Eminent Domain and the International Market: An Examination of Whether Midstream Companies Can Justifiably Show Public Use

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I. Introduction

The energy industry in Pennsylvania has seen rapid expansion over the past several years. Advancements in technology allow natural gas producers to tap previously unreachable shale gas reserves, bringing an unprecedented supply of fossil fuel energy to market. However, this increased supply is bottlenecked by a lack of midstream capacity. Midstream companies, whose business model revolves around the transport of fossil fuels, have launched pipeline projects that will extend across the landscape of Pennsylvania with hopes of alleviating this bottleneck. These projects will transport growing energy resources to a number of destinations. Some of these resources will be destined for regional energy markets, while others will serve as exports to the international market by way of large gas tanker ships.

Construction of these pipelines will require midstream companies to obtain hundreds, if not thousands, of rights of way agreements from Pennsylvania landowners. These rights of way will allow for the construction, operation, and maintenance of pipelines across those private properties. However, not all landowners support the expansion and construction of pipelines. Opponents of this new infrastructure will likely refuse to grant midstream companies a right of way across their land. In response, a midstream company may attempt to exercise its power of eminent domain, claiming the right to do so as a “public utility.” The effectiveness of these eminent domain proceedings will likely rest on one question: whether the use of eminent domain for the construction of pipelines satisfies the "public use" requirement when the purpose of this pipeline construction is for the transportation of natural gas products to international markets,

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1 Another issue that may be cited is the current downturn in natural gas prices. However, if developers overcome the issue of midstream capacity, use of existing fossil fuel reserves should increase, thereby correcting the current imbalance of supply and demand. PBA Environmental & Energy Law Section Newsletter Editor-in-Chief, Brandon J. Pierce, recently discussed this topic in his paper titled, “Trending Topics in Energy: The Midstream Natural Gas Sector in 2014 and Beyond”, PBA Environmental & Energy Law Section, Vol. 4, Ed. 1 (March 2014), found at http://ssrn.com/abstract=2410324.
rather than to the markets within Pennsylvania. More specifically, is public use met when natural gas (NG) and natural gas liquids (NGLs) are transported to coastal ports that will serve as export stations.\(^2\)

To resolve this question, this paper first examines the expansion of Pennsylvania’s energy production and the planned expansion of pipeline infrastructure. Next, it turns to eminent domain. To fully understand the applicability of eminent domain, this paper examines the power held by the party initiating these proceedings and the requirement that a taking by eminent domain confers a public benefit. This paper then examines the issue of whether the construction of a pipeline intended to transport natural gas and natural gas products destined for international markets satisfies the public benefit requirement for eminent domain. Lastly, it concludes whether eminent domain is a valid tool by which to acquire the right to cross private lands with these pipelines.

II. Background: The Expansion of the Energy Industry in Pennsylvania

Oil and gas developers have drilled thousands of shale gas wells since the introduction of unconventional drilling and hydraulic fracturing.\(^3\) These wells tap into fossil fuel reserves trapped at depths greater than 5,000 feet beneath the earth’s crust.\(^4\) Development of these deep shale formations has caused exponential growth in the production of natural gas products.\(^5\) In an effort to market this abundance, several midstream companies have proposed the construction of new pipelines that will transport natural gas products to, and through, eastern parts of

\(^2\) The most commonly referred to export stations include Cheniere Energy Partners’ Sabine Pass and Dominion’s Cove Point.
\(^3\) While hydraulic fracturing and horizontal drilling have both been utilized for years, it is the pairing of these technologies that has led to the industry’s recent shale development success.
Pennsylvania. Also note, that reference to natural gas _products_, rather than simply NG, has the potential to be an important distinction in any of these future eminent domain proceedings.

Reference to natural gas products includes both NG and NGLs. NGLs include ethane, propane, butane, isobutene, and pentane. The distinction between NG and NGLs is also relevant to the commodities market because the price of NGLs is highly influenced by the price of crude oil. This influence comes from the fact that propane as a commodity competes directly with crude oil based fuels. As the price of crude oil increases, fuels derived from crude oil also experience a similar increase. Since propane competes with these products, its price as a commodity responds to supply and demand, thereby experiencing a similar increase in price. At the time of this article’s publication, NGLs have a potentially higher profit margin than NG, resulting in the increased targeting and development of liquids-rich shale plays (rather than solely dry gas plays).

