URBAN GAS DRILLING

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Steven A. Wood
Taylor, Olson, Adkins, Sralla & Elam, LLP
6000 Western Place, Suite 200
Fort Worth, Texas 76008
817-332-2580
817-332-4740 (Fax)
swood@toase.com

An increase in demand for natural gas in recent years has resulted in the increased encroachment of natural gas drilling into urban areas. The byproducts of this relatively new phenomenon include public outcry over safety and air quality issues and attempts by local governments to respond to such concerns though the adoption of ordinances governing and in some cases prohibiting natural gas drilling. In an effort to promote the use and distribution of natural gas, the Texas legislature has vested gas pipeline companies ("gas utilities") with the power of eminent domain in order to help establish a network of pipelines that can ultimately deliver natural gas to end users.[1] This paper summarizes recent case law relating to the eminent domain authority of gas utilities and to the authority of Texas municipalities to regulate such companies.

I. *Tex. Midstream Gas Services, LLC v. City of Grand Prairie.*[2]

In 2007, Texas Midstream Gas Services, LLC ("TMGS") announced that it was going to construct a natural gas compressor station in the City of Grand Prairie ("City"). A compressor station is used to clean and pressurize the gas so that the gas can be transported through a pipeline from one location to another. Before the construction of the station commenced, Grand Prairie amended its development code to require all gas companies to apply for a special use permit ("SUP") prior to constructing compressor stations in certain districts. In order to obtain the SUP, the company had to agree that the compressor station would meet certain minimum setback and yard requirements, that the station would be surrounded by a security fence, that the station would be enclosed and meet certain structural specifications, that the station would not exceed pre-development sound levels, and that the property surrounding the station would contain a minimum level of landscaping. Any violation of the ordinance could be punished by a civil penalty of up to $2,000.00 per day.

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[1] Tex. Util. Code Ann. § 181.004 (Vernon 2007).

[2] 608 F.3d 200 (5th Cir. 2010).

TMGS filed suit against the City in federal district court, arguing that the City's regulations were preempted by the Pipeline Safety Act[3] and that such regulations impinged upon the company's eminent domain authority. The district court enjoined only the security fence requirement. On appeal, the court rejected TMGS's argument that because it had the power of eminent domain, it was not subject to the City's zoning requirements. The court held that although a city may not unreasonably exercise its police powers to "zone out" eminent domain authorities, a city may use its police powers to regulate the activities of such authorities as long as the police powers are not exercised in an unreasonable or arbitrary manner. The court further noted that the Pipeline Safety Act only preempts safety standards. As a consequence, the court upheld the trial court's determination that only the security fence requirement (contained in the City's amended development code) was unenforceable.

II. *Oncor Elec. Delivery Co., LLC v. Dallas Area Rapid Transit.*[4]

Another case that sheds light on the limits of a gas utility's eminent domain authority is *Oncor Elec. Delivery Co. LLC v. Dallas Area Rapid Transit.* Oncor Electric Delivery Company, LLC ("Oncor") is an electric utility company that owns and operates the largest electric distribution and transmission system in Texas. Oncor filed suit against Dallas Area Rapid Transit and the Fort Worth Transportation Authority (collectively the "Authorities"), both of which are governmental entities under Texas law, for the purpose of condemning property owned by the Authorities to construct a new electric transmission line. Oncor alleged that the basis for its authority to condemn public property was found in Section 181.004 of the Utilities Code, which states that "[a] gas or electric corporation has the right and power to enter on, condemn, and appropriate the land, right-of-way, easement, or other property of any person or corporation." The Authorities responded by

[3] 42 U.S.C. §§ 60101 – 60137.

[4] 369 S.W.3d 845 (Tex. 2012).

arguing that they were immune from condemnation suits and that Section 181.004 of the Utilities Code did not clearly and unambiguously waive such immunity. The district court agreed and granted summary judgment in favor of the Authorities. The summary judgment was upheld by a divided court of appeals. During the pendency of Oncor's petition to the Texas Supreme Court, the Texas legislature enacted H.B. 971, which added Section 37.053(d) to the Utilities Code. Section 37.053(d) provides in part:

> For transmission facilities ordered or approved by the Public Utilities Commission..., the rights extended to an electric corporation under Section 181.004 include all public land, except land owned by the state, on which the commission has approved the construction of the line.

