Mr. Bennion have any legal requirement imposed upon him to consent to be a working interest owner or to sign any operator's agreement with Shell. It also fails to mention Shell's Ex. 6, which is a letter to Mr. Bennion's attorney dated February 3, 1975, wherein Shell recognized Mr. Bennion's entitlements. (Shell Ex. 6)

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[1] Section 40-6-6(g), prior to the 1977 amendments, expressly provides that Mr. Bennion, as a nonconsenting owner, was entitled to a basic landowner's 1/8th royalty and his proportionate share of production.

B. Mr. Bennion's Tender of Costs.

Appellee states in its Statement of Facts that Mr. Bennion tendered payment to Shell of his alleged share of expenditures, but the payment was conditioned upon Shell's agreement that his share in the unit was greater than Shell believed to be the case. While it is true that Mr. Bennion in tendering Shell the sum of $26,293.87 in a check dated December 15, 1975, computed this amount based upon an incorrect percentage, it is also true that the amount of money tendered to Shell for his share of the costs was in excess of what Shell claimed was his obligation. Moreover, Mr. Bennion's computation of his interest is consistent with Shell's own computation contained in its Division Order sent to Mr. Bennion on February 11, 1975. (Shell's Ex. 7) It is also consistent with the Board's Order unitizing this section because the Board's Order specifically states that each unit shall be 640 acres in size, not 678.2 acres which is the actual size of Section 1. (Appendix No. 4 to Appellant's Brief) Shell used the actual size of Section 1 in computing the percentage of Mr. Bennion's interests and all of the other interest owners in the unit, and Mr. Bennion used 640 acres, the usual size of a section.

Moreover, Shell never offered to accept Mr. Bennion's tender of costs based upon the amount of Mr. Bennion's interest that the parties agreed upon and leave the remaining small percentage difference for further negotiation or judicial

resolution. Rather Shell rejected Mr. Bennion's December, 1975 tender of costs and refused to pay Mr. Bennion any production from the well for almost seven years because it was concerned, at that time, about a .001 per cent difference between what Mr. Bennion reasonably calculated to be his interest, .0312500%, based upon the Board's Spacing Order, Shell's own Division Order and the usual size of a section, and what Shell was claiming was Mr. Bennion's interest, .0294898%.

C. Shell's Refusal to Tender Mr. Bennion His Production in Kind.

Shell claims in its Statement of Facts that an additional reason why it refused to pay Mr. Bennion his payment in kind, even though it knew from day one that Mr. Bennion wanted his oil and gas in kind and knew that he had a legitimate business need for the product, was that it did not want to reward Mr. Bennion with increased oil prices. There is nothing in the record below to substantiate this claim on the part of Shell and therefore such a statement is merely after the fact conjecture supplied by Shell's counsel. Moreover, such a statement is directly contrary and logically inconsistent with the fact that Shell knew from the very beginning that Mr. Bennion wanted his product in kind. It cannot now claim that it withheld product from Mr. Bennion because it did not want him to receive the benefit of increased oil prices, when at the very beginning when Shell knew that Mr. Bennion wanted his product and refused to provide it to him, he

clearly would not have been benefiting from any increased oil prices if the production in kind at that time was tendered to him as he had requested. Mr. Gallion, Shell's counsel, doesn't even mention any concern of increased oil prices in his August 25, 1977 letter (Exhibit A-6).

The fact of increased oil prices and whether or not Mr. Bennion would eventually benefit from them was caused as a direct result of Shell's failure to provide Mr. Bennion with his product in kind evidently because there was a thousandths of a per cent difference between Mr. Bennion and Shell. Shell now contends illogically that it did not want Mr. Bennion to receive unfairly the benefit of increased oil prices when quite obviously this reason would have nothing to do with why Shell did not provide Mr. Bennion with his product in kind at the outset, and continuing thereafter, at a time when Mr. Bennion would not have benefitted from any price increases.

D. Mr. Bennion's Receipt of Accounting Information.

It was only after the July 26, 1979 Board hearing that Mr. Bennion received any meaningful accounting information from Shell. Prior to this time he had received an audit done by Tenneco, but the audit covered only the period from January, 1973 through December, 1974. (See pg. 5, July 9, 1980 Accountant letter to Stirba.) Obviously, since the unit well started to produce in July, 1974, the Tenneco audit was of little use to Mr. Bennion since it only covered the initial operation of the well.

The only other information he has received prior to this time was a two-page worksheet which is annexed to Shell's Exhibit 18.

