

Structuring Oil and Gas Pipeline Projects: Key Issues and Key Contracts Involved

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Overview

- **Objectives:**

- Understand U.S. Pipeline Industry Structure
- Understand U.S. Statutory and Regulatory Regimes Governing Project Development and Market Regulation



The Texas Longhorn Bull

Overview

- **Means to Understandings:**
 - Review U.S. Pipeline Industry Structures
 - Review U.S. Statutory and Regulatory Regimes Governing Project Development and Market Regulation
 - Review Project Structures and Frameworks
 - Review Risks that Potentially Attend Pipeline Project Development
 - Review Market Regulation



The Texas Longhorn Bull

Industry Fundamentals

- U.S. Pipeline Industry Fundamentals
 - Markets Drive Development – Supply and Demand
 - Private Enterprises Develop and Operate
 - Government Oversight Through Various Statutory and Regulatory Regimes
 - Private Sector Regulation Through
 - Public Participation
 - Social / Political Mechanisms –
 - Legal Recourse

Supply and Demand – Current Situation Evolving

- North American “Renaissance” in Crude Oil and Natural Gas Liquids Pipeline System Development
- Shale Development
- Logistics Bottlenecks
- Oil / Gas Value Differential
- Refinery Feedstocks and Process Modifications

Supply and Demand – Current Situation Evolving



Source: U.S. Energy Information Administration based on data from various published studies. Canada and Mexico plays from ARI.
 Updated: May 9, 2011

Regulation: Interstate vs. Intrastate Pipelines

- Interstate Systems
 - Transportation Crossing State or International Boundaries
 - Federally Regulated for Uniformity
 - Lessens Local Interference – Or Does It?
 - Federal Supremacy
- Intrastate Systems
 - Transportation Wholly Within a State
 - Regulated by Individual States
 - Allows Local Control
 - Must Meet Certain Minimum Federal Standards
 - Pipeline Safety
 - Environmental Protection

Regulation: Oil Pipelines vs. Gas Pipelines

- Pipeline Safety Act Applies to Design, Construction, Operation, Maintenance, Replacement, Etc. (49 USC 60101)
- Pipeline Safety Regulations Provide Safety Standards
 - Natural and Other Gas – 49 CFR Part 192
 - Hazardous Liquids – Crude Oil, Refined Products, NGLs – 49 CFR Part 195
 - Performance Based Regulations
- State Standards / Federal Preemption



Regulation: Oil Pipelines vs. Gas Pipelines

- Environmental Protection:
 - Federal Level
 - Clean Water Act
 - Clean Air Act
 - Endangered Species Act
 - National Environmental Policy Act
 - State Corollaries
 - Federal Preemption



Regulation: Development and Markets

- Development:
 - Gas Pipelines – Almost Always Closely Regulated – Natural Gas Act – Treated as Monopoly
 - Oil Pipelines – Sometimes – Rarely? – see National Environmental Policy Act
- Cross Border Development –
 - The Presidential Permit
 - National Interest Determination
- Market Regulation
 - Gas Pipelines – Natural Gas Act
 - Oil Pipelines – Interstate Commerce Act
 - Jay Costan – Presentation to Follow

Convergence of Regulatory and Commercial Objectives

- Common purpose to assure that a pipeline will be:
 - Financeable
 - Economic and fair in its operation (i.e., rates, access, terms of service)
 - Safe
 - Environmentally acceptable

Ownership Structures

- The Entity – Private Enterprise....
 - Corporation
 - Partnership
 - Joint Venture
 - Master Limited Partnership
- Implications
 - Taxation
 - Liability Limitation



Project Structures

- Project Structures
 - Grassroots Build by Existing Company
 - Formation of Joint Venture/Partnership
 - Contribution of Existing Assets to a Project
 - Reversal of Flow in an Existing System
 - Change of Commodity
 - All of the Above: Existing Asset, Reversal, Change of Commodity, and New Build Extension



□ Contractual Considerations

■ Contractual Needs

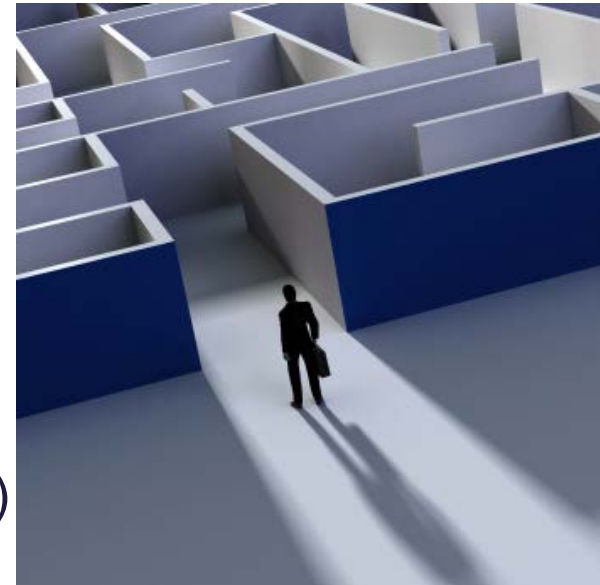
– Entity Formation (JV / Partnership)

