

RECENT DEVELOPMENTS IN TEXAS AND UNITED STATES ENERGY LAW

EDITED BY MELISSA M. POTOPOVA

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I. INTRODUCTION

The *Recent Developments in Texas and United States Energy Law* section consists of selected cases and brief discussions of legislation and regulations related to energy law.¹ Part II focuses on legislative developments in Texas Energy Law. This part includes an update discussing the major state legislation passed during the 80th Texas Legislative Session that concluded in June 2007. The analysis of the five most significant bills analyzes the potential affect of the legislation to the energy industry in Texas.

Parts III and IV contain case summaries for several important cases that will have a likely impact on the oil, gas and energy industry in the future. Part III discusses selected cases that have recently been decided by the Texas Supreme Court as well as several Texas Courts of Appeals. Part IV contains summaries from the fifth, seventh, and D.C. circuits.

¹ The content of the *Recent Developments* section is provided for general information purposes only. The short articles may serve as a useful beginning point in the legal research process, but are not intended as a substitute for primary research of the laws of the jurisdictions discussed.

II. LEGISLATIVE UPDATE FOR THE 80TH REGULAR TEXAS LEGISLATIVE SESSION

CONTRIBUTION BY D. MAYES MIDDLETON

During the 80th Regular Legislative Session, a number of important bills made it out of the House Energy Resources Committee and its Senate counterpart, the Natural Resources Committee; fourteen of those bills were signed into law by the Governor.² This summary will cover the five most important bills that affect oil and gas law in Texas:³

A. Bills Enacted into Law

H.B. 1920: Informal Complaint Process Regarding Loss of or Inability to Account for Natural Gas Gathered or Transported

I. Summary of Legislative Intent

The purpose of the bill is to create a process whereby natural gas producers can obtain information to determine what happened to “lost or unaccounted for gas” or line loss gas that was deducted from production volumes by natural gas gatherers, pipelines, and processors.⁴

This line loss deduction was perceived to be harmful to producers because gas purchase contracts commonly anticipate anywhere from 5 - 20% in line loss with no explanation or substantiation as to what has happened to the line loss gas.⁵ Under the bill, producers may now obtain information about what caused the loss of gas and whether some portion

2. Tex. H.B. 630, 80th Leg., R.S. (2007); Tex. H.B. 1170, 80th Leg., R.S. (2007); Tex. H.B. 1920, 80th Leg., R.S. (2007); Tex. H.B. 2061, 80th Leg., R.S. (2007); Tex. H.B. 2174, 80th Leg., R.S. (2007); Tex. H.B. 3273, 80th Leg., R.S. (2007); Tex. H.B. 3732, 80th Leg., R.S. (2007); Tex. H.B. 3385, 80th Leg., R.S. (2007); Tex. H.B. 3837, 80th Leg., R.S. (2007); Tex. H.B. 3838, 80th Leg., R.S. (2007); Tex. S.B. 1461, 80th Leg., R.S. (2007); Tex. S.B. 1666, 80th Leg., R.S. (2007); Tex. S.B. 1667, 80th Leg., R.S. (2007); Tex. S.B. 1670, 80th Leg., R.S. (2007).

3. Tex. H.B. 630, 80th Leg., R.S. (2007); Tex. H.B. 1920, 80th Leg., R.S. (2007); Tex. H.B. 2174, 80th Leg., R.S. (2007); Tex. H.B. 3273, 80th Leg., R.S. (2007); Tex. S.B. 1670, 80th Leg., R.S. (2007).

4. House Comm. on Energy Resources, Bill Analysis, Tex. H.B. 1920, 80th Leg., R.S. (2007).

5. *Id.*

of line loss gas belongs to the producer.⁶ Additionally, this bill is meant to give producers an extra incentive to use this informal complaint process because every cubic foot of gas they are able to recover means additional severance tax and royalties paid.⁷

II. Analysis

a. Requesting Information from the Gatherer, Pipeline or Producer About Line Loss

H.B.1920 is codified in section 85.065 of the Texas Natural Resources Code. The central premise of section 85.065 is that “a producer may submit a written request to a person who gathers or transports gas for the producer for an explanation of any loss of or inability to account for the gas tendered.”⁸ The burden of fulfilling an information request falls on the person deducting the line loss. As such, within 30 days of receiving a request from a producer, a written explanation must be provided to the producer for any line loss that was actually tendered to the gatherer, pipeline, or processor.⁹

Certain information is required to be included in an accounting requested by a producer. This information includes:

Any relevant information requested by the producer that is available to the person.¹⁰

Any or all of the information that would be required to be included in an accounting when a producer files a complaint with the Railroad Commission.¹¹

If the gatherer, pipeline, or processor provides an inadequate explanation for line loss or fails to provide any explanation for line loss within 30 days of receiving the producer’s written request, then the producer may file an informal complaint with the Railroad Commission.

b. Filing an informal complaint with the Railroad Commission against a gatherer, pipeline, or processor because of failure of explanation or inadequate explanation of line loss

A producer cannot file an informal complaint before the 30th day after

6. *Id.*

7. *Id.*

8. Tex. Nat. Res. Code Ann. § 85.065 (Vernon 2007).

9. § 85.065.

