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Oil & Gas Transportation Service Agreements: Key Issues & Considerations

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I. INTRODUCTION

Oil and gas producers primarily focus on the exploration and production of hydrocarbons; however, the value of the produced hydrocarbons is of little value, if they cannot be gathered and transported out of the field, processed to remove contaminants and other impurities, and ultimately transported to market. Thus, the midstream segment of the oil and gas industry—broadly encompassing gathering, compression, transporting, treating, processing, fractionation, storage, and the purchase and sale of oil, gas, and natural gas liquids (NGLs)—connecting oil and gas producers to the market is a fundamental and an invaluable component of the hydrocarbon value chain.

From a conceptual perspective, the movement (*i.e.*, gathering and transportation) of oil and gas is straightforward. After oil and gas producers drill, complete, and produce a well, the produced hydrocarbons are separated into their three primary components: oil, gas, and water. The term “gathering” generally refers to the process of individually collecting oil, gas, and water from one or more wellheads in the field and their relatively short movement to various points where they are independently aggregated. However, because oil and water are typically stored at or near the wellhead in storage tanks or central tank batteries, in the case of oil, and retention ponds, in the case of water, “gathering” is a concept uniquely related to gas, but it is not uncommon for the distinction to be blurred. The term “transportation” generally refers to the process of moving the independently aggregated quantities of oil, gas, and water out of the field to downstream delivery points for treating, processing, storage, or purchase and sale via a transportation and distribution infrastructure. This may involve any combination of movement, including via truck, rail, or pipeline, in the case of oil; pipeline, in the case of gas; and truck or pipeline, in the case of water. Notwithstanding the distinctions between gathering and transportation, practitioners should nevertheless be mindful that these terms and their related concepts are commonly used interchangeably in discussions between parties and within written agreements.

As indicated above, the physical characteristics of oil and gas cause certain commercial and legal issues to differ between them. For example, oil is produced as a viscous liquid that is typically stored in storage tanks or central tank batteries at or near the wellhead pending further movement out of the field. Conversely, gas is a mixture of gaseous hydrocarbons consisting primarily of methane that is not readily stored in the field. The most efficient way to handle gas in its gaseous state is by continual movement along a pipeline, which may involve one or more stages of compression and/or points of interconnection with other pipeline systems to facilitate movement. In addition, gas is commonly treated or processed within, or within close proximity to, the field in which it was produced, in order to remove water vapor and other impurities that may damage downstream pipeline systems and related equipment during its movement. Thus, agreements governing the movement of gas inherently involve different and additional complexities and issues not otherwise found in agreements governing the movement of oil.

For purposes of this paper, I have chosen to focus on issues and considerations with respect to the transportation of oil and gas via intrastate pipeline under Texas law commencing

from their separation to their delivery at downstream delivery points for further movement or handling. In this context, this paper will present an overview of transportation issues that practitioners may encounter and consider amongst interrelated issues and concepts that are appurtenant to and negotiated together when drafting transportation service agreements. Because of the additional complexities and issues related to the physical characteristics of gas, this paper primarily focuses on issues associated with the movement of gas; however, there are noteworthy distinctions regarding oil, which are highlighted throughout this paper.

Parties that own and/or operate pipeline systems and related infrastructure (*e.g.*, gathering, compression, treating, processing, and storage facilities) to provide transportation service for oil or gas are collectively referred to herein as “*Transporters*”; parties that have engaged or will engage Transporters to provide transportation service (*e.g.*, oil and gas producers, parties that have taken oil or gas in kind, and oil and gas marketing companies) are collectively referred to herein as “*Shippers*.” The point(s) at which the Shipper (or a third party on behalf of the Shipper) delivers oil or gas to the Transporter and the Transporter receives oil or gas for transportation service is referred to herein as the “*Receipt Point(s)*”; the downstream point(s) at which the Transporter redelivers oil or gas to the Shipper (or a third party designated by the Shipper) and the Shipper (or a third party designated by the Shipper) receives oil or gas is referred to herein as the “*Delivery Point(s)*.”

II. KEY ISSUES & CONSIDERATIONS

There are no standard or “master” form agreements governing the transportation of oil or gas. Each Transporter may have its own preferred agreement and the circumstances regarding the oil and gas and the specific needs of the Shipper (*e.g.*, location of the wells, production quantities, quality specifications, Receipt Point(s), Delivery Point(s), existing or to-be-constructed transportation infrastructure, certainty of performance, timing considerations) will dictate the terms and conditions negotiated and ultimately agreed to by the parties. Nevertheless, there is a thread of issues that commonly presents itself in discussions regarding the transportation of oil and gas via pipeline. This section identifies those issues and the considerations related thereto that Shippers and Transporters should be mindful of when negotiating and drafting transportation service agreements. It is important to bear in mind that these issues and considerations do not exist in a vacuum and commonly implicate other interrelated issues and concepts throughout transportation service agreements, many of which are identified herein.

A. Dedication

Transporters may invest significant capital to construct or expand pipeline systems and related infrastructure. To ensure utilization of the pipeline system and an acceptable return of capital costs (via fees for transportation service), the Transporter may require the Shipper to dedicate all oil and/or gas production from certain geographic areas, oil and gas leases, and/or wells for the term of the transportation service agreement. This arrangement is equally beneficial to the Shipper, since it provides an assured path to market for the Shipper’s oil or gas

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