

FERC Flexes Muscle Over Pipeline Shipments And Audits

Law360, New York (March 13, 2014, 6:06 PM ET) -- In February 2014, the Federal Energy Regulatory Commission issued two sets of orders expanding the use of its powers under the Interstate Commerce Act of 1887, well beyond FERC's traditional boundaries. The first category of orders relates to pipeline propane shipments to the Midwest and Northeast — regions that have experienced severe propane shortages in recent months. The second category of orders initiates audits of liquids pipeline companies for compliance with the entirety of FERC's liquids pipeline regulations.

Orders to Alleviate Propane Shortages

In early February, the National Propane Gas Association and certain of its members ("NPGA") filed a request for emergency relief with FERC under Section 1(15) of the ICA,[1] which permits FERC to "give directions for preference or priority in transportation" when it believes that "congestion or traffic, or other emergency" require immediate action.

The NPGA sought an order from the agency directing Enterprise TE Products Pipeline Company LLC to provide priority propane transportation service from the market/storage hub at Mont Belvieu, Texas, to propane storage facilities in the Midwest and Northeast. The NPGA explained that, among other things, extreme cold weather events this winter had caused high and increasing demand for propane, resulting in shortages and increased prices for the commodity. The NPGA further noted that extraordinary propane shortages in these regions could lead to inadequate heating, resulting in a threat to persons and livestock.

The interstate transportation service provided by Enterprise TE is subject to FERC's jurisdiction under the ICA. Such pipelines are required by statute to provide common carrier service. This obligation is typically met through the pipeline's capacity allocation, or prorationing, procedures which are designed to provide all shippers making reasonable requests for service with a reasonable opportunity to access pipeline capacity.

Enterprise TE provides "batched" transportation service, meaning that the pipeline transports segregated liquid hydrocarbons in batches; however, the pipeline's prorationing procedures provide firm (i.e., priority) capacity for contract shippers of diluent, with propane batches receiving lower priority. The NPGA requested that FERC exercise its emergency authority under Section 1(15) of the ICA to modify these priorities by directing Enterprise TE to prioritize propane shipments over shipments of diluent. The NPGA also noted that FERC could, if necessary, order Enterprise TE to reverse its ATEX pipeline — designed to transport ethane from the Northeast to the Gulf Coast — to provide propane service from the Gulf Coast to the Northeast.

FERC issued a notice on Feb. 6, 2014, requesting comments on the NPGA request by Feb. 11. However, on Feb. 7, FERC acted on its own authority under Section 1(15).

FERC found emergency conditions requiring immediate agency action. In particular, FERC relied on a Jan. 28, 2014, U.S. Department of Homeland Security report, which found that: (1) the U.S. Department of Transportation had issued emergency declarations in 35 states and the District of Columbia to facilitate the delivery of propane to residential and commercial customers, (2) states were providing emergency heating assistance to certain residents as a result of rising propane prices and (3) extreme cold weather events in the U.S. were expected to continue, with additional states/regions likely to extend/issue emergency declarations.

FERC further noted that companies were “short-filling” customer propane tanks in the Midwest and Northeast, that certain counties in Tennessee and Alabama had closed schools due to lack of propane for heat and that many states were curtailing propane deliveries to commercial and municipal facilities in order to provide propane to residential customers.

As a result, FERC directed Enterprise TE to provide priority transportation service for propane for seven days pending further action by the agency. FERC also encouraged further comments regarding the status of propane supplies, consumption rates and pricing. FERC did not address the NPGA’s request that FERC order Enterprise TE to reverse its ATEX ethane pipeline. On Feb. 10, Enterprise TE made a filing with FERC confirming its compliance with the order and, based on an agreement with the NPGA, requested an order that would enable the pipeline to provide priority service to propane shipments for an additional seven days. The NPGA filed a notice of withdrawal of its petition which became effective on Feb. 11, when FERC extended the priority propane service through Feb. 21.

