

URBAN NATURAL GAS PRODUCTION: PLANNING AND LEGAL ISSUES

A Presentation to the
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RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- Cases to be covered:
 - *Tex. Midstream Gas Services, L.L.C. v. City of Grand Prairie*
 - *Dallas Area Rapid Transit v. Oncor Elec. Delivery Co., L.L.C.*
 - *Texas Rice Land Partners, Ltd. v. Denbury Green Pipeline-Texas, L.L.C.*
 - *City of Houston v. Maguire Oil Co.*
 - *BCCA Appeal Group v. City of Houston*
 - *City of Houston v. Trail Enterprises, Inc.*

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Tex. Midstream Gas Services, L.L.C. v. City of Grand Prairie* (5th Cir. 2010)
- Facts:
- In 2007, TMGS announced that it was going to construct a natural gas compressor station in Grand Prairie.
- In 2008, the city amended its code to require that TMGS obtain an SUP from the city to operate the station, that the station comply with certain setback requirements, that it be surrounded by an 8 foot security fence and be enclosed by a building designed to maintain pre-development sound levels.

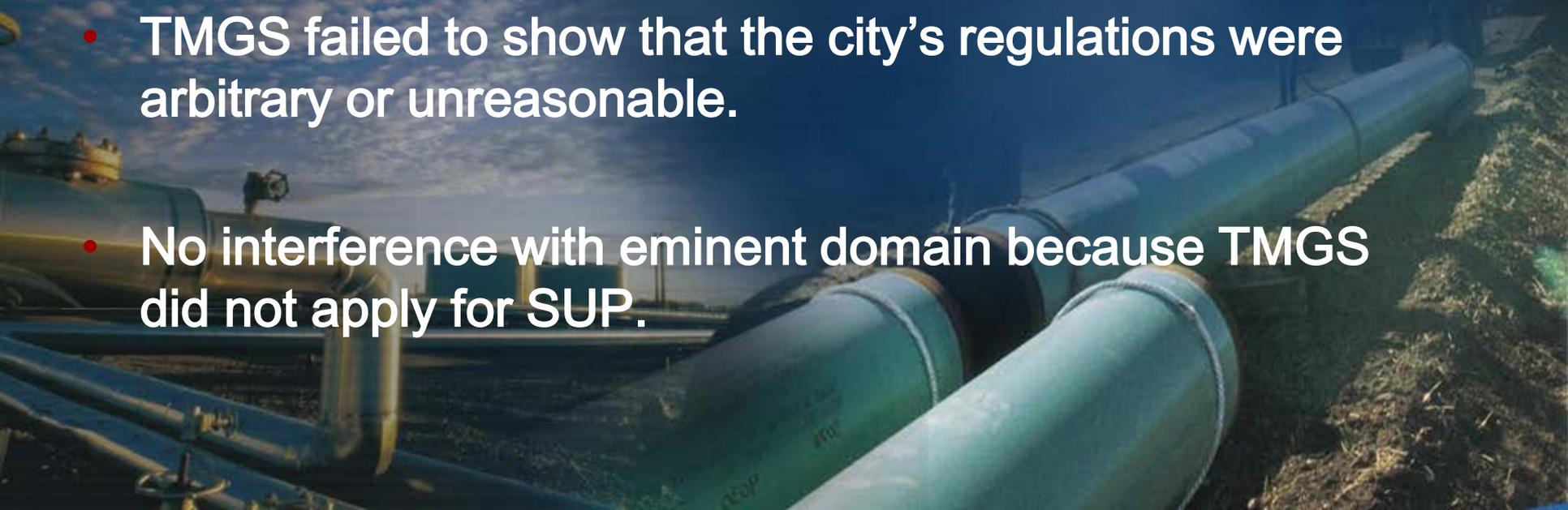
RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Tex. Midstream Gas Services, L.L.C. v. City of Grand Prairie* (5th Cir. 2010)
- Facts:
- TMGS filed suit arguing that the city's regulations were preempted by the Pipeline Safety Act and impinged upon TMGS's statutory eminent domain powers.



