FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA19-9-000

November 12, 2020

Maritimes & Northeast Pipeline, L.L.C.
Attention: Ms. Jennifer Rinker
FERC Compliance Officer
P.O. Box 1642
Houston, TX 77251-1642

Dear Ms. Rinker:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (Commission) has completed an audit of Maritimes & Northeast Pipeline, L.L.C. (Maritimes). The audit covered the period January 1, 2017 through December 31, 2018.

2. The audit evaluated Maritimes' compliance with: (1) accounting requirements of the Uniform System of Accounts Prescribed for Natural Gas Companies under 18 C.F.R. Part 201; (2) reporting requirements of the FERC Form No. 2, Annual Report for Natural Gas Companies, under 18 C.F.R. § 260.1; and (3) select provisions of Maritimes' FERC Natural Gas Act Tariff (Tariff). The enclosed audit report contains seven findings, one other matter, and 23 recommendations that require Maritimes to take corrective action.

3. On October 30, 2020, you notified DAA that Maritimes does not intend to contest any of findings of noncompliance and corresponding recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.

4. Maritimes should submit its implementation plan to comply with the recommendations within 30 days of this letter order. Maritimes should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar

quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311. This letter order constitutes final agency action. Maritimes may file a request for rehearing of this letter order with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713.

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of non-compliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Ms. Kristen Fleet, Acting Director and Chief Accountant, Division of Audits and Accounting at (202) 502-8063.

Sincerely,

JANEL BURDICK Digitally signed by JANEL BURDICK Date: 2020.11.10 07:40:54 -05'00' for

Larry R. Parkinson
Director
Office of Enforcement

Enclosure

Federal Energy Regulatory Commission
Office of Enforcement
Division of Audits and Accounting

AUDIT REPORT

Audit of Maritimes & Northeast Pipeline, L.L.C.'s compliance with:

- Accounting Requirements of the Uniform System of Accounts Prescribed for Natural Gas Companies in18 C.F.R. Part 201;
- Reporting Requirements of the FERC Form No. 2, Annual Report for Major Natural Gas Companies; and
- Select Provisions in Maritimes & Northeast Pipeline, L.L.C.'s Tariff.

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I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (Commission or FERC) has completed the audit of Maritimes & Northeast Pipeline, L.L.C. (Maritimes). The audit evaluated Maritimes' compliance with: (1) accounting requirements of the Uniform System of Accounts Prescribed for Natural Gas Companies under 18 C.F.R. Part 201; (2) reporting requirements of the FERC Form No. 2, Annual Report for Natural Gas Companies, under 18 C.F.R. § 260.1; and (3) select provisions of Maritimes' FERC Natural Gas Act (NGA) Tariff (Tariff). The audit covered the period January 1, 2017 to December 31, 2018.

B. Maritimes & Northeast Pipeline, L.L.C.

Maritimes is owned by three companies: (1) Spectra Energy Partners, LP (SEP) (77.53 percent); (2) Emera Incorporated (12.92 percent); and (3) Exxon Mobil Corporation (9.55 percent). On February 27, 2017, Spectra Energy Corp (SEC), the parent company of SEP, merged with Enbridge Inc. (Enbridge), making SEC a wholly owned subsidiary, and SEP an indirect subsidiary, of Enbridge. In December 2018, Enbridge entered into another merger transaction, whereby it acquired the outstanding public common units of SEP. Enbridge now owns SEP. Following the merger transaction, SEP was converted from a master limited partnership (MLP) to a corporation. As a result, Maritimes' profits or losses are now distributed to a taxable entity (a corporation), rather than a pass-through entity (an MLP).

Maritimes' pipeline starts at the U.S.-Canadian border in Baileyville, ME and from that point extends to Dracut and Beverley, MA. A portion of Maritimes' system, extending from Westbrook, ME to Dracut and Beverly, is jointly owned with Portland Natural Gas Transmission System (PNGTS). Maritimes' pipeline is operated and managed by two affiliates: (1) M&N Management, LLC (M&N Management) and (2) M&N Operating Company (M&N Operating). M&N Management handles the daily management functions for Maritimes, such as finance, external relations, accounting, regulatory compliance, and marketing. M&N Operating operates and maintains the pipeline, including physical operation, maintenance, and repair of the system, certain technical services, preparing operating budgets, and maintaining records.

C. Summary of Compliance Findings

Audit staff identified seven areas of noncompliance, which are summarized below. Section IV of this report contains a detailed discussion of the audit findings.

<u>Accounting and Reporting</u>

1. *Allocation of Labor Burden and Overhead Costs to Capital Projects* – Maritimes did not record labor burden and overhead costs to capital projects based on actual costs as required by the Commission. Instead, Maritimes used allocation percentages, for which it did not perform timely studies and maintain appropriate records. This prevented audit staff from verifying whether the allocation percentages used to reimburse affiliates were reasonable and representative of actual costs.

2. *Reporting of O&M Expenses for Incremental Rate Projects* – Maritimes did not perform a study to support the allocation percentage used to assign operations and maintenance (O&M) expenses to its incremental rate projects. Absent a study, audit staff could not determine whether this allocation percentage was reasonable and representative of the actual O&M expenses assigned to incremental rate projects. Maritimes also improperly aggregated maintenance expenses with operating expenses, rather than separately reporting these expenses for its incremental rate projects in its FERC Form No. 2. This reduced the accuracy and completeness of these expenses reported for Maritimes' incremental rate projects.

3. *Accounting for Nonoperating and Unrelated Expenses* – Maritimes' affiliates allocated to Maritimes certain nonoperating expenses and costs that had no relationship to its interstate pipeline operations, which Maritimes improperly recorded in operating expense accounts. Operating expenses are recoverable, while nonoperating and unrelated expenses are generally nonrecoverable from customers in cost of service rates. Therefore, recording these expenses improperly imposes a risk of including and recovering these expenses in future cost of service rate determinations.

4. *Accounting for Operating Expenses* – Maritimes improperly accounted for certain operating expenses, such as transmission operating expenses, regulatory activities, and legal fees, in a manner inconsistent with the Commission's accounting regulations. While these accounting misclassifications had no impact on total operating expenses, the misclassifications nevertheless reduced the accuracy and transparency of

operating expenses as reported in Maritimes' FERC Form No. 2 filings.

5. *FERC Form No. 2 Reporting* – Maritimes did not report complete information as required in certain supporting schedules of its 2017 and 2018 FERC Form No. 2 reports. This reduced the overall accuracy and usefulness of the information reported in the FERC Form No. 2.

FERC Tariff and Rates

6. *Fuel Retainage Quantity Filings* – Maritimes misreported the deferred fuel balance and negative lost and unaccounted for gas (LAUF) in its annual Fuel Retainage Quantity filings. Maritimes also did not separately break out its deferred fuel balance from other activities reported on Page 268, Miscellaneous Current and Accrued Liabilities, in its FERC Form No. 2 reports. These oversights reduced the accuracy and the usefulness of Maritimes' Fuel Retainage Quantity filings and FERC Form No. 2 reports for shippers and other stakeholders during the audit period.

7. *Reservation Charge Crediting* – Section 8 of Maritimes' Tariff contained general terms and conditions that were inconsistent with the Commission's reservation charge crediting policy. Maritimes also improperly included references to maintenance activities in the *force majeure* definition in section 26 of its Tariff. Making these tariff terms and conditions consistent with the Commission's policy will ensure that shippers are properly credited reservation charges for *force majeure* and non-*force majeure* events.

D. Other Matter

Audit staff identified one other matter, which is summarized below. Section V of this report contains a detailed discussion of this other matter.

1. *Tariff Penalty Crediting Provisions* – Maritimes' tariff provisions for scheduling penalties and park and loan penalties contain some inconsistencies with Commission policy. Although these provisions are in Maritimes' approved Tariff, updating these provisions will better align them with Commission policy, and provide the appropriate outcomes for assessing penalties to offending shippers and crediting back penalty revenues to non-offending shippers.

E. Recommendations

Audit staff's recommendations to remedy this report's findings are listed below. Section IV also contains these detailed recommendations for each finding. Maritimes will need to implement corrective actions to address each recommendation:

Allocation of Labor Burden and Overhead Costs to Capital Projects

1. Create policies and procedures to directly assign costs to capital projects or perform periodic studies of actual labor costs to ensure allocation percentages are reasonable and representative of actual costs, in accordance with General Instruction No. 9 (GI No. 9) and Gas Plant Instruction No. 4 (GPI No. 4).

2. Revise policies, procedures, and controls to ensure it maintains all records of studies supporting allocation percentages in accordance with General Instruction No. 2 (GI No. 2), if direct assignment of costs is impractical for capital projects.

3. Directly assign costs for capital projects; however, if direct assignment of costs is deemed impractical, Maritimes should provide the evaluation it conducted to make this determination. Subsequently, conduct a study to support the allocation percentages that Maritimes determines should be used to reimburse its affiliates for labor burden and overhead costs. Provide study results, including supporting documentation, to DAA within 90 days of receiving the final audit report.

4. Based on the study results, if the 100 and 130 percentage factors previously used are determined to be unreasonable or excessive compared to the results of the study, then adjust plant in service and other affected account balances for those amounts in accordance with GI No. 2(E) for the affected periods. Submit journal entries, calculations, and other supporting documentation within 30 days of receiving audit staff approval of the study performed and its results.

Reporting of O&M Expenses for Incremental Rate Projects

5. Revise policies and procedures to ensure FERC Form No. 2 Pages 217-217a are completed in accordance with the reporting instructions, including separately reporting maintenance expenses from operating expenses.

6. Conduct a study to support the allocation percentage used for assigning O&M expenses that are not directly assigned to incremental rate projects. Provide the study results, including supporting documentation, to DAA within 90 days of the receiving the audit report.

7. Train relevant staff on the revised methods to account for expenses related to incremental rate facilities and provide periodic training, as needed.

Accounting for Nonoperating and Unrelated Expenses

8. Revise policies, procedures, and controls to track, review, and account for nonoperating expenses and for expenses unrelated to its business allocated to it by affiliates consistent with Commission requirements.

9. Provide a recent journal entry and supporting documentation that demonstrate that the accounting misclassifications identified in this finding have been corrected and the related costs are now recorded in accordance with the Commission's accounting requirements.

10. Perform an analysis of expenses allocated to Maritimes by its affiliates to identify all nonoperating and other expenses unrelated to Maritimes' business operations that were incorrectly recorded as operating expenses by Maritimes during the audit period. This analysis should capture expenses in addition to those already identified during and subsequent to the audit period. Within 90 days of the date of the final audit report, provide results of the analysis, proposed correcting entries, and all applicable work papers supporting the analysis, to DAA.

