

**PRESENTED AT**

46<sup>th</sup> Annual Ernest E. Smith  
Oil, Gas and Mineral Law Fundamentals and Institute

March 26-27, 2020  
Houston, Texas

## **A PRIMER ON UNDERSTANDING OIL AND GAS TRANSPORTATION AGREEMENTS AND IDENTIFYING KEY ISSUES**

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## **I. INTRODUCTION**

While upstream companies primarily focus on the exploration and production of hydrocarbons, the value of the produced hydrocarbons is of little value if they cannot be processed and transported to market. The midstream segment of the oil and gas industry—broadly encompassing gathering, transporting, processing, fractionation, storage, and the purchase and sale of oil, gas, and natural gas liquids—connects oil and gas producers to consumers and end users and captures an invaluable component of the hydrocarbon value chain.

This paper presents a high-level overview of transportation agreements governing the movement of oil and gas from the wellhead to a point downstream for resale or further handling, and highlights certain issues that practitioners will encounter and should consider when negotiating transportation agreements. Except where expressly indicated otherwise, this paper will focus on Texas law and the intrastate movement of oil and gas.

At the outset, it is worth noting some of the obvious physical differences between oil and gas that make certain issues unique to their individual characteristics. Oil is produced as a viscous liquid that is typically stored in storage tanks at or near the wellhead. Gas, on the other hand, is a mixture of gaseous hydrocarbons consisting primarily of methane. The safest and most efficient mode of transporting gas in its gaseous state is by pipeline, which often involves one or more stages of compression to facilitate its movement. In addition, gas must often be processed or treated to remove water vapor and other impurities in the gas stream that may corrode pipelines and related equipment during its movement. Thus, at its core, agreements governing the transportation of gas inherently involve different and additional issues not otherwise found in agreements governing the transportation of oil. Because of the differences in the physical characteristics of oil and gas, not every transportation agreement is relevant to both oil and gas nor are the considerations the same when negotiating and drafting. The scope of this paper is generally written from the viewpoint of issues associated with the movement of gas along a pipeline; however, there are noteworthy distinctions regarding oil, which this paper highlights where significant.

## **II. GATHERING & TRANSPORTATION**

Conceptually, the transportation of oil and gas is straightforward. After oil and gas producers drill, complete, and produce a well, the produced hydrocarbons are initially separated into their three primary components: oil, gas, and water. The term “gathering” generally refers to the process of collecting gas from one or more wellheads and its relatively short movement to various points where it is aggregated for further movement. This may include one or more compressor stations and/or points of interconnection with a larger pipeline network. Because oil is typically stored in storage tanks or central tank batteries at or near the wellhead, “gathering” is

a concept uniquely related to gas; however, it is not uncommon to find the distinction blurred. Thereafter, “transportation” is the delivery of the accumulated volumes of oil and gas to one or more points of delivery via a dedicated transportation and distribution infrastructure. In the case of oil, this may include movement by truck, rail, or pipeline; in the case of gas, this involves movement by pipeline to a downstream processing plant or point of delivery. While gathering and transportation are independent concepts, practitioners should be mindful that these terms and their related principles are oftentimes used interchangeably in discussions between parties and within agreements. For purposes of this paper, we have chosen to focus on the transportation of oil and gas via pipeline following their separation at the wellhead to a point of delivery for resale or further handling, and refer to companies that own or operate such pipeline systems as “Transporters.”

There is no standard form agreement for the transportation of oil or gas. Each Transporter may have its own preferred agreement for the movement of oil and for the movement of gas, and the specific circumstances of the parties dictate the terms and conditions of each (*e.g.*, location of the wells, points of receipt and delivery, available transportation infrastructure, quality specifications of the oil or gas). The basic objective of these agreements is to provide for the transportation of oil and gas from within the producing acreage to downstream points where they can be resold or processed. The remainder of this section identifies certain common provisions and issues and considerations that practitioners should be mindful of when negotiating transportation agreements.

