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FERC Issues Final Audit Reports for Colonial Pipeline Company and Enterprise Product Partners L.P.

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The Federal Energy Regulatory Commission (FERC) Division of Audits and Accounting (DAA), Office of Enforcement, completed audits of Colonial Pipeline Company (Colonial) and Enterprise Product Partners L.P. (Enterprise) on June 17, 2015. The audits, which were initiated on February 6, 2014, took nearly a year and a half to complete. Both audits focused on each of the pipeline's compliance with FERC regulations for oil pipeline companies, with particular focus on their compliance with accounting and financial reporting regulations. The reports are significant because they represent the first time FERC Staff has conducted a comprehensive review of interstate oil and products pipelines' regulatory compliance in over 20 years. The Colonial audit identified five areas of noncompliance and made 14 recommendations to ensure future compliance. The Enterprise audit found 10 areas of noncompliance, including affiliate issues, and made 25 recommendations. Both companies have since initiated internal procedures to satisfy the audits' findings. They each have 30 days to submit to FERC their plans for implementing DAA's recommendations.

Background

Colonial and Enterprise are two of the country's largest interstate pipeline companies. Colonial owns and operates the largest-volume refined liquids petroleum products pipeline in the United States. It carries gasoline, kerosene, home-heating oil, and jet fuel to cities, airports, and military bases throughout the country. The Enterprise audit focused on Enterprise's subsidiary, Mid-America Pipeline Company, LLC (MAPL), which is a natural gas liquids (NGL) pipeline system with approximately 8,000 miles of pipeline.

Audit Findings and Recommendations

The Colonial audit identified five areas of non-compliance. These included Colonial's improper use of the consolidated method of accounting, as opposed to the equity method of accounting, to report its investment in three affiliates. Colonial also improperly reported interest during construction and certain non-operating expenses, such as donations, charitable contributions, and lobbying activities, as well as regulatory fees payable to Federal agencies. DAA explained which accounts those monies should have been reported to under its Uniform System of Accounts for Oil Pipeline Companies. In addition, DAA identified an improper inclusion of certain costs related to Colonial's intrastate pipeline services on Page 700 of its FERC Form 6, the annual financial report filed by all interstate oil pipeline companies. DAA determined that these areas of noncompliance did not affect Colonial's calculations of carrier property or total payables and operating expenses reported on the FERC Form 6. Importantly, DAA concluded that the areas of noncompliance did not affect the pipeline's rates because Colonial does not have any cost-of-service based rates on its system. All of Colonial's rates are derived using the FERC index methodology or are market-based.

The 14 recommendations for future compliance were split more or less evenly between the five areas of noncompliance. They require Colonial to update its policies and procedures to ensure that proper accounting is performed prospectively. Colonial was asked, however, to restate its 2013 FERC Form 6 page 700 with the corrected amounts in its 2014 Form 6. DAA also asked Colonial to submit reports, and the developed written policies and procedures, for its review.

The Enterprise audit identified 10 areas of non-compliance related to maintenance of MAPL's accounts. DAA found that MAPL did not apply correct rates to intermediate points for two series of intermediate price movements involving an affiliate on its system from 2011 to 2012. This resulted in an under recovery of revenues of $1.7 million, and MAPL did not report this amount as affiliated company transactions. MAPL also improperly accounted for depreciation, resulting in a higher depreciation expense and larger accumulated reserve totaling $2.3 million. Smaller dollar values were attributed to MAPL's misreporting of carrier property, charitable contributions, and damages. There were also accounting errors related to relocation expenses, retained income, and prepaid leases. Finally, MAPL failed to file a cash management agreement when it established its cash management program, which should have been filed within 10 days of the effective date of the rule or entry into the program.

The 25 recommendations for future compliance were directed at MAPL, specifically, and Enterprise, generally. They focused on Enterprise implementing and improving employee training and updating documentation to incorporate new compliance policies for DAA's review. DAA also asked Enterprise to refile MAPL's 2011, 2012, and 2013 FERC Form 6's to correct the identified accounting errors. Additionally, DAA recommended that Enterprise develop a process to detect and review unexplained variances in its books and records. There also were prospective recommendations, such as removing the dollar threshold limitation for all prepaid lease payments in its accounting records on a going forward basis starting with 2014.

The Enterprise audit report noted Enterprise's robust separation of functions program, which segregated pipeline transmission and marketing function employees to prevent undue affiliate preferences. The audit report acknowledged that this strict separation is mandatory for natural gas pipelines, and that FERC's regulations do not contain the same code of conduct restrictions for oil pipelines. However, FERC's explicit reference to Enterprise's program suggests that it may expect other oil pipeline companies to follow suit.

Implications

The Colonial and Enterprise audits represent the first FERC audits of oil pipeline companies in over 20 years. To provide perspective, between 2008 and 2014, DAA issued reports on 224 audits, all of which were for natural gas and electric companies. Within the past year, FERC announced that it was beginning audits of two additional oil pipeline companies, Enbridge Energy Partners LP and Plantation Pipe Line Company. FERC Staff has stated that FERC will continue to audit oil pipeline companies.

According to FERC's annual report of its enforcement activities, the audit process "is designed to enable company compliance staff to replicate procedures DAA employs in its audits and provides companies with the necessary information to evaluate their compliance programs." Audits are a rigorous and time consuming process for the subject companies. The Colonial and Enterprise audits both took over a year to complete, during which time the companies were required to participate in several meetings, on-site and at FERC; to host DAA staff site-visits; to participate in employee interviews; to hold DAA-initiated trainings; and to respond to hundreds of data requests. The specter of audits has led several oil pipeline companies to evaluate their compliance programs and to assess their risks regarding FERC enforcement. Several companies are using compliance programs intended to comply with the Natural Gas Act as models for compliance with the Interstate Commerce Act, the governing statute for oil pipelines.

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