Oil and Gas, Natural Resources, and Energy Journal

Volume 2 | Number 3
2016 SURVEY ON OIL & GAS

September 2016

Utah

Jim Tartaglia

Matt Gabriel

ONE J

Oil and Gas, Natural Resources, and Energy Journal

VOLUME 2 NUMBER 3

UTAH

Jim Tartaglia and Matt Gabriel[*]

Table of Contents

* Jim Tartaglia and Matt Gabriel are Associates with Steptoe & Johnson PLLC. Jim is licensed in West Virginia, and Matt is licensed in Colorado, Utah, and Montana. Both Jim and Matt concentrate their practices in the area of energy law. The authors would like to extend a special thanks to Amanda Dick, 2L at the University of Arizona James E. Rogers College of Law, for her diligent research assistance.

I. Introduction

This year produced three notable rulings by Utah courts and a number of important legislative developments impacting the oil and gas industry. In *Trans-Western Petroleum, Inc. v. United States Gypsum Co.*, the Supreme Court of Utah answered a certified question regarding the appropriate measure of expectation damages for the breach of an oil and gas lease.[1] In *Womack v. Womack*, the Court of Appeals of Utah addressed the right of a life tenant to the proceeds derived from an oil and gas lease.[2] And in *Metropolitan Water District of Salt Lake & Sandy v. Questar Gas Co.*, the Court of Appeals considered the scope of authority of local water districts to regulate a public utility's natural gas pipelines located within the water district's non-exclusive easements.[3]

In addition to the above case law, the following four bills were signed into law: (i) Senate Bill 17 clarifies certain portions of Utah's oil and gas severance tax statute; (ii) Senate Bill 134 amends the act regarding the Oil and Gas Conservation Account; (iii) Senate Bill 159 extends the exemption from state severance tax on oil and gas; and (iv) House Bill 276 seeks to revamp Utah's public land management regime.

II. Case Law

A. Trans-Western Petroleum, Inc. v. United States Gypsum Co.

The most recent development in *Trans-Western Petroleum, Inc. v. United States Gypsum Co.* involved a certified question from the Tenth Circuit to the Supreme Court of Utah to answer the specific issue of how expectation damages should be measured for the breach of an oil and gas lease.[4] Prior litigation between United States Gypsum Company ("US

1. No. 20140453, 2016 WL 3369544, at *1 (Utah June 16, 2016).
2. 372 P.3d 690, 691 (Utah Ct. App. 2016).
3. 361 P.3d 709, 710 (Utah Ct. App. 2015).
4. No. 20140453, 2016 WL 3369544, at *1 (Utah June 16, 2016).

Gypsum") and Trans-Western Petroleum, Inc. ("Trans-Western") gave rise to a dispute over the appropriate calculation of contract damages. US Gypsum, who owned the oil and gas beneath lands in Sevier County, Utah, granted an oil and gas lease to Trans-Western in September 2004, effective as of August 17, 2004, the same date a prior lease then held by assignee Wolverine was to expire.[5] A few weeks after the execution of the lease, based on Wolverine's assertion that its prior lease remained effective, U.S. Gypsum rescinded the Trans-Western lease claiming a mistake of fact regarding the validity of the Wolverine lese.[6] Trans-Western then filed suit in federal court over the alleged breach, and after early procedural hurdles were surpassed, the district court found that U.S. Gypsum's cancellation of the Trans-Western lease constituted breaches of contract and the covenant of quiet enjoyment.[7] However, the court awarded only nominal damages to Trans-Western, and on appeal the Tenth Circuit certified this question as to how to appropriately measure expectation damages for the breach of an oil and gas lease under Utah law.[8]

U.S. Gypsum argued that damages for breach of an oil and gas lease should be measured as general damages for breach of a contract to sell real estate, being the difference between the price paid for the lease and the market value of that lease at the time of breach.[9] Trans-Western, on the other hand, asserted that the non-breaching party must be placed "'in as good a position as if the contract had been performed,' and doing so required an award for expectation damages based on an amount that it could have sold the lease for during its term.[10] Furthermore, Trans-Western argued that the courts should admit post-breach evidence in order to determine an accurate amount of damages awardable.[11]

The Supreme Court of Utah discussed an array of relevant authority about the nature and classifications of the oil and gas lease as a source of both contractual rights and property interests. After reviewing the lack of consensus among states and commentators, the court found such distinctions to have no bearing on the measure of expectation damages.[12]

---

5. *Id*.
6. *Id*.
7. *Id*.
8. *Id*.
9. *Id*.
10. *Id.* at *2.
11. *Id*.
12. *See id*. at *3-4 ("[W]e do not see that the specific classifications of the oil and gas lease in various jurisdictions make any difference as to the type of expectation damages

Instead, the court ruled that the oil and gas lease should be treated like any other contract, the breach of which may result in an award of general and consequential damages to the non-breaching party.