10. § 85.065(a).

11. § 85.065(a).

the end of the production period covered by the complaint.¹² In filing the informal complaint, the producer must:

Specify the production period covered by the complaint.¹³

State that at least 30 days have elapsed since the end of the production period covered by the complaint.¹⁴

Describe the type of gas meter used and state the date the meter was last calibrated if the producer metered the volume of gas tendered to the gatherer or transporter.¹⁵

If all the requirements of the informal complaint have been met, the gatherer or transporter has 14 days to respond to the complaint.¹⁶ The gatherer or transporter must also provide to the Railroad Commission and the producer an accounting of the gas tendered during the production period covered by the complaint.¹⁷

The accounting may be provided in MCF or BTU,¹⁸ and it must include information the Railroad Commission “determines to be necessary to resolve an informal complaint under [the] section, which may include”¹⁹ the following:

The amount of gas from the producer for each well that has a meter.²⁰

A lab analysis of the composition and heating value of the gas and other substances tendered by the producer, if such an analysis has been performed.²¹

If available, a schematic drawing of the person’s system for gathering or transporting gas that shows each meter type, the date each meter was last calibrated, the accuracy of each meter, and all equipment that alters, disposes of or otherwise consumes any of the gas from the producer.²²

The estimated amount of gas used for fuel, flared, or vented for construction, repair, maintenance, or other operational uses and, if information is available, the location of that use.²³

The estimated amount of contaminants or other impurities removed from the gas and the location at which the impurities were removed.²⁴

The estimated amount of liquid hydrocarbons and condensate removed from the gas and the location at which the liquid hydrocarbons

12. § 85.065(b).

13. Tex. Nat. Res. Code Ann. § 85.065(b)(1) (Vernon 2007).

14. § 85.065(b)(2).

15. § 85.065(b)(3).

16. § 85.065(c).

17. § 85.065(c)

18. Tex. Nat. Res. Code Ann. § 85.065(c) (Vernon 2007).

19. § 85.065(c).

20. § 85.065(c)(1).

21. § 85.065(c)(2).

22. § 85.065(c)(3).

23. Tex. Nat. Res. Code Ann. § 85.065(c)(4) (Vernon 2007).

24. § 85.065(c)(5).

and condensate were removed.²⁵

The estimated amount of gas lost and the location at which the gas was lost.²⁶

The estimated amount of gas redelivered by the gatherer or transporter, including the amount of gas sold that was allocated to the producer, and the location at which the redelivery of the gas occurred.²⁷

Any amount of gas received from the producer that remains unaccounted for.²⁸

Any other information the person who gathered or transported the gas considers relevant to the resolution of the complaint.²⁹

The Legislature recognized that all gatherers or transporters may not be able to provide the necessary information to the producer within 14 days of the complaint. As such, the Railroad Commission may grant an extension.³⁰ However an accounting must be provided to the Railroad Commission and the producer no later than 45 days after the informal complaint was filed.³¹

The Legislature also recognized that a gatherer or transporter may not have the information necessary to provide an accounting of line loss.³² In this circumstance, the producer or gatherer must provide both the Railroad Commission and the producer with a written explanation of the reason why the gatherer or transporter cannot provide the necessary information.³³

c. Punishment for Failure to Comply and Applicability of Section 86.065

If a gatherer or transporter fails to provide the required accounting or failed to explain their inability to provide an accounting, then the informal complaint is deemed valid³⁴ and the Railroad Commission may take any action it considers appropriate.³⁵ This includes the issuance of an order in a formal proceeding to prevent waste by the gatherer or transporter.³⁶

It is important to note that this bill is not retroactive and only applies to a contract between a producer and a person who gathers or transports

25. § 85.065(c)(6).

26. § 85.065(c)(7).

27. § 85.065(c)(8).

28. Tex. Nat. Res. Code Ann. § 85.065(c)(9) (Vernon 2007).

29. § 85.065(c)(10).

30. § 85.065(d).

31. § 85.065(d).

32. § 86.065(e).

33. Tex. Nat. Res. Code Ann. § 86.065(e) (Vernon 2007).

34. § 86.065(f).

35. § 85.065(g).

36. § 85.065(g).

gas that is entered into or renewed on or after September 1, 2007.³⁷ Also, this bill only applies to line loss that is tendered after September 1, 2007.³⁸

Lastly, this bill provides a method for the producer to verify through an accounting that line loss gas has been credited to the total volume tendered. A producer is entitled to audit the books and records of the gatherer or transporter that pertain to their contract for the purposes of verifying whether any line loss gas tendered has been properly allocated to the volume of gas tendered as required by the contract.³⁹ This type of audit cannot be conducted more than once annually.⁴⁰

H.B. 3273: Expanding Powers and Duties of the Railroad Commission; Providing Administrative Penalties

I. Summary of Legislative Intent

The Natural Gas Pipeline Competition Study Advisory Committee was formed in order to conduct a study on the extent to which viable competition exists in the Texas natural gas pipeline industry from wellhead to burner tip.⁴¹ H.B. 3273 is the culmination of discussions addressing the recommendations of the Study Committee. It gives the Railroad Commission the authority to (1) impose administrative penalties for certain natural gas related activities; (2) add provisions concerning appointment of a mediator in an informal complaint; (3) prohibit mandatory confidentiality provisos in a producer's contract for the sale, transportation, or gathering of natural gas; and (4) establish the Railroad Commission's authority to set market based rates in certain circumstances.⁴²

II. Analysis

H.B.3273 is codified in sections 81.058, 81.059, 81.060, and 81.061 of the Texas Natural Resources Code.

a. Section 81.058: Administrative Penalty for Certain Natural Gas Related Activities

This section allows the Railroad Commission to impose an administrative penalty against a purchaser, transporter, gatherer, shipper,

37. § 85.065(h).