The Texas Supreme Court began its analysis by assuming, without deciding, that governmental entities are immune from condemnation suits. The court then turned its attention to the question of whether such immunity has been waived by Section 181.004 of the Utilities Code. As noted above, such provision gives Oncor the right to condemn the property of a "person" or "corporation." The definition of "corporation" found in Chapter 181 of the Utilities Codes does not include a government or government agency. However, because the definition of the term "person" was not contained in the Utilities Code, the court looked for the meaning of the term in the Code Construction Act ("CCA"). Although the CCA does state that the definition of a person includes governmental entities, the court noted that in 2001 the legislature amended the CCA to clarify that the mere use of the term "person" in a statute does not indicate legislative intent to waive sovereign immunity "unless the context of the statute indicates no other reasonable construction." The court further stated that it was arguable whether the Authorities were "corporations" for the purposes of Section 181.004 of the Utilities Code. After conceding that this question was "difficult," the court decided that it was not necessary to answer this question because of Section 37.053(d) of the Utilities Code–a provision that the court explained only applied to electric utilities and not to gas

corporations. Section 37.053(d) provides that "the rights extended to an electric corporation under Section 181.004 include all public land, except land owned by the state, on which the commission has approved the construction of the line." The court concluded that this language clearly and unambiguously waived the Authorities' immunity.

This case is important, from a city's perspective, because it bolsters the city's argument that a city's governmental immunity has not be waived for condemnation suits by gas utilities. The court in this case was unwilling to conclude that the City's immunity had been waived by Section 181.004 of the Utilities Code–which is the statutory basis for condemnation suits by gas utilities. Instead, the court relied on another provision in the Utilities Code (Section 37.053(d)) which: (1) clearly and unambiguously provides for a waiver of immunity for condemnation suits involving public property; and (2) only applies to electric utilities.

III. *City of Houston v. Trail Enters., Inc.*[5]

Trial Enterprises, Inc. ("Trail") brought suit against the City of Houston ("City") alleging that its ordinance prohibiting drilling of oil and gas wells near the area of Lake Houston–a source of public drinking water–constituted a compensable taking of Trail's property rights. Trail also alleged that the City violated Trail's due process rights under article I, section 17 of the Texas Constitution. The court analyzed these facts under the traditional takings analysis set forth in the *Penn Central*[6] and *Sheffield Development Co.*[7] cases, which require courts to take into account the following three factors in determining whether a regulatory taking has occurred: (1) the character of the governmental action; (2) the extent to which the regulation has interfered with reasonable and investment-backed expectations; and (3) the economic impact of the regulation on the claimant.

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[5] 377 S.W.3d 873 (Tex. App.–Houston [14th Dist.] 2012, pet. filed).

[6] *Penn Central Transp. Co. v. City of New York,* 438 U.S. 104 (1978).

[7] *Sheffield Dev. Co. v. City of Glenn Heights*, 140 S.W.3d 660 (Tex. 2004).

With respect to the first factor, the court held that the factor weighed heavily in the favor of the City because the express purpose of the prohibition on drilling near Lake Houston was to protect the public water supply. With respect to second factor, the court held that this factor also weighed heavily in the City's favor because at the time Trail acquired the property, the drilling of new wells was prohibited by the City. As such, Trail could not have had a reasonable expectation to be able to drill a new well at the time of acquisition.

Regarding the third factor, the court noted that a diminution in property value, standing alone, cannot establish a taking. The City argued that the value of the property had not been completely diminished because the property was currently generating revenue from preexisting wells and because the City's ordinance only effectively prohibited the drilling of new wells on approximately twenty-five percent of the property. Even so, the court held that this factor weighed in Trail's favor because Trail was able to produce evidence of a significant economic impact to the property as a result of the City's prohibition on drilling. Having concluded that two out of the three *Penn Central* factors weighed heavily in favor of the City, the court held that "justice and fairness do not require compensation in this case."