- Cost Sharing / Budgeting
- Revenue Sharing
- Control
- Capital Raising



Contractual Considerations

- Contractual Needs
 - Project Development
 - Engineering Design
 - Materials Procurement / Transportation
 - Connection Agreements (Systems, Terminals)
 - Land / Right-of-Way
 - Construction – Multiple Spreads
 - Construction Oversight
 - Engineering Procurement & Construction



Contractual Considerations

- Contractual Needs
 - Revenue!!!
 - Transportation Agreement
 - Throughput & Deficiency Agreement
 - Non-Transportation Services
 - Tanking / Storage
 - Distribution – e.g., Truck Rack / Marine Loading



Contractual Considerations

- Contractual Needs
 - System Operation and Maintenance
 - Operating Agreement
 - Linefill
 - Emergency Response Resources
 - Master Services Agreements



Risks Potentially Attending Development

– Abundant Interplay / Overlap

- Commercial Risk
- Financial Risk (Getting the Leverage Right)
- Management Risk
- Organizational Risk
- Contractor Risk
- Regulatory Risk ↔ Political / Social Risk

Commercial Risk

- Contractual Support – Revenue
- Development Cost – All Factors Considered?
- Operations Cost – All Factors Considered?
- Making Promises
- Market Dynamics

Management Risk

- Leadership Experience: Battlefield Experience, i.e., Good Judgment When It Matters Significantly
- Leadership Commitment: Not to the Project but to the Enterprise
- Management Team: Experienced? Integrated? Transparent?
- Implementing Lessons Learned?
- Safety Culture?

Organizational Risk

- In-house Expertise / Management Capacity
- Outsourcing:
Design? ↔ Project Planning? ↔
Construction? ↔ Inspection? ↔
Integration? ↔ Commissioning?
- Institutional Culture



Organizational Risk

- Organizational Capacity
- Capacity In-House
- Execution
- Oversight/Supervision
- Best Left to Experts?
- Best Done by the Company?



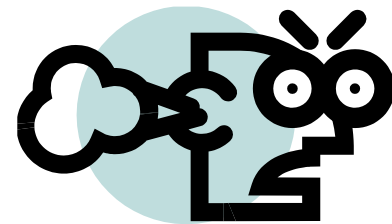
Contractor Risk

- Contractor Capacity
- Success Rate
- Possible Issues – Labor, Regulatory, Local, Criminal
- Litigation History – Plaintiff or Defendant?
- Quality of Work
- Oversight/Supervision – Meaningful or Solicitous?
- Liens – Huge Issue

Regulatory Risk ↔ Social and Political Risk

Regulatory Risk ↔ Social and Political Risk aka Project Authorization and Safety Regulation

- Authorizations
 - Oil Pipelines vs. Natural Gas Pipelines
 - Interstate vs. Intrastate - NEPA and Routing



Regulatory Risk

- Preconstruction Notifications - 49 CFR 191.22(c)(1)(i)
- Project Design Review (Pipeline Safety Act Reauthorization)
- Design – 49 C.F.R. Part 195, Subpart C
- Construction – 49 C.F.R. Part 195, Subpart D
- Agency Inspection and Enforcement
- Facility Oil Spill Response Plan (FRP) [33 U.S.C. § 1321(j); 49 C.F.R. Part 194]



Authorization Risk ↔ Social and Political Risk

- Federal
 - National Environmental Policy Act of 1969
 - Clean Water Act Sec. 404 (Dredge and Fill)
 - Rivers and Harbors Act Sec. 10 (Obstructions to Navigation)
 - Endangered Species Act of 1973
 - Migratory Bird Treaty Act
 - National Historic Preservation Act
 - Federal Clean Air Act

Authorization Risk ↔ Social and Political Risk

- State

- Environmental and “Routing”
- Illinois / Pennsylvania vs. Texas / Missouri
- Highway / Waterway
- Species
- Archaeology



Authorization Risk ↔ Social and Political Risk

- Regional and Local
 - Environmental, e.g., Water Protection, Tree Preservation....
 - Land Use
 - Road Use – Significant Local Interest

Social / Political Risk

- Three Theses
 - History Catches Up - Usually in a Big Hurry
 - We Help History Catch Up
 - There is Value in Being Prepared to Think and Act Like Government