In answering this limited question, the Supreme Court of Utah held "that the appropriate measure of expectation damages for the breach of an oil and gas lease is much the same as the measure of expectation damages for a breach of contract and may include both general and consequential damages."[13] To assess general damages for a breach of an oil and gas lease, the court should look to the "difference between the contract price of the lease and the market value of the lease at the time of the breach."[14] In addition, the court may award consequential damages to be measured "by the gains [the promised] performance could produce … or the loss that is produced by the absence of such performance."[15] In order to recover consequential damages, the injured party must prove that such consequential damages (i) were caused by the breach of the lease, (ii) were foreseeable at the time the parties entered the contract, and (iii) are calculable with reasonable certainty.[16] The Supreme Court of Utah further explained that because post-breach evidence may help to establish the value of a contract at the time of breach, trial courts may exercise discretion to allow parties to use such evidence to establish and measure their expectation damages.[17] Thus, "for the limited purpose of expectation damages in a breach of contract claim, [the court] will treat oil and gas leases as [it] would treat any other lease under Utah law."[18]

B. In re Estate of Womack

In *Womack v. Womack*, the Court of Appeals of Utah addressed the timeliness of a petition to re-interpret a will, and in doing so considered the rights of a life tenant with regard to proceeds from subsurface mineral development.[19] Gordon Womack died in 1989 and devised to "to each of my three children, for life, remainder to the children of each of my children

available when a contract is breached in the oil and gas context. We are aware of no jurisdiction that has carved out a special rule for oil and gas leases with respect to the formulation of the measure of expectation damages. And we can imagine no theoretical reason for doing so.").

13. *Id.* at *2.
14. *Id.* at *5.
15. *Id.*
16. *Id.*
17. *Id.* at *6.
18. *Id.* at *4.
19. 372 P.3d 690, 691 (Utah Ct. App. 2016).

… per stirpes."[20] The probate court issued a 1992 order finding that each child of the testator "received a one-third life-estate interest in the mineral rights and a one-third interest in the surface" of a 160-acre parcel of which the testator died seized.[21] The devisees leased the oil and gas underlying those 160 acres in 2008, and in 2014, one of the testator's children petitioned to reopen Mr. Womack's estate to clarify who was entitled to receive the proceeds from the 2008 lease.[22] The district court ruled that the 2014 petition to reopen the estate, by seeking to construe the will differently than the 1992 order, was time-barred by the six month statute of limitations applicable to petitions for vacation or modification of the final order.[23]

The petitioner timely appealed the trial court ruling and claimed that the district court erred in its interpretation of the Probate Code, and because his petition called for the court's resolution of ambiguity in the order, it should not be subject to the six-month limitations period.[24] The Court of Appeals of Utah upheld the lower court's ruling, and in doing so explained the key reasoning behind the petition: the life-estate holder is "entitled to enjoy the land in the same manner as it was enjoyed before the creation of the life estate."[25] Therefore, if existing mineral extraction operations are being conducted on the property at the time the life-estate is created, the life tenant will be entitled to royalties payable under the lease; however, the life tenant is not entitled to proceeds from mineral development commenced after the creation of the life estate.[26] In this case, the children were not entitled to the royalty payments from the 2008 oil and gas lease, because it was executed after the bequest of their life estate. Therefore, the grandchildren-remaindermen were entitled to all proceeds derived from the 2008 oil and gas lease. Moreover, because the petition to reopen the estate would result in a modification of the previous final order, the petition was barred by the statute of limitations.

---

20. *Id*. at 692.
21. *Id*.
22. *Id*.
23. *Id*. at 692-93.
24. *Id*. at 693.
25. *Id*. at 694 (quoting 2 Howard R. Williams & Charles J. Meyers, *Oil and Gas Law*, § 513, at 654-55 (1989)).
26. *Id*. (citing 31 C.J.S. *Estates* § 49 (2015); Weekley v. Weekley, 27 S.E.2d 591, 593 (W. Va. 1943); Hynson v. Jefferies, 697 So.2d 792, 797 (Miss. Ct. App. 1997)).