11. Train relevant staff on the revised methods to account for nonoperating expenses and unrelated expenses and provide periodic training, as needed.

Accounting for Operating Expenses

12. Revise policies, procedures, and controls to track, report, review, and account for administrative and general (A&G) and operating expenses consistent with the Commission's accounting regulations.

13. Provide a recent journal entry, and supporting documentation, which demonstrates that the identified accounting misclassifications are now recorded in accordance with the Commission's accounting regulations.

14. Train relevant staff on the revised methods to account for A&G and operating expenses and provide periodic training as needed.

FERC Form No. 2 Reporting

15. Revise policies and procedures to ensure complete and accurate information is reported in the FERC Form No. 2 in accordance with the instructions of the report.

16. Review the reporting deficiencies with relevant staff to ensure they include on a prospective basis all required information in the FERC Form No. 2.

Fuel Retainage Quantity Filings

17. Revise procedures and controls to ensure that Maritimes calculates, and reports deferred fuel balances consistently with section 20 of its Tariff.

18. Update procedures to ensure that positive and negative LAUF are included as a component of Customer Use Gas in the projected fuel retainage percentage (FRP) calculation of its annual fuel filings, on a prospective basis. Also, provide footnote disclosures in the annual fuel filing as needed to increase transparency.

19. Discuss the procedural changes that resulted in an over collection in deferred fuel balance with shippers. Maritimes should provide DAA with documentation to support that these discussions occurred and the outcome with shippers before its next fuel retainage quantity filing.

20. Inform Maritimes' staff that prepares the supporting schedule for Account 242 of the FERC Form No. 2 to break out each activity comprising the account balance according to the reporting threshold amount required by the instructions, including breaking out Maritimes' cumulative deferred fuel balance when it exceeds the reporting threshold.

Reservation Charge Crediting

21. Revise policies and procedures to establish and maintain compliance with Commission's reservation charge crediting requirements.

22. File tariff revisions made to its reservation charge crediting provisions for *force majeure* and non-*force majeure* events in sections 8.8 and 8.9 of its

Tariff, and remove (i) maintenance activities from its definition of a *force majeure* event and (ii) any restrictions on non-*force majeure* events from its definition of non-*force majeure* event, in section 26 of its Tariff. File these tariff revisions with the Commission within 60 days of the issuance of this report.

23. Make an informational posting to inform shippers of the revisions made to tariff sections 8.8, 8.9, and 26.

F. Compliance and Implementation of Recommendations

Audit staff further recommends that Maritimes submit to DAA for review:

- Plans for implementing corrective actions that address each recommendation within 30 days after the issuance of this report;

- Quarterly reports describing Maritimes' progress in completing corrective actions taken for each recommendation. Maritimes should submit these nonpublic quarterly reports no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the Commission issues this audit report, and continuing each quarter until Maritimes completes all recommended corrective actions; and

- Copies of written policies and procedures developed or updated in response to the audit report's recommendations; copies of journal entries made to correct accounting errors and deficiencies; and other information supporting the corrective actions made. Maritimes should submit these documents for audit staff's review in the first nonpublic quarterly report after it completes them.

II. Background

A. Maritimes' Pipeline System

Maritimes and Northeast Pipeline (M&NP) is a high-pressure pipeline system that transports natural gas domestically and internationally. M&NP begins at production fields located offshore in Goldboro, Nova Scotia, extends through Nova Scotia and New Brunswick to the U.S.-Canadian border near Baileyville, ME, and from the border through Westbrook, ME to Dracut and Beverly, MA. The 341-mile Canadian portion of the pipeline system stretches from Goldboro to Baileyville and is owned by Maritimes' affiliate, Maritimes & Northeast Pipeline L.P. The 343-mile portion of the pipeline system in the United States stretches from Baileyville to Westbrook and is owned by Maritimes; the portion stretching from Westbrook to Dracut and Beverly is jointly owned with PNGTS. Maritimes is a party to an operating agreement with PNGTS, which was responsible for the construction of the jointly owned facilities.

M&NP was constructed in 1999 and was originally designed to transport gas supplies from the Sable Offshore Energy Project's (SOEP) processing plants, located in Nova Scotia, to the U.S.-Canadian border and through Maine and New Hampshire, with one terminus in Dracut, MA and another in Beverly, MA.[1] At these locations, Maritimes interconnects with Tennessee Gas Transmission and Algonquin Gas Transmission L.L.C. (Algonquin). In recent years, the production of the SOEP processing plants has gradually decreased, and SOEP wells are currently shut-in and the processing plants are off-line. This is primarily due to the lower price of U.S. domestically produced gas from the Marcellus Shale area located in the Appalachian Basin of the United States. Because SOEP production has diminished, gas now flows primarily south to north on Maritimes' system. Currently, Maritimes' gas supplies enter M&NP from PNGTS in the U.S., with additional supplies entering from Canaport LNG LP's and Corridor Resources Inc.'s (Corridor) receipt points on M&NP in Canada.[2]

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[1] SOEP was Canada's first offshore natural gas project. Offshore exploration, followed by formation of a joint venture and initiation of regulatory application processes, led in 1998 to approval of the development of SOEP as well as construction of M&NP, which would carry Sable natural gas to markets in Nova Scotia, New Brunswick, and the U.S. Northeast. According to SOEP's website, December 31, 2018 marked the end of natural gas production from the project. *See* www.soep.com.

[2] Canaport LNG LP is a Canadian limited partnership jointly owned by Repsol S.A. and Irving Oil Ltd., which operates an LNG import facility in Saint John, New Brunswick. Corridor is a Canadian corporation which, among other activities, explores

B. Maritimes' Rates and Services

Maritimes filed an NGA section 4 rate case with the Commission in Docket No. RP15-1026-000 on May 29, 2015.[3] On January 27, 2016, Maritimes filed a formal settlement proposal, which reduced its rates for all services to a level below the rates then in effect, which the Commission accepted.[4] The settlement included a rate moratorium, which stipulated that the rates established by the settlement were to remain in effect until at least November 1, 2019. The settlement also included a comeback provision, which required Maritimes to file a new rate case by July 1, 2020.[5] Additionally, the settlement provided that once the Atlantic Bridge Project was placed in service, Maritimes' rates would be reduced a second time. The Atlantic Bridge Project is a construction project between Maritimes and its affiliate, Algonquin, which is intended to move natural gas into New England and to specific end-use markets in the Canadian Maritime provinces. The project's application was filed with the Commission in Docket No. CP16-9-000, and the project is still under construction.

The maximum recourse rates charged to shippers under Maritimes' Tariff are based on the straight-fixed variable (SFV) rate design methodology. Under the SFV methodology, fixed costs are recovered through a reservation charge and variable costs are recovered through a commodity charge. Shippers have the option to execute negotiated rate contracts for services offered under the Tariff. During the audit period, eight shippers held about one-third of Maritimes' total pipeline capacity on a firm basis. One shipper among those eight held nearly 80 percent of that firm capacity under a negotiated rate agreement. With respect to the other seven firm shippers, only one had a negotiated rate agreement. The negotiated rates were less than the Tariff recourse rates.

During the audit period, Maritimes' Tariff contained a fuel retainage quantity (FRQ) tracker; an interruptible revenue sharing mechanism; and an annual charge adjustment (ACA) tracker. Maritimes FRQ tracker recovered the cost of gas used in operations, including LAUF, and a cash true-up for any under- or over-recoveries of gas

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for and develops natural gas resources in New Brunswick. In March 2020, Corridor changed its name to Headwater Exploration Inc.

[3] On June 30, 2015, the Commission accepted and suspended Maritimes' filing, subject to refund, and establishing hearing and settlement procedures. *Maritimes & Northeast Pipeline, L.L.C.,* 151 FERC ¶ 61,272 (2015).

[4] *See Maritimes & Northeast Pipeline*, *L.L.C.*, 154 FERC ¶ 61,182 (2016).

[5] Maritimes submitted this filing on May 29, 2020. *Maritimes & Northeast Pipeline, L.L.C.,* Docket No. RP20-921, Section 4 Rate Case Filing (May 29, 2020).

realized as a result of operations. Maritimes used the interruptible revenue sharing mechanism tracker to share equally with all mainline shippers' interruptible revenues collected in excess of $6.2 million during a twelve-month period from August 1 of the preceding year to July 31 of the current year. Maritimes' ACA tracker recovered Commission-assessed annual charges. Maritimes was required under its Tariff to make annual filings with the Commission detailing changes in its FRQ tracker and interruptible revenue sharing mechanism tracker.

C. Implementation of the 2017 Tax Cuts and Jobs Act

On July 18, 2018, the Commission issued Order No. 849, finalizing its procedures and regulations regarding the effect of reduced corporate income taxes on natural gas pipelines and their rates.[6] Notably, Order No. 849 required interstate natural gas pipelines to file "FERC Form No. 501-G," a one-time abbreviated cost and revenue study designed to illustrate the effect of reduced corporate income tax rates, which the Commission could use to determine whether the pipeline's rates may be unjust and unreasonable under the NGA. The Commission's order proposed four options to account for reduced corporate income tax rates; Maritimes chose the waiver option.[7]

On November 1, 2018, Maritimes filed a request seeking waiver of the FERC Form No. 501-G filing requirement. The Commission agreed and granted a waiver

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[6] In December 2017, President Trump signed the Tax Cuts and Jobs Act into law, which reduced the marginal federal corporate income tax rate from 35 to 21 percent. In response, on March 15, 2018, the Commission issued a Notice of Proposed Rulemaking proposing to require interstate natural gas pipelines to file new FERC Form No. 501-G. *See Interstate and Intrastate Natural Gas Pipelines; Rate Changes Relating to Federal Income Tax Rate*, 83 FR 12,888 (Mar. 26, 2018), FERC Stats. & Regs. ¶ 32,725 (2018) (the NOPR). On July 18, 2018, the Commission issued its final rule in Order No. 849. *See Interstate and Intrastate Natural Gas Pipelines; Rate Changes Relating to Federal Income Tax Rate*, Order No. 849, 164 FERC ¶ 61,031 (2018), *reh'g denied*, Order No. 849-A, 167 FERC ¶ 61,051 (2019).