### *Dedication*

Transporters invest significant capital to construct or expand pipeline infrastructure. To ensure utilization of the pipeline system and an acceptable return of capital costs (via fees for transportation services), a Transporter may require a producer to dedicate all oil and gas production from certain geographic areas, oil and gas leases, and/or wells for the life of the agreement. Such an arrangement is equally beneficial to producers, since it provides an assured market for their production which, in turn, facilitates their ability to obtain financing and otherwise to conduct business planning from a position of economic stability.<sup>1</sup>

When a dedication is tied to a geographic area, the producer generally commits all of the production it owns or controls in the area for the term of the agreement. Practitioners should pay particular attention to the scope of the dedication and specify whether the dedication applies only to the leases or wells owned by the producer at the time the agreement is entered into or also to any future leases or wells acquired in the geographic area during the term of the agreement. If leases or wells within the geographic area are

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<sup>1</sup> Michael P. Pearson, *A Primer on Marketing Hydrocarbons*, 44th Ann. Adv. Oil, Gas & Energy Res. L. Course, St. Bar of Tex., 21 (2018) (hereinafter, “Marketing Hydrocarbons”).

previously dedicated to a third party Transporter, the producer and Transporter should be mindful of excluding those leases and wells from the dedication, but provide for the dedication of the production therefrom upon the expiration of the underlying commitments.

### *Covenants Running with the Land*

Properly negotiated transportation agreements provide that the dedication is a covenant running with the land, which has significant ramifications in bankruptcy proceedings. As we have seen, producers have elected, as part of their restructuring strategy in bankruptcy, to “reject” certain gathering and transportation agreements.<sup>2</sup> Transporters, faced with the prospect of unrecouped capital investments and the loss of fees from transportation service on their pipeline systems, have, in most cases, contested the right of the producer/debtor to reject such agreements on grounds that they contain express covenants (*e.g.*, the dedication) that run with the land and are, therefore, real property interests that cannot be terminated by the producer’s bankruptcy.<sup>3</sup> These arguments provide that a covenant running with the land is an interest in real property that is primarily attached to the land, rather than being contractual in nature and, as such, it should not constitute an executory contract under section 365 of the Bankruptcy Code.<sup>4</sup> In Texas, a covenant runs with the land when (a) it touches and concerns the land, (b) it relates to a thing in existence or specifically binds the parties and their assigns, (c) it is intended by the original parties to run with the land, (d) successors to the burden have notice, and (e) there is horizontal privity of estate between the original covenanting parties.<sup>5</sup>

In recent years, bankruptcy courts have given considerable attention to the issue of covenants running with the land. In 2018, the U.S. Court of Appeals for the Second Circuit affirmed the District Court and Bankruptcy Court for the Southern District of New York and held in *Sabine Oil & Gas Corp. v. Nordheim Eagle Ford Gathering, LLC*<sup>6</sup> that a debtor could reject certain midstream gathering agreements pursuant to section 365 of the Bankruptcy Code, because they did not create a real covenant that ran with the land under Texas law.<sup>7</sup> The court found that the covenants in the agreements failed to “touch and

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<sup>2</sup> Michael P. Pearson, *Covenants Running with the Land*, 48 St. Mary’s L.J. 727, 732 (2017) (hereinafter, “Covenants Running with the Land”).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 753–54.

<sup>5</sup> *Inwood N. Homeowners’ Ass’n, Inc. v. Harris*, 736 S.W.2d 632, 635 (Tex. 1987); *Westland Oil Development Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903 (Tex. 1982) (requiring horizontal privity of estate between the covenanting parties at the time the covenant is created). For an in-depth analysis of acreage commitments and covenants running with the land, see *Covenants Running with the Land*, *supra* n. 2.

<sup>6</sup> See *Sabine Oil & Gas Corp. v. Nordheim Eagle Ford Gathering, LLC (In re Sabine Oil & Gas Corp.)*, 550 B.R. 59 (Bankr. S.D.N.Y. 2016); *aff’d*, 567 B.R. 869 (S.D.N.Y. 2017); *aff’d*, 734 Fed. Appx. 64 (2d Cir. 2018).