C. Metropolitan Water District of Salt Lake & Sandy v. Questar Gas Co.

In *Metropolitan Water District of Salt Lake & Sandy v. Questar Gas Co.*, the Court of Appeals of Utah analyzed whether a local water district has authority to regulate a public utility's natural gas pipelines located within the water district's non-exclusive easements.[27] The Metropolitan Water District of Salt Lake & Sandy ("District") owns and operates the Salt Lake Aqueduct ("SLA"), a water pipeline that delivers water from a reservoir to a treatment plant and storage facilities.[28] The SLA was constructed between 1939 and 1951 within a non-exclusive easement reserved under an 1898 federal land patent.[29] In 1955, after the construction of the SLA, the land was dedicated to Salt Lake County for public use.[30] Questar Gas Company ("Questar") maintains a natural gas pipeline that runs parallel to, and in places across, the SLA to provide gas supply to various homes in the area.[31] Questar installed its pipeline pursuant to franchise agreements with Salt Lake County, and also entered into a fifty-year license agreement with the Bureau of Reclamation ("BOR").[32] After the BOR quitclaimed the easement area to the District, the license expired in December 2006 and the District and Questar failed to negotiate a new agreement.[33] The District's own regulations require a license agreement for utility crossings of the SLA.[34] After the failed negotiations with Questar, the District filed a motion for summary judgment seeking a declaratory judgment that the Questar pipeline belonged to the District, and that Questar's continued use of the pipeline constituted trespass and a public nuisance.[35] The District further claimed that Questar's pipeline unreasonably interfered with the SLA and the District's future plans for development within the SLA.[36] The trial court denied the District's motion and granted Questar's motion to dismiss, which the District promptly appealed.

The Court of Appeals upheld the lower court's ruling, holding that the District lacked express or implied statutory authority to regulate a public

27. 361 P.3d 709, 710 (Utah Ct. App. 2015).
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.* at 711.
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *See id.*

utility's natural gas pipeline located within its non-exclusive easement.[37] Unlike other governmental bodies, the District was never authorized to regulate public utilities within its geographical reach,[38] and is able to carry out its duties and responsibilities without any need to regulate such conduct.[39] The Court of Appeals also affirmed the trial court's conclusion that Questar's pipeline did not unreasonably interfere with the District's use of the SLA due to the absence of evidence of past interference during their sixty-year coexistence and the claimed interference with the District's future plans being mere speculation.[40]

III. Legislation

A. S. B. 17

Senate Bill 17, which became effective upon approval on March 28, 2016, amended various portions of the Utah oil and gas severance tax statute. Namely, S. B. 17 adds the following definitions under Utah Code § 59-5-102(1)(a):

> (a) "Royalty rate" means the percentage of the interests described in Subsection (2)(b)(i) as defined by a contract between the United States, the state, an Indian, or an Indian tribe and the oil or gas producer.
>
> (b) "Taxable value" means the total value of the oil or gas minus: (i) any royalties paid to, or the value of oil or gas taken in kind by, the interest holders described in Subsection (2)(b)(i); and (ii) the total value of oil or gas exempt from severance tax under Subsection (2)(b)(ii).
>
> (c) "Taxable volume" means: (i) for oil, the total volume of barrels minus: (A) for an interest described in Subsection (2)(b)(i), the product of the royalty rate and the total volume of barrels; and (B) the number of barrels that are exempt under Subsection (2)(b)(ii); and (ii) for natural gas, the total volume of

37. *Id*. at 713-14.

38. *See id.* at 716 ("The District enjoys no statutory authority to regulate public utilities comparable to the express statutory authority of UDOT, Salt Lake County, and Sandy City.").

39. *Id*. at 714 ("We do not see how the ability to regulate Questar and other public utilities within the SLA corridor is necessary to the District's ability to carry out its duties and responsibilities.").

40. *Id*. at 719.