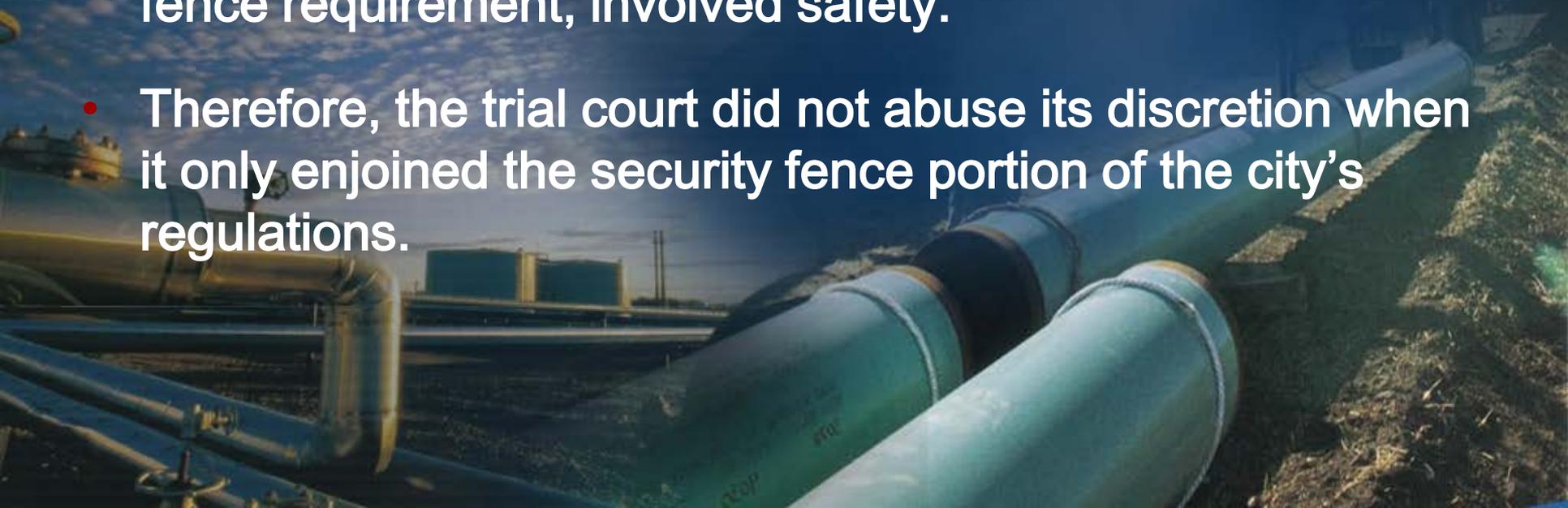
RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Tex. Midstream Gas Services, L.L.C. v. City of Grand Prairie* (5th Cir. 2010)
- Held:
- TMGS's eminent domain power does not supersede generally applicable zoning regulations that are not arbitrary or unreasonable.
- TMGS failed to show that the city's regulations were arbitrary or unreasonable.
- No interference with eminent domain because TMGS did not apply for SUP.



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Tex. Midstream Gas Services, L.L.C. v. City of Grand Prairie* (5th Cir. 2010)
- Held:
- The Pipeline Safety Act only preempts safety standards.
- None of the city's regulations, except for the security fence requirement, involved safety.
- Therefore, the trial court did not abuse its discretion when it only enjoined the security fence portion of the city's regulations.

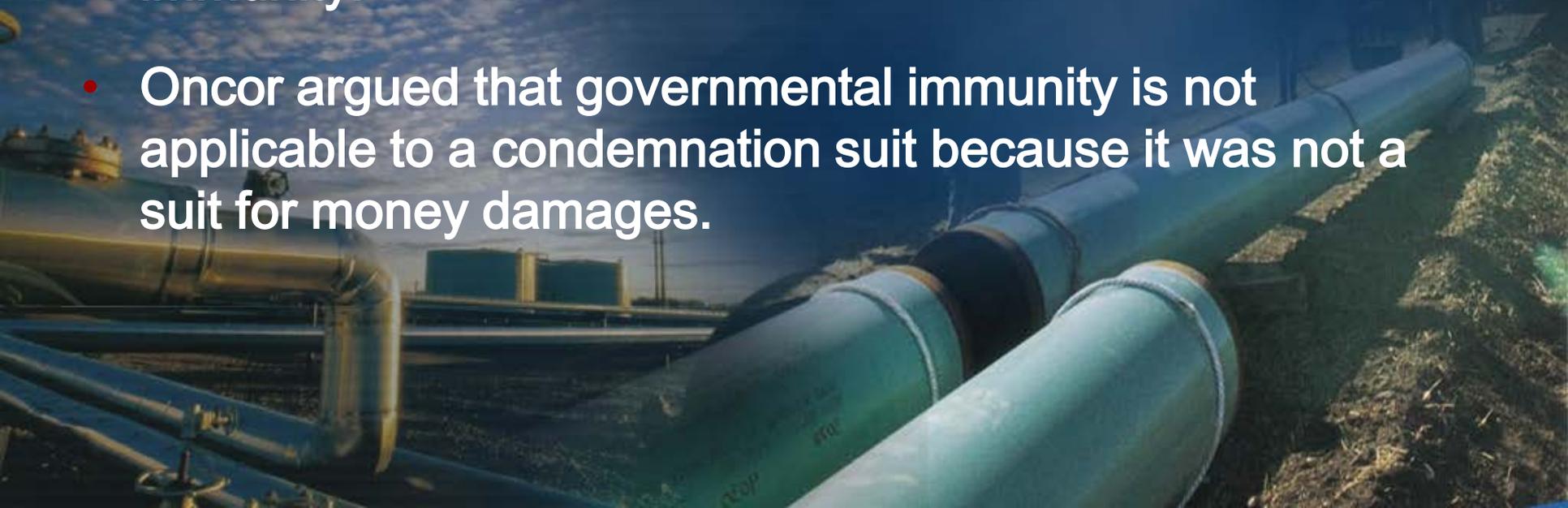


RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Dallas Area Rapid Transit v. Oncor Elec. Delivery Co., L.L.C.* v. (Tex. App. --Dallas 2010)
- Facts:
- Oncor, an electric utility, sued DART and the Fort Worth Transportation Authority (both governmental entities) to condemn an easement for use in constructing an electric transmission line.
- Oncor based its authority to condemn public property on section 181.004 of the Utilities Code, which gives the power of eminent domain to a “gas or electric corporation” to condemn the property of a “person” or “corporation.”