38. Tex. Nat. Res. Code Ann. § 86.065(h) (Vernon 2007).

39. § 85.065(h).

40. § 85.065(h).

41. House Comm. on Energy Resources, Bill Analysis, Tex. H.B. 3273, 80th Leg., R.S. (2007).

42. *Id.*

seller of natural gas, certain person, or any other entity under the jurisdiction of the Railroad Commission after there has been notice and opportunity for a hearing.⁴³ Under this section there are two circumstances in which the Railroad Commission may impose an administrative penalty:

A violation of a Commission rule adopting standards or a code of conduct for entities in the natural gas industry prohibiting unlawful discrimination.⁴⁴

Unreasonable discrimination against a seller of natural gas in the purchase of natural gas from the seller.⁴⁵

The bill also tries to protect a seller who files a discrimination complaint. As such, an administrative penalty may be levied if the Railroad Commission determines that a person is engaged in prohibited discrimination because the shipper or seller filed a formal or informal complaint with the Railroad Commission.⁴⁶ However, for a fine to be levied under this section, the complaint must relate to the person's purchase, transportation or gathering of gas.⁴⁷ This section is somewhat similar to whistleblower statutes that try to prevent retaliation because of a complaint filed against the alleged wrongdoer.

A penalty can be imposed on a party to an informal complaint resolution proceeding if (1) the party failed to participate in the proceeding, or (2) the party failed to provide information requested by a mediator in the proceeding.⁴⁸ Under this section, the administrative penalty imposed cannot exceed \$5,000 per day, however each day a violation occurs, or continues to occur is considered a separate violation.⁴⁹ The bill also contemplates the possibility that a monetary penalty may not be sufficient, and provides that if an entity is engaging in prohibited discrimination, the Railroad Commission can issue any order necessary and reasonable to prevent any further discrimination from continuing.⁵⁰ Lastly, the remedy provided in this section is stackable or "cumulative" with any other remedy ordered by the Railroad Commission.⁵¹

b. Section 81.059: Appointment of Mediators for Informal Complaints

Under this section, the Railroad Commission can appoint a staff member to mediate a complaint or the parties can agree to employ and

43. Tex. Nat. Res. Code Ann. § 81.058(a) (Vernon 2007).

44. § 81.058(a)(1).

45. § 81.058(a)(2).

46. § 81.058(b).

47. § 81.058(b).

48. Tex. Nat. Res. Code Ann. § 81.058(c) (Vernon 2007).

49. § 81.058(d).

50. § 81.058(e).

51. § 81.058(f).

pay an independent mediator.⁵² However, this section notes that the Railroad Commission can still require the parties to participate in the formal complaint resolution process, and it notes that filing an informal complaint is not a prerequisite for filing a formal complaint.⁵³

c. Section 81.060: Confidentiality Provisions

This section prohibits a requirement that a confidentiality provision be included in a contract in which a producer is a party for the sale, transportation, or gathering of natural gas.⁵⁴ This section only applies to contracts entered into on or after September 1, 2007,⁵⁵ but a confidentiality provision in a contract entered into before September 1, 2007 becomes unenforceable on the date the contract expires.⁵⁶

d. Section 81.061: Authority to Establish Market-based Rates

This section allows the Railroad Commission to use either a cost of service method or a market-based method to set rates in a formal rate proceeding against a gatherer if the Railroad Commission determines that the rate is necessary to remedy discrimination in transportation or gathering services.⁵⁷ Allowing the Railroad Commission to set rates to remedy unreasonable discrimination against a seller creates a significant deterrent for such behavior, especially when coupled with the increased power to levy fines.

S.B. 1670: Certificate of Compliance Issued by the Railroad Commission to Owners and Operators of Certain Wells

I. Summary of Legislative Intent

This bill addresses some of the problems the Railroad Commission has in collecting outstanding reconnecting fees from oil and gas operators. S.B. 1670 requires outstanding fees be paid before receiving or renewing a certificate of compliance from the Railroad Commission.⁵⁸ Additionally, this bill prohibits operation of any well if the person operating the well does not show a certificate of compliance or if the

52. § 81.059(a).

53. Tex. Nat. Res. Code Ann. § 81.059(c), (e) (Vernon 2007).

54. § 81.060(a).

55. § 81.060(a).

56. § 81.060(b).

57. § 81.061(a)-(c).