[7] The four options included: (1) file a limited NGA section 4 filing to reduce the pipeline's rates to reflect the decrease in the federal corporate income tax rate pursuant to the Tax Cuts and Jobs Act and the elimination of the income tax allowance for master limited partnership pipelines consistent with the Revised Policy Statement, (2) make a commitment to file a general NGA section 4 rate case in the near future, (3) file a statement explaining why an adjustment to its rates is not needed, or (4) take no action other than filing the One-time Report.

because Maritimes had a rate moratorium in effect until November 1, 2019.[8] Even though Maritimes received the waiver, it nonetheless made accounting entries to adjust its accumulated deferred income taxes in response to the corporate income tax rate change. Specifically, Maritimes decreased its deferred income tax liability by $78.4 million and increased its deferred income tax asset by $30.3 million and offset these amounts by a $108.7 million increase to its regulatory liability account on December 22, 2017. On September 10, 2018, SEP, on behalf of its pipeline affiliates, including Maritimes, filed with the Commission a request to eliminate accumulated deferred income taxes, requesting to record these amounts to income as an adjustment to retained earnings.[9] This request was made to address the Commission's ruling in Order No. 849 directing jurisdictional pipelines to eliminate tax allowances from cost of service rates when they distribute income to MLPs.[10] As of December 31, 2019, Maritimes had not removed these balances, as the Commission had not acted on SEP's request.

D. Related Party Transactions

As noted above in Section I, Maritimes is operated and managed by two affiliates: M&N Management and M&N Operating. However, all employees and shared services are provided by Enbridge, Maritimes' corporate parent, and Texas Eastern Transmission, LP (Texas Eastern), an affiliated Commission-regulated interstate natural gas pipeline. Enbridge provides all corporate and shared services – such as information technology, human resources, legal, and finance services, the cost of which is allocated to its subsidiaries, including M&N Management. Texas Eastern provides all operating services – such as asset integrity, technical, engineering, and construction services, the cost of which is allocated to its affiliates, including M&N Operating. Pursuant to an omnibus agreement and operating agreement with M&N Management and M&N Operating, respectively, costs are then allocated to Maritimes.

Historically, M&N Management and M&N Operating allocated all non-labor costs at the invoice price; and all labor costs at 100 and 130 percent above employees' base salaries, respectively, pursuant to their agreements with Maritimes. However, Maritimes represented during the audit that since the merger of Enbridge and SEC in February 2017, Enbridge has continued to implement process improvements to better capture and report data internally and externally. Maritimes represented that these improvements have allowed operating costs to be directly assigned to Maritimes, without compromising the

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[8] *Maritimes & Northeast Pipeline*, *L.L.C.*, 165 FERC ¶ 61,174 (2018).

[9] *Spectra Energy Partners, L.P.*, Docket No. AC18-220-000, Request for Approval by Chief Accountant (Sept. 10, 2018).

[10] Order No. 849, 164 FERC ¶ 61,031, at PP 6-9, 49-62.

allocation of shared services from affiliates. However, even though process improvements have been made for the direct assignment and allocation of operating expenses, Maritimes still allocates capital costs from M&N Management and M&N Operating based on the omnibus and operating agreements. Maritimes confirmed that it has no plans to refine the allocation percentages being used.

Additionally, Maritimes' affiliates, Texas Eastern and Enbridge, are currently making refinements to their direct assignment and allocation of non-construction related expenses. One such example pertains to how central function costs are charged to affiliates. Prior to 2019, all central function costs were allocated to all affiliates, including costs that only benefited one entity. Starting in 2019, central function costs that only benefit one entity have been directly charged to that entity. For example, legal fees incurred solely for the benefit of Texas Eastern are now directly assigned to Texas Eastern, rather than being allocated among all affiliates. Maritimes recognized during the audit that it should not be allocated costs that it does not benefit from. As a result, Maritimes continued to make process changes and improvements in 2019 and 2020, while the audit was ongoing, to remove costs that it did not benefit from and to prevent the allocation of these types of costs to Maritimes. Due to these ongoing process changes, audit staff focused its examination on 2017 and 2018 capital project costs, O&M expenses, and A&G expenses.

III. Introduction

A. Objectives

The audit evaluated Maritimes' compliance with: (1) accounting requirements of the Uniform System of Accounts Prescribed for Natural Gas Companies under 18 C.F.R. Part 201; (2) reporting requirements of the FERC Form No. 2, Annual Report for Natural Gas Companies, under 18 C.F.R. § 260.1; and (3) select provisions of Maritimes' Tariff. The audit covered the period January 1, 2017 to December 31, 2018.

B. Scope and Methodology

Audit staff performed the following actions to facilitate the testing and evaluation of Maritimes' compliance with Commission requirements relevant to the audit objectives:

<u>Audit Planning, Processes, and Administration</u>

- *Review of Public Information* – Reviewed publicly available materials to understand Maritimes' corporate structure and subsidiaries, pipeline system operations, and affiliate and parent company relationships. Reviewed Commission filings and orders to understand Maritimes' transportation rates and other rate mechanisms. This review also covered significant regulatory actions, such as certificated projects, tariff modifications, accounting filings and decisions, and other key matters. Reviewed Maritimes' Tariff provisions, rate schedules, and service agreements; FERC Form No. 2 and 3Q filings; Security and Exchange Commission Forms 10-K and 10-Q; main corporate website; and informational postings on its electronic bulletin board, along with information in news media and on other internet websites.

- *Conferred with Commission Staff* – Conferred with other Commission offices about certain tariff provisions and to ensure that the audit report findings were consistent with Commission precedent and policy.

- *Regulatory Requirements and Criteria* – Reviewed regulatory requirements and criteria to evaluate Maritimes' compliance with each audit objective. This included applicable accounting and reporting requirements, tariff provisions, rate filings and orders, and other relevant regulatory cases involving Maritimes or other companies.

- *Opening and Closing Conferences* – Held an opening conference to explain the audit process, address questions, clarify basic information, and discuss data requests and site visit procedures subsequent to commencing the audit. At the conclusion of audit field work, held a closing conference to discuss audit report findings and recommendations, and next steps in the audit process.

- *FERC Data Requests* – Issued formal data requests and emails to obtain information and documents that were not publicly available. Data requests served to collect evidence relating to Maritimes' policies, procedures, accounting and reporting practices, and other practices that were evaluated for compliance.

- *Conference Calls* – Held regular teleconferences with Maritimes on administrative and technical matters. These discussions clarified the company's policies and procedures, enhanced audit staff's understanding of information received in data responses, and addressed administrative matters relating to data requests, site visits, and audit progression.

- *Site Visits* – Conducted two site visits at Maritimes' headquarters in Houston, TX. Each site visit provided the opportunity to discuss matters in person, perform on-site inspection and analysis, and observe and evaluate underlying procedures, practices, and controls supporting compliance.

    - *Initial Site Visit* – Discussed corporate structure and affiliate relations, pipeline operations and related tariff provisions, accounting and billing systems, historical and effective rates, and surcharges and tracking mechanisms. Observed and discussed business practices, procedures, and internal control structures for various accounting and reporting matters. Interviewed employees and managers responsible for performing tasks within the audit's scope.

    - *Second Site Visit* – Obtained a detailed understanding of Maritimes' key accounting and operational practices and procedures. Audit staff's interviews and discussions focused on Allowance for Funds Used During Construction (AFUDC), Construction Work in Progress (CWIP), affiliate transactions, nonoperating expenses, pipeline operations, tracking mechanisms, and FERC Form No. 2 accounting and reporting.

- *Board of Directors Meeting Minutes and Audit Committee Meeting Minutes* – Reviewed corporate Board of Directors meeting minutes and Audit Committee meeting minutes to identify audit risks relating to the audit scope.

- *Audit Testing* – Tested Maritimes' compliance with the Commission's accounting and financial reporting requirements, and select tariff provisions by evaluating, on a sample basis, evidence supporting the amounts reported in the

FERC Form No. 2, and the activities and documents supporting the operational requirements of Maritimes' FERC Tariff.

Maritimes Tariff Requirements

Rate Filings and Commission Orders

- *Natural Gas Rate Filings and Orders* – Reviewed Maritimes' filings and related Commission orders establishing rates, including recourse rates, negotiated rates, and tracking mechanisms, effective in the audit period.

Operational Balancing Agreements

- *Processes and Procedures* – Reviewed Maritimes' processes and procedures for managing, tracking, and documenting operational balancing agreements (OBAs) with other pipelines.

- *OBAs* – Reviewed Maritimes' OBAs and system maps to determine whether Maritimes had OBAs at all interconnection points in accordance with its Tariff and Commission policy. Additionally, reviewed the terms and conditions of each OBA to determine whether Maritimes was complying with the requirements of each OBA.

Pipeline Transportation Capacity

- *Processes and Procedures* – Examined Maritimes' processes and procedures for quantifying, marketing, and posting firm and interruptible capacity to understand and evaluate consistency with its Tariff.

- *Transparency of Available Capacity* – Analyzed processes to offer customers capacity through open seasons and evaluated whether they were transparent and user-friendly for new and existing customers.

- *Capacity Allocation Practices and Postings* – Observed, through an on-site walkthrough of Maritimes' system, the operation of Maritimes' capacity allocation process, to assess whether Maritimes allocated capacity consistent with its Tariff when nominations at a receipt or delivery point exceeded available capacity. Reviewed Maritimes' electronic bulletin board postings to determine whether Maritimes posted noncritical and critical notices when capacity allocations occurred.

Pipeline Transportation Rates and Shipper Billings

- *Tariff Rate Schedules* – Reviewed rate schedules in Maritimes' Tariff to understand the transportation services and rates available to customers.

- *Shipper Billings* – Tested a sample of firm and interruptible customer invoices to determine whether Maritimes charged the appropriate cost-based rates specified in its Tariff or, alternatively, the appropriate rates specified in conforming or non-conforming negotiated rate agreements.

- *Transactional Report Postings* – Evaluated a sample of transactional reports to determine whether the postings complied with 18 C.F.R. § 284.13. Compared a sample of postings to customer invoices to test whether the postings reflected the rates charged to shippers.

- *Index of Customers* – Reviewed Maritimes' index of customers to determine whether it was updated quarterly, and whether data was consistent between the index of customers, transactional report postings, and billing invoices.

Tracking and Balancing Rate Mechanisms

- *Tracker Filings* – Reviewed a sample of Maritimes' tracker filings and compared balances in the filings to Maritimes' FERC Form No. 2 filings, volumetric measurement reports, and general ledger. Verified source data supporting quantities reported in tracker filings for 2018 and examined calculations for data accuracy. Checked select appendices in Maritimes' tracker filings against supporting documents to determine whether information filed with the Commission was accurate. Discussed with Maritimes specific components of Maritimes' tracker filings, protests to such filings, and measures Maritimes took to comply with related Commission orders.

- *Accounting for Trackers* – Analyzed journal entries for Maritimes' tracking mechanisms to determine whether Maritimes properly accounted for related costs, such as regulatory assets and liabilities, depreciation, and amortization.