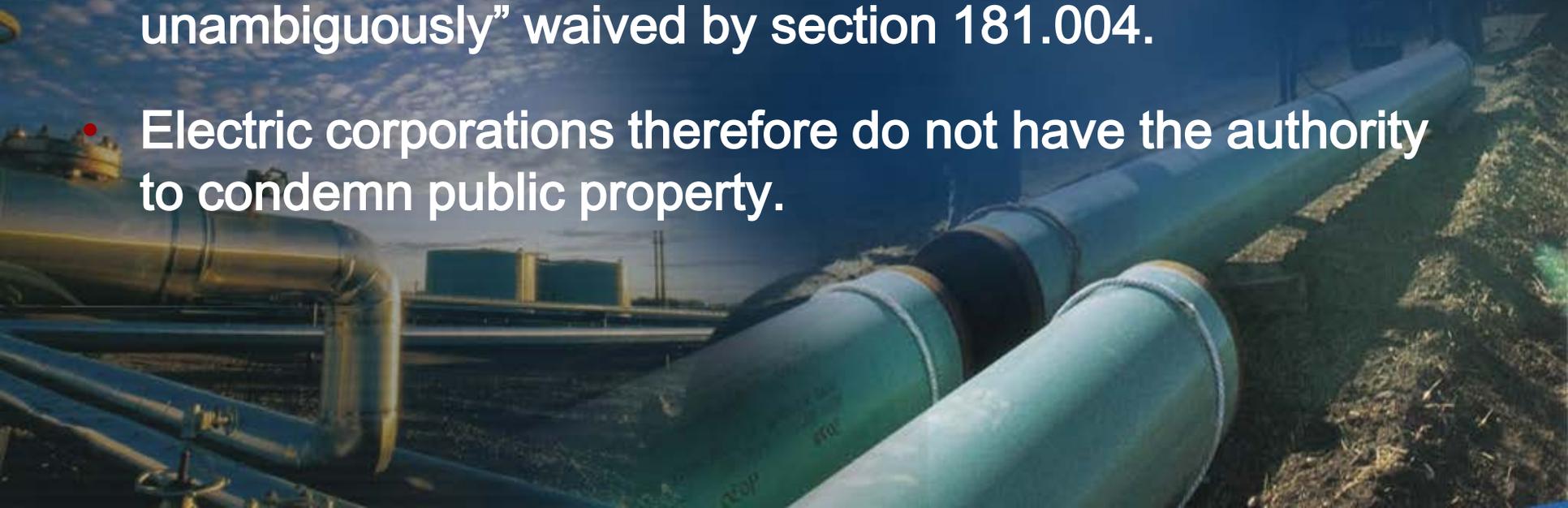
RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Dallas Area Rapid Transit v. Oncor Elec. Delivery Co., L.L.C.* v. (Tex. App. --Dallas 2010)
- Facts:
- The governmental entities argued that section 181.004 did not “clearly and unambiguously” waive governmental immunity.
- Oncor argued that governmental immunity is not applicable to a condemnation suit because it was not a suit for money damages.



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Dallas Area Rapid Transit v. Oncor Elec. Delivery Co., L.L.C.* v. (Tex. App. --Dallas 2010)
- Held:
- Governmental immunity applies to condemnation suits.
- Governmental immunity was not “clearly and unambiguously” waived by section 181.004.
- Electric corporations therefore do not have the authority to condemn public property.



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Oncor Elec. Delivery Co., L.L.C. v. Dallas Area Rapid Transit* (Tex. 2012)
- Facts:
- During the pendency of the appeal to the Texas Supreme Court, the Texas legislature enacted House Bill 971, which extended an electric corporation's power of eminent domain to include the acquisition of "all public land, except land owned by the state, on which the [PUC] has approved the construction of a [transmission] line."
- *See* section 37.053(d) of the Texas Utilities Code.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Oncor Elec. Delivery Co., L.L.C. v. Dallas Area Rapid Transit* (Tex. 2012)
- Held:
- Section 37.053(d) waives governmental immunity in condemnation suits by electric corporations (but not gas corporations).
- Therefore, the judgment of the court of appeals was vacated and the case was remanded to the trial court.



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Texas Rice Land Partners v. Denbury Green Pipeline* (Tex. 2012)
- Facts:
- Denbury Resources, Inc. is a pipeline company that desired to build a CO2 line from Mississippi to oil wells located in Texas.
- Even though the pipeline was only intended to service Denbury, when it applied for a permit from the Texas RRC, Denbury claimed that it was a “common carrier” and that the product transported through the pipeline would be “owned by others but transported for a fee.”

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Texas Rice Land Partners v. Denbury Green Pipeline* (Tex. 2012)
- Facts:
- The Texas RRC granted Denbury a permit to construct the pipeline.
- Texas Rice Land Partners refused Denbury entry onto TRLP's property.
- Denbury sued seeking a court order to gain entry onto and survey the property.