58. Senate Comm. on Energy Resources, Bill Analysis, Tex. S.B. 1670, 80th Leg., R.S. (2007).

certificate of compliance has been cancelled.⁵⁹

II. Analysis

S.B. 1670 was codified by redesignating sections 85.161 to 85.167 of the Texas Natural Resources Code as sections 91.701 to 91.707 and amending sections 85.3855, 86.004, 91.114, 91.142, and 101.003. This bill is highly technical and only a summary of its provisions are described in order to give a general overview of the changes.

Under the bill, a well owner or operator has an affirmative duty to secure a certificate of compliance for a well, and an operator of a pipeline or other carrier is prohibited from connecting with a well until the owner or operator has furnished a certificate of compliance.⁶⁰ There is an additional prohibition on operators of pipelines that transport oil, making it unlawful for them to reconnect, rather than transport, oil from a well that doesn't have a valid certificate of compliance.⁶¹ However the real "teeth" of the act are found in section 91.706. Per this section, if an operator uses or reports use of a well for production, injection, or disposal for which the operator's certificate of compliance has been cancelled, then the Railroad Commission may refuse to renew the operator's organization report (Report to Commission) until the operator pays the \$300 fee stipulated by this bill and the Commission issues a certificate of compliance.⁶²

The Railroad Commission believes that the changes proposed by the bill will accelerate compliance and ensure that the Railroad Commission receives all reconnect payments due to the Commission from operators who have produced or used a well with a cancelled certificate at the time of a P-5 renewal.⁶³ Unfortunately, some difficulties in the application of this bill could arise because the Railroad Commission cannot reissue a certificate of compliance without resolution of a violation; this could prevent an operator with a delinquent P-5 from doing what is necessary to resolve a violation.⁶⁴

59. *Id.*

60. Tex. Nat. Res. Code Ann. §§ 91.701, 91.702 (Vernon 2007).

61. § 91.705.

62. § 91.706.

63. Fiscal Note, Tex. S.B. 1670, 80th Leg., R.S. (2007).

64. *Id.*

H.B. 630: Notice to a Surface Owner by an Oil or Gas Well Operator of the Issuance of a Permit for Certain Oil and Gas Operations*I. Summary of Legislative Intent*

H.B. 630 requires that oil and gas exploration and production companies give written notice to landowners within 15 days of receiving a drilling permit. It is an attempt to remedy situations in which a landowner is unaware that an oil and gas exploration and production company has obtained a permit to use the landowner's land.⁶⁵ It is a response to the problems that lack of a statutory requirement created between oil and gas companies and landowners, especially in the urban areas above the Barnett Shale.⁶⁶ However, this bill only applies to the drilling of new oil or gas wells or the reentry of a plugged or abandoned well and the provisions of this bill can be avoided by contract.⁶⁷

II. Analysis

H.B. 630 was codified by adding sections 91.701 to 91.705 to the Texas Natural Resources Code.

Notice under this act only applies to the drilling of new wells or the reentry of a plugged and abandoned well.⁶⁸ It specifically does not apply to the plugging back, reworking, sidetracking, or deepening of an existing well that has not been plugged and abandoned, and it does not apply to the use of a surface location of an existing well that has not been plugged and abandoned.⁶⁹ Essentially, it targets new oil and gas wells or the reentry of abandoned wells.

Written notice must be given to the surface owner no later than 15 days after the Railroad Commission issues a permit to drill a new well or reenter an abandoned well.⁷⁰ However, if there is an alternative provision concerning notice in a contract between the operator and surface owner, then the surface owner has waived the written notification requirement provided by this statute.⁷¹

This bill reiterates that the mineral estate is the dominant estate in Texas and that a failure to give notice under this act does not restrict,

65. Senate Comm. on Natural Resources, Bill Analysis, Tex. H.B. 630, 80th Leg., R.S. (2007).

66. *Id.*

67. *Id.*

68. Tex. Nat. Res. Code Ann. § 91.702 (Vernon 2007).

69. § 91.702.

70. § 91.703.

71. § 91.703.

limit, work as a forfeiture of, or terminate any existing or future right to develop the mineral estate in land.⁷² H.B. 630 doesn't impose a harsh punishment for failure to give notice, but rather encourages producers and landowners to include a notice requirement in an exploration and drilling contract.

H.B. 2174: Excluding the Transportation of Gas to and from a Liquefied Natural Gas Marine Terminal from Being Considered a Gas Utility

I. Summary of Legislative Intent

This bill creates a specific category of non-gas utility pipelines. It is limited to pipelines used to (1) serve a Liquid Natural Gas (LNG) marine terminal, or (2) transport gas from a LNG marine terminal to the owners or an underground storage facility.⁷³

This bill clarifies that intrastate pipeline and storage facilities for LNG are not gas utilities, although they must still be built to all state and federal safety requirements.⁷⁴ H.B. 2174 was enacted in response to a LNG marine terminal's unique purpose—a LNG marine terminal does not buy and sell gas or transport gas for a fee.⁷⁵

II. Analysis

H.B. 2174 was codified by amending section 101.003 of the Texas Utilities Code and section 121.007. The first section of this bill amends the Utilities Code to exclude a LNG marine terminal from the definition of a "gas utility."⁷⁶ The second section provides that a person operating a natural gas pipeline, a LNG pipeline, or an underground storage facility is not a gas utility, if the person certifies to the Railroad Commission that the pipeline or storage facility is solely used to deliver natural gas or LNG (1) to a LNG marine terminal, (2) from a LNG marine terminal to the owner of the gas or another person on behalf of the owner of the gas, or (3) that is acquired or sold by the person as necessary for the operation or maintenance of its facility which is excluded as a gas utility under this section.⁷⁷

72. § 91.705.