<sup>7</sup> Richard A. Howell and Vienna Flores Anaya, *Texas Bankruptcy Court – Applying Oklahoma Law – Concludes That Gathering Agreements Created Covenants Running With the Land and Cannot be Rejected by the Alta Mesa Resources*

concern” the debtor’s real property.<sup>8</sup> The court reasoned that the acreage dedications in the agreements were not burdens on the producer’s real property interests; rather, the dedications concerned “only minerals extracted from the ground, which indisputably constitute personal property, not real property, under Texas law.”<sup>9</sup> The court also concluded that if horizontal privity of estate was a requirement under Texas law for a covenant to run with the land, such horizontal privity was not present between the debtor and the midstream companies.<sup>10</sup> The court explained that horizontal privity is created when there is a “conveyance of an interest in property that itself is being burdened with the relevant covenant, not the conveyance of an interest in property that is distinct from (even if somewhat related to) the property burdened by the covenant.”<sup>11</sup>

Despite the *Sabine Oil* decision, the issue of covenants running with the land continued to be litigated before bankruptcy courts. On September 30, 2019, departing from the *Sabine Oil* decision, the U.S. Bankruptcy Court for the District of Colorado in *Monarch Midstream, LLC v. Badlands Prod. Co.*<sup>12</sup> rejected a debtor’s attempt to sell assets free and clear of a gas gathering and processing agreement and agreement for disposal of salt water, ruling that each constituted covenants running with the land that could not be rejected or eliminated pursuant to a sale of assets under section 363 of the Bankruptcy Code.<sup>13</sup> The court focused on the same elements as those addressed in *Sabine Oil*.

In its analysis of the touch and concern requirement, the court found that the gas gathering and processing agreement encompassed real property, making *Sabine Oil* inapplicable.<sup>14</sup> The court reasoned that unlike *Sabine Oil*, the dedication in the agreement covered “non-extracted minerals.”<sup>15</sup> The court held that a conveyance of a real property interest for a covenant was not necessary to satisfy the “touch and concern” requirement under Utah law.<sup>16</sup> The court found that the dedicated interest in the oil and gas reserves, leases, and

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*Debtors*, <https://www.jw.com/news/energy-bankruptcy-alert-judge-isingur-ruling-in-alta-mesa> (last visited Mar. 1, 2020).

<sup>8</sup> *In re Sabine Oil & Gas Corp.*, 550 B.R. at 67–68.

<sup>9</sup> *Id.* at 67.

<sup>10</sup> *Id.* at 68–70.

<sup>11</sup> *Id.* at 68–69.

<sup>12</sup> See Order on Wapiti Utah, L.L.C.’s Motion for Judgment on the Pleadings and Monarch Natural Gas, LLC’s Motion for Summary Judgment, *Monarch Midstream, LLC, f/k/a Monarch Natural Gas, LLC v. Badlands Production Company f/k/a Gasco Production Company, et al.*, Adv. Case No. 17-01429-KHT (Bankr. D. Colo. Sept. 30, 2019), ECF No. 61.

<sup>13</sup> Jennifer F. Wertz, Richard A. Howell & Vienna Flores Anaya, *Major Decision in Energy-Related Bankruptcies: Colorado Court in Monarch Midstream Case Departs from Sabine Oil and Finds Gathering Agreement Established a Covenant Running with the Land*, <https://www.jw.com/news/energy-bankruptcy-colorado-bankruptcy-court-monarch-midstream-sabine-oil> (last visited Mar. 1, 2020).

<sup>14</sup> *Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 869 (Bankr. D. Colo. 2019).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

all other lands within the area of mutual interest sufficiently affected the use, value, and enjoyment of the debtor's interest in the oil and gas leases subject to the gas gathering and processing agreement by limiting the right to possess, develop, and dispose of the minerals and salt water.<sup>17</sup>

The court again distinguished *Monarch Midstream* from *Sabine Oil* in its discussion of horizontal privity.<sup>18</sup> The court rejected the argument that horizontal privity was absent because no real property interests were conveyed under the agreements.<sup>19</sup> Instead, the court found that there was in fact a conveyance (*i.e.*, the gas gathering and saltwater disposal systems) related to the land that was burdened by the applicable dedications.<sup>20</sup>