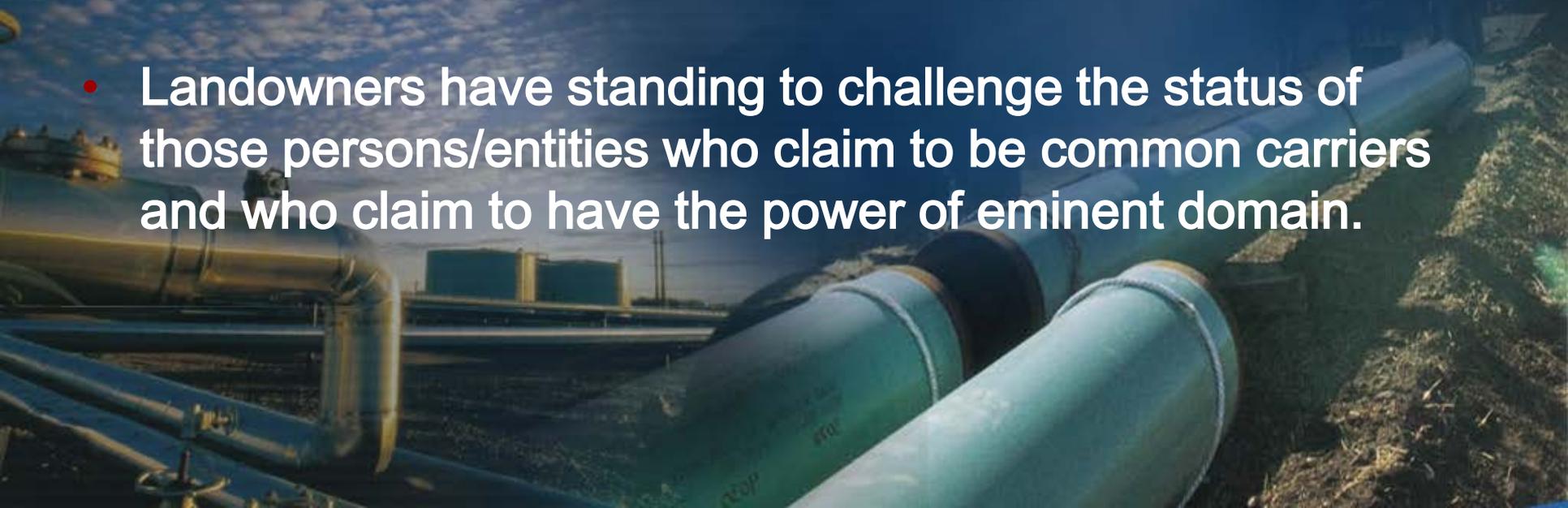


RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Texas Rice Land Partners v. Denbury Green Pipeline* (Tex. 2012)
- Held:
- A “common carrier” is a person/entity that owns or operates “a pipeline for the transportation of [various substances] to or for the public for hire....”
- Common carriers, and not private carriers, have the power of eminent domain.
- The mere fact that the Texas RRC grants a permit to a person/entity does not conclusively establish that the person/entity is a common carrier.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *Texas Rice Land Partners v. Denbury Green Pipeline* (Tex. 2012)
- Held:
- Testimony from Denbury that there was a “possibility of transporting other people’s gas in the future” was insufficient to establish common carrier status.
- Landowners have standing to challenge the status of those persons/entities who claim to be common carriers and who claim to have the power of eminent domain.



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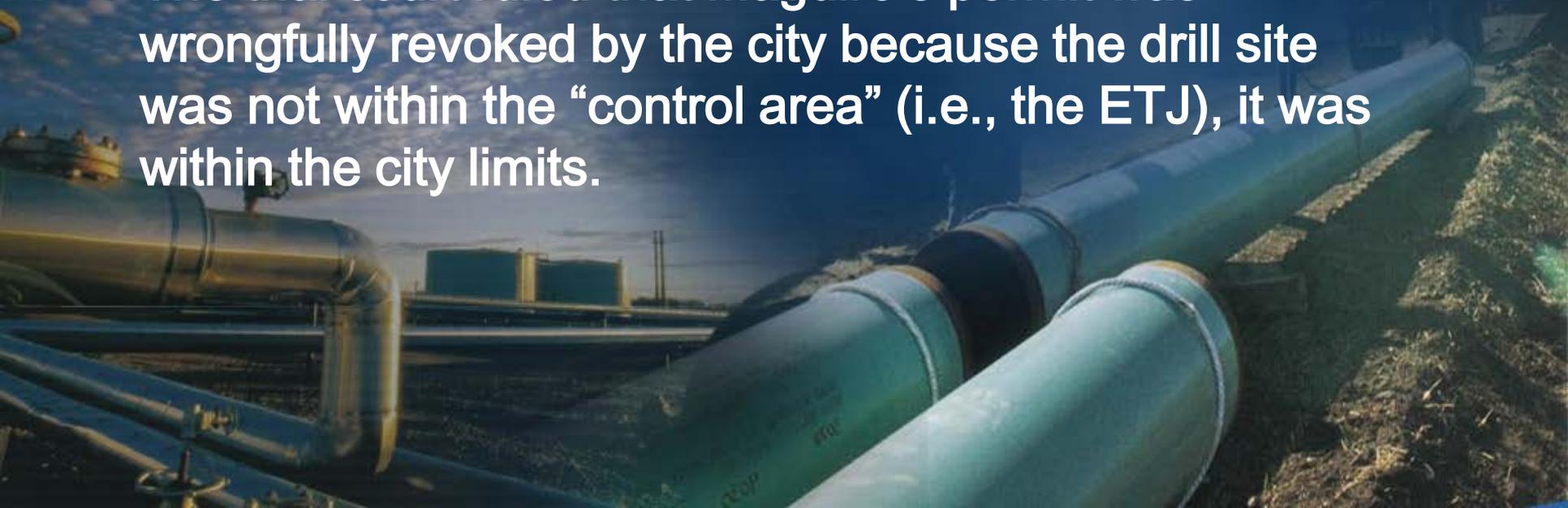
- *City of Houston v. Maguire Oil Co.* (Tex. App.—Houston 2011)
- Facts:
- Maguire Oil Co. applied for a permit to drill a gas well 300 feet west of Lake Houston.
- The city initially granted the permit, and Maguire spent over \$250,000 building roads and preparing to drill the well site.
- The city subsequently revoked the permit citing a provision of the city code that prohibited drilling within the “control area,” defined as 1000 feet around Lake Houston or any of its drains, streams or tributaries.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Maguire Oil Co.* (Tex. App.—Houston 2011)
- Facts:
- The term “control area” was defined to mean an area within the city’s extra territorial jurisdiction (ETJ).
- In 1993, Maguire sued the city for inverse condemnation, due process violations, negligent misrepresentation, estoppel and promissory estoppel.
- The case was litigated over the next 14 years in state and federal court!

