

PRESENTED AT

42nd Annual Ernest E. Smith
Oil, Gas and Mineral Law Institute

April 15, 2016
Houston, Texas

**Product Disposition or
How to Get Your Oil and Gas to Market**

Kathleen E. Magruder

**Product Disposition or
How to Get Your Oil and Gas to Market
By
Kathleen E. Magruder**

So you've done the hard work: You've negotiated leases, rights of way, financing agreements, and other necessary documents. You've obtained necessary permits from local, state, and federal officials. In some cases, you've obtained or amended field rules at the Railroad Commission. Your client has drilled a successful well that is ready to produce. What's next? How does production become a "product" that is sold?

This paper is intended to provide a very high level view of the products that can come from that successful well and some of the federal regulations and laws that affect the movement of those products, e. g. oil, gas, natural gas liquids, etc., from the lease to the consumer. In addition to a discussion of the transportation of hydrocarbons, there is a brief discussion derivatives regulation as the sale and movement of hydrocarbons is often affected by regulators who have no direct contact with the energy business. Do not assume this is a complete listing of all appropriate authorities or regulations. For example, the issue of licenses needed to sell and/or move product is not addressed. Federal rules are intricate – given overlapping jurisdiction of multiple agencies. In addition, each state through which a product moves has its own laws and rules. Some regulators have jurisdiction over safety, siting, and operations while others have jurisdiction over the rates that can be charged for the movement of the products. In addition, other regulators and self-regulating organizations have jurisdiction over how the products can be marketed. Therefore, while not a "deep dive" on product movement and disposition, it should, however, give you a flavor of the complexity attached to moving and marketing your clients' products to an ultimate end user.

BACKGROUND

Although we generally speak of an oil well or a gas well, it happens that a single well can produce both. Oil, natural gas, and natural gas liquids are produced along with a variety of other substances, e. g. water, hydrogen sulfide, arsenic, carbon dioxide, helium, nitrogen, and other compounds, and the wellhead product must be treated or processed in some manner in order to prepare the product for transport and further processing. Each product has its own path to market and each mode of transport has its own regulatory regime.

As happens too often, much of the regulation around the transportation of hydrocarbon products has been motivated by accidents. The Exxon *Valdez*, an oil supertanker, ran aground in Alaska in 1989 and spawned legislation that created new regulation of oil tankers. An explosion of an old natural gas distribution pipeline in San Bruno, CA, in 2010 caused the Pipeline Hazardous Materials Safety Administration (PHMSA) to propose new natural gas pipeline safety regulations in March 2016. A train accident in Lac-Mégantic, Quebec, in 2013 prompted new rail regulation for transportation of crude oil and other hazardous materials by pipeline.

I. Crude Oil

Crude oil is a naturally occurring, unrefined petroleum composed of hydrocarbon deposits and other organic materials. Crude oil can be refined to produce usable products such as gasoline, diesel and various forms of petrochemicals. It is a nonrenewable resource, also known as a fossil fuel, which means that it can't be replaced naturally at the rate we consume it and is therefore a limited resource.¹

A. Pipelines

Crude oil moves from the wellhead to market, in large part, through pipelines. The American Petroleum Institute (API) estimates there are more than 190,000 miles of liquid petroleum pipelines in the United States.²

The Hepburn Act of 1906³ began the economic regulation of interstate oil pipelines by permitting the Interstate Commerce Commission (ICC) to set rates for interstate oil pipelines, classified those interstate oil pipelines as common carriers. The act was an amendment to the existing Interstate Commerce Act (ICA). The ICC was responsible for regulating interstate oil pipelines until 1977 when the Department of Energy (DOE) Organization Act of 1977⁴ transferred regulation of interstate oil pipelines from the ICC to DOE and, ultimately, to the Federal Energy Regulatory Commission (FERC).

1. Economic Regulation

The Energy Policy Act of 1992 required FERC to provide a "simplified and generally applicable" ratemaking methodology for oil pipelines; authorized FERC to streamline oil pipeline proceedings; and deemed oil pipelines' existing rates were just and reasonable as of the enactment of the 1992 Act. FERC initiated a rulemaking that culminated with the adoption of Order No. 561⁵ that implemented the requirements of the law. Generally, it:

- Adopted indexing as the "simplified, generally applicable ratemaking methodology";
- Permitted the use of the cost-of-service, settlement, or market-based rate change methodologies;
- Streamlined oil pipeline procedures by addressing the treatment of protests and complaints; revising tariff filing and accounting requirements; and instituting an alternative dispute resolution procedure.

¹ <http://www.investopedia.com/terms/c/crude-oil.asp>

² <http://www.api.org/Oil-and-Natural-Gas-Overview/Transporting-Oil-and-Natural-Gas/Pipeline>

³ 59th Congress, Sess. 1, ch. 3591, 34 Stat. 584, codified in 49 U. S. C.

⁴ P. L. 95-91, 91 Stat. 565

⁵ 18 C.F.R. Parts 341, 342, 343, 344, 345, 347, 360, 361, and 375 (1993)

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

Title search: Product Disposition or How to Get Your Oil and Gas to Market

Also available as part of the eCourse

[2016 Oil, Gas and Mineral Law eConference](#)

First appeared as part of the conference materials for the
42nd Annual Ernest E. Smith Oil, Gas and Mineral Law Institute session
"Regulatory and Legislative Developments Affecting Product Disposition"