In other words, prior to going before the Board pursuant to the Amended Application, Mr. Bennion had received absolutely no itemized expenditure information for the years 1975, 1976, 1977, 1978, and 1979. He had also received no production information prior to July, 1977, and thereafter he received no additional production information until after the July, 1979 Board hearing. After the July, 1979 hearing Shell provided to Mr. Bennion's counsel additional accounting information. (Ex. A-8 through A-12, Shell Ex. 23) The handwritten sheets provided by Shell contain numerous errors and internal inconsistencies and are not internally consistent in reporting the volume of gas and oil produced from the well.

It was in response to these facts and the fact that Shell's state reports did not conform with the production figures reported to Mr. Bennion in its worksheet submitted to Mr. Bennion's accountant in September, 1977 that the Board entered its Order allowing Mr. Bennion to audit Shell's books and records in Houston, Texas at Shell's expense. Mr. Bennion had already been given three different sets of figures and the Board's Order was justified.

ARGUMENT

I. THIS COURT MAY REVIEW ALL QUESTIONS OF LAW RAISED BY THIS APPEAL AND SUBSTITUTE ITS OWN JUDGMENT FOR THAT OF THE BOARD ON MATTERS OF STATUTORY CONSTRUCTION.

As noted by Defendant-Respondent, this appeal raises important issues of first impression in the state of Utah regarding the proper construction of Utah's Oil and Gas Conservation Act. Specifically, the appeal calls into question the interpretation of the Act's use of the term "production" and the correct method of computing royalty and working interests under the Act. Also, other questions of law arising out of the relationship between the unit operator of an oil and gas well and a nonconsenting working interest owner, as defined by the Act, are presented by this appeal.

In its Brief, Shell attempts to limit this Court's powers by coaxing it to accept as the proper standard of review one which would allow the Court to set aside a Board decision only on a finding that the Board acted arbitrarily or capriciously. Such a limitation on the scope of review in this case is a serious misapprehension of basic principles in the field of administrative law. A judicial tribunal is always empowered to review determinations of law made by administrative bodies such as the Board of Oil, Gas & Mining. And when the Board or other body is found to have acted improperly the Court is free to substitute its own judgment for the judgment of the Board. See Packard Motor Car Company v. N.L.R.B., 330 U. S. 485 (1947).

There are times when the legislature precludes by statute any judicial review, or limits the scope of judicial review by giving the administrative tribunal greater authority in certain

areas of its expertise. It can be argued that legislative silence concerning judicial review should be taken to mean courts must pay more deference to the administrative determinations. But none of these legislative considerations are present in this Court's review of the Board's decision. The applicable section of the Act governing judicial appeal of Board action is Section 40-6-10(b) which expressly provides that:

> An action or appeal involving any provision of this act, or a rule, regulation, or order shall be determined as expeditiously as feasible. The trial court shall determine the issues on both questions of law and fact and shall affirm or set aside such rule, regulation or order or remand the cause to the commission for further proceedings. Such court is hereby authorized to enjoin permanently the enforcement by the commission of this act, or any part thereof, or any act done or threatened thereunder, if the plaintiff shall show that as to him the act or conduct complained of is unreasonable, unjust, arbitrary or capricious, or violates any constitutional right of the plaintiff, or if the plaintiff shows that the act complained of does not constitute or result in waste, or does not in a reasonable manner accomplish an end that is the subject matter of this act. (Emphasis Added.)

It could not be clearer. The statute gives to the trial court the responsibility of determining the issues of law and fact in any case where the appeal involves a provision of the act, or an order of the Board. It is precisely such an appeal that Mr. Bennion took to the Third Judicial District Court and now brings to this Court. As is clearly seen from reading the statute in its entirety, the criteria for review which the Respondent would mistakenly have this Court follow, pertain only

when one is seeking injunctive relief against the Board. This is not the relief sought by Mr. Bennion.

Shell's misunderstanding of the appeals provision of the Act is evident by its statement of what it calls the "review of discretionary administrative orders." (Respondent's Brief at 11.) The statute, as noted conclusively above, expressly provides for the review of both questions of fact and law. But even if that provision were not a part of the Act, this Court would have authority to substitute its own judgment for the Board's when construing the meaning of the statute. Statutory construction is always considered a question of law, and so being is left to the independent determination of the judicial tribunal to whom the appeal is taken. Packard Motor Car Company v. N.L.R.B., 330 U.S. at 491 (1947). This is especially true where, as is the case here, its administrative body is composed principally of non-lawyers.