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Maguire Oil Co.* (Tex. App.—Houston 2011)
- Facts:
- In March 2009, a jury returned a \$2 million verdict in favor of Maguire.
- The trial court ruled that Maguire’s permit was wrongfully revoked by the city because the drill site was not within the “control area” (i.e., the ETJ), it was within the city limits.



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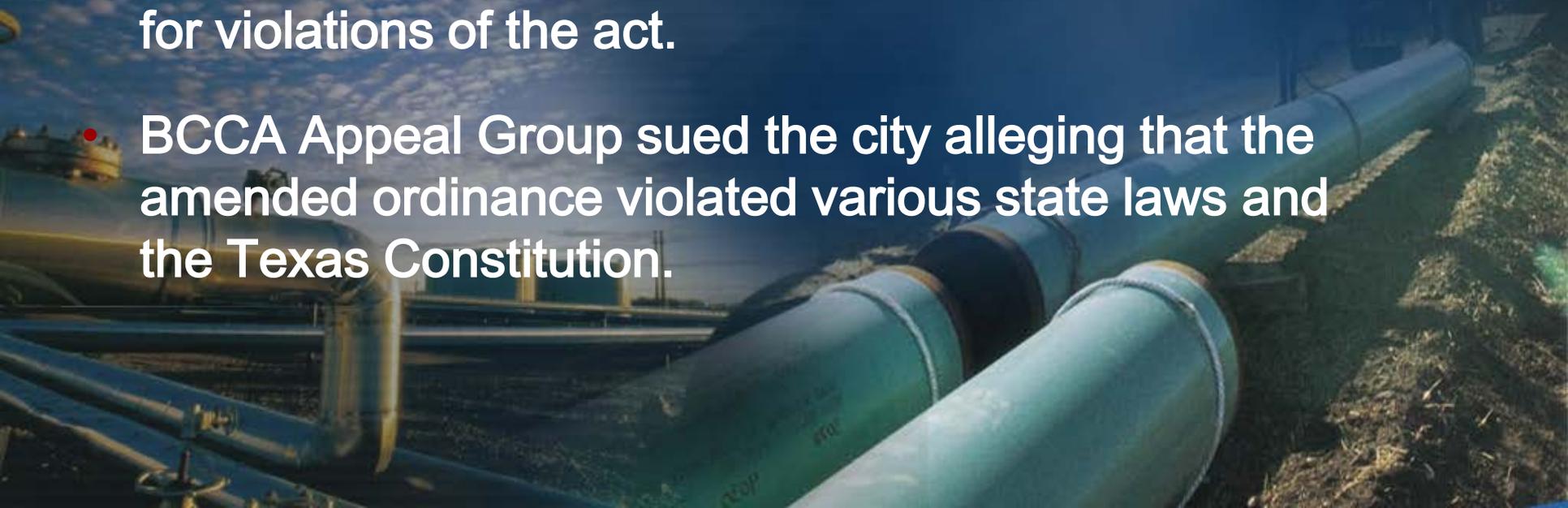
- *City of Houston v. Maguire Oil Co.* (Tex. App.—Houston 2011)
- Facts:
- Maguire argued on appeal that the city's enforcement of an inapplicable ordinance unreasonably interfered with its right to use and enjoy its mineral estate (i.e., was a regulatory taking).
- The city argued in response that the actions of an individual employee in enforcing an inapplicable ordinance cannot serve as the basis for intent by the city to appropriate Maguire's mineral interest rights.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *MaGuire Oil Company v. City of Houston* (Tex. App.—Houston 2007)
- Held:
- The court rejected the city’s argument: the actions of an individual employee who is a “final decision maker” in enforcing an inapplicable ordinance or arbitrarily revoking a permit without a legitimate basis may result in a regulatory taking of property.
- It is not necessary to prove “intent” to take property to prevail on a regulatory takings claim.
- The city effected a regulatory taking when it intentionally and unreasonably interfered with Maguire’s right to use and enjoy its mineral estate.