In December 2019, the U.S. Bankruptcy Court for the Southern District of Texas held that midstream gathering agreements created covenants running with the land that could not be rejected by debtors under Oklahoma law.<sup>21</sup> While the *Sabine Oil* decision found that the agreements failed to satisfy both the touch and concern and privity elements, the bankruptcy court in *Alta Mesa* found that both of those elements were present in the debtors' agreements with the defendants.<sup>22</sup> The court explained that a covenant touches and concerns the land when it requires the performance of a physical act upon the land that directly benefits the landowner.<sup>23</sup> The gathering agreements met that requirement because the midstream companies used their surface easements to build a modern gathering system, which enhanced the value of the leases.<sup>24</sup> On the other hand, the agreements imposed costs and restrictions on the handling of hydrocarbons.<sup>25</sup> In regard to the privity element, the court noted that the debtors' leases granted easements to the debtors for the development of hydrocarbons and that the debtors granted a portion of those easements to the midstream companies to provide gathering services.<sup>26</sup> The court distinguished its holding from *Sabine Oil*, noting that "the surface easements directly affect the lessee's underlying mineral interest" because "[w]ithout the surface easement, the lessee cannot capture reserve hydrocarbons."<sup>27</sup>

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<sup>17</sup> *Id.* at 869–870; *see* Wertz, Howell & Anaya, *supra* n. 13.

<sup>18</sup> *Monarch Midstream*, 608 B.R. at 874.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*; *see* Wertz, Howell & Anaya, *supra* n. 13.

<sup>21</sup> *Alta Mesa Holdings, LP v. Kingfisher Midstream, LLC (In re Alta Mesa Res., Inc.)*, 2019 Bankr. LEXIS 3859 (Bankr. S.D. Tex. 2019); Howell & Anaya, *supra* n. 7.

<sup>22</sup> *Alta Mesa Holdings*, 2019 Bankr. LEXIS 3859, at \*16.

<sup>23</sup> *Id.* at \*23–24; *see* Howell & Anaya, *supra* n. 7.

<sup>24</sup> *Alta Mesa Holdings*, 2019 Bankr. LEXIS 3859, at \*26–27; *see* Howell & Anaya, *supra* n. 7.

<sup>25</sup> *Id.*

<sup>26</sup> *Alta Mesa Holdings*, 2019 Bankr. LEXIS 3859, at \*33–34.

<sup>27</sup> *Alta Mesa Holdings*, 2019 Bankr. LEXIS 3859, at \*28–29; *see* Howell & Anaya, *supra* n. 7.

### *Service-Level Commitments*

The level of service that a Transporter will provide a producer when taking oil and gas delivered by the producer at a point of receipt is often characterized as “firm service” or “interruptible service.” At its most basic, firm service provides that a Transporter may interrupt its performance obligation only to the extent that such performance is prevented for reasons of force majeure. Conversely, interruptible service provides that a Transporter may interrupt its performance obligation at any time. In some instances, parties may agree that certain quantities of oil and gas receive firm service, while quantities in excess thereof receive interruptible service.

Practitioners for oil and gas producer’s should be mindful to ensure the producer has the appropriate service-level commitment given its expected production, transportation needs, and the availability of alternative Transporters with available transportation capacity to provide service to a producer. Practitioners for Transporters should be mindful to ensure that the company has, and can maintain, sufficient transportation capacity to provide firm service (if applicable) as to all, or a lesser negotiated volume, of a producer’s oil or gas given the Transporter’s commitments to other parties utilizing the same pipeline system.

### *Curtailment*

The concept of curtailment broadly addresses what happens when less than all of a producer’s oil and gas can be transported in keeping with the applicable service-level commitments. Examples include operational constraints or other operating conditions affecting the availability of capacity at any point of receipt or point of delivery or otherwise constraining the ability of a Transporter to transport oil or gas (provided that the producer has made such oil or gas available for delivery at the points of receipt and is otherwise in compliance with the transportation agreement (*e.g.*, quality specifications, pressure obligations)). In keeping with the agreed-upon service-level commitment, curtailment is first allocated amongst producers receiving interruptible service, followed by those receiving firm service. Within each service-level, curtailment is allocated on a pro-rata basis among the parties therein.

### *Temporary and Permanent Releases*

The accumulation of curtailment over an extended period of time may warrant a temporary release, and eventual permanent release, of a producer’s affected oil and gas from the transportation agreement and the dedication of such affected oil and gas thereunder. During a temporary release, a producer is generally permitted to transport the affected oil and gas by alternative means or agreement with third parties. Following resolution of the

circumstances giving rise to the curtailment, the temporary release terminates and producer's affected oil and gas is again subject to the transportation agreement and the dedication.