73. House Comm. on Energy Resources, Bill Analysis, Tex. H.B. 2174, 80th Leg., R.S. (2007); Senate Comm. on Natural Resources, Bill Analysis, Tex. H.B. 2174, 80th Leg., R.S. (2007).

74. House Comm. on Energy Resources, Bill Analysis, Tex. H.B. 2174, 80th Leg., R.S. (2007); Senate Comm. on Natural Resources, Bill Analysis, Tex. H.B. 2174, 80th Leg., R.S. (2007).

75. House Comm. on Energy Resources, Bill Analysis, Tex. H.B. 2174, 80th Leg., R.S. (2007); Senate Comm. on Natural Resources, Bill Analysis, Tex. H.B. 2174, 80th Leg., R.S. (2007).

76. Tex. Util. Code Ann. § 101.003(7) (Vernon 2007).

77. § 121.007.

H.B. 2174 narrowly applies to LNG marine terminals and was specifically targeted at the upcoming Freeport LNG terminal; however, with the anticipated increase in LNG, this act will become increasingly important.⁷⁸

III. TEXAS STATE CASELAW UPDATE

CONTRIBUTION BY THE EDITORIAL STAFF OF THE
TEXAS JOURNAL OF OIL, GAS, AND ENERGY LAW

*A. Seagull Energy E&P, Inc. v. R.R. Comm'n of Texas, 226 S.W.3d 383
(Tex. 2007).*

Seagull Energy E&P, Inc. (Seagull) held a lease in a field comprised of several discontinuous, lenticular gas sands that was regulated by the Railroad Commission of Texas (the Commission) as a single reservoir. Seagull's lease overlaid three vertically separated sands. Seagull originally completed a well into one of these sands, and the Commission later granted Seagull a permit to complete a new well into all three sands. Because concurrent production from both wells violated field rules, the first well was shut in before the new well began production. The new well was successfully completed in two of the sands, but not in the third. Because Seagull's first well had produced from this third sand, Seagull sought an exception permit to reopen the well so they could produce from the third sand. The Commission denied the permit, and Seagull appealed, claiming that (1) the permit to reopen the first well was a drilling permit and the Commission only had the authority to deny production permits in commingled fields and (2) the Commission's denial of the permit was unconstitutional because it amounts to a taking of Seagull's gas in the third sand.

In affirming judgment against Seagull, the Texas Supreme Court first held that the Commission had authority to regulate both drilling and production in a commingled field designated as a single reservoir. The court found that the Texas legislature intended for the Commission to

⁷⁸ *Hearings on Tex. H.B. 2174 Before the House Comm. On Energy Resources*, 80th Leg., R.S. (March 22, 2007) (statement of James Mann for Freeport LNG).

have broad discretion in regulating commingled oil and gas, and it further noted that the legislature clarified the Commission's authority in response to Seagull's suit by amending the Texas Natural Resource Code.⁷⁹ The court also held that even though a mineral owner has a right to its fair share of minerals on or under its property, such a right does not extend to include specific oil and gas beneath the property. Therefore, the Commission's denial of the permit did not constitute a taking.

B. Quigley v. Bennett, 227 S.W.3d 51 (Tex. 2007).

Robert Bennett, a geologist, filed suit against Michael Quigley, an oil and gas operator, for fraud, conversion, and quantum meruit, alleging that Quigley fraudulently induced him into performing services related to an oil and gas lease. The jury found in favor of Bennett on all three claims and awarded damages. The trial court entered judgment against Quigley based on Bennett's election to recover on the fraud claim. Despite the fact that his services were not rendered pursuant to any written agreement, Bennett argued at trial and on appeal that his damages compensation should be measured by the value of the overriding royalty interest. The Texas Supreme Court disagreed and held that an agreement to transfer a royalty interest is invalid unless it is in writing because an overriding royalty interest in an oil and gas lease falls within the statute of frauds. The court concluded that allowing recovery of the value of a royalty interest when the interest itself could not be recovered because of the statute of frauds would circumvent protections of the statute. Minus evidence of the value of a royalty interest, the only evidence of damages was testimony regarding cash-based compensation for Bennett. The court held that the evidence regarding the value of Bennett's work was insufficient to support the entire \$1 million in fraud damages awarded by the jury. However, the court refused to render judgment on the fraud claim in favor of Quigley because there was some evidence that Bennett suffered damage from Quigley's actions. The case was remanded for further proceedings.

C. Marathon Petrol. Co. v. Galveston Cent. Appraisal Dist., 236 S.W.3d 335 (Tex. App.—Houston [1st Dist.] 2007, no pet. h.).