This Court has recognized the principle that courts always must exercise their judicial prerogative and decide questions of law. For example, in Utah Hotel Company v. Industrial Commission, 151 P.2d 467 (Utah 1944), the Supreme Court held that questions of law must always be determined in the first instance by a court of law; otherwise, the determination could not carry the force of law. In that case, the Utah Hotel Company brought suit against the Industrial Commission to review a commission order which held the Hotel Company liable for unpaid

taxes on all members of interstate orchestras. The court stated that the Industrial Commission had authority to interpret the Employment Security Act as necessary, but that such interpretations were not binding on the courts. Final decisions, on matters of law, are binding only when made by an appropriate judicial tribunal:

> A "decision" or "finding" by an administrative agency upon a judicial question is never a binding decision, for under the doctrines of supremacy of law and a separation of powers a binding decision of a question of law affecting private rights may only be made by an appropriate court acting judicially. Id. at 470. (Emphasis added.)

The cases cited by Shell do not support its arguments. In not one of those cases is there a statute which resembles the language in §40-6-10(b). Language from one of the opinions quoted by Shell in its Brief is illustrative of Shell's misunderstanding of the law of judicial review under the circumstances of this case:

> . . . the well-established rule is that the courts indulge [the administrative tribunal] considerable latitude in determinations he makes on questions of fact and also in the exercise of his discretion with respect to the responsibilities which the law imposes on him . . . . Respondent's Brief at 11 (quoting from Central Bank & Trust Co. v. Brimhall, 28 Utah 2d 14, 18, 497 P.2d 638, 641 (1972). (Emphasis added)

Thus, even the cases relied upon by Shell do not leave questions of law to the discretion of the Board. In the original appeal to the Third Judicial District the parties stipulated that there existed no genuine issues as to any material fact.

Judgment and Order of Dismissal at 21. But even if there were, the language of § 40-6-10(b) is unequivocal. The court shall decide both questions of law and fact. See also Withers v. Golding, 111 P.2d 550 (Utah 1941).

II. MR. BENNION'S PROPORTIONATE SHARE OF OIL AND GAS PRODUCTION FROM THE TEW1-1B5 WELL VESTED AT THE TIME OF THE SPACING ORDER AND HIS RIGHTFUL SHARE OF PRODUCTION SHOULD BE AWARDED IN KIND FROM THE ENTRY OF THAT ORDER.

In its Brief, Shell makes two basic arguments against Mr. Bennion's right to receive his proportionate share of oil and gas in kind:

(1) That the law of capture prevails until the entry of the pooling order and, therefore, Mr. Bennion has no statutory or common law right to any production--in cash or in kind--until the date of that order, and

(2) That it would be grossly unfair for Mr. Bennion to receive his proportionate share in kind. Neither argument adequately addresses the legal issues framed by this appeal, nor do they satisfy the significant circumstances presented in this case.

A. Mr. Bennion Has A Statutory Right to his Proportionate Share of Production Prior to the Pooling Order.

Shell's first argument that the law of capture operates to deny Mr. Bennion any rights at all in his private property prior to the entry of a pooling order ignores the impact of Utah's Oil and Gas Conservation Act on the common law. Both the Board and the trial court recognized that under Utah's Oil & Gas

Conservation Act a nonconsenting owner such as Mr. Bennion has a right to production which vests prior to the date of the pooling order. In an earlier case, In re Bennion, Cause No. 139-18, the Board stated:

> With respect to the applicant's rights under §40-6-6(h), U.C.A., the Board must again first address the issue of jurisdiction. The Board rejects the narrow construction of 40-6-6(h), U.C.A., presented by Gulf Oil Company. Gulf maintains that this becomes viable only upon the filing of a petition for relief under the provision, thus precluding the Board from requiring Gulf to pay the applicant a landowner's royalty of 1/8th from the date of first production from the subject well. However, the Board construes §40-6-6(h), U.C.A., as a statutory rendition of the rights of non-consenting working interest owners.
>
> The statute allows the nonconsenting owner certain property rights which become effective when oil is produced upon a drilling unit. While the petitioner may request the Board to enforce those rights, they do not lie dormant until triggered by a petition. (Emphasis Added.)

This position taken by the Board and the trial court is in accordance with the weight of case law and scholarship on the issue. See Appellant's Brief at 11-19 and authorities cited therein.

