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Blog Post

Industry Update: Texas Mandates All Texas-Produced Natural Gas Be First Made Available for Sale to Power Producers Before Export Out-of-State

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On February 17, 2021, Texas Governor Greg Abbott, citing emergency powers, issued a mandate directing the Texas Railroad Commission (“RRC”), the state’s oil and gas regulator, to require “all [Texas] sourced natural gas be made available for sale to local power generation opportunities before leaving the state” temporarily through Sunday, February 21, 2021. In response, the RRC issued a formal [Notice to Operators](#) (the “Notice”) the next day restating (verbatim) the Governor’s mandate but did not otherwise issue any rules or provide any formal guidance to the industry. The lack of specificity in the Notice has left natural gas producers, shippers, marketers, customers and end-users questioning how to interpret the mandate, what the penalties will be for non-compliance (if any), and how (or whether) the RRC will enforce it, if it is enforceable at all.

Scope. The scope of the mandate is broad and would on its face seem to apply to any natural gas produced within the state of Texas that is to be shipped or transported out of the state. There are no express exceptions for existing contractual obligations or for gas already produced and in route to its final destination outside the state. There are also no express exceptions based on the means or availability of transport, the final destination, the end use of the gas, gas commingled with gas sourced outside of the state, or gas that cannot practically be transported to any “local” Texas power generator.

There is also no distinction drawn between gas in a gaseous state and gas in liquefied form, thereby presumably picking up LNG, even though LNG cannot immediately be utilized by conventional natural gas-fired power generators. The only apparent exception to the mandate is gas produced out-of-state that is being shipped through Texas to another state or country.

Right of First Refusal/First Offer Considerations. The Notice specifies that Texas-sourced gas is to “be made available for sale.” In effect, this means that producers and shippers are expected to give Texas natural gas-fired generators either a right of first refusal or right of first offer with respect to any Texas-produced natural gas that they have slated to ship out-of-state on or before February 21, 2021. The Notice does not, however, specify any sort of procedure or standards for offers or making gas available for sale, arguably affording producers/shippers seeking to comply with the Notice a measure of flexibility in how they comply with the Notice. Certain defenses could be available to producer/shippers and we encourage affected parties to reach out to their Kirkland & Ellis contacts to discuss specific defenses that could be applicable to their specific situation.

- **Offer Price.** There is no requirement to offer the prevailing market price for gas and no specified price ceilings or floors for offers. At the same time, as noted above, there are no express exceptions for existing contractual requirements.
- **Other Offer Terms & Conditions.** The Notice does not specify what terms and conditions an offer may or may not include or how long an offer must be held open. Given the lack of specificity in the Notice, a producer/shipper could take a position that it could, among other terms, require a potential customer to accept the same delivery terms that its out-of-state customers have agreed to (e.g., contract term, risk allocation, an indemnity for any losses incurred by the shipper/producer for breaching its existing contractual obligations, etc.).

Temporary. Notwithstanding the breadth of the mandate’s scope, its duration is short and it will expire by its terms on Sunday, February 21, 2021.

Penalties for Non-Compliance. None are specified in the Notice.

Enforceability. The immediate question to many is whether such a broad mandate is enforceable, even in an emergency as severe and far-reaching as the one that prompted Governor Abbott to issue it.

Governor Abbott specifically cited authority under Chapter 418 of the Texas Government Code and his disaster declaration issued on February 12, 2021; however, there is no apparent statutory authority under Texas law that would give the RRC the ability to enforce such a mandate, and RRC Commissioner Jim Wright publicly questioned whether RRC has the authority to implement the mandate, noting that the RRC likely does not have the authority to interfere with existing contracts between private companies.

The mandate may be subject to challenge as a violation of the “Commerce Clause” of the U.S. Constitution (Article I, Section 8, Clause 3), which reserves to the U.S. Congress the power to regulate commerce with foreign nations and between U.S. states (as well as commerce with Indian tribes). The U.S. Supreme Court, in interpreting the Commerce Clause, has construed it broadly as a limitation on state regulatory authority even when Congress has not enacted legislation, forbidding states from discriminating against interstate commerce and from otherwise from imposing non-discriminatory restrictions that unduly burden interstate commerce.

Finally, the mandate may also be subject to challenge as unconstitutional as a violation of the federal preemption doctrine under the Supremacy Clause of the U.S. Constitution (Article VI, Paragraph 2) and contravenes the bilateral trade terms in the U.S.–Mexico–Canada Agreement (“USMCA”), which supersede Texas law. Congress has vested the Federal Energy Regulatory Commission (“FERC”) with authority to regulate interstate natural gas transportation, and has divided between FERC and the U.S. Department of Energy (“DOE”) the authority to regulate the import and export of natural gas and the facilities used therefor. FERC and DOE have approved, and established extensive regulatory regimes governing, the transportation of natural gas, including liquefied natural gas, from Texas to neighboring states, Mexico, and numerous other foreign nations. The Notice, therefore, may be found to conflict with, or impermissibly regulate, activities that Congress has placed within exclusive federal jurisdiction through the Natural Gas Act.

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