> MCFs minus: (A) for an interest described in Subsection (2)(b)(i), the product of the royalty rate and the total volume of MCFs; and (B) the number of MCFs that are exempt under Subsection (2)(b)(ii).
>
> (d) "Total value" means the value, as determined by Section 59-5-103.1, of all oil or gas that is: (i) produced; and (ii) (A) saved; (B) sold; or (C) transported from the field where the oil or gas was produced.
>
> (e) "Total volume" means: (i) for oil, the number of barrels: (A) produced; and (B) (I) saved; (II) sold; or (III) transported from the field where the oil was produced; and (ii) for natural gas, the number of MCFs: (A) produced; and (B) (I) saved; (II) sold; or (III) transported from the field where the natural gas was produced.
>
> (f) "Value of oil or gas taken in kind" means the volume of oil or gas taken in kind multiplied by the market price for oil or gas at the location where the oil or gas was produced on the date the oil or gas was taken in kind.

S. B. 17 further clarified the application and calculation of the severance tax in several ways, including but not limited to amendments to Utah Code § 59-5-102(2)(b) and –(3)(a)-(c), which now read as follows:

> (2)(b) The severance tax imposed by Subsection (2)(a) does not apply to: (i) an interest of: (A) the United States in oil or gas or in the proceeds of the production of oil or gas; (B) the state or a political subdivision of the state in oil or gas or in the proceeds of the production of oil or gas; and (C) an Indian or Indian tribe as defined in Section 9-9-101 in oil or gas or in the proceeds of the production of oil or gas produced from land under the jurisdiction of the United States; and (ii) the value of: (A) oil or gas produced from stripper wells, unless the exemption prevents the severance tax from being treated as a deduction for federal tax purposes; (B) oil or gas produced in the first 12 months of production for wildcat wells started after January 1, 1990; and (C) oil or gas produced in the first six months of production for development wells started after January 1, 1990.
>
> (3)(a) The severance tax on oil shall be calculated as follows: (i) dividing the taxable value by the taxable volume; (ii)(A)

> multiplying the rate described in Subsection (4)(a)(i) by the portion of the figure calculated in Subsection (3)(a)(i) that is subject to the rate described in Subsection (4)(a)(i); and (B) multiplying the rate described in Subsection (4)(a)(ii) by the portion of the figure calculated in Subsection (3)(a)(i) that is subject to the rate described in Subsection (4)(a)(ii); (iii) adding together the figures calculated in Subsections (3)(a)(ii)(A) and (B); and (iv) multiplying the figure calculated in Subsection (3)(a)(iii) by the taxable volume.
>
> (b) The severance tax on natural gas shall be calculated as follows: (i) dividing the taxable value by the taxable volume; (ii)(A) multiplying the rate described in Subsection (4)(b)(i) by the portion of the figure calculated in Subsection (3)(b)(i) that is subject to the rate described in Subsection (4)(b)(i); and (B) multiplying the rate described in Subsection (4)(b)(ii) by the portion of the figure calculated in Subsection (3)(b)(i) that is subject to the rate described in Subsection (4)(b)(ii); (iii) adding together the figures calculated in Subsections (3)(b)(ii)(A) and (B); and (iv) multiplying the figure calculated in Subsection (3)(b)(iii) by the taxable volume.
>
> (c) The severance tax on natural gas liquids shall be calculated by multiplying the taxable value of the natural gas liquids by the severance tax rate in Subsection (4)(c).

B. S. B. 134

Senate Bill 134 amended the Oil and Gas Conservation Account statute, Utah Code § 40-6-14.5, with the relevant portions of the amended bill now reading as follows:

(6)(a) The balance of the Oil and Gas Conservation Account at the end of the fiscal year may not exceed 100% of the fiscal year appropriation for Subsection 3(a).

(b) Any Excess money at the end of the fiscal year above the balance limit established in Subsection (6)(a) shall be transferred to the general fund.[41]

This Senate Bill was approved on March 30, 2016, and effective as of May 10, 2016.[42]

---

41. S.B. 134, 2016 Gen. Sess. (Utah 2016).
42. *Id.*

C. S. B. 159

Senate Bill 159 extends the severance tax exemption, being Utah Code § 59-5-120, which was previously slated to end on June 30, 2016.[43] The new expiration date is June 30, 2026.[44] The term "tar sands" was also amended to read "oil sands."[45] The text of the bill remains otherwise unchanged, and now reads as follows: "Beginning on January 1, 2006, and ending on June 30, 2026, no severance tax required by this chapter is imposed on oil and gas produced, saved, sold, or transported if the oil or gas produced, saved, sold or transported is derived from: (1) coal-to-liquids technology; (2) oil shale; or (3) oil sands."[46] Senate Bill 159 was approved on March 28, 2016, effective as of May 10, 2016.[47]

