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Texas Law Update

Chris Reeder

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This paper summarizes the significant legislative, regulatory and case law developments during 2014 and 2015 for gas markets and power markets. It provides a summary only; please consult the actual decisions and precedent to determine important details about each.

I. Gas Market Developments

A. Legislation.

The legislature adopted HB40, prohibiting local government units from regulating oil and gas production activities within their boundaries. The legislation provides that the state (impliedly through the Texas Railroad Commission) has sole jurisdiction over such activities. The legislation is a response to an ordinance adopted by the City of Denton, which sought to prohibit fracking within its city limits.

B. Regulatory Enactments.

Responding in part to the Texas Supreme Court's opinion in *Texas Rice Producers, Ltd v. Denbury Green Pipeline*, 363 S.W.3d 192 (Tex. 2012), the Railroad Commission amended its Rule 70 on pipeline permits. As amended, the rule requires a T-4 permit applicant to provide facts that demonstrate that its intended use qualifies for the permit classification sought. In *Denbury*, the Texas Supreme Court found that the mere issuance of a pipeline permit to a pipeline owner did not definitely establish the pipeline owner's utility status, and therefore did not definitely establish that it possesses eminent domain authority. The court had observed that the Railroad Commission has no provisions to examine the manner in which the owner will operate the pipeline, and therefore did not consider whether the pipeline owner's intended operations could qualify as "utility" service necessary to possess eminent domain rights. By this rulemaking, the Railroad Commission imposed additional disclosure requirements applicable when a pipeline owner seeks to obtain a T-4 permit. Specifically, the owner (or operator) must now designate whether the pipeline is to be classified as a common carrier, gas utility, or private line. It must further include a sworn statement substantiating the factual basis for the classification sought, as well as attesting that the applicant is knowledgeable about the applicability and extent of eminent domain rights under Tex. Prop. Code Ch. 21. The Railroad Commission rejected requests that it implement an investigative or adjudicatory scheme to evaluate such statements and determine whether factually they warrant the classification sought. The Railroad Commission explained that it lacks authority to engage in such determinations. It also stated that the sworn statements would provide sufficient transparency into the owner's or operator's intended use for the pipeline.

C. Railroad Commissions Cases.

Eastman Chemical Co. v. Westlake Ethylene Co., G.U.D. 10296, Final Order (December 9, 2014)

Eastman shipped petroleum liquids (ethylene) over Westlake's pipeline system. Eastman filed a discrimination claim under the Common Carrier Act (Tex. Nat. Res. Code Ch. 111) against Westlake, contending that Westlake provided more favorable shipping terms to one of its affiliates than Eastman, charging rates that were not just and reasonable and ultimately curtailing Eastman's deliveries to the pipeline. Westlake contended that the Common Carrier Act's discrimination provisions do not apply because the Act does not apply to anything other than crude petroleum transportation. The hearing examiner agreed with Westlake, but the Railroad Commission reversed. It found that a pipeline constructed through an exercise of eminent domain and carrying petroleum refined products, subjected the owner to the Common Carrier Act along with its discrimination provisions. After making this jurisdictional determination, the Railroad Commission eventually found, based on the record, that Westlake had engaged in discrimination against Eastman, and ordered Westlake to revise its tariff and cease such discriminatory practices.

D. Court Cases

1. Upstream

Chesapeake Exploration, LLC v. Hyder, No. 14-0302 (Tex. July 13, 2015)

This involves deduction of post-production costs from royalties. Chesapeake, as well operator, deducted various post-production costs from royalties paid to the lessor. Hyder sued, contending that the contract did not permit such construction. The court confirmed that the general rule is that absent contract modification, an oil and gas lease allows the lessee to deduct post-production costs from royalties. The court examined the facts here and determined that the contract clearly changed that rule, and affirmed the Court of Appeals ruling that ordered Chesapeake to refund the deducted costs.

Warren v. Chesapeake Exploration, LLC, 759 F.3d 413 (5th Cir. 2014)

Warren involves the same issue of whether the lease allows the lessee to deduct post-production costs from royalties. The 5th Circuit Court discussed the *Hyder* decision and interpreted the lease to expressly prohibit the deduction of post-production costs from royalties, based on language requiring that the royalty be calculated "at the mouth of the well"? It distinguished *Hyder* on the basis of the lease containing different language, and affirmed a judgment dismissing the lessor's claims seeking repayment of deducted post-production costs.

2. Midstream

Crosstex North Tex. Pipeline L.P. v. Gardiner, 451 S.W. 3d 150 (Tex. App. – Fort Worth 2014, Pet. Filed)

The plaintiffs owned a ranch and other acreage for horse riding and cattle raising. Crosstex acquired adjacent property and constructed a compressor station on that property. The Gardiners sued for nuisance, contending that noise and odors emanating from the station interfered with their use and enjoyment of their property. A jury had awarded \$2.042 million to the Gardiners in damages for nuisance. The court of appeals reversed the judgment for lack of factual sufficiency. The court detailed efforts that Crosstex had made to reduce the amount of

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