When negotiating temporary and permanent release provisions, considerations include (a) the circumstances leading to curtailment (*e.g.*, curtailment caused by producer vs. operational constraints of the pipeline), (b) whether curtailment has occurred for a certain number of cumulative days or aggregate number of days within a specified period, (c) the wells or quantity of oil and gas affected by curtailment and the resulting release of such oil and gas, (d) the duration of a temporary release and any limitations on the producer's arrangement for alternative transportation (*e.g.*, limiting the term, and renewal rights, of alternative arrangements to the shortest time possible), (e) the availability of alternative Transporters with available transportation capacity to provide service to a producer, and (f) the circumstances that may permit an eventual permanent release of affected oil and gas if curtailment occurs for an extended period of time.

### *Units of Measurement*

Transportation services are generally provided on a fee basis. When oil is transported, the rate for service is often expressed in terms of dollars per barrel (defined as forty two (42) U.S. gallons) (Bbl). When gas is transported, the rate for service may be expressed (a) volumetrically as dollars per one thousand (1,000) cubic feet of gas (Mcf) or one million (1,000,000) cubic feet of gas (MMcf) or (b) in heating value equal to one million (1,000,000) Btu (MMBtu). A Btu is an abbreviation for "British Thermal Unit," which is defined as the quantity of heat required to raise the temperature of one (1) pound of water (H<sub>2</sub>O), from fifty-eight and five-tenths degrees (58.5°) Fahrenheit to fifty-nine and five-tenths degrees (59.5°) Fahrenheit.

Transportation agreements may set forth various fee components depending on the type of services provided by a Transporter. For example, in the context of gas, transportation agreements may contain fees for transportation, carbon dioxide (CO<sub>2</sub>) treating, conditioning, compression, and hydrogen sulfide (H<sub>2</sub>S) disposal. Practitioners negotiating gas transportation agreements should be mindful of the units of measurement being used throughout the agreement to ensure that there is a meeting of the minds between the parties regarding how gas is measured (both at the points of receipt and points of delivery) and how various formulas and fees are calculated.



### *Delivery Pressure & Compression*

To effectuate the movement of gas along a pipeline, transportation agreements often require the parties to deliver gas to the various points of receipt and points of delivery, as applicable, at a pressure sufficient to enable the gas to enter the downstream pipeline system at its prevailing working pressure, but not to exceed the maximum allowable operating pressure (MAOP) of the relevant downstream pipeline. When the prevailing working pressure of a pipeline increases, parties may require additional compression to effectuate the movement of gas and continued operation of the pipeline system. A gas transportation agreement should provide the delivery pressure parameters at the various points of receipt and points of delivery, whether the parties are obligated to provide compression, and, if so, which party will bear the costs related thereto.

### *Fuel, Lost and Unaccounted for Gas*

Fuel, lost and unaccounted for gas (FL&U) refers to gas used as fuel in the operation of the pipeline system, and any gas that is lost and unaccounted for due to evaporation or other losses. Each producer utilizing the pipeline system bears its pro rata share of FL&U. FL&U may be expressed as the producer's pro rata share of a fixed percentage of the gas received by the Transporter in its operation of the pipeline system or as the producer's pro rata share of the actual gas consumed, lost, and unaccounted for in the operation of the pipeline system.

### *Minimum Volume Commitments*

Transportation agreements often contain minimum volume commitments (MVC) that require an oil and gas producer to provide certain minimum volumes of oil or gas over a set period of time. Such MVC provisions may be advantageous to Transporters, as it allows for the recoupment of capital investments (often via fees for transportation service) related to the construction or improvement of the pipeline system. MVC provisions are often coupled with payment mechanics governing what happens when there is a shortfall in meeting the MVC. If, for example, a producer fails to meet the MVC for a specified period, it may be obligated to pay a deficiency payment equal to (a) the deficiency fee *multiplied* by (b) the MVC *less* the actual quantity of oil or gas received by the Transporter.

When negotiating transportation agreements, practitioners should consider whether MVC provisions should include certain volume tolerances that allow for *de minimis* shortfalls or operational constraints that may prevent an oil and gas producer from meeting the MVC. Internal commercial teams can provide invaluable guidance in setting the appropriate MVC quantity that accounts for these considerations, such as establishing a monthly MVC versus

a daily MVC that allows for certain operational downtime of a producer. Furthermore, parties can craft certain provisions that allow oil and gas producers to “credit” or “bank” excess volumes delivered to and received by the Transporter against any prior or future shortfall amounts.