A number of companies are leading the charge for the construction of these pipelines, with some intending to transport NG, while others will transport NGLs. Sunoco Logistics is one company intending to transport NGLs by way of its proposed Mariner East pipeline. A second group of energy companies has proposed the PennEast Pipeline, which would transport NG to both Pennsylvania and New Jersey.

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8 Id.
9 Id. Petroleum yields a number of heating fuels used by the consumer, including heating oil, kerosene, and propane. Therefore, as the price of one commodity increases, commodities competing in the same market experience similar increases in price. U.S. ENERGY INFORMATION ADMINISTRATION, [http://www.eia.gov/tools/faqs/faq.cfm?id=41&t=6](http://www.eia.gov/tools/faqs/faq.cfm?id=41&t=6).
Also relevant to note is the recent decision by Dominion and its business partners to construct the Cove Point Liquefied Natural Gas (LNG) Terminal.\textsuperscript{13} While it appears that the current plan is to use existing pipeline and rights of way to transport NG to this facility for liquefaction,\textsuperscript{14} future pipeline projects may be proposed to increase the volume of NG received and exported. If such an event were to occur, some eminent domain questions may still be at issue.\textsuperscript{15}

The export of natural gas products to the international market is an emerging industry within the United States. The Marcus Hook Industrial Complex intends to participate in this new industry by exporting NGLs to both domestic and European markets, as well as other overseas locations.\textsuperscript{16} Projects such as Dominion’s Cove Point should also be online sometime in the year 2017, and will provide for the export of LNG produced in the United States to countries overseas (such as India and Japan).\textsuperscript{17}

To date, it is known that at least a large portion of the Marcus Hook NGLs destined for the international market will flow through Sunoco Logistics’ Mariner East pipeline.\textsuperscript{18} It is this fact that will likely spur the discussion of whether eminent domain is appropriate if the pipeline is used primarily for the transport of energy overseas and not to the citizens of Pennsylvania.

\textbf{III. Eminent Domain and the International Energy Market}

With new agreements being executed between American and international energy companies, it remains unclear what volume of natural gas products flowing through these new pipelines will be made available to the local markets. Sunoco Logistics is already engaged in a

\begin{footnotesize}
\textsuperscript{13} \textsc{Dominion Cove Point}, \url{https://www.dom.com/covepoint}.
\textsuperscript{14} \textsc{Petro Wiki}, \url{http://petrowiki.org/Liquified_natural_gas_%28LNG%29}.
\textsuperscript{15} \textsc{Dominion Cove Point}, \url{https://www.dom.com/covepoint}.
\textsuperscript{16} \textsc{Sunoco Logistics}, \url{http://www.sunocologistics.com/Customers/Business-Lines/Terminal-Facilities/Marcus-Hook-Industrial-Complex/232/}.
\textsuperscript{17} \textsc{Dominion Corporate News Releases}, \url{https://www.dom.com/corporate/news/news-releases/136996}.
\textsuperscript{18} \textsc{Sunoco Logistics}, \url{http://www.sunocologistics.com/Customers/Business-Lines/Natural-Gas-Liquids-NGLs/NGL-Projects/208/}.
\end{footnotesize}
dispute regarding this fact, which lends support to the proposition that local markets may receive little benefit from these natural gas products being transported.\textsuperscript{19} The filings in that case state that Sunoco Logistics’ purpose for the pipeline is to provide energy suppliers with reserves so that they can reach “local, regional, and international markets.”\textsuperscript{20} However, Sunoco Logistics’ filings also state that if demand exceeds pipeline capacity, then interstate shippers with contractual agreements are guaranteed the full capacity allotted under each respective agreement.\textsuperscript{21} Parties without a contractual agreement will receive their capacity of NGLs “subject to allocation” among all shippers without contractual agreements.\textsuperscript{22} With this in mind, what if the reserves transported by the Mariner East pipeline are purchased entirely by exporters? How will this affect eminent domain proceedings?

Eminent domain is the power of a state to take, or authorize the taking of, “private property for a public use without the owner’s consent” subject to the payment of just compensation.\textsuperscript{23} If none of the NGLs flowing through these new pipelines are made available for purchase by the local market, then the very purpose of eminent domain is seemingly defeated. There would be no public use because everything would be going to the overseas consumer.