IV. *City of Houston v. Maguire Oil Co.*[8]

In 1991, Maguire Oil Co. ("Maguire") applied for a permit to drill a gas well inside the city limits of the City of Houston ("City"). The location of the well was within 300 feet of Lake Houston and was within the city limits of the City. The City issued the permit and subsequently ratified and extended the permit. After Maguire spent at least $250,000 preparing to drill the well, City staff believed that the permit had been issued in error because the City's drilling ordinance prohibited drilling within 1000 feet of a "control area" (defined to mean an area within 1000 feet of Lake Houston from property *within the City's extraterritorial jurisdiction*). The City staff issued a stop

[8] 342 S.W.3d 726 (Tex. App.–Houston [14 th Dist.] 2011, pet. denied).

work order and after all attempts to negotiate a resolution failed, Maguire and the City spent the next fourteen years litigating this matter in state and federal court. The case finally went to trial on March 16, 2009 with the primary issue being the merits of Maguire's inverse condemnation claim against the City. The jury awarded Maguire damages of $2,000,000 which was subsequently upheld by the trial judge.

On appeal, the City argued that the *Penn Central* takings analysis is not applicable because there can be no taking of property as a result of the "unauthorized actions" of the City staff who attempted to enforce the terms of an inapplicable ordinance. Maguire countered that the City's attempt to enforce an inapplicable ordinance to prevent Maguire's use and enjoyment of the mineral estate is a perfect example of a regulatory taking when analyzed under the three *Penn Central* regulatory takings factors. The court rejected the City's argument that the *Penn Central* takings analysis does not apply, reasoning that such argument was not raised before the trial court and citing the lack of applicable case law supporting such argument. The court further opined that the City may not have "intended" to take Maguire's property when it enacted its drilling ordinance, but it certainly intended to prevent Maguire from drilling for gas when it enforced its drilling ordinance. As such, the court held that, to the extent that a plaintiff is required to demonstrate that the City's taking of its property was an "intentional act," Maguire had met such burden. The also court reasoned that "Maguire's rights were no less interfered with because the City's intentional act rested on an erroneous interpretation of its own ordinance." For these reasons, the court affirmed the judgment of the trial court. In doing so, the court established a rule that the intentional but erroneous enforcement of an ordinance based upon the City's mistake can give rise to an inverse condemnation claim.

V. *Tex. Rice Land Partners v. Denbury Green Pipeline-Texas, LLC.*[9]

In March of 2008, Denbury Green Pipeline-Texas, LLC ("Denbury") applied with the Railroad Commission ("Commission") to operate a gas pipeline in Texas. The permit application, designated a Form T-4,[10] has two boxes for the applicant to indicate whether the pipeline will be operated as a "common carrier" or a "private line." Denbury checked the box for common carrier. The permit application also requires an applicant to check one of three boxes to indicate whether the applicant will be transporting only gas purchased from others, owned by others but transported for a fee, or both purchased from others and transported for others. Denbury checked the box indicating that the gas transported would be owned by others but transported for a fee. In fact, the purpose of Denbury's pipeline was to transport gas that it owned from Mississippi to Denbury-owned oil wells located in south Texas to facilitate the production of oil. Eight days after Denbury filed its application, the Commission granted the T-4 permit.

After Denbury obtained approval from the Commission for the route of the pipeline, Denbury approached Texas Rice Land Partners, Ltd. ("Texas Rice") to enter onto Texas Rice's property for the purpose of surveying the land in preparation for condemning a pipeline easement. Texas Rice refused entry to Denbury, and Denbury in turn sued Texas Rice for an injunction to be permitted to survey the property. After a hearing, the trial court rendered judgment in favor of Denbury based largely on the fact that Denbury was deemed by the Commission to be a "common carrier" pursuant to Section 111.002(6) of the Texas Natural Resources Code ("NRC"). According to Section 111.019 of the NRC, only common carriers are vested with the power of eminent domain. The court of appeals affirmed the trial court's decision, over one justice's dissent, concluding that Denbury had established its status as a common carrier as a matter of law.