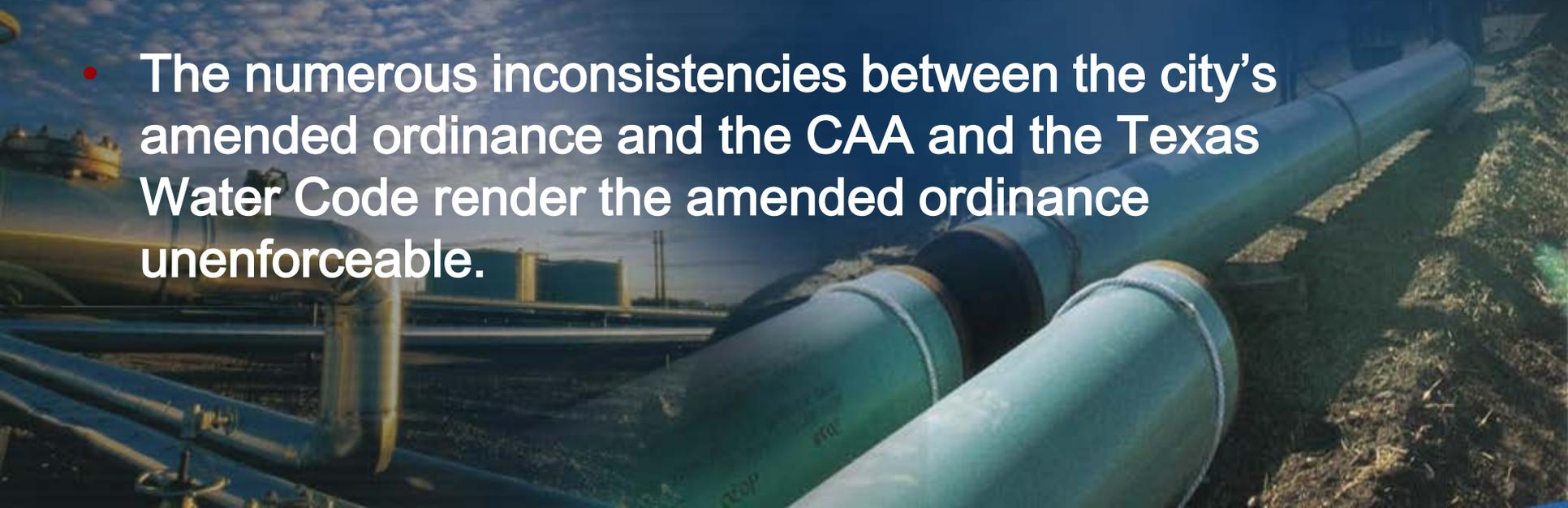
RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *BCCA Appeal Group v. City of Houston* (269th Judicial Dist. Ct. Mem. Op., Dec. 29, 2010)
- Facts:
- In 2007, the City of Houston adopted amendments to its air quality ordinance which empowered city employees to investigate violations of the state's Clean Air Act (CAA) and to impose criminal penalties for violations of the act.
- BCCA Appeal Group sued the city alleging that the amended ordinance violated various state laws and the Texas Constitution.



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *BCCA Appeal Group v. City of Houston* (269th Judicial Dist. Ct. Mem. Op., Dec. 29, 2010)
- Held:
- A city's ordinance cannot be inconsistent with a state statute or make unlawful an act or condition approved or authorized by state law or by the TCEQ's rules or orders.
- The numerous inconsistencies between the city's amended ordinance and the CAA and the Texas Water Code render the amended ordinance unenforceable.



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *BCCA Appeal Group v. City of Houston* (269th Judicial Dist. Ct. Mem. Op., Dec. 29, 2010)
- Ruled:
- The city's amended ordinance expanded the CAA's definition of a "facility" to include the term "source." So, under the CAA, a facility containing three "sources" would be considered one "facility" but under the city's ordinance, would be considered three facilities. Thus, the operator would need to obtain three registration permits under the city ordinance instead of one. The court determined that this "inconsistency" was unreasonable.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *BCCA Appeal Group v. City of Houston* (269th Judicial Dist. Ct. Mem. Op., Dec. 29, 2010)
- Ruled:
- The city's enforcement of the amended ordinance by only assessing criminal penalties is "inconsistent" with the state's more flexible approach to enforcement of the provisions of the CAA which provides for civil or administrative alternatives to criminal penalties.