Marathon Petroleum (Marathon) protested the appraisal value of its inventory as determined by the Galveston Central Appraisal District (GCAD). It argued that the value of petroleum products currently held in its tanks but awaiting transportation to out-of-state customers should not be factored into the appraisal value because these products were

79. TEX. NAT. RES. CODE ANN. § 86.081(b) (Vernon 2005).

exempt from ad valorem taxes under the commerce clause of the United States Constitution. Marathon separated its petroleum products intended for out-of-state customers into specifically designated refinery tanks, but it retained the power to change the destination of the petroleum products and maintained complete control over them. When GCAD rejected Marathon's protest, Marathon filed suit. The district court granted summary judgment for GCAD, and Marathon appealed. The Court of Appeals affirmed the district court's ruling that GCAD was entitled to summary judgment as a matter of law. It held that the petroleum products destined for out-of-state customers were still subject to state property taxes because the products had not yet entered the stream of interstate commerce when the appraisal was conducted. The court supported this position by outlining U.S. Supreme Court precedents holding that neither intention nor preparation to ship products out-of-state actually places the products into the stream of interstate commerce. While the dormant commerce clause prohibits certain state regulation of interstate commercial activity, the products had yet to move out of the state of Texas. Therefore, the products were still a part of the general mass of property in Texas and were not exempt from the ad valorem tax imposed by GCAD.

D. Petro Pro, Ltd. v. Upland Res., Inc., No. 07-05-0327-CV, 2007 Tex. App. LEXIS 4690 (Tex. App. — Amarillo June 14, 2007, pet. filed).

This case concerns a dispute between assignors (collectively "Upland"), assignees (collectively "Petro Pro"), and intervening royalty owners over the construction of two oil and gas wellbore assignments. The assignments expressly limited the assigned interest "insofar and only insofar as said leases cover rights in the wellbore" of a given well. The court found the language of the assignment to be unambiguous and restricted its analysis to the plain language of the assignment in rendering the scope of the assigned interest. In order to determine the extent of the estate conveyed, the court assessed the vertical and horizontal rights covered by the assignment. It held that the vertical limit of the assignment included the entire depth of the wellbore. It did not limit it to the horizon which was open at the time of the assignment. In the horizontal dimension, the court held that the right of the assignee to produce was limited to any formation that might presently be reached from the existing wellbore. Thus, the assignment conveyed to Petro Pro the exclusive right to oil and gas within the confines of the assigned wellbore and the right to produce from any formation traversed by the wellbore. Upland, however, retained their interest in the remainder of the leasehold estate and thus the right to produce oil and gas outside of the assigned wellbore. This construction describes a somewhat restrictive

leasehold interest that is consistent with the fact that, from an area standpoint, a wellbore assignment is the narrowest form of oil and gas assignment.

E. Sabine Mining Co. v. Combs, No. 13-06-330-CV, 2007 Tex. App. LEXIS 6766 (Tex. App. – Corpus Christi Aug. 23, 2007, no pet. h.) (mem. op.).

Sabine Mining Company (Sabine), a subsidiary of the North American Coal Company, appealed a district court ruling that the replacement parts for Sabine's dragline machines were not tax exempt under the Texas tax code's "property used in manufacturing" exemption.⁸⁰ Sabine first requested an \$896,410 sales tax refund from the state, arguing that the dragline replacement parts qualified under the statute as property used in the manufacturing of coal. Sabine used the massive dragline machines to strip overlying dirt and rock from atop underground lignite coal deposits. The Comptroller of Public Accounts refused the refund request, and Sabine filed suit. The Court of Appeals affirmed the district court's ruling that the parts were not exempt from state sales tax. The court held that the draglines were not used in manufacturing as defined by the statute.

The court strictly construed the language of § 151.318, ruling (1) any physical and chemical changes to the coal were only indirectly the result of the draglines and (2) draglines prepare coal for manufacturing but are not involved in the actual manufacturing of marketable coal. The court insisted its narrow reading of the exemption-granting statute was consistent with the legislature's intent in adopting the amended version of the statute in 1997. The amendment was drafted in response to two cases that interpreted manufacturing as an integrated process, a construction that potentially could have been applied to almost every stage of the manufacturing process.

F. FPL Energy Upton Wind I, L.P. v. City of Austin, 240 S.W.3d 456 (Tex. App. – Amarillo Oct. 18 2007, no pet. h.)

FPL Energy Upton Wind I, L.P. (FPL) constructed a wind turbine facility to generate electric energy to the City of Austin (Austin). The parties' contract provided that if Austin did not accept the energy at FPL's agreed-upon connection point, Austin would be responsible for a curtailment payment for the unaccepted energy.

All of the energy that was covered under the agreement between FPL and Austin was to be transported across the ERCOT grid. When the total

80. TEX. TAX CODE ANN. § 151.318 (Vernon 2006).

electric energy being transmitted onto the ERCOT grid reaches high volumes, ERCOT can issue instructions, referred to as OOME (Order of Magnitude Estimate) down instructions, that electric energy producers limit their generation of electric energy for periods of time to lessen congestion on the grid. On some occasions, ERCOT issued OOME down instructions to FPL. On each of these occasions, ERCOT allowed FPL to continue to generate a portion of its electric energy capacity, and Austin accepted and paid for the energy delivered to the specified point of delivery. FPL attempted to charge Austin the curtailment price for periods of decreased production due to the OOME down instructions. Austin protested the imposition of these fees and FPL filed suit for breach of contract.

