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UTAH

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I. INTRODUCTION

Oil and gas production continues to be an important sector of Utah's economy. Following a 25% loss in production between 2014 and 2015, Utah's production continues to slowly rebound.[2] Crude oil production in 2019 appears to be slightly ahead of 2018 production.[3] Monthly production averages slightly over three million barrels, placing Utah among the top ten states in crude oil production.[4] Along

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2. *Utah Field Production of Crude Oil*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFPUT1&f=M [https://perma.cc/8F33-7ULW] (last visited Oct. 10, 2019).

3. *Id.*

4. *Petroleum & Other Liquids: Crude Oil Production,* U.S. ENERGY INFO. ADMIN., https://www.eia.gov/dnav/pet/pet_crd_crpdn_adc_mbbl_m.htm [https://perma.cc/C39L-4WDW] (last visited Oct. 10, 2019).

with the continuing increase in production, the state's legal framework governing oil and gas continues to develop.

This Article examines recent changes in Utah statutes and regulations along with new case law developments involving the oil and gas industry. In particular, this Article discusses a recent federal bankruptcy decision involving midstream agreements,[5] the revision to a Utah statute that now requires mandatory reporting of unclaimed mineral interests,[6] and recent revisions to Utah's oil and gas regulations.[7]

II. CASE LAW

A. *Federal Cases*

1. Monarch Midstream, LLC v. Badlands Production Company, et al

The United States Bankruptcy Court for the District of Colorado, construing Utah law, recently held that a Gas Gathering and Processing Agreement ("GGPA") and a Salt Water Disposal Agreement ("SWDA") were covenants running with the land that could not be extinguished through a bankruptcy sale.[8] In so holding, the bankruptcy court became the first court to distinguish the recent *Sabine* decision, which held that midstream agreements were not covenants running with the land and could be discharged in bankruptcy.[9]

Initially, in 2010, Monarch Midstream, LLC ("Monarch") acquired portions of midstream infrastructure that serviced the Riverbend oil and gas assets ("Riverbend Assets") held by Badlands Energy, Inc., formerly known as Gasco Energy, Inc. ("Badlands"). Following the purchase, Monarch and Badlands entered into a GGPA and SWDA, wherein Badlands dedicated and committed all "*[g]as reserves in and under*" and all "gas owned by production and produced from" the leases held by Badlands within an area of mutual interest

5. *In re Badlands Energy, Inc.*, 608 B.R. 854 (Bankr. D. Colo. 2019).
6. UTAH CODE ANN. § 75-2-105 (West 2019).
7. UTAH ADMIN. CODE R. 850-21 *et. seq.*
8. *In re Badlands Energy, Inc.*, 608 B.R. 854.
9. *In re* Sabine Oil & Gas Corp., 547 B.R. 66 (Bankr. S.D.N.Y. 2016); affirmed in *In* re Sabine Oil & Gas Corp., 567 B.R. 869 (S.D.N.Y. 2017) and *In re* Sabine Oil & Gas Corp., 734 Fed.Appx. 64 (2d Cir. 2018) (finding that a midstream agreement did not constitute a covenant running with the land and the burden could, therefore, be discharged through a bankruptcy sale).

("AMI").[10] Under the GGPA, Badlands was required to deliver quarterly a minimum volume of gas or pay Monarch a shortfall as liquidated damages. Under the SWDA, Badland committed to dispose of all its operational water within the AMI with Monarch's disposal facilities. Both the GGPA and SWDA expressly stated that they were covenants running with the land.

In 2017, Badlands Energy, Inc. and related entities filed for chapter 11 bankruptcy. The bankruptcy court ordered a "free and clear" sale authorizing Badlands to auction a portion of the Riverbend Assets to Wapiti Utah, LLC ("Wapiti"). As part of the sale, Badlands rejected the GGPA and SWDA, which were not assumed or assigned to Wapiti. Monarch objected to the sale on grounds that the agreements could not be rejected, since they were covenants running with the land.

The bankruptcy court determined that the Colorado choice of law provisions in the GGPA and SWDA were not applicable, ruling that Utah law governed because property interests are created and defined by the law of the state where the property is located.[11] The court ruled that under Utah law the GGPA and SWDA were covenants running with the land. The court applied a four-element test: (1) the covenant must "touch and concern" the land; (2) there must be privity of estate; (3) the covenant must be in writing; and (4) the parties must intend for the covenant to run with the land.[12] Neither party disputed that the covenant was in writing, so the court focused on the other three elements.