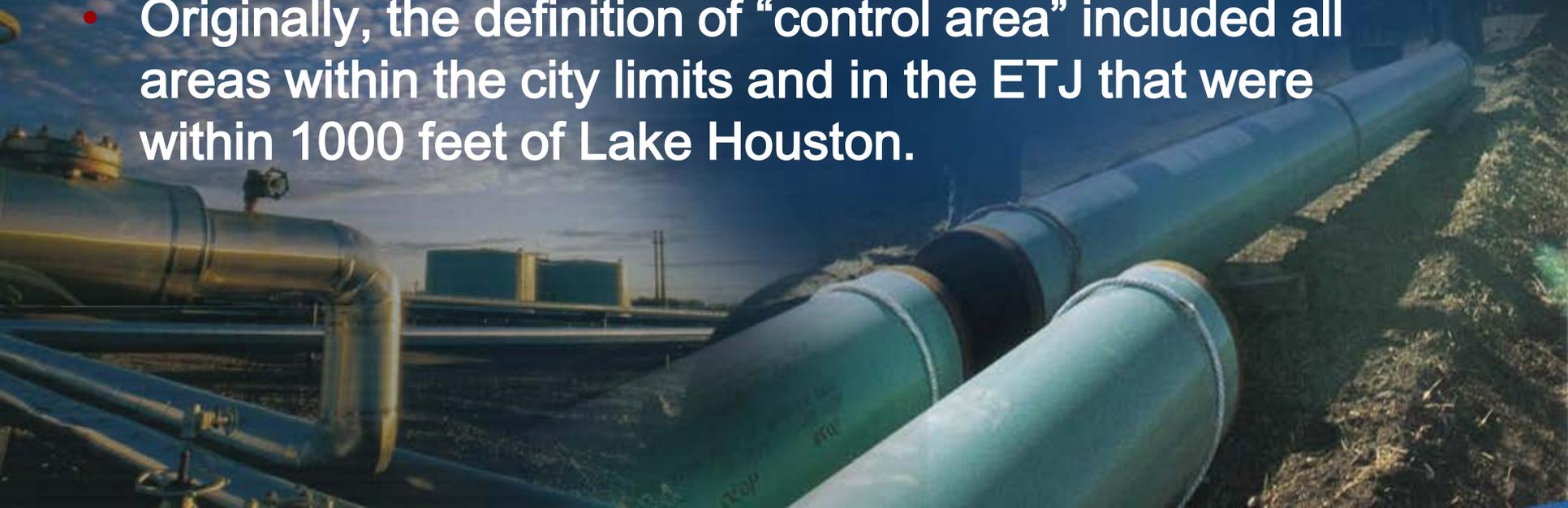


RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *BCCA Appeal Group v. City of Houston* (269th Judicial Dist. Ct. Mem. Op., Dec. 29, 2010)
- Ruled:
- The city's enforcement of the amended ordinance is also "inconsistent" with the Texas Water Code which requires that all allegations of violations of the CAA be reported to TCEQ prior to the time that prosecution of a criminal case may be commenced.
- There is also no provision in the amended ordinance to dismiss a criminal case if TCEQ determines that no violation has occurred or that criminal penalties would not be appropriate...as required by the Water Code.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Facts:
- In 1967, the City of Houston enacted an ordinance that prohibited the drilling of a new oil or gas well in the “control area” near Lake Houston.
- Originally, the definition of “control area” included all areas within the city limits and in the ETJ that were within 1000 feet of Lake Houston.



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Facts:
 - In 1977, the city amended the definition of “control area” to only apply to areas in the ETJ that were within 1000 feet of Lake Houston.
 - In 1997, the city again amended the definition of “control area” and restored the original meaning of the term.



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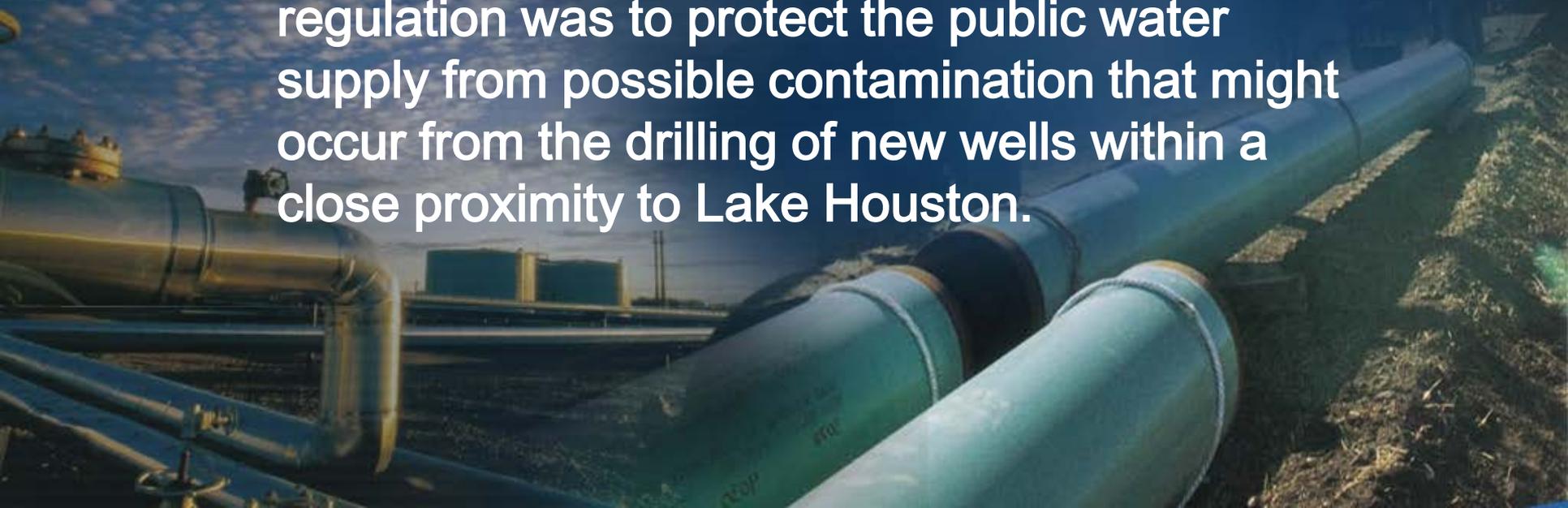
- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Facts:
- Trail Enterprises owned several oil wells on property near Lake Houston that existed prior to the adoption of the ordinance in 1967.
- In 2003, Trail Enterprises sued the city alleging that the city's prohibition on well drilling constituted an unconstitutional regulatory taking of property.
- The trial court awarded damages to Trail Enterprises approaching \$17 million.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Analysis:
- The appellate court analyzed the facts under the three-pronged test from *Penn Central Transp. Co. v. City of New York* (1978) :
 - (1) the character of the governmental action;
 - (2) the extent to which the regulation interferes with the claimant's reasonable and distinctive investment-backed expectations; and
 - (3) the economic impact of the regulation on the claimant.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Analysis:
 - Character of the governmental action:
 - The court held that this factor weighed heavily in favor of the city because the purpose of the regulation was to protect the public water supply from possible contamination that might occur from the drilling of new wells within a close proximity to Lake Houston.