Furthermore, Shell completely ignores the fact that the Spacing Order entered by the Board of Oil, Gas and Mining in Cause No. 139-8 on September 20, 1972, expressly precluded Mr. Bennion, or anyone other than Shell, from drilling a well in the section covered by the Spacing Order. In other words, from the moment of that Order giving Shell the exclusive right to drill, Mr. Bennion and all other mineral interest owners in the section

were denied the right to capture any oil and gas under their property and exercise the usual rights of ownership thereon. The logical quid pro quo of that denial of property rights is to guarantee that for the lost right to capture and sell the oil and gas, the individual owner will receive the right to a share of the production itself--which is precisely what the Utah Act provides.

That being the case, there is little logic in Shell's argument that Mr. Bennion had no right to production, even though his property was being drained, and he was being precluded from drilling his own well, unless and until he filed an application with the Board. If this Court refused to follow both the Board the the Court below in holding that the Pooling Order is retroactive to the date of first production, it would in effect take Mr. Bennion's property and give it to the Respondent without any offsetting compensation, and find no constitutional infirmity in so doing. Such a conclusion is untenable. Not only would it violate our constitutional guarantees on both state and federal levels, it would, in any context, be absurd. Yet it is just such a result that the Respondent argues for.

Moreover, the efforts expended by Shell in its brief on the basic question of retroactivity indicate that Shell either perceives but dimly the true issue on appeal or that it wants to camouflage the real issue by drawing the Court's attention to the outdated law of capture. As mentioned earlier in this Brief,

both the Board and the trial court recognized that Mr. Bennion's royalty interest and working interest operated retroactively to the date of first production, because it occurred after the entry of the Spacing Order. In fact, Shell does not appeal that determination; but makes an argument against it in its brief only to set up the self-serving statement that Shell attempted to voluntarily pay Mr. Bennion a share of proceeds from first production, having no legal obligation to do so. See Respondent's Brief at 16.

The true issue which this Court must determine is whether Mr. Bennion's recognized share of production can be demanded in kind. It is inconsistent for the Board and the trial court to recognize the right to payment of a nonconsenting owner's interest in kind as existing under the Act but not retroactively when, indeed, his interests to proceeds are enforced retroactively. There is no logical nor legal basis for drawing such a distinction between interests prior to pooling and interests subsequent. The statute certainly lends no support for such an arbitrary distinction:

> . . . as to each owner who does not agree, he shall be entitled to receive from the person or persons drilling and operating the well on the unit his share of the production applicable to his interest. . . . Utah Code Anno. § 40-6-6(g) (prior to 1977 amendments.)

In his treatise, Kulp defines "royalty" in the context of an oil and gas lease as:

> A share of the product or proceeds therefrom reserved to the lessor as a part of the consideration for execution of the lease. Kulp, Oil and Gas Rights, Topic 6 § 10.36 (1954).

A common provision in many leases is to allow the mineral interest lessor the right to receive production in kind. Apparently, the Board and the trial court treated Mr. Bennion as a forced lessor and gave him the right of a lessor to demand production in kind. That right should be co-extensive with the right as a forced lessor to share proportionately in production of the well from the date of its first production. Any other interpretation of Mr. Bennion's rights would put him on a less favored, discriminatory status vis a vis the other mineral interest owners, a result which the intent of the Act cannot tolerate.

B. Retroactive Payment of Mr. Bennion's Share of Production In Kind Is Just and Fair Under the Circumstances.

Shell's other argument, that it would be grossly unfair for Mr. Bennion to receive his product in kind, considering the dramatic movement in oil prices during recent years, is both specious and unfounded. Shell contends that Mr. Bennion was dilatory in making his demand for production in kind and in pursuing a pooling order; therefore, awarding him the relief he seeks would defeat the purposes of the Act. By so contending, Shell would have this Court see Mr. Bennion as a scheming one who purposefully orchestrated the delay of Shell's payment to coincide with the course of world oil prices, of which Mr. Bennion is imagined somehow to have had a prophetic foreknowledge.

Such a picture does not fit into the facts as contained in the record on appeal. The reality is that Mr. Bennion put Shell on notice of his demands in a timely fashion, and that Mr. Bennion timely filed for relief with the Board. Specifically, Mr. Bennion notified Shell in 1973 that he wanted production in kind, well before the time of his application with the Board in 1975. Thereafter, Mr. Bennion repeatedly attempted to negotiate with Shell concerning his entitlement to receive production in kind.