In its decision, the court relied heavily on the Utah case of *Flying Diamond Oil Corp. v. Newton Sheep Company*.[13] The "touch and concern" element typically requires a showing of some physical effect to the land. However, the court, following *Flying Diamond*, held that the "touch and concern" element is met when a covenant either enhances or diminishes the value of the land.[14] The bankruptcy court distinguished *Sabine* by highlighting that the gas dedication in *Sabine* only covered the gas and condensate produced and saved from the wells. Under both Texas and Utah law, extracted minerals are personal property, not real property, and therefore the "touch and

10. *In re Badlands Energy, Inc.*, 608 B.R. at 869.
11. *Id.* at 867.
12. *Id.*; *see also* Flying Diamond Oil Corp. v. Newton Sheep Co., 776 P.2d 618, 624 (Utah 1989) (*hereinafter* "Flying Diamond").
13. *See Flying Diamond*, 776 P.2d 618.
14. *In re Badlands Energy, Inc.*, 608 B.R. at 868.

concern" element was not satisfied. The GGPA in question, however, dedicated the interest in all gas reserves "*in and under*" those leases held in the AMI.[15] The court reasoned that these dedicated reserves could be broadly defined to include the unproduced oil and gas, which is real property under Utah law.[16] The court determined that a dedication of the unproduced oil and gas, which were real property interests themselves, diminished the value of the land. Therefore, the GGPA and SWDA covenants did in fact "touch and concern" the land.

To determine the "intent" element, the court once again followed *Flying Diamond* and held that an express statement that the covenant was intended to run with the land was dispositive of intent.[17] Both the GGPA and the SWDA contained multiple statements expressly stating the intention to create a covenant running with the land. On this basis, the court held the "intent" element was easily satisfied.

Turning to the requirement of "privity," the court considered the three types of privity typically required: (1) vertical, (2) horizontal, and (3) mutual. Under Utah law, vertical privity is found when a person claiming the benefit, or subject to the burden, is the successor to the original person so benefited or burdened.[18] The court determined vertical privity existed, as Wapiti was the successor to Badland, the original party to the GGPA and SWDA.[19] Horizontal privity exists under Utah law when "the original covenanting parties create a covenant in connection with a simultaneous conveyance of the estate."[20] The bankruptcy court determined simultaneous conveyances did occur. First, the GGPA's dedication burdening the gas reserves constituted conveyance of the mineral estate. Additionally, the grant of easements in both the SWDA and GGPA were held to be conveyances of real property interests, thereby creating horizontal privity.[21] Finally, unlike other jurisdictions, Utah has never adopted the requirement to show mutual privity. Thus, the court concluded that the simultaneous interests of the Badlands and Monarch in the gas reserves within the AMI satisfied a showing of mutual privity to the extent required under Utah law.[22] Ultimately, the

15. *Id.* at 869.
16. *Id.*
17. *Id.* at 870.
18. *Flying Diamond*, 776 P.2d at 628.
19. *In re Badlands Energy, Inc.*, 608 B.R. at 871.
20. *Flying Diamond*, 776 P.2d at 628.
21. *In re Badlands Energy, Inc.*, 608 B.R. at 874.
22. *Id.* at 873.

court determined that since the SWDA and GGPA were covenants running with the land, they are "part of the bundle of sticks that Wapiti acquired when it purchased the Riverbend Assets, and they are not subject to elimination utilizing [the bankruptcy code]."[23] An appeal of the decision is expected.

Additional litigation in Utah and across the United States is expected to help delineate the *Sabine* decision and determine when midstream agreements create real property interests that cannot be rejected in bankruptcy. Until that case law develops, the *Monarch* decision provides authority for the proposition that a midstream agreement creates a real property interest that survives a "free and clear" bankruptcy sale, so long as it burdens hydrocarbons in the ground.

III. STATUTES / REGULATIONS

A. *2019 S.B. 78: Utah Code Ann. § 75-2-105*

On March 25, 2019, Governor Herbert signed Senate Bill 78 into law. This bill amended Utah's law governing the escheat of property to the state when a decedent's heirs cannot be located.[24] The new law amends Utah Code Ann. § 75-2-105 by identifying the Utah State School and Institutional Trust Lands Administration ("SITLA") as the state agency responsible for administering the unclaimed mineral interests, clarifying the state's initiation of a quiet title action and creating an affirmative duty to report information regarding intestate succession to the state.[25]

Under the old statute, no state agency was specifically tasked with the administration of escheated mineral interests. However, as the interest escheated "for the benefit of the permanent state school fund," the escheated interests were usually administered by SITLA. The amendment codifies this long standing practice granting SITLA explicit administration authority over escheated mineral interests.[26] In addition, the amendment also grants SITLA the authority to file a quiet title action in district court in order to confirm the state's claim to unclaimed mineral interests.[27] Finally, the amendment creates an

23. *Id.* at 874.
24. UTAH CODE ANN. § 75-2-105(2) (West 2019)..
25. *See* S.B. 78, 63d Leg., Gen. Sess. (Utah 2019) (eff. May 14, 2019).
26. UTAH CODE ANN. § 75-2-105(3) (West 2019).
27. UTAH CODE ANN. § 75-2-105(4) (West 2019).

affirmative duty for operators, owners, and payors to submit information concerning "the identity of the decedent, the results of a good faith search for heirs . . ., the property interest from which the minerals or mineral proceeds derive, and any potential heir" to SITLA within 180 days of acquiring the information.[28]

At this point, the new statute appears to provide a regulatory framework for dealing with escheated interests. Although the revised statute creates an affirmative duty to report, it does not provide for an enforcement mechanism. Absent any penalty or enforcement mechanism it is unclear how, if at all, the new statute will change how operators report unclaimed mineral interests to SITLA.