Since the Department of Energy Organization Act established FERC and gave it authority over liquid hydrocarbon pipelines in 1977, the commission has never acted on its authority under Section 1(15) of the ICA. However, FERC did so now to address an extraordinary situation.

FERC’s responsiveness to the NPGA request indicates an agency priority to protect the public interest in a timely manner. Notably, FERC acted without any public comment by the pipeline’s diluent shippers, notwithstanding that the commission’s order could have impacted a wide array of commercial arrangements for those customers. Further, FERC’s emergency action has not alleviated the concerns of the NPGA.

On March 6, 2014, the President and CEO of the NPGA testified before the House Energy and Commerce Committee’s Subcommittee on Energy and Power, advocating a number of actions, including a review of federal propane export policies, a Federal Trade Commission investigation to evaluate propane market performance, increased transparency regarding liquids hydrocarbon pipeline operations and the need for additional infrastructure.

It remains to be seen whether there will be any momentum to address these issues as the winter season comes to an end and, with it, the cold weather events the NPGA identified as the “most direct[]” cause of propane shortages in the U.S. With respect to FERC, it is not expected that emergency action will become the new normal for liquids pipelines, although FERC has certainly demonstrated its willingness to do so when a bona fide emergency exists that can be alleviated by prioritizing certain categories of transportation service.

Audits of Liquids Pipeline Companies

Also in February, FERC's Office of Enforcement initiated compliance audits of two liquids pipeline companies: Colonial Pipeline Company and Enterprise Products Partners LP, with subsidiary Mid-America Pipeline Company LLC being the primary focus of the Enterprise audit.

FERC has the authority to undertake compliance audits with respect to other types of regulated entities (e.g., natural gas pipelines), and such audits are common place. However, FERC has not previously exercised its audit authority over liquids pipeline companies with any level of frequency, much less in this level of detail. Prior FERC audits of liquids pipeline companies have been limited to compliance with accounting and financial reporting requirements. However, in the letters initiating these audits, the scope is identified as encompassing the "regulations for oil pipeline companies in parts 340-357, including the Uniform System of Accounts in 18 C.F.R. pt. 352 and FERC Form No. 6 financial reporting requirements in 18 C.F.R. Section 357.2."

Collectively, these are the entirety of FERC's liquids pipeline regulations. Thus, in addition to addressing accounting and financial reporting compliance, it appears that these audits will include a much broader review by FERC than those previously undertaken, including, for example, a review for compliance with rate setting and tariffs, rate methodologies and procedures and depreciation study requirements.

While it is not possible to know at this time whether these audits will be confined to Colonial and Enterprise or are part of a new FERC approach to liquids pipeline compliance, these audits strongly suggest that FERC-regulated liquids pipeline companies should pay heightened attention to their compliance posture.

Liquids pipeline companies should consider undertaking annual compliance reviews, subject to consultations with counsel regarding the appropriate scope and processes. Such internal audits could consist of, for example, a review for the following: (1) whether service on liquids pipeline assets has been properly classified as interstate, intrastate or both based on current operating conditions; (2) whether all tariff filing and posting requirements have been met; (3) whether jurisdictional service has been provided in a manner that is not unduly discriminatory or unduly preferential; (4) whether the pipeline has proper documentation to support any initial rates set by agreement of an unaffiliated third party; (5) whether the rate indexing procedures have been followed and properly documented; (6) whether the company is keeping its books and records in accordance with the Uniform System of Accounts for Oil Pipeline Companies; (7) whether the company has kept its records in accordance with the applicable record retention requirements; and (8) whether the company has correctly and timely filed its quarterly and annual reports.

While this scope for an internal review may be wider than that of any audit, it is not unusual for FERC's audit staff to identify issues beyond those encompassed by the initial audit. Moreover, undertaking periodic compliance reviews is generally a good practice for any regulated entity.

—By Michelle Boudreaux, Caldwell Boudreaux Lefler PLLC

Michelle Boudreaux is a partner in Caldwell Boudreaux Lefler's Houston office.

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[1] 49 App. U.S.C. Section 1(15) (1988).

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