D. H. B. 276

In 2012, the Utah legislature enacted the Transfer of Public Lands Act, which required that "on or before December 31, 2014, the United States shall (a) extinguish title to public lands; and (b) transfer title to public lands to the state."[48] Subsequently, in 2013, the Utah Legislature coordinated an economic study to determine the feasibility of such a transfer.[49] The study, titled *An Analysis of a Transfer of Federal Lands to the State of Utah*, was completed in November of 2014.[50]

John C. Ruple and Robert B. Keiter, in a trio of white papers published between October 2014 and December 2015, discussed both the legal and economic implications of a land transfer, explain the results of the economic study, and highlight three key drawbacks to Utah's claim to federal lands: (1) under the Property Clause of the Constitution of the United States the federal government is entitled to authority over public land, and Utah accepted this authority as a condition to statehood;[51] (2)

43. S.B. 159, 2016 Gen. Sess. (Utah 2016).
44. *Id*.
45. *Id*.
46. *Id*.
47. *Id*.
48. UTAH CODE ANN. §63L-6-103 (West 2016).
49. PUBLIC LANDS POLICY COORDINATING OFFICE AMENDMENTS, 2013 Utah Laws Ch. 337 (H.B. 142).
50. Jan Elise Stabro, *An Analysis of a Transfer of Federal Lands to the State of Utah* 1-784 (2014), http://gardner.utah.edu/wp-content/uploads/2015/08/1.-Land-Transfer-Analysis-Final-Report.pdf.
51. Robert B. Keiter and John C. Ruple, *A Legal Analysis of the Transfer of Public Lands Movement*, Stegner Center White Paper 2014-02 (Oct. 7, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2516004.

state management of public lands would be just as inefficient as federal management of the same, and would likely not be profitable;[52] and, (3) a transfer of federal land would likely not include the subsurface minerals, which would be the state's primary source of revenue from those lands.[53] Despite the above hurdles, the state has taken steps toward bringing suit against the federal government in order to gain authority over federal lands in Utah; however, as of this writing, no suit has been filed. Nonetheless, Utah passed H.B. 276 this year, which enacted the Utah Public Land Management Act, as well as several other bills related to public land transfers.[54] The bill includes mineral exploration and production among the primary goals of the act,[55] calls for the development of land use plans to ensure efficient development and conservation of public lands,[56] and creates several funds to aid with public land management.[57] Notably, H.B. 276 becomes effective on the day the state receives title to at least 100,000 acres of public land from the federal government pursuant to Utah Code Ann. §63L-8-103. As explained above, the state is yet to receive federal lands under this section and thus the Utah Land Management Act is (and perhaps will remain) on the shelf.

52. Robert B. Keiter and John C. Ruple, *The Transfer of Public Lands Movement: Taking the 'Public' Out of Public Lands*, Stegner Center White Paper 2015-01 (Jan. 28, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2555922.

53. Robert B. Keiter and John C. Ruple, *When Winning Means Losing: Why a State Takeover of Public Lands May Leave States Without the Mineral Rights They Covet*, Stegner Center White Paper 2015-02 (Dec. 9, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2701292.

54. H.B. 276, 2016 Gen. Sess. (Utah 2016); *see also* Commission for the Stewardship of Public Lands and Private Donations for Public Lands Litigation, H .B. 287, 2016 Gen. Sess. (Utah 2016); Public Lands Act Amendments, H.B. 105, 2015 Gen. Sess. (Utah 2015); Legislative Approval of Land Transfers, H.B. 303, 2015 Gen. Sess. (Utah 2015); Evaluating Federal Land, S.B. 48, 2015 Gen. Sess. (Utah 2015); Interstate Compact on Transfer of Federal Lands Amendments, H.B. 132, 2015 Gen Sess. (Utah 2015).

55. UTAH CODE ANN. §63L-8-103 (West 2016).

56. UTAH CODE ANN. §63L-8-202 (West 2016).

57. *See* UTAH CODE ANN. §63L-8-307, §63L-8-308, §63L-8-309, §63L-8-310 (West 2016).