Tariff Penalties

- *Penalty Revenue Sharing* – Reviewed Maritimes' tariff to determine whether it contained a provision for crediting penalty revenues to non-offending shippers and whether the language was consistent with the Commission's regulations.

- *Waiver of Penalties* – Evaluated transactions and interviewed Maritimes personnel to assess whether Maritimes' waiver of penalties was applied on a non-discriminatory basis consistent with its Tariff.

Reservation Charge Crediting Practices

- *Commission Policy* – Reviewed the Commission's reservation charge crediting policy directing audit staff to scrutinize pipelines' compliance in audits.[11]

- *Reservation Charge Crediting Methodology* – Reviewed Maritimes' Tariff for *force majeure* and non-*force majeure* event definitions and applicable reservation charge crediting provisions for consistency with Commission policy statement.

- *Force Majeure and Non-Force Majeure Events* –Evaluated *force-majeure* and non-*force majeure* events to understand the circumstances, whether Maritimes' classified these events appropriately, and whether affected firm shippers were appropriately credited for a reduction in nominated or scheduled capacity. Determined whether Maritimes made corresponding postings on its electronic bulletin board for *force majeure* or non-*force majeure* events in the form of critical and noncritical notices.

<u>Uniform System of Accounts Requirements</u>

- *Accounting Processes, Procedures, and Controls* – Evaluated Maritimes' financial accounting processes, procedures, and controls established to comply with the accounting requirements under 18 C.F.R. Part 201. Interviewed Maritimes' employees responsible for accounting policies, procedures, and practices to determine how these employees ensure that Maritimes' decisions align with the Commission's accounting requirements.

- *Chart of Accounts* – Reviewed Maritimes' chart of accounts to understand the account coding used to record journal entry transactions.

- *Accounting Systems* – Discussed Maritimes' accounting systems to understand the operations, inputs and outputs, and the interrelationships between modules

[11] *See Natural Gas Supply Ass'n,* 135 FERC ¶ 61,055, at P 28 (urging pipelines to come into compliance with the Commission's reservation charge crediting policy and directing audit staff to examine pipelines' tariffs and practices during audits for such compliance), *reh'g denied*, 137 FERC ¶ 61,051 (2011).

and feeder systems supporting Maritimes' general ledger and subledgers.

- *Significant Accounting Matters* – Tested select balance sheet and income statement accounts to determine whether the amounts recorded therein complied with Commission accounting regulations under 18 C.F.R. Part 201. Examples of significant accounting matters examined included:

  - *AFUDC* – Tested Maritimes' calculation of debt and equity AFUDC rates. This included the components of the capital structure used to determine the capital ratio, the method used to calculate the monthly accrual, and the accounting for AFUDC. More specifically, this included evaluating the support for the balances and cost rates used to derive the debt and equity components of the AFUDC rate calculation, and the application of short-term debt as the first source of financing. Besides these tests, audit staff reviewed Commission decisions involving the maximum AFUDC rate, rate orders involving Maritimes' AFUDC rate calculation, and past audit reports.

  - *CWIP* – Evaluated construction activities for projects to test whether the costs qualified as a component of construction under the Commission's Uniform System of Accounts. Examined Maritimes' process for placing capital projects into service and designation of property retirement units, and related account classifications.

  - *Capital Improvements and General Maintenance* – Evaluated Maritimes' capital improvement and general maintenance justification and approval process. Obtained an overview of the project life cycle, which encompassed each phase from creation to completion. Examined the assignment of costs – such as labor, overhead, and materials and supplies – to project work orders, and related accounting decisions.

  - *Depreciation Rates and Expense* – Verified the application of Commission-approved depreciation rates and the calculation of depreciation expense. Evaluated depreciation-related accounts and traced amounts from the FERC Form No. 2 to the general ledger. Reviewed disclosures in the FERC Form No. 2 filings for unusual activities or adjustments in depreciation accounts.

  - *Affiliate Transactions* – Reviewed affiliate transactions to determine whether Maritimes recorded revenues and costs, for the goods and services it provided or received, in the appropriate account. This included a review of M&N Management's and M&N Operating's charges to assess whether direct and shared costs were properly collected, allocated, and recorded.

  - *Operating and Nonoperating Expenses* – Examined operating expense accounts to determine whether Maritimes recorded nonoperating expenses (e.g., lobbying expenses, charitable contributions, penalties, fines, and entertainment expenses) in operating expense accounts. Examined whether Maritimes recorded operating expenses in the proper expense accounts.

  - *Current and Deferred Income Taxes* – Reviewed the adjustments made to the deferred tax and regulatory asset and liability accounts in response to the Tax Cuts and Jobs Acts of 2017 and Maritimes' related FERC Form No. 501-G filing required in response to the Commission's Order No. 849.

  - *System Gas Accounting* – Reviewed system gas activities to understand Maritimes' accounting for imbalances, line pack, deferred fuel resulting from the operations of its fuel retainage mechanism, and other system gas activities under Commission Order No. 581.[12]

<u>FERC Form No. 2 Reporting Requirements</u>

- *Reporting Processes, Procedures, and Controls* – Reviewed and evaluated processes, procedures, and controls for complying with Commission financial reporting requirements in 18 C.F.R. § 260.1. Interviewed employees that performed financial reporting and management oversight to assess their understanding of the processes, procedures, and controls.

- *FERC Form No. 2 Preparation and Filing* – Examined procedures for preparing, reviewing, and filing Maritimes' FERC Form No. 2 filings to assess completeness and accuracy of financial statements and schedules.

- *Variance Analysis* – Performed variance analyses of balance sheet and income statement accounts reported in the FERC Form No. 2 filings for the audit period. Analyzed anomalies to identify potential accounting and reporting concerns.

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[12] *Revisions to Uniform System of Accounts, Forms, Statements, and Reporting Requirements for Natural Gas Companies*, Order No. 581, 72 FERC ¶ 61,301 (1995), *order on reh'g*, Order No. 581-A, 74 FERC ¶ 61,223, order granting clarification, 75 FERC ¶ 61,106 (1996); *see also Uniform System of Accounts, Forms, Statements, and Reporting Requirements for Natural Gas Companies*, Notice of Correction, 118 FERC ¶ 61,245 (2007) (making correction to Order No. 581).

- *Notes to Financial Statements* – Reviewed the Notes to Financial Statements to understand significant accounting policies and events, and to identify potential accounting and reporting concerns. Compared certain notes in the financial statements to specific schedules for consistency in reported information.

- *Accuracy and Completeness in Reporting* – Sampled FERC Form No. 2 accounts and reviewed supporting documentation to evaluate whether Maritimes accurately reported activities and balances. As part of the review, audit staff traced account balances in the FERC Form No. 2 to Maritimes' general ledger and reviewed individual schedules and related detail pages to test for consistent and complete reporting under the FERC Form No. 2 instructions. Some of the more significant examples of testing included:

    - *Non-Traditional Rate Treatment Afforded to New Projects* – Traced amounts reported on Page 217 of the 2017 FERC Form No. 2 to the general ledger and supporting worksheets to determine whether information was reported accurately. Determined whether Maritimes maintained separate and identifiable accounts for costs and revenues associated with its incremental rate projects as the Commission's expansion orders required.

    - *Gas Account Natural Gas* (*Page 520*) – Compared volumes reported on Page 520 of the 2018 FERC Form No. 2 to operational data to test for accuracy. Audit staff focused on the November 2018 accounting/October 2018 production month and obtained source documents for a sample of volumes of gas received, delivered, used, and lost on the system.

    - *Other Select Schedules* – Determined whether select FERC Form No. 2 schedules were accurate and complete, including: Unappropriated Retained Earnings (pages 118-119); Other Paid-In Capital (page 253); Other Regulatory Assets and Liabilities (pages 232 and 278); and Gas Operation and Maintenance Expense (pages 317-325). Identified and assessed reasons for material changes that impacted O&M and A&G accounts.

IV. Findings and Recommendations

A. Accounting and Reporting

1. Allocation of Labor Burden and Overhead Costs to Capital Projects

Maritimes did not record labor burden and overhead costs to capital projects based on actual costs as required by the Commission. Instead, Maritimes used allocation percentages, for which it did not perform timely studies and maintain appropriate records. This prevented audit staff from verifying whether the allocation percentages used to reimburse affiliates were reasonable and representative of actual costs.

Pertinent Guidance

- 18 C.F.R. Part 201, GI No. 2, Records, states in part:

> A. Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto.
>
> B. The books and records referred to herein include not only accounting records in the limited technical sense, but all other records, such as minute books, stock books, reports, correspondence, memoranda, etc., which may be useful in developing the history of or facts regarding any transaction.
>
> . . . . .
>
> E. All amounts included in the accounts prescribed herein for gas plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5, Other Deductions.

- 18 C.F.R. Part 201, GI No. 9, Distribution of Pay and Expenses of Employees, states:

> The charges to gas plant, operating expense and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance,

and operations, shall be based upon the actual time engaged in the respective classes of work, or in case that method is impracticable, upon the basis of a study of the time actually engaged during a representative period.

- 18 C.F.R., Part 201, Gas Plant Instruction No. 4 (GPI No. 4), Overhead Construction Costs, states:

> A. All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.
>
> B. As far as practicable, the determination of payroll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.
>
> C. The record supporting the entries for overhead construction costs shall be so kept as to show the total amount of each overhead for each year, the nature and amount of each overhead expenditure charged to each construction work order and to each utility plant account, and the bases of distribution of such costs.

Background

Maritimes is managed and operated by two affiliated companies: M&N Management and M&N Operating. M&N Management oversees Maritimes' daily business functions, such as external relations, finance, accounting, regulatory compliance, and marketing pursuant to an omnibus agreement. M&N Operating operates and maintains Maritimes' pipeline system, including physical operations, system maintenance and repair, certain technical services, preparing operating budgets, and maintaining records pursuant to an operating agreement. In 1996, when Maritimes executed these agreements with M&N Management and M&N Operating, they were not affiliated. However, as a result of corporate mergers and reorganizations, Maritimes has since become affiliated with these two companies.

According to these agreements, Maritimes is required to reimburse M&N Operating and M&N Management for all costs associated with construction of Maritimes' capital projects. Maritimes reimburses these affiliates for all non-labor costs at the invoice price and for all labor costs, respectively, at 100 and 130 percent above employees' base salaries. Maritimes' affiliates assessed these percentages to cover the labor burden and overhead costs of their employees. Labor burden represents the costs a business incurs to employ a worker, including the actual wages or salary that it pays to its employees, but also including other costs such as payroll taxes, retirement and health benefits, worker's compensation, life insurance, and other fringe benefits. Overhead costs represent the costs of office rents, support services, and other miscellaneous costs.