The main issue in dispute was whether the contract required Austin to pay for energy that it did not accept at the contractual point of delivery, even when the curtailment was ERCOT-initiated. The court held that, while the agreement obligated Austin to pay for energy not accepted at the contractually agreed upon point of delivery, FPL went too far by requiring Austin to pay “even when ERCOT initiates the curtailment.” Thus, when FPL was required to limit its production due to OOME down instructions, Austin’s duty to pay under the agreement was not triggered.

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IV. FEDERAL CASELAW UPDATE

CONTRIBUTION BY THE EDITORIAL STAFF OF THE
TEXAS JOURNAL OF OIL, GAS, AND ENERGY LAW

A. Edge Petroleum Operating Co. v. GPR Holdings, L.L.C. (In re TXNB Internal Case), 483 F.3d 292 (5th Cir. 2007).

Edge Petroleum Operating Company, Inc. (Edge), a producer of natural gas, sold gas to GPR Holdings, L.L.C., Aurora Natural Gas, L.L.C., and Golden Prairie Supply Services, L.L.C. (collectively “the debtors”). The debtors sold the gas to Duke Energy Trading and Marketing, L.L.C. (Duke), which then resold the gas to third parties. Edge was not paid by the debtors, who subsequently declared bankruptcy. Rather than bringing an action against the debtors, Edge sought to recover from Duke the amount the debtors owed for the gas as well as damages for conversion of its security interest in the gas under the Texas Mineral Lien Act.⁸¹ The court held that there are circumstances in which the statutory lien created by the Texas Mineral Lien Act in favor of a producer, such as Edge, could be enforced against the proceeds of a sale of its gas to a third party by a downstream purchaser, such as Duke. It also held that Edge arguably possessed a lien on the gas and the proceeds from Duke’s resale of the gas. However, the court ruled that even if Edge did have a lien, it could not recover its security interest through an action for conversion against Duke. Duke did not act improperly by reselling the gas. Edge’s sale of the gas to the debtors was consistent with prevailing practice in the industry and constituted an implied consent to resale of the gas to downstream purchasers such as Duke. Duke received the gas from the debtors without notice of Edge’s rights in the gas and, when it resold the gas, did not use the gas in a manner so inconsistent with the manner in which it was received as to assert a property right inconsistent with that of Edge. The court also rejected Edge’s argument that Duke, who was holding Edge’s money pending payment by the debtors, was in the position of a trustee upon resale of the gas. Duke had no notice that Edge had a lien or that Edge had not been paid by the debtor, and Duke’s knowledge of § 9.343 was not enough notice to put Duke in the position of a trustee.

81. TEX. BUS. & COM. CODE ANN. § 9.343 (Vernon 2001).

B. Sierra Club v. EPA, 499 F.3d 653 (7th Cir. 2007).

The Environmental Protection Agency (EPA) issued a permit to Prairie State Generating Company (Prairie) to build a 1,500-megawatt coal-fired electrical generating plant in southern Illinois, near St. Louis. The Sierra Club asked the EPA's Environmental Appeals Board to reverse the permit because it violated two provisions of the Clean Air Act. The Board refused to repeal the permit, and the Sierra Club brought suit against the EPA.

Prairie's plant was designed to operate as a "mine-mouth" plant; it is situated near a large supply of coal and runs a half-mile long conveyor belt and interface system with the mine. The nearby coal, however, has a high-sulfur content.

The first provision of the Clean Air Act at issue requires that a plant have the "best available control technology" for minimizing pollution emissions.⁸² The Sierra Club argued that this requirement would only be met by redesigning the plant to use low-sulfur coal. Low-sulfur coal would have to be transported from more than a thousand miles away and would require changes to the design of the plant. The EPA, however, distinguished between requiring a plant to use the "best available" control technology versus requiring the plant to change the fundamental scope of the power plant's operations. It reasoned that receiving low-sulfur coal from thousands of miles away would require the plant to redesign. The EPA refused to extend the Clean Air Act to require redesign and ruled in favor of Prairie. The 7th Circuit deferred to the EPA's decision.

The second provision requires plant emissions to not exceed the limits imposed by the Clean Air Act's national ambient air quality standards.⁸³ The Sierra Club protested the standard used by the EPA to measure the amount of ozone emitted by the plant. The EPA used the one-hour standard to determine whether or not Prairie's proposed plant would fall within the limits allowed under the Clean Air Act, as opposed to the more stringent eight-hour standard. The EPA has adopted the eight-hour standard, but a formula has not been put into place to determine the new estimate. Thus, the EPA used the old one-hour standard to illustrate that the plant would be unlikely to violate the Clean Air Act's provision under the new standard. The 7th Circuit deferred to the EPA's judgment on this issue as well.

