King & Spalding

Client Alert

Global Transactions Practice Group

December 19, 2012

FERC Issues Report Discussing Office of Enforcement Audit of Rockies Express Pipeline LLC

The Federal Energy Regulatory Commission issued an Audit Report on November 29, 2012 summarizing the audit of Rockies Express Pipeline LLC performed by the Office of Enforcement's Division of Audits (Docket No. PA11-5-000). The Audit Report provides useful insights into the conduct of a FERC audit of an interstate natural gas pipeline company, the detailed information that Audit Staff will examine and the Office of Enforcement's expectations regarding strict compliance with FERC's accounting, posting, and tariff implementation requirements.

Audit Staff identified a number of areas in which Rockies Express had failed to comply with FERC requirements or provisions of the pipeline's tariff. The report describes a total of fifteen recommendations to remedy these areas of noncompliance. Rockies Express has agreed to implement all of the Staff recommendations. In addition, Rockies Express has agreed with Staff recommendations that it (i) submit plans for implementing the Staff's recommendations, (ii) prepare nonpublic quarterly submissions describing its progress in implementing Staff's recommendations, and (iii) submit nonpublic copies of all written policies and procedures developed in response to Staff's recommendations. The audit report does not discuss imposition of any other penalties or sanctions against Rockies Express.

The scope of the audit was broad, covering the following areas: (1) the requirement to file contracts with material deviations under Section 154.1(d) of the Commission's regulations; (2) application of select portions of Rockies Express' FERC Gas Tariff, including those governing penalties, balancing mechanisms, capacity allocation, and tracking mechanisms; (3) accuracy of certain information submitted in FERC Form No. 2, including fuel use, fuel retention, and gas imbalances; (4) proper implementation of the North American Energy Standards Board (NAESB) standards; and (5) proper maintenance of the Index of Customers. The audit covered the 40-month period from January 2009 through April 2012.

Force Majeure Tariff Provisions

The Audit Report notes that, in *Natural Gas Supply Association*, 135 FERC ¶ 61,055 (2011), the Commission directed its Audit Staff to evaluate whether pipeline tariffs comply with the Commission's force majeure and reservation charge crediting policies. The Audit Report describes two areas in which

For more information, contact:

James F. Bowe, Jr.
+1 202 626 9601
jbowe@kslaw.com

William E. Rice
+1 202 626 9602
wrice@kslaw.com

Grace Su
+1 202 626 2952
gsu@kslaw.com

King & Spalding
Washington, D.C.
1700 Pennsylvania Avenue NW
Suite 200
Washington, D.C. 20006
T: +1 202 737 0500
F: +1 202 626 3737

www.kslaw.com

Rockies Express' tariff was not in full compliance with the relevant FERC polices. First, the tariff did not provide for full reservation charge credits for non-force majeure outages. The tariff required such crediting if Rockies Express failed to schedule at least 98% of a shipper's nominations, rather than 100%. Second, the tariff's definition of force majeure included items that Staff found could be within the pipeline's control. Staff recommended adding the words "unplanned or emergency" before force majeure language describing repairs, alterations or replacements. Rockies Express has filed to make the indicated tariff revisions in Docket No. RP12-765-000.

Compliance with the Uniform System of Accounts

Pipelines subject to cost-based rate regulation must comply with FERC's Uniform System of Accounts (18 C.F.R. Part 201 (USofA)).[1] The Audit Report describes USofA noncompliance with regard to Rockies Express' accounting for shipper imbalances, cash-outs, and revenue credits. The Audit Report notes similar noncompliance with regard to accounting for fuel and electric power tracker costs. Interestingly, the Audit Report does not question the accuracy of the numerical accounting entries, but rather is limited to discussing the accounts to which Rockies Express should have booked the entries. The Audit Report provides a roadmap describing the USofA accounts which Rockies Express needs to use to achieve compliance. Rockies Express agreed to implement the accounting changes identified in the Audit Report.

Inaccurate Reporting of Incidental Purchases and Sales

The Audit Report notes that Rockies Express did not adhere to its tariff in reporting incidental natural gas purchases and sales. The Audit Report discusses the steps Rockies Express must take to comply with its tariff, and the company has agreed to make the changes. The Audit Report recommends that Rockies Express refile its 2009 and 2010 annual reports of incidental purchases and sales to reflect final allocated purchase and sales instead of planned and confirmed purchases and sales. This is one of the few areas in which Rockies Express was required to refile information with the Commission to comply with Staff recommendations.

Noncompliance with Form No. 2 Instructions

The Audit Report discusses Rockies Express' failure to comply with certain Form No. 2 filing instructions, for the most part related to reporting of natural gas quantities. One particular area of interest concerns noncompliance with respect to page 520, which requires reporting of a pipeline's overall physical sources and uses of gas. Page 520 information is significant because FERC uses the reported natural gas service quantities to allocate its annual charges to pipelines. Thus, inaccuracies in page 520 information could have financial consequences. Page 520 is a concern for virtually all jurisdictional natural gas pipelines; even market-based rate storage providers granted a Form No. 2 waiver are required to file page 520 to facilitate FERC's ACA calculations.

---

[1] Independent storage companies authorized to charge market-based rates are generally granted waivers of the USofA requirements. In granting such waivers, however, the Commission requires a market-based rate storage company to maintain accounts and financial information in accordance with generally accepted accounting principles, which as a practical matter suggests a format similar to that required under the USofA.

Posting Errors and NAESB Standards Compliance

The Audit Report identified a number of areas of noncompliance resulting from inaccurate information found on Rockies Express' web site, including errors in the index of customers and available capacity postings. Staff also noted failures to comply with the NAESB standards applicable to website design. Some of the areas of noncompliance seem relatively minor, such as posting a change in available capacity one day late or using the label "Tariffs" instead of the NAESB specified "Tariff." Staff attributed much of the observed noncompliance to administrative error and recommended that Rockies Express strengthen its controls and procedures to avoid such errors in the future and to ensure the accuracy of information.

Conclusion

The Audit Report highlights the level of detail that is likely to be involved in a FERC audit of an interstate pipeline. It also shows that FERC's Office of Enforcement will seek strict compliance with all of the Commission's requirements. Much of the identified noncompliance appears to be the result of simple errors, which could have been avoided.

While monetary penalties were not imposed, it is clear that Rockies Express will need to expend considerable resources to comply with the Audit Report's recommendations. The clear message pipelines and storage companies should take away from the Rockies Express Audit Report is that they should review their procedures to ensure compliance with the Commission's requirements and devote adequate resources to ensure continued compliance, including robust steps to ensure the accuracy and timeliness of filed, recorded and posted information.