The plain truth of the matter is that Shell was the dilatory party in this dispute. Shell tries to get much mileage from its offers to pay Mr. Bennion a percentage of proceeds from the production which occurred between the Spacing and Pooling Orders. But Mr. Bennion exercised his right to demand payment in kind, which Shell refused to make at a time well before the rise in oil prices. Had Shell not been guilty of wrongfully withholding such payment, and had paid production in kind as the oil or gas was produced, there would be no element of "windfall" present in this suit. Furthermore, all considerations of payment in kind aside, Shell made no payments of cash until ordered to by the Board of Oil, Gas & Mining.

A similar situation occurred in Wood Oil Co. v. Corporation Commission (Wood #2), 239 P.2d 1023 (Okla. 1950). In that case, the mineral interest owner (Toklan) delayed for a time before asserting his rights to a share of production. The unit

operator (Wood Oil), on the other hand delayed in making payments of shares to Toklan, but nevertheless raised Toklan's delay as grounds for estopping its assertion of a share in production. The court held:

> With the entry of the [spacing] order of April 1, 1947, the right of Toklan to participate in the production arose as a matter of law and Wood Oil, . . . cannot properly ask to profit by the laxity of another which, at worst, is but comparable to its own. Id. at 1027.

Furthermore, Shell's argument that an award of payment of production in kind prior to the pooling order would be unfair fails to take into consideration the fact that Shell could have noticed up for hearing Mr. Bennion's involuntary pooling application if it had so desired. Instead Shell chose to wait and see if it could persuade Mr. Bennion to sign the pooling agreement and fit neatly into Shell's desired program of operation. Shell should not now be allowed to impose a standard on Mr. Bennion which Shell itself has not met.

If one of the purposes of the Act is to provide involuntary pooling where a drilling unit cannot be voluntarily pooled, it is just as feasible for the operator of that drilling unit to pursue such an application with the Board of Oil, Gas and Mining, as it is with a royalty interest owner. This feature is especially important in view of the fact that in most instances the operator, with its legal sophistication in oil and gas matters, will be in a better position to avail itself of statutory

remedies provided by the Act than the individual mineral interest owner.

Furthermore, the true inequity in the present dispute is that Mr. Bennion had to wait almost seven years, even after Shell was fully aware of his claims, to receive his royalties. Certainly if any one was dilatory, it was Shell and not Mr. Bennion. Shell ignored Mr. Bennion's repeated requests for his oil and gas in kind, and only after being ordered by a state agency, did it pay Mr. Bennion an amount "purportedly" due him. Shell's contention that it did this "voluntarily" is completely specious, as a reading of the record reveals.

III. MR. BENNION IS ENTITLED TO PREJUDGMENT INTEREST SINCE HIS RIGHT TO RECEIVE ROYALTIES EXISTED FROM THE DATE OF THE WELL'S FIRST PRODUCTION.

It is unquestionable that if Mr. Bennion was not entitled to receive any royalties prior to the date of the Board's Interim Order, he would not be entitled to any prejudgment interest. Obviously, prejudgment interest does not accrue until such time an obligation or an indebtedness exists. Shell argues that since no debt existed prior to the time of the Board's order, it now has no obligation for prejudgment interest. Such an argument is not only fallacious, but also completely contrary to the position taken by the Board in entering the Order from which this appeal is taken.

Not only did the Board decide that Mr. Bennion was entitled to receive production in cash from the date of the

well's first production, but it also awarded Mr. Bennion six per cent interest, or $2,554.06 on his royalty interest from the date of first production through May 6, 1980. It is not clear why the Board chose not to award Mr. Bennion interest on his working interest as well. However, it is only logical that if he is entitled to receive interest on his royalty interest, he also is entitled to receive interest on his working interest as well. Both royalty obligations were withheld from Mr. Bennion when due and payable to him, and therefore Shell is obligated for interest on the amount of each royalty from the date it was due and payable through May 6, 1980.

CONCLUSION

Fundamentally, this case is one of property rights in gas and oil produced by TEW1-1B5 Well. Shell's arguments fail to address the basic fact that the assets produced by Shell belong in part to Mr. Bennion. The Oil and Gas Conservation Act does more than conserve our energy resources; it serves another purpose of safeguarding the private property rights of an individual mineral interest owner as guaranteed by our state and federal constitutions. In accordance with those guarantees, and in the interest of fairness, Appellant respectfully prays this Court to grant Mr. Bennion his proportionate share of oil and gas in kind from the time of first production.

RESPECTFULLY SUBMITTED this 14th day of October, 1982.

McKAY, BURTON, THURMAN & CONDIE

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MAILING CERTIFICATE

I hereby certify that on the 14th day of October, 1982, I mailed two true and correct copies of the foregoing REPLY BRIEF OF APPELLANT, postage prepaid, to:

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