With a growing demand for exported natural gas products, the possibility that NGLs transported by the Mariner East pipeline never see local or even domestic markets is not too far-fetched. The courts will need to justify the finding of public use in order to meet all elements of an eminent domain proceeding. Absent this finding, the courts may be inclined to deny these midstream companies the ability to appropriate private lands. The outcome of this problem will

\textsuperscript{19} Pennsylvania Public Utility Commission Docket No. 2014-2411941, Rewrite Opinion and Order 10/2/2014. Note however, Sunoco Logistics has withdrawn these petitions with the hope of resolving these issues with the public before pursuing further legal action.

\textsuperscript{20} Id.

\textsuperscript{21} Id.

\textsuperscript{22} Id.

\textsuperscript{23} BALLENTINE’S LAW DICTIONARY, 2010 Lexis Nexis.
rest on an analysis of the statutory requirements of eminent domain and relevant case law, in
addition to an examination of the circumstances surrounding this emerging export industry.

IV. Regulation and Adjudication of Eminent Domain

Eminent domain is often met with criticism, and for good reason. The citizens of
Pennsylvania are granted the “inherent and indefeasible” right to possess and acquire property by
the Commonwealth’s Constitution.24 This ideal has been fundamental to our country since the
Declaration of Independence identified the “pursuit of happiness” as one of the unalienable
rights held by man.25 However, individual rights must sometimes bend to the rights of the public.

Both the Pennsylvania and the United States Constitution allow for the appropriation of
private lands if it is necessary for the public good. Article I, Section 10 of the Pennsylvania
Constitution26 grants this authority, as well as the Fifth Amendment of the United States
Constitution.27 To understand what this authority means and how it may be exercised, a greater
look at Pennsylvania’s statutes and case law are necessary.

We will first examine the statutory requirements of eminent domain and the public use
requirement. Next, we will look at what a finding of public use in an eminent domain analysis
could mean for local municipalities. Lastly, we will examine the ways in which Pennsylvania
courts interpret the statute and its public use element.

A. Statutory Requirements of Eminent Domain

Eminent domain is “the power of the Commonwealth to take private property for public
use in return for just compensation.”28 The element of public use is paramount to the legitimate

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24 PA. CONST. art. I, § 1.
25 Declaration of Independence (US 1776).
26 PA. CONST. art. I, § 10. (“[P]rivate property [shall not] be taken or applied to public use, without authority of law
and without just compensation being first made or secured.”).
27 U.S. Const. amend. IV (“No person shall . . . be deprived of life, liberty, or property, without due process of law;
nor shall private property be taken for public use, without just compensation.”).
exercise of eminent domain. In furthering the requirement of public use, 26 Pa.C.S. § 204 prohibits the use of “eminent domain to take private property in order to use it for private enterprise.” However, this statute does allow an exception for public utilities. Public utilities may exercise eminent domain through the authority granted in 15 Pa.C.S. § 1511. It states in pertinent part that:

(a) A public utility corporation shall, in addition to any other power of eminent domain conferred by any other statute, have the right to take, occupy and condemn property for one or more of the following principal purposes and ancillary purposes reasonably necessary or appropriate for the accomplishment of the principal purposes:

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(2) The transportation of artificial or natural gas, electricity, petroleum or petroleum products or water or any combination of such substances for the public.
(3) The production, generation, manufacture, transmission, storage, distribution or furnishing of natural or artificial gas, electricity, steam, air conditioning or refrigerating service or any combination thereof to or for the public.

A public utility is defined by statute as “any person or corporations now or hereafter owning or operating in this Commonwealth equipment or facilities for transporting or conveying natural or artificial gas, crude oil, gasoline, or petroleum products . . . by pipeline or conduit, for the public for compensation.” The public use requirement is present in all of the above statutes, supporting the fact that this element is crucial when depriving a landowner of their property rights.