### *Maximum Daily Quantity*

The maximum daily quantity (MDQ) is the maximum quantity of oil or gas each day that a producer is permitted to deliver into the pipeline system. The MDQ is an important commercial consideration for operational and safety reasons. As quantities of a hydrocarbon increase on a pipeline, so too does the pressure and the obligation to maintain pressure differentials to ensure the efficient movement of the hydrocarbon along the pipeline.

If a MDQ is stated in a transportation agreement, the parties should address what is to be done with quantities in excess of the MDQ. Considerations include whether to (a) provide that excess quantities will be transported if capacity is available, (b) release quantities in excess of the MDQ, (c) require that the Transporter be given the first option to transport the excess quantities, or (d) provide for firm or interruptible service and differing rates for excess quantities.

### *Quality Specifications*

Quality specifications in transportation agreements are important as they provide certainty to an oil and gas producer as to the quality of oil or gas that a Transporter will accept at the points of receipt, and certainty to a Transporter that it is not obligated to accept oil or gas that may contain impurities or other foreign materials that may prevent the proper operation of its pipeline system, including measurement equipment. Quality specifications within oil transportation agreements may include requirements regarding the oil’s viscosity, gravity, pour point, and basic sediment and water (BS&W) content. In gas transportation agreements, these specifications may include requirements regarding the minimum gross heating value, maximum and minimum temperature, and limitations on the amount of hydrogen sulfide (H<sub>2</sub>S), carbon dioxide (CO<sub>2</sub>), oxygen, nonhydrocarbon gases, and water vapor. When oil or gas does not meet the quality standards, it is often referred to as “off-spec” or “non-conforming.”

Practitioners have many issues to consider when negotiating quality specification provisions, including (a) whether and when the Transporter is permitted to restrict or shutoff receipt of non-conforming product, (b) whether the Transporter is permitted to accept non-conforming product and any treating or blending fees related thereto, (c) when

the parties become aware of the delivery of non-conforming gas and the delivery of notice to the other party regarding such non-conformance, (d) the obligation of the producer to take steps to conform product to the quality specifications, and (e) any indemnification obligations related to damage to the pipeline system as a result of the delivery of non-conforming product.

#### *Title; Risk of Loss; Control and Possession*

Transportation agreements typically require oil and gas producers to warrant that, at the time of receipt by the Transporter, the producer has good title to the oil and gas and the right to deliver all such oil and gas to the Transporter free and clear of all liens, encumbrances, and other claims. The producer retains title to the hydrocarbons during its movement, but parties will negotiate the risk of loss based on which party has control and possession of the hydrocarbon at the time.

Generally, an oil and gas producer is in control and possession of the hydrocarbons until they are received by the Transporter at the points of receipt and after such hydrocarbons have been delivered by the Transporter to the producer at the points of delivery. The Transporter is in control and possession of the hydrocarbons from and after the time it is received by the Transporter at the points of receipt until it is delivered to the producer at the points of delivery.

#### *Force Majeure*

The underlying principles of force majeure that excuse a party's performance for events beyond the control of the party are also present in transportation agreements. As it relates to these agreements, practitioners should consider the scope of specified force majeure events in light of operations and activities appurtenant to transporting oil and gas. These may include one or more of the following: (a) weather events (*e.g.*, floods, high water, hurricanes, tropical storms, other named storms or natural disasters); (b) delays in obtaining permits from any governmental authority having jurisdiction; (c) the inability of the parties to obtain, or delays in obtaining (at reasonable costs and after the exercise of reasonable diligence) rights-of-way, easements, servitudes, licenses, and other surface rights and related approvals; (d) the partial or complete failure or refusal of operators of any downstream pipeline to receive volumes of oil and gas tendered (to the extent not resulting from the Transporter's acts or omissions and not a result of the failure of the producer's market); (e) the inability of the parties to obtain, or delays in obtaining (at reasonable costs and after the exercise of reasonable diligence) necessary materials, equipment, supplies, vendors, or suppliers; and (f) mechanical failures, breakage or accident to machinery,

compressors, facilities, or pipelines in which hydrocarbons are transported, processed, stored, or used.