The Commission requires pipelines to charge labor costs, including labor burden and overheads based on actual costs or a representative allocation percentage supported by evidence, such as a study, where it is impractical to charge actual costs incurred.[13] Maritimes confirmed that it did not perform any studies to support the percentages assessed above employees' base salaries until 2015. According to Maritimes, for that 2015 study it performed a cost comparison of the actual labor burden and overhead costs to the 100 and 130 percent allocation factors. However, Maritimes did not retain any documents to support the study's cost comparison to actual cost figures.

In accordance with GI No. 2(A) and (B), companies must maintain records to permit ready identification, analysis, and verification of all facts regarding any transaction. Companies are also not permitted to record labor costs based on arbitrary percentages or assumed amounts. Absent timely studies and adequate support, audit staff could not determine whether the allocation percentages developed in 1996 were reasonable and representative of actual labor costs incurred by Maritimes during the audit period. Keeping this in perspective, the Commission's regulations in GI No. 2(E) direct companies to record any payments or accruals in excess of actual charges that are unreasonable or unsupported in Account 426.5, Other Deductions.

In 2017, Maritimes underwent a significant reorganization due to SEC, one of its parent companies, merging with Enbridge. As a result of this merger, Maritimes made some significant accounting process changes. Therefore, the 2015 study may be outdated

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[13] *See* 18 C.F.R. Part 201, GI No. 9, Distribution of Pay and Expenses of Employees, and GPI No. 4, Overhead Construction Costs.

and no longer representative, in addition to the concern of having no records to support the actual cost figures used in the study. The Commission requires studies be performed based on a representative time period. Maritimes should have considered performing a new study after the merger and process changes were implemented to ensure that the percentages assessed above employees' base salaries were representative and reasonable.

In 2018, Maritimes' affiliates began directly assigning rather than allocating O&M expenses but did not make similar process changes for capital projects. Maritimes should implement similar procedures for labor costs assigned to capital projects. This would better align with the Commission's regulations that require companies to determine labor costs based on actuals before considering the use of an allocation percentage. If this is impractical, Maritimes must perform regular studies and retain records to support the allocation percentages used.

Recommendations

DAA recommends that Maritimes:

1. Create policies and procedures to directly assign costs to capital projects or perform periodic studies of actual labor costs to ensure allocation percentages are reasonable and representative of actual costs, in accordance with GI No. 9 and GPI No. 4.

2. Revise policies, procedures, and controls to ensure it maintains all records of studies supporting allocation percentages in accordance with GI No. 2, if direct assignment of costs is impractical for capital projects.

3. Directly assign costs for capital projects; however, if direct assignment of costs is deemed impractical, Maritimes should provide the evaluation it conducted to make this determination. Subsequently, conduct a study to support the allocation percentages that Maritimes determines should be used to reimburse its affiliates for labor burden and overhead costs. Provide study results, including supporting documentation, to DAA within 90 days of receiving the final audit report.

4. Based on the study results, if the 100 and 130 percentage factors previously used are determined to be unreasonable or excessive compared to the results of the study, then adjust plant in service and other affected account balances for those amounts in accordance with GI No. 2(E) for the affected periods. Submit journal entries, calculations, and other supporting documentation within 30 days of receiving audit staff approval of the study performed and its results.

2. Reporting of O&M Expenses for Incremental Rate Projects

Maritimes did not perform a study to support the allocation percentage used to assign O&M expenses to its incremental rate projects. Absent a study, audit staff could not determine whether this allocation percentage was reasonable and representative of the actual O&M expenses assigned to incremental rate projects. Maritimes also improperly aggregated maintenance expenses with operating expenses, rather than separately reporting these expenses for its incremental rate projects in its FERC Form No. 2. This reduced the accuracy and completeness of these expenses reported for Maritimes' incremental rate projects.

Pertinent Guidance

- 18 C.F.R. Part 201, GI No. 9, Distribution of Pay and Expenses of Employees, states:

  The charges to gas plant, operating expense and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance, and operations, shall be based upon the actual time engaged in the respective classes of work, or in case that method is impracticable, upon the basis of a study of the time actually engaged during a representative period.

- *Revision to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines,* Order No. 710, 122 FERC ¶ 61,262, at P 23 (2008), states:

  > Where incremental rates for new capacity have been approved, the Commission has required pipelines to maintain their accounting records so as to be able to identify the facilities and related costs used to provide service to the incremental rate customers. To date, however, the Commission has not required the disaggregation of these costs in Forms 2 and 2-A. The NOPR proposed that a proper rate assessment would be enhanced by providing a breakdown of costs related to these separate facilities. The NOPR proposed to add a new schedule to Forms 2 and 2-A, at page 217, entitled "Non-Traditional Rate Treatment Afforded New Projects," to report the following: (1) The name of the facility; (2) the docket number under which the facility was approved; (3) the type of rate treatment (e.g., incremental or another rate treatment); (4) the amount of plant in service; (5) the amount of accumulated depreciation; (6) the amount of accumulated deferred income taxes; (7) amount of operating expenses; (8) the amount of maintenance expenses; (9) the amount

> of depreciation expense; (10) incremental revenues; and (11) other expenses…
> … [With] that addition, we adopt the new requirements proposed in the NOPR.

- FERC Form No. 2 schedule page 217a, Non-Traditional Rate Treatment Afforded New Projects, instructions state in part:

> 7) In column g, report the total amount included in the gas operations expense accounts during the year related to the facility (Account 401, Operation Expense).
> 8) In column h, report the total amount included in the gas maintenance expense accounts during the year related to the facility.

Background

Commission policy allows pipelines to seek an incremental rate on a facility, which is the charging of a rate different from the approved recourse rate stated in a pipeline's tariff. Pipelines can seek incremental rates for new or expansion projects. The Commission stated in its 1999 Pricing Policy Statement that pipeline expansion projects, in the absence of a predetermination of rolled-in pricing, must be able to recover their costs without subsidization from existing customers.[14] Under this policy, Maritimes currently has five lateral incremental rate projects approved by the Commission.

Audit staff reviewed Maritimes' processes and procedures, accounting records, and interviewed employees, to determine whether Maritimes correctly accounted and reported for the revenues and costs associated with incremental rate projects. This review identified Maritimes derived O&M expenses based on a one percent allocation of gross plant for each incremental rate project. Maritimes confirmed it did not perform a study to support this allocation percentage. Absent a study, audit staff could not determine whether the allocation percentage was reasonable and representative of the actual O&M expenses assigned to each incremental rate project. Maritimes explained this allocation percentage was used when the Commission approved its first incremental rate project 22 years ago in 1998. Audit staff's review of Maritimes' incremental rate project filings and Commission orders verified there was no mention or specific details describing the allocation percentage used to assign O&M expenses to incremental rate projects.

It is the Commission's general policy that jurisdictional companies should directly assign costs when possible; and when direct assignment is impractical, costs should be

[14] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 (1999).

allocated based on a reasonable method. In Northwest and Transcontinental rate proceedings, the Commission addressed the 1999 Pricing Policy Statement, emphasizing direct assignment of costs is preferred to prevent subsidization of costs from existing customers.[15] In Michigan Gas, the Commission addressed the allocation of common cost emphasizing that any method can be used as long as it is fully supported.[16] Further, GI No. 9, Distribution of Pay and Expenses of Employees, requires labor costs charged to O&M expense accounts to be based on actual time or a study of the time actually engaged during a representative period. Therefore, it is necessary for Maritimes to perform a study to support the O&M expenses assigned to its incremental rate projects.

Audit staff also identified that Maritimes aggregated maintenance expenses with operating expenses in Column G (Operating Expenses), rather than separately reporting these expenses in Column H (Maintenance Expense) on Pages 217-217a, Non-Traditional Rate Treatment Afforded New Projects, of its FERC Form No. 2. In accordance with Order No. 710 and the instructions on Pages 217-217a, Maritimes should report O&M expenses separately on these pages. Absent doing so, this reduced the accuracy and completeness of expenses reported for Maritimes' incremental rate projects.

Recommendations

DAA recommends that Maritimes:

5. Revise policies and procedures to ensure FERC Form No. 2 Pages 217-217a are completed in accordance with the reporting instructions, including separately reporting maintenance expenses from operating expenses.

6. Conduct a study to support the allocation percentage used for assigning O&M expenses that are not directly assigned to incremental rate projects. Provide the study results, including supporting documentation, to DAA within 90 days of the receiving the audit report.

7. Train relevant staff on the revised methods to account for expenses related to incremental rate facilities and provide periodic training, as needed.

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[15] *Northwest Pipeline Corp.,* 87 FERC ¶ 61,266, at 62,045 (1988), and *Transcontinental Gas Pipe Line Corp.,* 106 FERC ¶ 61,299, at PP 190 and 190 (2004).

[16] *Michigan Gas Storage Co.,* 89 FERC ¶ 61,131, at 61,377 (1999).

3. Accounting for Nonoperating and Unrelated Expenses

Maritimes' affiliates allocated to Maritimes certain nonoperating expenses and costs that had no relationship to its interstate pipeline operations, which Maritimes improperly recorded in operating expense accounts. Operating expenses are recoverable, while nonoperating and unrelated expenses are generally nonrecoverable from customers in cost of service rates. Therefore, recording these expenses improperly imposes a risk of including and recovering these expenses in future cost of service rate determinations.

Pertinent Guidance

- 18 C.F.R. Part 201, General Instruction No. 14 (GI No. 14), Transactions with Associated Companies, states in relevant part:

> Transactions with associated companies shall be recorded in the appropriate accounts for transactions of the same nature. Nothing herein contained, however, shall be construed as restraining the utility from subdividing accounts for the purpose of recording separately transactions with associated companies.

- 18 C.F.R. Part 201, General Instruction No. 23 (GI No. 23), Accounting for Derivative Instruments and Hedging Activities, states in part:

> B. The accounting for the changes in the fair value of derivative instruments depends upon its intended use and designation. Changes in the fair value of derivative instruments not designated as fair value or cash flow hedges will be recorded in account 175, derivative instrument assets, or account 244, derivative instrument liabilities, as appropriate, with the gains recorded in account 421, miscellaneous nonoperating income, and losses recorded in account 426.4, other deductions.

- 18 C.F.R Part 201, Account 426.4, Expenditures for Certain Civic, Political and Related Activities, states:

> This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing referenda, legislation or ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the

> decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

- 18 C.F.R. Part 201, Account 426.5, Other Deductions, states in part:

> This account shall include other miscellaneous expenses which are non-operating in nature, but which are properly deductible before determining total income before interest charges.