B. *Admin Code R850-21*

The Utah state regulations governing oil and gas had their first major revision since 2005 when SITLA repealed and replaced its oil and gas regulations, Utah Admin. Code R850-21, effective June 1, 2019. At first glance, the revisions appear to be primarily stylistic with shortened and simplified regulations and updated terminology. However, several newly created rules and revisions will have a more substantive effect.[29]

Although the entirety of U.A.C. R850-21 was repealed and replaced, the majority of the substantive changes occurred to the following rules: (1) 175 (Definitions);[30] (2) 500 (Lease Provisions);[31] and (3) 600 (Transfer by Assignment or Operation of Law).[32]

Revisions to Rule 175 include redefining various subparts of the oil and gas leasehold estate for record title,[33] removing definitions for "non-working interests" and "working interests,"[34] and adding new definitions for "operating rights" and "diligent operations."[35] The newly created definition for "diligent operations" allows for a limited cessation of operations that "do not exceed ninety (90) days in

28. UTAH CODE ANN. § 75-2-105(6) (a-b) (West 2019).
29. *See, e.g.,* UTAH ADMIN. CODE R. 850-21-500 (2019) (changing the minimal annual rental from $40 to $500); *see also* UTAH ADMIN. CODE R. 850-21-175(5) (2019) (defining what qualifies as diligent operations).
30. UTAH ADMIN. CODE R. 850-21-175 (2019).
31. UTAH ADMIN. CODE R. 850-21-500 (2019).
32. UTAH ADMIN. CODE R. 850-21-600 (2019).
33. UTAH ADMIN. CODE R. 850-21-175(13) (2019)..
34. *See* UTAH ADMIN. CODE R. 850-21-175(4)(c) & (e) (2004).
35. UTAH ADMIN. CODE R. 850-21-175(5) & (10) (2019).

duration" or a "cumulative period in excess of one hundred eighty (180) days" within a lease absent agency approval.[36]

Changes to lease provisions, found in Rule 500, include revisions to the annual lease rental, lease primary terms, minimum royalty production rates, retention of records, and requirements for lease extensions. The new minimum annual lease rental, regardless of acreage, increased from $40 to $500.[37] The new rules remove the limitation that the primary term for a lease not exceed ten years.[38] Similarly, the new rules are silent as to a minimum production royalty rate, which was previously required to be 2.5% of the gross proceeds.[39] SITLA is now required to retain records for seven years, an increase from the previous six years.[40] Leases are no longer automatically extended by inclusion in a SITLA approved unit plan for development or operation.[41] However, the new rules provide for an extension of two years, or until the end of the primary term, whichever is longer, for those leases in active units that terminate or contract on/or before January 1, 2021.[42] Leases that are committed to a new unit formed after the rules effective date of June 1, 2019, will not be entitled to this automatic extension.[43]

The regulations related to transfers and assignments were also modified. For instance, overriding royalty assignments are defined as "non-leasehold assignments" and must be filed with SITLA but only for record keeping purposes.[44] Filing of other non-leasehold assignments is not required, although they may be filed with SITLA for record keeping purposes.[45] Assignments are now considered effective upon approval by SITLA.[46] SITLA is also given the authority to "void" any assignment in which the certification of net revenue interest is false or where the aggregate burden is in excess of 20%.[47]

36. UTAH ADMIN. CODE R. 850-21-175(5) (2019).
37. UTAH ADMIN. CODE R. 850-21-500(1)(b) (2019).
38. UTAH ADMIN. CODE R. 850-21-500(3) (2004).
39. UTAH ADMIN. CODE R. 850-21-500(2) (2004).
40. *Compare* UTAH ADMIN. CODE R. 850-21-500(7)(d) (2004) *with* UTAH ADMIN. CODE R. 850-21-500(5)(c) (2019).
41. *Compare* UTAH ADMIN. CODE R. 850-21-500(5)(d) (2004) *with* UTAH ADMIN. CODE R. 850-21-500(3) (2019).
42. UTAH ADMIN. CODE R. 850-21-500(3)(e)(i)(ii) (2019).
43. *Id*.
44. UTAH ADMIN. CODE R. 850-21-600(2) (2019).
45. *Id*.
46. UTAH ADMIN. CODE R. 850-21-600(3)(d) (2019).
47. UTAH ADMIN. CODE R. 850-21-600(3)(f) (2019).

The effects of the new regulations are expected to be minor. The majority of the revisions, including those highlighted above, incorporate long standing agency practices.