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[9] 363 S.W.3d 192 (Tex. 2012).

[10] *See* Exhibit "A" attached hereto.

On appeal, the Texas Supreme Court opined that to "qualify as a common carrier with the power of eminent domain, the pipeline must serve the public; it cannot be built only for the builder's exclusive use." Any exercise of eminent domain authority for purely private use is *per se* unconstitutional. The court held that under this analysis, Denbury was not a common carrier endowed with the power of eminent domain. Denbury's pipeline was intended to transport gas belonging to Denbury from one Denbury site to another. Under the NRC, a person is a common carrier if he:

> owns, operates, or manages, wholly or partially, pipelines for the transportation of carbon dioxide ... to or for the public for hire, but only if such person files with the commission a written acceptance of the provisions of this chapter expressly agreeing that, in consideration of the rights acquired, it becomes a common carrier subject to the duties and obligations conferred or imposed by this chapter.[11]

Additionally, the NRC provides:

> The provisions of this chapter do not apply to pipelines that are limited in their use to the wells, stations, plants, and refineries of the owner and that are not a part of the pipeline transportation system of a common carrier....[12]

In reversing the decision of the court of appeals, the court concluded that a "private enterprise cannot acquire unchallenged condemnation power under Section 111.002(6) merely by checking boxes on a one-page form and self-declaring its common-carrier status." Accordingly, once a landowner challenges the status of the pipeline company, the burden falls upon the company to establish its common-carrier status if it wishes to exercise the power of eminent domain.

In the event a city is threatened with condemnation by a gas corporation, *Denbury* is significant because it underscores the need to analyze the status of the gas corporation to make sure that the corporation is in fact a common carrier–and not just claiming to be a common carrier before the commission. If the proposed pipeline is intended to benefit or in fact does benefit only the gas

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[11] Tex. Nat. Res. Code Ann § 111.003(a) (Vernon Supp. 2012).

[12] *Id.* at § 111.019.

corporation (or its parent corporation), the gas corporation is not acting as a common carrier. In such case, a city might successfully make two arguments: (1) that because the gas corporation is not a common carrier, it does not possess the power to condemn property under Chapter 111 of the NRC; and (2) that the proposed condemnation of public property is without a public purpose and is therefore unconstitutional.

VI. *Southern Crushed Concrete, LLC v. City of Houston.*[13]

In October 2003, Southern Crushed Concrete, LLC ("SCC") applied to the Texas Railroad Commission ("Commission") for an air quality permit to move an already-permitted facility to a new facility located in the City of Houston ("City"). In May of 2007, the City passed an ordinance requiring concrete-crushing facility operators to obtain a municipal permit. The municipal requirements to obtain a permit are more restrictive than those required by the Texas Clean Air Act ("TCAA") and the Commission rules. Specifically, the City's ordinance prohibited the operation of a concrete- crushing facility within 1,500 feet of a school facility and other enumerated uses. The TCAA prohibit concrete-crushing facilities to be located within 1,350 feet of a school. The Commission granted SCC's permit application, concluding that SCC's proposed facility would not violate the requirements of the TCAA. The SCC applied for a permit from the City, but was denied because the proposed location of the concrete-crushing facility was within 1,500 feet of a school.

SCC sued the City seeking a declaration that the City's ordinance is preempted by the TCAA and an injunction against its enforcement. The trial court granted summary judgment in favor of the City and the court of appeals affirmed. The sole issue on appeal to the Texas Supreme Court was whether the City's ordinance is preempted by the TCAA because the ordinance makes unlawful an act approved or authorized under the TCAA or the Commission's rules.[14]

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[13] No. 11-0270, 2013 WL 561468 (Tex. Feb. 15, 2013).

[14] Tex. Health & Safety Code Ann. § 382.113(b) (Vernon 2010).