Social / Political Risk

- Pre-Project Intelligence
 - Social
 - Political
 - Environmental
 - Historical
 - Gather Local Intelligence
- Separate the Legitimate Concern from the Disingenuous Vitriol

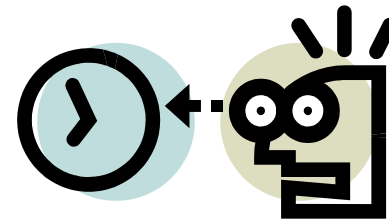


Social / Political Risk

- Pre-Project Reviews
- What are the Regulatory Agencies Not Doing?
- Get Out Front - Push NEPA / ESA - Agencies Procrastinate
- Help the Public Understanding
- What is the Public Concerned About that the Agencies Aren't Addressing?

Negative Outcomes

- Cost
- Delay
- Cost and Delay
- Delay and Cost
- Enforcement
- Incident – Injury or Fire or Spill or
- More Enforcement
- Disputes
- Project Cancellation



Mitigating the Risk

- Pre-Project Intelligence
- At the Table, Observing, Monitoring
- Expert Reviews and Evaluations
- Collaboration - “Technical Advisory Group”
- Think and Act Like Government
- Get Out Front of Political and Social Issues
- Ensure Participants Up and Down the Chain are Vested



Helping Hands

- Credits

- O.B. Harris, O.B. Harris, LLC, Houston, Texas
- Bill Byrd, RCP Inc., Houston, Texas
- Tom Jensen, Holland & Hart, Washington, DC

About SNR Denton

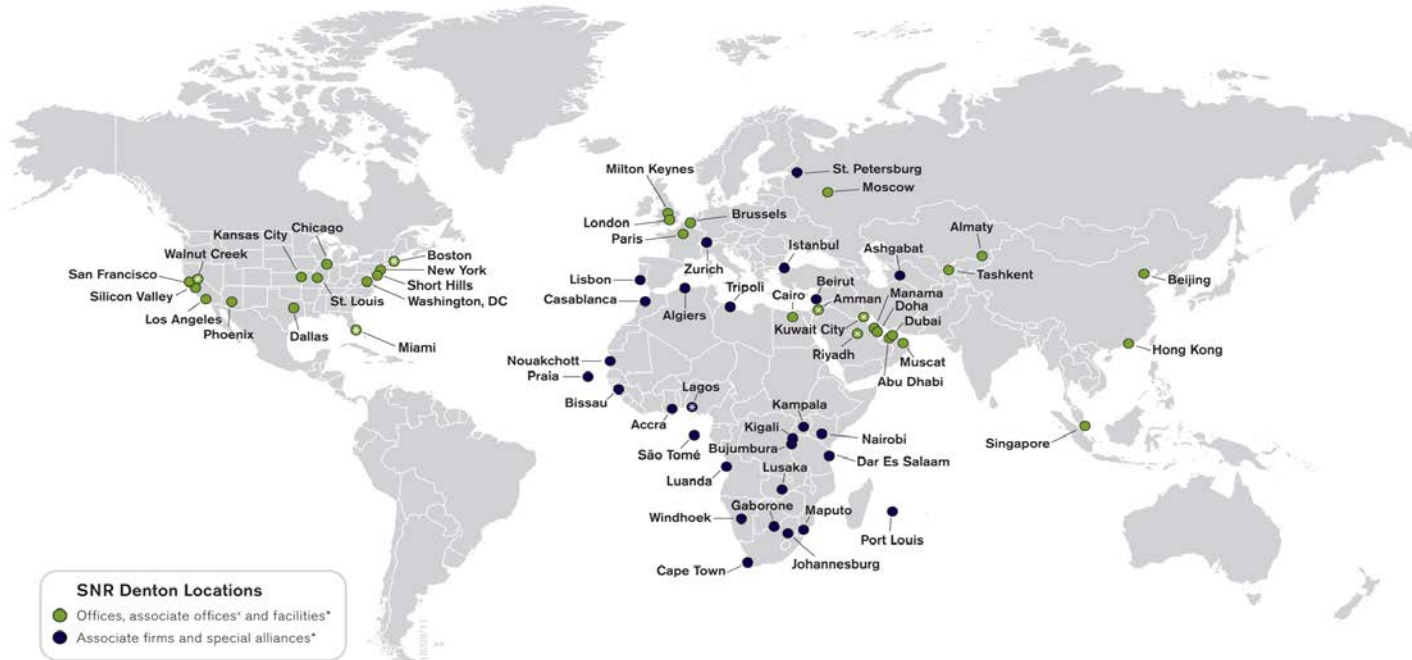
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