Background

Enbridge and certain of its Commission-regulated subsidiaries allocated nonoperating expenses and unrelated expenses to Maritimes. Maritimes' affiliates established specific cost centers and used allocation methods, such as the Modified Massachusetts Formula.[17] Audit staff reviewed a sample of expenses allocated to Maritimes to determine the nature of these expenses and whether Maritimes recorded them in the appropriate accounts consistent with Commission accounting requirements. The review identified that Maritimes misclassified certain nonoperating expenses as operating expenses and improperly recorded them in Account 930.2, Miscellaneous General Expenses, and that some expenses allocated to Maritimes by affiliates did not relate to Maritimes' interstate pipeline business. Specifically, audit staff's review identified the following account misclassifications:

- *Lobbying Activities* – Enbridge paid annual membership dues to the American Petroleum Institute (API) and allocated to Maritimes a share of the dues. According to the API invoice, 60 percent of the dues was used for lobbying activities, indicating that the other 40 percent was used for business operations. Maritimes recorded the entire invoice amount in Account 930.2, including the lobbying portion, which is a nonoperating expense. In accordance with the instructions of Account 426.4, Expenditures for Certain Civic, Political and Related Activities, amounts incurred for influencing public officials, such as lobbying expenses, are recorded in this account. Maritimes agreed Account 426.4 was the appropriate account to record lobbying expenses.

- *Realized Loss* – Enbridge allocated to Maritimes a portion of a realized loss for an equity derivative related to restricted stock options; Maritimes recorded the realized loss in Account 930.2. Audit staff's review determined that this derivative was not

[17] The Modified Massachusetts Formula allocates costs using a three-factor formula based on net plant, labor (headcount), and earnings to allocate expenses.

designated as fair value or cash flow hedge. According to GI No. 23, losses on a derivative instrument that are not designated as fair value or cash flow hedge should be recorded to Account 426.5, Other Deductions. Therefore, Maritimes should have recorded the realized loss in Account 426.5, a nonoperating expense account, rather than Account 930.2, an operating expense account. Maritimes agreed Account 426.5 was the appropriate account to record the realized loss.

- *Corporate Acquisition* – Enbridge allocated expenses relating to its corporate acquisition of Canadian Midstream assets to Maritimes, which Maritimes recorded in Account 930.2. Audit staff inquired about the nature of the expenses and how the acquisition involved and benefited Maritimes. Maritimes agreed the acquisition did not involve or benefit Maritimes and it should not have been allocated these expenses.

- *Settlement Conference* – Algonquin incurred travel expenses to attend a Commission settlement conference relating to Algonquin's Fuel Reimbursement Quantity filing.[18] A portion of these travel expenses was allocated to Maritimes, which it recorded in Account 930.2. Maritimes agreed it should not have been allocated these expenses since they were unrelated to Maritimes' operations and business activities.

- *Oil Pipeline Facilities* – Enbridge directly or indirectly owns and operates oil pipeline facilities. Enbridge routinely allocated expenses associated with these oil pipeline facilities to affiliates, including Maritimes. Maritimes received and recorded these allocated costs in Account 930.2. Maritimes confirmed during the audit that it did not own, operate, or lease any oil pipeline facilities, and agreed it should not have been allocated these expenses.

- *Gas Storage Facilities* – Texas Eastern owns and operates physical natural gas storage facilities. It routinely allocated expenses associated with these facilities to affiliates. Maritimes received and recorded these allocated costs in Account 930.2. Maritimes confirmed during the audit that it did not own, operate, or lease any physical gas storage facilities, and agreed it should not have been allocated these expenses.

The procedural and control weaknesses that resulted in the improper accounting classifications of the nonoperating expenses and unrelated business expenses just described are concerning. The Commission provides operating and nonoperating expense accounts to ensure costs are properly classified for cost of service ratemaking purposes. Absent proper accounting, there is a risk that Maritimes may include nonoperating expenses and expenses unrelated to its business in operating expense accounts and recover such costs from customers in its cost of service rates.

[18] *See Algonquin Gas Transmission, LLC*, 164 FERC ¶ 61,094 (2018).

It is imperative that Maritimes and its affiliates evaluate and understand the nature of the costs included in cost centers allocated to Maritimes. This will permit Maritimes' affiliates to identify and remove unrelated expenses from its cost centers and for Maritimes to properly account for nonoperating expenses in accordance with the Commission's accounting requirements. For any unrelated business expenses inadvertently included in these costs centers and then recorded on Maritimes' books, Maritimes should record these expenses to Account 426.5, until it can appropriately write them off Maritimes' books.

Audit staff's concerns prompted Maritimes and its affiliates to perform a review of the cost centers, allocation methods, and accounting procedures used. While some changes were made during the audit, Maritimes and its affiliates were still in the process of reviewing and making further changes after audit staff completed its field work. Since these changes were not fully implemented, audit staff did not evaluate the new procedures. However, Maritimes believes the new procedures will reduce the risk of future accounting misclassifications in these areas. Further, Maritimes ensured audit staff that going forward appropriate accounting procedures and controls will be in place to record nonoperating expenses and identify unrelated business expenses. Audit staff will review the new procedures and controls when Maritimes submits documentation to support corrective actions taken for each recommendation below.

Recommendations

DAA recommends that Maritimes:

8. Revise policies, procedures, and controls to track, review, and account for nonoperating expenses and for expenses unrelated to its business allocated to it by affiliates consistent with Commission requirements.

9. Provide a recent journal entry and supporting documentation that demonstrate that the accounting misclassifications identified in this finding have been corrected and the related costs are now recorded in accordance with the Commission's accounting requirements.

10. Perform an analysis of expenses allocated to Maritimes by its affiliates to identify all nonoperating and other expenses unrelated to Maritimes' business operations that were incorrectly recorded as operating expenses by Maritimes during the audit period. This analysis should capture expenses in addition to those already identified during and subsequent to the audit period. Within 90 days of the date of the final audit report, provide results of the analysis, proposed correcting entries, and all applicable work papers supporting the analysis, to DAA.

11. Train relevant staff on the revised methods to account for nonoperating expenses and unrelated expenses and provide periodic training, as needed.

4. Accounting for Operating Expenses

Maritimes improperly accounted for certain operating expenses, such as transmission operating expenses, regulatory activities, and legal fees, in a manner inconsistent with Commission's accounting regulations. While these accounting misclassifications had no impact on total operating expenses, the misclassifications nevertheless reduced the accuracy and transparency of operating expenses as reported in Maritimes' FERC Form No. 2 filings.

Pertinent Guidance

- 18 C.F.R. Part 201, GI No. 14, Transactions with Associated Companies, states in part:

  > Transactions with associated companies shall be recorded in the appropriate accounts for transactions of the same nature. Nothing herein contained, however, shall be construed as restraining the utility from subdividing accounts for the purpose of recording separately transactions with associated companies.

- 18 C.F.R. Part 201, Account 856, Mains Expenses, states in part:

  > This account shall include the cost of labor, materials used and expenses incurred in operating transmission mains.

- 18 C.F.R. Part 201, Account 920, Administrative and General Salaries, states in part:

  > A. This account shall include the compensation (salaries, bonuses, and other consideration for services, but not including directors' fees) of officers, executives, and other employees of the utility properly chargeable to utility operations and not chargeable directly to a particular operating function.

- 18 C.F.R. Part 201, Account 922, Administrative expenses transferred – Credit, states in part:

  > This account shall be credited with administrative expenses recorded in accounts 920 and 921 which are transferred to construction costs or to nonutility accounts.

- 18 C.F.R. Part 201, Account 923, Outside Services Employed, states in part:

> A. This account shall include the fees and expenses of professional consultants and others for general services which are not applicable to a particular operating function or to other accounts. It shall include also the pay and expenses of persons engaged for a special or temporary administrative or general purpose in circumstances where the person so engaged is not considered as an employee of the utility.

- 18 C.F.R. Part 201, Account 926, Employee Pensions and Benefits, states in relevant part:

> A. This account shall include pensions paid to or on behalf of retired employees, or accruals to provide for pensions, or payments for the purchase of annuities for this purpose, when the utility has definitely, by contract, committed itself to a pension plan under which the pension funds are irrevocably devoted to pension purposes, and payments for employee accident, sickness, hospital, and death benefits, or insurance therefor. Include, also, expenses incurred in medical, educational or recreational activities for the benefit of employees, and administrative expenses in connection with employee pensions and benefits.

- 18 C.F.R. Part 201, Account 928, Regulatory Commission Expenses, states in part:

> A. This account shall include all expenses (except pay of regular employees only incidentally engaged in such work) properly includible in utility operating expenses, incurred by the utility in connection with formal cases before regulatory commissions, or other regulatory bodies, or cases in which such a body is a party, including payments made to a regulatory commission for fees assessed against the utility for pay and expenses of such commission, its officers, agents, and employees.
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> Items
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> 1. Salaries, fees, retainers, and expenses of counsel, solicitors, attorneys, accountants, engineers, clerks, attendants, witnesses, and others engaged in the prosecution of, or defense against petitions or

> complaints presented to regulatory bodies, or in the valuation of property owned or used by the utility in connection with such cases.
>
> 2. Office supplies and expenses, payments to public service or other regulatory commissions, stationery and printing, traveling expenses, and other expenses incurred directly in connection with formal cases before regulatory commissions.

Background

Audit staff reviewed selected transactions to determine whether Maritimes recorded costs consistent with Commission accounting requirements. The review focused on transactions recorded to A&G expense accounts for the last quarter of 2018. Audit staff examined Maritimes' invoicing and accounts payables processes, assessed supporting documentation, and interviewed employees. The review identified several transactions misclassified in the wrong expense account based on the nature of the transaction. While these accounting misclassifications had no impact on total operating expenses, they reduced the accuracy and usefulness of Maritimes' FERC Form No. 2 filings. Specifically, audit staff's review identified the following misclassifications:

- *Transmission Operating Expenses* – Maritimes incurred expenses for fire-protective clothing worn by personnel performing transmission operations. These expenses related to an operational rather than administrative and general business function. Accordingly, Maritimes should have recorded these costs in Account 856, Mains Expense, rather than Account 921, Office Supplies and Expenses. Account 856 directs companies to include the cost of materials used, and expenses incurred, in operating transmission mains.

- *Regulatory Activities* – Maritimes incurred expenses associated with legislative and regulatory monitoring activities, which are administrative and general in nature. However, these expenses related to fees incurred for outside consulting services, rather than office supplies and expenses. Accordingly, Maritimes should have recorded these expenses in Account 923, Outside Services Employed, rather than Account 921. Account 923 directs companies to record costs for professional consultants and others for general services which are not applicable to a particular operating function or to other accounts.