30 Property Rights Protection Act, May 4, 2006, P.L. 148, § 1; 26 Pa.C.S. § 204(a)
31 Id. at 26 Pa.C.S. § 204(b)(2)
32 15 Pa.C.S. § 1511.
B. Eminent Domain and Local Zoning

The outcome of this public use issue will also affect the ability of local municipalities to zone for facilities associated with these new pipelines. The Municipal Planning Code allows for certain exemptions from zoning in the event a facility is “reasonably necessary for the convenience and welfare of the public.” More specifically, this statute states:

This article shall not apply to any existing or proposed building, or extension thereof, used or to be used by a public utility corporation, if, upon petition of the corporation, the Pennsylvania Public Utility Commission shall, after a public hearing, decide that the present or proposed situation of the building in question is reasonably necessary for the convenience or welfare of the public.

Based on the foregoing, local municipalities that desire to regulate shale gas activity within their boundaries through the means of local zoning will have a stake in the outcome of this issue. Depending on how this issue is resolved, communities may, or may not, be able to regulate its presence.

C. Eminent Domain in the Courts

Case law is instructive on how courts will interpret the public use requirement. Courts hold that an enterprise is private or public based on “whether or not it is open to the use and service of all members of the public who may require it,” not the number of persons whom actually use it. The fact that only a limited number of people use a utility service “does not make it a private undertaking,” so long as the “general public has a right to subscribe to it.” The court must also examine the manner in which the enterprise solicits “business from end users.”

34 53 P.S. § 10619.
35 15 Pa.C.S. § 10619.
Courts interpret the language “to or for the public” in 15 Pa.C.S. 1511(a)(3) as contemplating two different actions. They have held “to” the public means the act of “supplying natural gas directly to individual end-users,” while “for” the public means the “intermediate step of selling natural gas to other pipelines for resale directly” to end users. While the court used only the language “natural gas” and not “natural gas products,” it is likely that this distinction would have no effect in the event of an adjudication involving natural gas products, including NGLs.

In Drexelbrook, a landlord sought to be classified as a public utility when he supplied his tenants with gas, electricity, and water. These services were to be provided to only those individuals who shared the landlord-tenant relationship. The court found that there were no services being furnished to the public. Stating that the appropriate test is “whether or not it is open to the use and service of all members of the public who may require it,” not upon the number of persons by whom it is used, the court held that the proposed arrangement did not meet the meaning of a public utility. The court also found persuasive the Public Utility Commission (PUC) Chairman’s comment, stating that the test “is not whether all tenants are being furnished service, but whether anybody from the public outside of the apartment could demand service.”

In Bethlehem Steel, Energy Production Company was engaged in the production and sale of NG to interstate pipeline and distribution companies. Energy Production then decided to explore alternative markets and entered into an agreement with Bethlehem Steel Corporation for

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41 Id.
42 Drexelbrook, 212 A.2d at 432-33.
43 Id. at 436.
44 Id. at 439.
45 Id.
46 Id. at 436.
47 Bethlehem, 713 A.2d at 137.
the sale of NG. Energy Production and Bethlehem Steel entered into a subsequent agreement naming Energy Production as the sole NG provider for Bethlehem. The parties then constructed a pipeline for the supply of NG to the Bethlehem Steel facilities. Bethlehem Steel’s previous NG provider, Peoples Natural Gas Co., filed suit, claiming Bethlehem violated the Public Utility Code because they were not a certified public utility company. The court found that while supplying NG to only one exclusive consumer did not qualify Energy Production as a public utility, they also had to look at whether Energy Production solicited and attempted to secure other consumers. Facts showed that Energy Production made proposals and had negotiations with other companies about being a supplier; however, there were never any finalized agreements. The court held that mere “negotiations concerning the possibility of public utility activity” did not warrant finding that Energy Production engaged in public utility activities. The court went on to further state that “it is for the legislature, not the [PUC] or this court to determine what business activity comes within the purview of the [PUC].”

In Kovalchik, National Fuel sought to condemn a portion of a private landowner’s property for the purpose of constructing pipelines that would gather gas from local NG producers. The landowner objected, seeking injunctive relief from the courts arguing that there is no statutory grant of power to exercise eminent domain when constructing only gathering lines. The court turned to the language of 15 Pa.C.S. 1511 in order to determine the issue and

48 Id.
49 Id. at 138
50 Id.
51 Id.
52 Id. at 142-43
53 Id. at 143-44.
54 Id.
55 Id. at 144.
57 Id. at 25-26.
relied on the language “to or for the public” when deciding that case. The court held that the language “to or for the public” contemplates two different actions, and that selling NG to the intermediate market for the resale to individual end-users would meet the “for the public” requirement. The court concluded that National Fuel’s exercise of eminent domain was valid based on this holding.