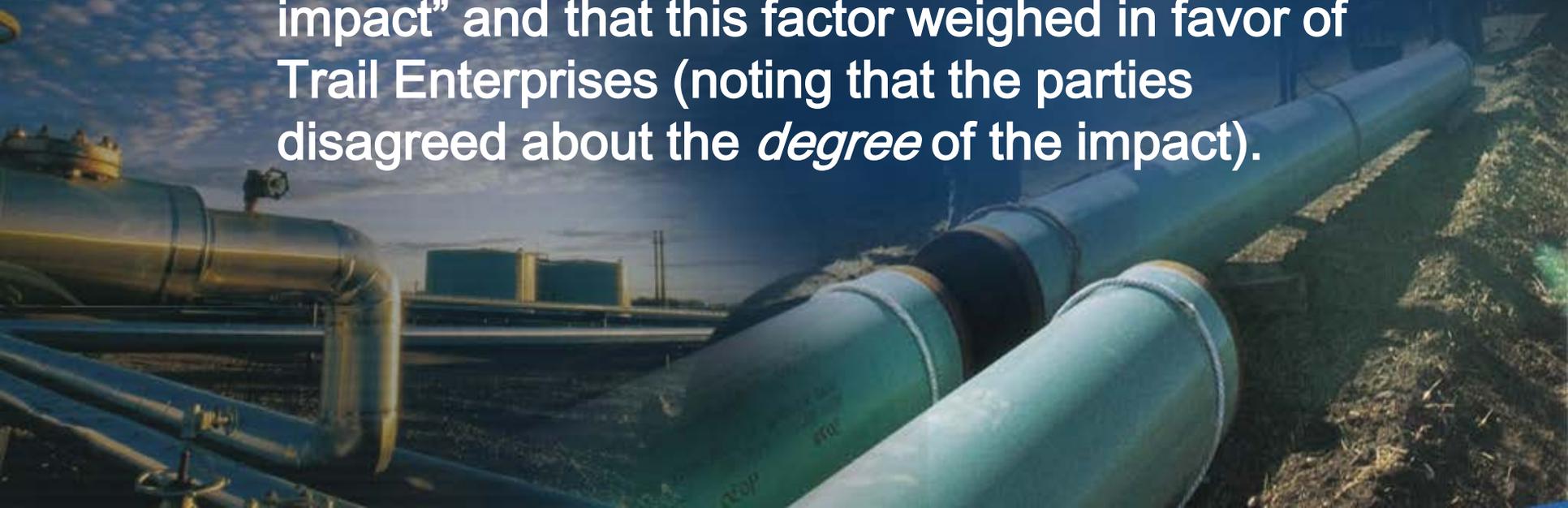


RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Analysis:
 - Reasonable, Investment-Backed Expectations:
 - The court held that this factor also weighed heavily in favor of the city because at the time Trail Enterprises acquired an interest in the property, the drilling of new wells was prohibited by the city's ordinance; therefore, it was not reasonable for Trail Enterprises to expect to generate revenue from the drilling of new wells.

RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Analysis:
 - Economic Impact of the Regulation:
 - The court held that Trail Enterprises did produce evidence of “fairly significant economic impact” and that this factor weighed in favor of Trail Enterprises (noting that the parties disagreed about the *degree* of the impact).



RECENT CASE LAW AFFECTING URBAN DRILLING REGULATION

- *City of Houston v. Trail Enterprises, Inc.* (Tex. App.—Houston 2012)
- Holding:
 - Because two out of the three factors weighed in favor of the city, the court was unwilling to conclude that a compensable “taking” of property had occurred.
- Caveats:
 - This case will likely be appealed!
 - This case might have had a different result had Trail Enterprises been able to produce more evidence at trial regarding its investment expectations.

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