- *Attorney Fees* – Maritimes incurred attorney fees to prepare its application to abandon by lease facilities to PNGTS[19] and to intervene in another proceeding.[20] These expenses related to costs incurred in connection with formal cases before the Commission. Accordingly, Maritimes should have recorded these expenses in Account 928, Regulatory Commission Expenses, rather than Account 923. Account 928 directs companies to record expenses incurred in connection with formal cases before regulatory commissions.

- *Salaries and Benefits* – Maritimes' ultimate parent, Enbridge, allocated to Maritimes expenses that included A&G salaries, A&G salaries transferred to construction, and post-retirement benefits. While these expenses were A&G in nature, Maritimes' practice was to record all of these expenses in Account 930.2. This practice is inconsistent with GI No. 14, which requires an operating company to record costs charged to it, by affiliates, in the appropriate account, as if it directly incurred the cost. Account 920, Administrative and General Salaries, directs companies to record A&G salaries properly chargeable to utility operations that are not chargeable directly to a particular operating function. Account 922, Administrative Expenses Transferred – Credit, directs companies to record A&G expenses cleared from Accounts 920 and 921 that it transfers to construction. Account 926, Employee Pensions and Benefits, directs companies to record all post-retirement benefit expenses. Based on these account instructions, Maritimes should have recorded A&G salaries, A&G salaries transferred to construction, and the post-retirement benefits to Accounts 920, 922, and 926, respectively, rather than Account 930.2.

As mentioned above, audit staff identified these accounting misclassifications based on reviewing a sample of transactions from 2018. Maritimes agreed that, due to the process in place at the time, other accounting misclassifications may have been identified had audit staff expanded its testing. During the audit, Maritimes was in the process of reviewing and improving its accounting procedures in this area. While Maritimes made some changes during the audit, it was still reviewing and making further changes when audit staff completed its audit field work. These changes are important because accounting for expenses in the correct A&G and operating expense accounts will ensure proper functionalization in the development of its cost of service and will improve

[19] *Maritimes & Northeast Pipeline, L.L.C.,* Docket No. CP18-516-000 (application of Maritimes) (June 29, 2018).

[20] *Portland Natural Gas Transmission System*, Docket No. CP18-506-000 (Maritimes' motion to intervene) (July 19, 2018).

the transparency and usefulness of the information in Maritimes' FERC Form No. 2 filings.

Since these changes were not fully implemented, audit staff did not evaluate Maritimes' new procedures. Maritimes believes its new procedures will reduce the risk of accounting misclassifications, and Maritimes ensured audit staff that going forward it will have appropriate procedures and controls in place to record A&G expenses, as well as other operating costs, in the correct accounts. Audit staff will review the new procedures and controls when Maritimes submits documentation to support corrective actions taken for each recommendation below.

Recommendations

DAA recommends that Maritimes:

12. Revise policies, procedures, and controls to track, report, review, and account for A&G and operating expenses consistent with the Commission's accounting regulations.

13. Provide a recent journal entry, and supporting documentation, which demonstrates that the identified accounting misclassifications are now recorded in accordance with the Commission's accounting regulations.

14. Train relevant staff on the revised methods to account for A&G and operating expenses and provide periodic training as needed.

5. FERC Form No. 2 Reporting

Maritimes did not report complete information as required in certain supporting schedules of its 2017 and 2018 FERC Form No. 2 reports. This reduced the overall accuracy and usefulness of the information reported in the FERC Form No. 2.

Pertinent Guidance

- 18 C.F.R. Part 260.1(b)(4), FERC Form No. 2 Annual Report for Major Natural Gas Companies, states in part:

> The form must be filed in electronic format only, as indicated in the general instructions set out in that form.

- FERC Form No. 2, Page 354, Distribution of Salaries and Wages, Instructions, state in part:

> Report below the distribution of total salaries and wages for the year. Segregate amounts originally charged to clearing accounts to Utility Departments, Construction, Plant Removals and Other Accounts, and enter such amounts in the appropriate lines and columns provided. Salaries and wages billed to the Respondent by an affiliated company must be assigned to the particular operating function(s) relating to the expenses.

- FERC Form No. 2, Page 358, Transactions with Associated (Affiliated) Companies, Instruction 4, states:

> Where amounts billed to or received from the associated (affiliated) company are based on an allocation process, explain in a footnote the basis of the allocation.

- FERC Form No. 2, Page 508, Compressor Stations, Instruction 2, states:

> For column (a), indicate the production areas where such stations are used. Group relatively small field compressor stations by production area. Show the number of stations grouped. Identify any stations held under a title other than full ownership. State in a footnote the name of owner or co-owner, the nature of respondent's title, and percent of ownership if jointly owned.

Background

Maritimes is required to report financial and operational information annually in the FERC Form No. 2 in accordance with the report's instructions. Audit staff reviewed Maritimes' 2017 and 2018 FERC Form No. 2 reports to determine whether Maritimes provided complete and accurate information in accordance with the reports' instructions.

Audit staff found instances where Maritimes did not provide accurate and complete information. As reflected in the table, four schedules were not completed as required by the FERC Form No. 2 instructions:

Ref.	Schedule	Pages	Reporting Error
A.	General Description of Construction Overhead Procedures	Page 218-218a	Maritimes did not completely explain its construction overheads as required by instruction 1 on Page 218. Maritimes also improperly referenced an outdated rate case for the ROE in the footnote to Column (d), Line 5 on Page 218a.
B.	Distribution of Salaries and Wages	Page 354	Maritimes did not separately report maintenance payroll billed by affiliated companies, as required by the instructions for this page.
C.	Transactions with Associated Companies	Page 358	Maritimes did not provide a footnote explaining the allocation method used for amounts billed from associated companies, as required by Instruction No. 4.
D.	Compressor Stations	Page 508	Maritimes did not report co-owners and percent ownership of jointly owned compressor stations, as required by Instruction No. 2

These inconsistencies reduced the accuracy and usefulness of Maritimes' FERC Form No. 2 reports. The Commission and other stakeholders use the information in the FERC Form No. 2 for cost of service ratemaking purposes and to make other informed decisions. For these reasons, it is important that Maritimes reports complete and accurate information in accordance with the FERC Form No. 2 reporting instructions.

Recommendations

DAA recommends that Maritimes:

15. Revise policies and procedures to ensure complete and accurate information is reported in the FERC Form No. 2 in accordance with the instructions of the report.

16. Review the reporting deficiencies with relevant staff to ensure they include on a prospective basis all required information in the FERC Form No. 2.

B. Tariff Administration

6. Fuel Retainage Quantity Filings

Maritimes misreported the deferred fuel balance and negative LAUF in its annual Fuel Retainage Quantity filings. Maritimes also did not separately break out its deferred fuel balance from other activities reported on Page 268, Miscellaneous Current and Accrued Liabilities, in its FERC Form No. 2 reports. These oversights reduced the accuracy and the usefulness of Maritimes' Fuel Retainage Quantity filings and FERC Form No. 2 reports for shippers and other stakeholders during the audit period.

Pertinent Guidance

- FERC Form No. 2, Page 268, Miscellaneous Current and Accrued Liabilities (Account 242); Instructions, states:

    1. Describe and report the amount of other current and accrued liabilities at the end of year.

    2. Minor items (less than $250,000) may be grouped under appropriate title.

- Maritimes' Tariff, Second Revised Volume No. 1, Part 6, General Terms and Conditions, states in section 20, in part:

    20.1 General. Periodically rates and charges under Pipeline's Tariff shall be adjusted to reflect changes in Pipeline's expenditures such as the Fuel Retainage Quantity. The Fuel Retainage Quantity ("FRQ") shall be determined by multiplying Customer's receipts at the point(s) of Receipt by the Fuel Retainage Percentage ("FRP"). During the term of the Service Agreements executed hereunder, Pipeline will periodically track changes in its requirement to retain gas in-kind in compensation for the quantities of Company Use Gas used to provide service for Customers.

    20.3 Projected FRP. With each filing hereunder for each specified calendar period Pipeline shall calculate a Projected FRP as the quotient obtained by dividing (a) the projected annual quantities of Company Use Gas for each specified

> calendar period by (b) the projected annual throughput for each specified calendar period.[21]

- *Gulf South Pipeline Company*, *LP*, 155 FERC ¶ 61,132, at PP 4, 6 (2016), states in relevant part:

> Among other things, the Commission interpreted [Gulf South's] GT&C section 6.9.4(5)(b) as being consistent with the Commission's policy, set forth in Wyoming Interstate Company,[22] that a negative LAUF component must be used to reduce a positive fuel use component when setting the overall fuel and LAUF retention percentage.
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> A fundamental requirement for all fuel use and LAUF cost trackers is that they assess shippers no more or less than the cost of service. The Commission has recognized a narrow exception when overall fuel and LAUF retention percentages become negative.[23] The Commission has previously found that holding overall retention percentages at zero, rather than allowing the overall retention percentages to become negative, is reasonable so long as all of the over-recovered amount is eventually returned to the shipper.[24] The Commission permits this narrow exception because charging a negative rate – in other words, paying shippers to use the system – could distort the incentive to use capacity efficiently.[25] However,

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[21] "Company Use Gas" as used in Maritime's Tariff means "the amount of gas used for fuel, including compressor and heater fuel; gas used for maintenance; gas lost as a result of Force Majeure events, the ownership of which cannot be reasonably identified; and unaccounted for gas." Maritimes' Tariff, Second Revised Volume No. 1, Part 6, General Terms and Conditions, Section 1, Definitions. Changes in Company Use Gas shall be tracked pursuant to GT&C section 20.

[22] *Wyoming Interstate Co.,* 121 FERC ¶ 61,213, at P 17 (2007).

[23] *Colorado Interstate Gas Co.,* 128 FERC ¶ 61,117, at P 32 (2009).

[24] *Columbia Gulf Transmission Co.,* 132 FERC ¶ 61,134, at P 43 (2010).

[25] *Sabine Pipe Line LLC,* 125 FERC ¶ 61,241, at P 7 (2008).

> the Commission has consistently ruled that pipelines may not apply the "never less than zero" convention for individual components of a fuel redetermination filing because doing so could prevent a positive component from fully offsetting a negative component, which in turn would lead to a rate that is higher than the cost of service.