Equally important to providing a precise definition of force majeure, is stating what is excluded from force majeure. These may include one or more of the following: (a) the inability to secure funds, arrange bank loans, or other financing; (b) economic or financial hardship, including the oil and gas producer's ability to secure transportation of oil or gas at a lower or more advantageous fee than the fee provided in the transportation agreement; (c) the loss of the producer's market; and (d) the loss or failure of the producer's oil or gas supply or depletion of reserves.

While the suspension of a party's performance due to force majeure generally only lasts to the extent of such force majeure event, practitioners should consider the consequences of lengthy or frequent declarations of force majeure and whether such circumstances give rise to a reduction in service fees, deficiency payments, temporary or permanent releases, or termination of the underlying transportation agreement altogether.

### **III. REGULATORY FRAMEWORK**

While a complete discussion of the regulatory framework applicable to transportation agreements is beyond the scope of this paper, no discussion is complete without a high-level overview of regulatory considerations governing the transportation of oil and gas in the U.S.<sup>28</sup> The regulatory framework applicable to transportation agreements is generally differentiated by the type of hydrocarbon being transported (in the case of this paper, oil or gas) and whether transportation is subject to federal or state laws. The vast array of federal and state regulations governing the approval, construction, operation, modification, and abandonment of oil and gas pipelines, and the rates that can be established for transportation services thereon, warrant thoughtful consideration prior to the commencement of any construction activities of such pipelines or the negotiation of any transportation agreement.

#### *Regulation of Gas Pipelines*

##### Natural Gas Act of 1938

At the outset of the nineteenth century, pipeline companies raced to construct vast networks of interstate pipelines to satisfy increasing demand for gas across the U.S. Because these pipelines provided the only path to transport gas to market, the gas industry became premised upon the merchant role of pipeline companies—that is, pipelines as both

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<sup>28</sup> For an excellent discussion of the historical regulatory framework in the gas industry, see Marketing Hydrocarbons, *supra* n. 1 at 19-25.

purchasers of gas from gas producers and as resellers of such gas to end users.<sup>29</sup> In response to concerns about the emergence of monopolistic tendencies within the gas pipeline industry, Congress passed the Natural Gas Act of 1938 (NGA),<sup>30</sup> which declared that the business of transporting and selling gas for ultimate distribution to the public, and the federal regulation thereof, were in the public interest.<sup>31</sup> In doing so, the NGA subjected companies engaged in the transportation of gas in interstate commerce, or the sale in interstate commerce of gas for resale for ultimate public consumption, to the jurisdiction of the Federal Power Commission (FPC).<sup>32</sup> The NGA gave the FPC authority to regulate all rates and charges made, demanded, or received by such companies to ensure they are “just and reasonable.”<sup>33</sup>

### Federal Energy Regulatory Commission

The Federal Energy Regulatory Commission (FERC) succeeded to the regulatory responsibilities of the FPC and was granted authority under the NGA to regulate the transportation of gas in interstate commerce. Generally speaking, pipelines engaged in the transportation of gas in interstate commerce qualify as “natural gas companies” as defined in the NGA and are therefore subject to the jurisdiction of the FERC.<sup>34</sup>

Acting in its capacity as an independent federal agency within the U.S. Department of Energy, FERC’s responsibilities under the NGA and the Natural Gas Policy Act (NGPA) include (a) the review and approval or denial of applications, and the issuance of certificates, for the construction, operation, modification, or abandonment of interstate pipelines, including gas storage facilities and liquefied natural gas (LNG) terminals; (b) the review and establishment of “just and reasonable” rates that interstate pipelines can charge for transportation service; and (c) oversight of all activities to provide shippers with equal and open access to the interstate pipeline system.<sup>35</sup>

FERC’s jurisdiction over interstate pipelines, however, is limited. For example, FERC generally has no jurisdiction over (a) the production of gas, which is generally left to regulation by state agencies in which the gas is produced; (b) pipeline safety or security, which is the purview of the Pipeline and Hazardous Materials Safety Administration (PHMSA) of the U.S. Department of Transportation; (c) gathering pipelines (even if they cross state lines), which are omitted from FERC’s regulatory purview and authority under

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<sup>29</sup> *Id.* at 20-12.

