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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.¹

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

¹ 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”).

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