

Locke Lord QuickStudy: Texas Oil and Gas Gathering Systems Should Not Cease Gathering Service Without Considering Railroad Commission Rule 73?

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Texas oil and gas producers have recently faced economic challenges from low commodity prices brought on by a combination of the global pandemic and oversupply caused by the production dispute between Russia and Saudi Arabia. As a result, midstream companies, particularly oil and gas gathering companies, may find themselves facing the prospect of declining gathering volumes, and even missed minimum volume commitment payments, that make the gathering deal unprofitable or prevent the recovery of the significant capital outlay required to build and operate the system. Gathering agreements frequently protect midstream companies in such cases, allowing them to terminate the agreement for a breach or allowing termination in the event the midstream company determines that the continued provision of services to the producer has become uneconomic. But gatherers should be wary about exercising such contractual options without first complying with a little known, but very important, rule of the Railroad Commission of Texas (“Commission”).

Statewide Rule 73 requires a pipeline company that seeks to disconnect or cease providing “pipeline services” to a well or lease to first either obtain the written consent of the producer or the permission of the Commission. The Commission has specifically determined that the existence of a gathering agreement with contractual remedies for non-payment or declining profitability DOES NOT comply with the written consent requirement of Rule 73. Failure to comply with this rule can subject a pipeline company to administrative penalties from the Commission and the possibility that the producer will file a complaint for which the remedy could be to require continuation of the gathering service. The Commission has the power to approve a Rule 73 application administratively, but if a producer contests the application the prescribed process is a contested evidentiary hearing before an administrative law judge.

In determining whether or not to approve a request to physically disconnect from, or cease providing service to, a well or lease, Rule 73 states that the Commission may consider relevant factors, including but not limited to:

- operational integrity of the pipeline facilities;
- operational integrity of the equipment on the well or lease;
- cost of continued operation of the physical connection or service;
- risk to public safety, human health and the environment;

- availability of alternative transportation;?
- protection of correlative rights; and
- prevention of waste.?

The very few cases that have been decided under Rule 73 indicate that the Commission's decision involves a balance of the following key considerations: (1) the economics of continuing to provide service, (2) the safety of the pipeline system, and (3) the possibility that shutting in a well could cause waste. There is a fairly consistent line of precedent indicating that the Commission cannot order a gatherer to provide service at a loss or in circumstances that are uneconomic, but if the gatherer's Rule 73 application is challenged, or if the producer files a complaint with the Commission, the gatherer may well have to prove in an evidentiary hearing before a judge that operation of its system meets the standards for uneconomic operation. That is an expensive and time consuming proposition, even where the ability to demonstrate the prescribed criteria is clear cut. ?

Thus, if a gatherer confronts declining volumes or missed payments that render its service uneconomic, it must evaluate compliance with Rule 73 in addition to whatever contractual rights it may also have. Furthermore, as the current state of the oil and gas market has brought Rule 73 into sharper focus, going forward it may warrant drafting changes to the remedies a gatherer can pursue in a gathering agreement, including perhaps charging a "low volume fee" with respect to receipt points that become uneconomic due to limited volume delivery by the producer.?

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