<sup>30</sup> 15 U.S.C. §717, *et seq.*

<sup>31</sup> 15 U.S.C. §717(a).

<sup>32</sup> 15 U.S.C. §§717(b), 717a(6).

<sup>33</sup> 15 U.S.C. §717c.

<sup>34</sup> *See* Marketing Hydrocarbons, *supra* n. 1 at 20.

<sup>35</sup> *Id.*; FERC, *What FERC Does*, <https://www.ferc.gov/about/ferc-does.asp> (last visited Mar. 13, 2020).

the NGA; and (d) pipelines operating in a single state that do not transport gas that has travel or will travel across state lines (*i.e.*, intrastate pipelines).

### Railroad Commission of Texas

Intrastate pipelines qualify as “gas utilities” under the terms of the Texas Utilities Code.<sup>36</sup> The Railroad Commission of Texas (RRC) is the state agency that has regulatory jurisdiction over such intrastate pipelines as gas utilities.<sup>37</sup> The RRC is responsible for assuring that each rate made, demanded, or received by a gas utility is “just and reasonable,” so as to ensure fair and non-discriminatory access to gas transportation.<sup>38</sup> In addition, the RRC’s Transportation Standards and Code of Conduct provide that no gas utility or non-utility transporter can unreasonably discriminate in rates, terms of service, or access to service.<sup>39</sup>

### *Regulation of Oil Pipelines*

#### Federal Energy Regulatory Commission

FERC’s jurisdiction over oil pipelines arises under the Interstate Commerce Act (ICA),<sup>40</sup> which regulates common carriers engaged in the transportation of oil or other commodities (excluding water and gas) by pipeline in interstate commerce. Generally excluded from its authority are oil pipeline construction, storage facilities, terminal facilities, and truck loading facilities, unless these functions are an integral part of transportation. What constitutes interstate commerce is based on the fixed and persistent intent of the shipper when transporting oil, including where the shipment of oil began, where the shipment of oil comes to rest, and whether there is a break (*e.g.*, storage or processing facilities) in the continuous interstate movement of the oil. As with gas, FERC’s responsibilities include ensuring fair and non-discriminatory access to the pipeline network by evaluating, among other things, rates (whether market-based or cost-based) charged for similar transportation services, and unfair advantages between contracting parties. For oil, FERC’s authority is strictly economic, in that it does not actually authorize or issues permits for oil pipelines.

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<sup>36</sup> Tex. Util. Code §§102.001, 104.001, 121.051, 121.052, and 121.151 (2017).

<sup>37</sup> Tex. Util. Code Ann. §103.003; *see* Marketing Hydrocarbons, *supra* n. 1 at 36.

<sup>38</sup> Tex. Util. Code §104.003(a); *see* Marketing Hydrocarbons, *supra* n. 1 at 36-37.

<sup>39</sup> Rule 7.7001, Natural Gas Transportation Standards and Code of Conduct, 16 Tex. Admin. Code §7.7001 (2017); *see* Marketing Hydrocarbons, *supra* n. 1 at 36-37.

<sup>40</sup> 49 U.S.C. §§ 1-15 (1976), reprinted in 49 U.S.C. app. §§ 1-15 (1988).

## Railroad Commission of Texas

In Texas, midstream companies transporting oil generally qualify as “common carriers” under the Texas Natural Resources Code.<sup>41</sup> The RRC has regulatory jurisdiction over such common carriers, which is generally defined as anyone who owns, operates, manages, or engages in the business of operating a pipeline to transport oil to or for the public for hire. The RRC’s authority includes ensuring that rates are just and reasonable and that transportation service is provided on a non-discriminatory basis.

### **IV. CONCLUSION**

The midstream industry covers a broad swath of activities encompassing gathering, transporting, processing, fractionation, storage, and the purchase and sale of oil, gas, and natural gas liquids. While a comprehensive discussion of the midstream industry is beyond the scope of this paper, this paper seeks to provide a primer on high-level issues and considerations related to the transportation of oil and gas from the producing acreage to one or more downstream points for resale or processing.

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<sup>41</sup> Tex. Nat. Res. Code (2019).