V. How Will Courts Reconcile Exports with Eminent Domain

Courts will likely find that the public use requirement is met even though the majority of natural gas products transported through newly proposed pipelines may be exported. However, the courts should be highly critical of the facts and circumstances surrounding the use of eminent domain in this scenario. Both the courts and legislators should work to ensure that this expanding marketplace is not allowed to condemn private property simply for the purpose of transporting their product to the international market.

Sunoco Logistics and similar companies propose that their pipelines will bring increased supply to local, regional, and international markets. Such an assertion is likely not enough to show that the public use element will be met. A greater examination of the factors should be undertaken. Turning to the agreements that Sunoco Logistics is entering into, it is possible that exporters will contractually speak for all of the NGLs entering the Mariner East pipeline. In such a case, none of the proposed pipelines will be serving the residents of Pennsylvania and will likely fail to meet the public use requirement. This scenario resembles the one decided in Drexelbrook, where only the parties in a contractual landlord-tenant agreement were able to purchase the utilities offered. Just like the landlord in Drexelbrook, Sunoco Logistics would be contractually obligated to provide natural gas products to companies exporting these fuels to the

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58 Id. at 27-28.
59 Id. at 30-31.
60 Id.
international energy market. This also places Sunoco Logistics outside of the issue and facts
decided in Kovalchick, because the natural gas products are not being sold to an intermediate for
later sale to the individual consumer. Lastly, this type of arrangement is also prohibited under 26
Pa.C.S. § 204, which prohibits the use of eminent domain for private enterprise, unless the actor
falls within the definition of a public utility.61

However, if midstream companies allocate some of these products (including NGLs) to
local use, the element of public use is arguably shown. This reasoning still stands even if
exporters speak for the majority of the natural gas products supply. This is in line with
Drexelbrook, which required only a showing that the utility is available to those of the public
who require it. However, this should not be the only factor examined by a court. Just as the court
did in Bethlehem Steel, a court deciding this issue should examine whether Sunoco Logistics or
its peers marketed these natural gas products to other parties. An analysis of these marketing
activities should also include an examination of what practices were used. Given the fact that
international markets may prove more financially lucrative than local markets, a court should
examine whether local and domestic companies can bid competitively with exporters. If there is
a financial inability for domestic markets to secure a share of the gas products being transported
by the proposed pipelines, then such transportation should not be considered for the “public use”
because the public is essentially priced out of and can no longer participate in the marketplace.
Instead, the sole purpose would appear to be transportation to the international market in order
for the company to reap the financial rewards.

It is unclear what percentage of the natural gas products being transported through these
pipelines will be made available to the local markets. However, if these local markets are able to
secure a share sufficient enough to resell within that market, then the element of public use

should be met with ease. The legislature seemingly recognized the value and need for energy throughout the Commonwealth when providing public utility companies with the power to use eminent domain.

Even if the midstream companies can show that construction is for the purpose of public use, continued oversight should occur. The export of natural gas products into the international market is a new venture for the United States. There is potential for abuse in the event international market prices see a sharp uptick sometime after pipeline construction is complete. Local supplies may be cut back in favor of higher profits on exports. If this were to happen, the public use element would be defeated. However, public use would be a moot point at that time because eminent domain proceedings would be complete and the pipelines constructed. Therefore, some form of continued oversight should occur to ensure that upfront availability of supplies to the domestic market is not merely a façade to show public use.

VI. Conclusion

Property rights are important to the private landowner. This point is one in which the founding fathers of this country were willing to start a revolution over. However, even the rights of the private landowner must bend to the greater needs of the general public.

Both the Pennsylvania and Federal legislatures identify public use as a justifiable reason for appropriating private lands. Public utilities enjoy greater deference than most when exercising this power of eminent domain. The traditional use of eminent domain by these companies has always fit within the meaning of public use, but the expansion of these companies into the international market may test the limits of that tradition. Pipelines that would normally transport natural gas products to the individual end-user will now transport this energy to export stations, where it will be destined for the overseas consumer. The introduction of these export
markets into the eminent domain proceedings will continue to blur the line between public use and private enterprise until we fully understand the demand of the overseas consumers.