C. Exxon Mobil Corp. v. FERC, 501 F.3d 204 (D.C. Cir. 2007).

Exxon Mobil Corporation (Exxon) challenged the facial validity of two

82. 42 U.S.C. § 7475(a)(4) (2000).

83. 42 U.S.C. § 7475(a)(3).

Federal Energy Regulatory Commission (FERC) regulations⁸⁴ and requested a pre-enforcement review for their proposal to build a natural gas pipeline from the North Slope of Alaska to the contiguous United States. The appellate court held that the regulations were not facially invalid and denied Exxon's request for review.

Exxon contended that the two regulations exceed FERC's authority under the Natural Gas Act (NGA)⁸⁵ and the Alaska Natural Gas Pipeline Act⁸⁶ because the regulations allow FERC to arbitrarily condition approval of a certificate on the requirement that the pipeline is built with a greater capacity than proposed by the company. Exxon argued that this authority to increase a pipeline's required capacity would deter pipeline development by making projects too costly and risky for a company to undertake.

FERC argued that the contested regulations merely codify their existing authority and practice of requiring certain design changes relating to routing, cost allocations, and initial service rates when necessary. FERC had not claimed the authority to designate pipeline capacity as a condition to issuing a certificate and agrees that they would not be able to require a change in capacity as a condition under the NGA's prohibition against compelling enlargement of transportation facilities.

The court observed that Exxon misread the contested regulations as granting more authority than FERC actually asserts. The court noted that while there could be invalid applications of the regulations, the regulations themselves were not facially invalid. Because Exxon's challenge to the regulations arose from their own misinterpretation and not from FERC's assertion of greater authority than granted by the regulations, the court denied Exxon's petition for review.

D. Trans. Agency of N. Cal. v. FERC, 495 F.3d 663 (D.C. Cir. 2007).

Petitioner, Transmission Agency of Northern California and the City of Vernon, California (Vernon), appealed three orders of the Federal Energy Regulatory Commission (FERC). The disputed orders required Vernon to issue refunds to the California Independent System Operator Corporation (CAISO) for exceeding the allowable collection of its transmission revenue requirement (TRR). FERC determined the refunds to CAISO were necessary to restore CAISO's just and reasonable rate.

The court acknowledged that it was dealing with a "matter of some

84. 18 C.F.R. §§ 157.36, 157.37.

85. 15 U.S.C. § 717 (2005).

86. 15 U.S.C. § 720 (2008).

complexity,” but then noted that the dispute’s legal issue was easier to grasp. Vernon challenged the FERC orders by questioning whether FERC had the authority to review Vernon’s TRR under the just and reasonable standard. If FERC did have this review authority, Vernon questioned whether FERC then had the authority to order Vernon to refund any over-collection of its TRR.

The court determined that FERC did have the authority to review Vernon’s TRR under the just and reasonable standard. FERC is authorized by the Federal Power Act (FPA)⁸⁷ to ensure that the rates received by a public electric utility are just and reasonable. Municipal utilities such as Vernon, however, are considered “non-public” and are exempt from the FPA. But the court emphasized that FERC may consider the rates of a municipal utility to the extent that they affect the rates of an umbrella transmission facilities manager. As Vernon was a part of such an umbrella entity (CAISO), the court held that FERC had established the impossibility of ensuring that CAISO’s rates were just and reasonable without reviewing Vernon’s TRR under the same standard.

The court held that FERC did not have the authority to order Vernon to refund any over-collection of its TRR. The court again looked to the FPA, stating that the FPA only provided FERC with refund authority over public utilities while not mentioning non-public municipal utilities. A specific reference to these utilities would be required to override the FPA’s exemption of non-public utilities. The court vacated in part the lower court’s order requiring Vernon to give refunds and remanded for further proceedings.

E. S. Cal. Edison Co. v. FERC, 502 F.3d 176 (D.C. Cir. 2007).

The court reviewed an order from the Federal Energy Regulatory Commission (FERC) rejecting Southern California Edison Company’s (SCE) revised rates. The action arose from a contract between SCE and the City of Corona, California (Corona) in which SCE agreed to install interconnection facilities to provide electrical interconnection service to the city. Under the parties’ agreement, Corona paid SCE the estimated cost of installing the interconnection facilities in advance and SCE agreed to furnish Corona with a final invoice for the actual installation cost within twelve months after the facilities’ in-service date. SCE failed to meet the invoice deadline. Instead it filed rate revision sheets to collect the balance of the costs from Corona with FERC some twenty months after the deadline. Applying federal law, FERC rejected SCE’s revised rates on the ground that the twelve-month deadline was a condition precedent to SCE’s right to recover the costs and this condition was not

87. 16 U.S.C. § 792 (2008)

satisfied. SCE sought review claiming that the contract was governed by California law, under which the twelve-month deadline is not a condition precedent, and therefore it was entitled to recover the full costs, less damages (if any) caused by the delay. The circuit court concluded that the choice-of-law provision in the agreement between SCE and Corona unambiguously stated that the contract was governed by California law and that FERC was required to give effect to the intent of the parties. It remanded the case back to FERC to be construed under applicable California law.