The court first explained that the purpose of the TCAA is to "safeguard the state's air resources from pollution by controlling or abating air pollution and emissions of air contaminants." The court then held that the City's ordinance is preempted by the TCAA because it effectively seeks to moot the authorization granted by the Commission to construct the concrete-crushing facility.

This case is significant because it sets the stage for a potential new attack on a city's authority to regulate above-ground appurtenances owned by the pipeline industry. A pipeline company, such as the one in the *Texas Midstream Gas Services* case cited above, may now argue that a city's setback requirements contained in its drilling ordinance are preempted by the TCAA.

APPLICATION FOR PERMIT TO OPERATE A PIPELINE IN TEXAS

(See 16 TAC 3.70)

FORM T-4
(8/06)

Railroad Commission of Texas
Gas Services Division
License & Permits Section

Permit No._____

ORGANIZATION INFORMATION

1. Operator (Applicant) (See Instruction 1) | Address

P5#_____

2. Does the above named operator own pipeline? ☐ Yes ☐ No If "No", give name and address of owner.

3. Does the above named operator conduct or control the economic operations on the pipeline? ☐ Yes ☐ No
If "No", give name, address and P-5# of economic operator. (See Instruction 2)

P5#_____

PIPELINE INFORMATION

1. Mark appropriate block for each of the following questions:
   a) Are the pipelines covered under this permit ☐ Interstate ☐ Intrastate
   b) Fluid transported:
   ☐ Crude ☐ Condensate ☐ Gas (*) ☐ Products (*) ☐ Full Gas Well Stream ☐ Full Oil Well Stream ☐ Other (*)
   * Specify _____
   c) Does fluid contain H_2S? ☐ Yes ☐ No If yes, at what concentration? _____ ppm
   d) Pipeline classification:
   If answer to (b) is other than natural gas, will the pipeline be operated as ☐ a common carrier or as ☐ a private line? (Ch. 111, Texas Natural Resources Code)
   If answer to (b) is natural gas, will the pipeline be operated as a ☐ gas utility or as a ☐ private line? (Texas Utilities Code)
   NOTE: A natural gas pipeline permit will not specify whether the pipeline is a gas utility or a private line. The Gas Services Division Gas Utility Audit Section will make that determination and notify the operator of its status.
   e) Does pipeline use any public highway or road, railroad, public utility, or other common carrier right-of-way? ☐ Yes ☐ No
   f) Will the pipeline carry only the gas and/or liquids produced by pipeline owner or operator? ☐ Yes ☐ No
   If answer to (f) is "No", is the gas and/or liquids:
   ☐ Purchased from others. ☐ Owned by others, but transported for a fee. ☐ Both purchased and transported for others.

2. a) New installation? ☐ Yes ☐ No New Construction Report Number _____
   b) Renewal for same operator? ☐ Yes ☐ No (see 16 TAC 8.115 for applicability)
   c) Extension or modification? ☐ Yes ☐ No
   If there has been a change in operator or ownership, give name and address of previous operator, owner, or lessor: (Attach form T4B)

3. Check detailed purpose(s) for which described pipeline will be used:
   ☐ Transmission ☐ Terminal (Storage Field) ☐ Industrial Distribution
   ☐ Gathering ☐ Gas Lift ☐ Manufacturing Feed Stock (Own Consumption)
   ☐ Gas Injection ☐ Gas Plant ☐ Other (explain) _____

4. U.S.G.S. 7.5 Minute Quad attached? (Scale 1" = 2,000 feet) ☐ Yes ☐ No
   Overview map (24" x 24" / 1" = 20 miles or less) attached and digital data sent? ☐ Yes ☐ No

I declare, under penalties prescribed in Sec. 91.143, Texas Natural Resources Code, that I am authorized to make this report, that this report was prepared by me or under my supervision and direction, and that data and facts stated therein are true, correct, and complete, to the best of my knowledge.

_____ _____
(Type or Print Name of Person) (Date)

_____ _____
(Title) (Signature)

Inquiries regarding this application should be directed to:

Name: _____ Address: _____ Phone: (A/C) _____

Fax (_____) _____ E-mail _____

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