Background

In 2010, the Commission approved Maritimes' fuel retainage quantity mechanism found in section 20 of its Tariff. Maritimes' fuel retainage quantity mechanism allows it to retain a portion of gas tendered by shippers to transport their gas and to provide for LAUF on its pipeline system. Maritimes is required to make an annual Fuel Retainage Quantity filing (fuel filing) with the Commission to update its projected FRP of its fuel retainage quantity mechanism. As defined in section 20.3 of Maritimes' Tariff, the projected FRP represents the projected annual quantities of Company Use Gas divided by projected annual throughput. As defined in the definitions of Maritimes' Tariff, Company Use Gas includes gas losses, unaccounted for gas, and other inputs. Maritimes tracks the difference between gas retained and actual fuel burned to determine its over or under deferred fuel balance, which it reports in an annual fuel report filed with the Commission.

Reporting of Deferred Fuel Balance

Audit staff reviewed measurement data supporting Maritimes' fuel filings to test whether Maritimes appropriately calculated, tracked, and accounted for its projected FRPs and deferred fuel balance in accordance with its Tariff. This review identified that Maritimes correctly accounted for and tracked its deferred fuel balance, but did not accurately report the cumulative deferred fuel balance in its 2015-2018 fuel filings.[26] For this period, Maritimes mistakenly reported the prior year activity rather than the cumulative balance, as the beginning balance in each subsequent year's fuel filing. As a result, Maritimes reported an incorrect cumulative deferred fuel balance each year.

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[26] *See* Maritimes' Fuel Filings, at Appendix B, Schedule B, Page 2 of 2. Docket No. RP15-1327 approved October 28, 2015; Docket No. RP16-1287 approved October 25, 2016; Docket No. RP17-1104 approved October 17, 2017; and Docket No. RP18-1232 approved October 29, 2018.

The table below shows the reported and corrected cumulative deferred fuel balances for 2015 to 2018.[27] As of December 31, 2018, Maritimes reported an under collection of 349,159 Dth, when it had an over collection of 615,226 Dth.[28]

Year	Reported Dth	Corrected Dth	Price Per Dth[29]
2015	(637,812)	(217,363)	$2.62
2016	1,079,652	964,385	$2.52
2017	743,856	526,493	$2.99
2018	(349,159)	615,226	$3.15

Maritimes also did not separately break out the deferred fuel balance reported in Account 242, Miscellaneous Current and Accrued Liabilities, in its FERC Form No. 2 reports. As of December 31, 2018, Maritimes reported one item in this account, a gas imbalance payable totaling $11,177,442. However, this amount represented the aggregation of deferred fuel with other payables due to its shippers. This reporting on an aggregated basis was inconsistent with Page 268 of the FERC Form No. 2 instructions, which require separate reporting of activities greater than $250,000. The corrected deferred fuel balance exceeded this threshold, and therefore Maritimes should have reported the deferred fuel balance separately from the other payables in this account for 2016-2018.[30] Reporting the deferred fuel balance correctly in the annual fuel filings and FERC Form No. 2 will increase the transparency of over collected fuel amounts to shippers.

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[27] An under collection of fuel is represented in parentheses.

[28] Additional review outside of the initial periods tested identified that, in its 2019 fuel filing, Maritimes continued to report its deferred fuel balance incorrectly as an under collection of 201,635 Dth instead of reporting its actual over collection of 762,750 Dth.

[29] The prices per Dth used in this table are taken from U.S. Energy Information Administration data found at https://www.eia.gov/dnav/ng/hist/rngwhhdA.htm.

[30] The deferred fuel balance was approximately $1,952,640 (762,750 x $2.56) in Account 242 as of December 31, 2019. The deferred fuel balance was in a liability position for 2016-2019, and an asset position for 2015. Asset positions are reported in Account 174, Miscellaneous Current and Accrued Assets. While a separate reporting schedule exists for Account 242 in the FERC Form No. 2, there is not a supporting schedule or similar requirement for Account 174.

Treatment of Negative LAUF

Shippers provide gas above the amount nominated and scheduled for delivery to cover the gas used to operate fuel compressors and for LAUF. LAUF can be either positive or negative depending on a pipeline's fuel estimates and actual operating characteristics. For most pipelines, LAUF is typically positive, because the pipeline loses gas on its system and must increase its projected FRP for the coming year to recover this gas from shippers. However, pipelines can have negative LAUF, where the pipeline experiences a gain, rather than loss of gas on its system for various reasons. The dominant drivers of negative LAUF on pipeline systems are measurement discrepancies resulting from temperature and pressure deviations from assumed conditions, inaccuracies in heating value conversions, and meter inaccuracies.

Audit staff's review determined that Maritimes did not factor in negative LAUF in its annual projected FRP calculation, even though Customer Use Gas as defined in its Tariff includes LAUF. Maritimes explained that it often has experienced negative LAUF on its system since establishing its fuel tracking mechanism in 2010. Maritimes asserted that the negative LAUF is primarily due to a measurement inaccuracy at the interconnect between Maritimes and its affiliate, Maritimes & Northeast Pipeline, LP. Maritimes stated that this meter inaccurately measures gas due to two primary operational changes that have occurred on Maritimes' system: (1) the flow of gas has reversed from a southernly direction to a northernly direction of flow, and (2) Maritimes has been experiencing more volatile and lower flows of gas.

According to Commission policy emphasized in the *Wyoming Interstate* and *Gulf South* decisions, when LAUF is negative, it should be offset against the fuel consumed at compressor stations to the extent it does not reduce the company's combined, i.e., overall, FRP below zero. If the overall FRP is reduced to zero, any remaining negative LAUF should be carried forward to future periods, where it offsets positive fuel.[31] By excluding negative LAUF from its annual FRP calculation, Maritimes' annual projected FRPs were inflated, which caused Maritimes to over collect gas from shippers through its fuel tracking mechanism. While Maritimes' fuel tracking mechanism has a true-up provision, Maritimes does not automatically refund gas over collected unless Maritimes makes a cash sale or other cash transaction (e.g., resolution imbalance) pursuant to section 20.4 of its Tariff. During the audit period, Maritimes did not implement section 20.4, to provide cash refunds through its true-up provision. As a result, shippers did not benefit or receive any cost savings from negative LAUF.

[31] *See Wyoming Interstate Co.*, 121 FERC ¶ 61,213, at P 17 (2007); *Gulf South Pipeline Co., LP*, 155 FERC ¶ 61,132, at PP 4-6 (2016).

Based on the Commission's policy, Maritimes should have included LAUF in the projected FRP calculation. This pertains to both positive and negative LAUF, since Maritimes' Tariff did not allow for the exclusion of LAUF from Customer Use Gas. Maritimes explained that it was not familiar with the Commission's policy decisions pertaining to negative LAUF until audit staff informed it of the *Wyoming Interstate* and *Gulf South* orders. Specifically the Commission held in Gulf South that its policy is that "a negative LAUF component must be used to reduce a positive fuel use component when setting" an FRP, and the Commission further stated that this practice is necessary to achieve the "fundamental requirement" of such trackers, noting that the "fundamental requirement for all fuel use and LAUF cost trackers is that they assess shippers no more or less than the cost of service."[32]

Maritimes' own Tariff's language provides for the inclusion of negative LAUF in the FRP calculation. Accordingly, Maritimes should have adhered to the Commission's policy and included negative LAUF in its projected FRP calculation. This would have reduced the deferred fuel balance and the projected FRP, ultimately resulting in cost savings to shippers.

Recommendation

DAA recommends that Maritimes:

17. Revise procedures and controls to ensure that it calculates and reports deferred fuel balances consistently with section 20 of its Tariff.

18. Update procedures to ensure that positive and negative LAUF are included as a component of Customer Use Gas in the projected FRP calculation of its annual fuel filings, on a prospective basis. Also, provide footnote disclosures in the annual fuel filing as needed to increase transparency.

19. Discuss the procedural changes that resulted in an over collection in deferred fuel balance with shippers. Maritimes should provide DAA with documentation to support that these discussions occurred and the outcome with shippers before its next fuel retainage quantity filing.

20. Inform Maritimes' staff that prepares the supporting schedule for Account 242 of the FERC Form No. 2 to break out each activity comprising the account balance according to the reporting threshold amount required by the instructions, including breaking out Maritimes' cumulative deferred fuel balance when it exceeds the reporting threshold.

[32] *Gulf South,* 155 FERC ¶ 61,132, at PP 4, 6.

7. Reservation Charge Crediting

Section 8 of Maritimes' Tariff contained general terms and conditions that were inconsistent with the Commission's reservation charge crediting policy. Maritimes also improperly included references to maintenance activities in the *force majeure* definition in section 26 of its Tariff. Making these tariff terms and conditions consistent with the Commission's policy will ensure that shippers are properly credited reservation charges for *force majeure* and non-*force majeure* events.

Pertinent Guidance

- *Natural Gas Supply Ass'n*, 135 FERC ¶ 61,055, at P 12 (2011) (*NGSA*),[33] states in relevant part:

  > [T]he Commission has a well-established and longstanding policy concerning the reservation charge credits which all interstate pipelines must provide their firm shippers during both *force majeure* and non- *force majeure* situations. … [A] number of pipelines do not have tariff provisions properly implementing our reservation charge crediting policy. However, the Commission believes that voluntary action by such pipelines to bring their tariffs into compliance is a more efficient and less burdensome method of obtaining compliance, than initiating an immediate industry-wide NGA section 5 proceeding requiring all pipelines to make filings showing whether their tariffs comply. Therefore, the Commission urges all pipelines to review their tariffs to determine whether their individual tariff is in compliance, and, if not, make an appropriate filing to come into compliance.

- *NGSA*, 135 FERC ¶ 61,055 at P 28, states in part:

  > [T]he Commission is directing the Division of Audits in the Office of Enforcement that future audits of interstate pipelines conducted by the Division of Audits should include whether the tariffs comply with the Commission's reservation charge crediting policy.

[33] *See also NGSA*, *order on reh'g*, 137 FERC ¶ 61,051 (2011).

- *NGSA*, *order on reh'g*, 137 FERC ¶ 61,051, at P 23 (2011), states in relevant part:

> [I]f the Division of Audits determines during an audit of an interstate pipeline that its reservation charge crediting tariff provisions do not comply with Commission policy, then the Division of Audits may work with the pipeline to obtain voluntary compliance and, if unsuccessful, recommend that the Commission initiate a section 5 proceeding.

Background

Shippers pay pipeline companies a reservation charge for firm service based on the volume of capacity a shipper reserves on the pipeline. When the pipeline curtails, interrupts, or is unable to provide firm service on a primary path, and shippers cannot redirect or use their reserved capacity, the pipeline may be required to provide affected shippers a credit of the reservation charge; these credits apply to non-*force majeure* and *force majeure* events.

Non-*force majeure* events are interruptions within a pipeline's control and include interruptions resulting from planned and routine maintenance. It is Commission policy for a pipeline to issue full reservation charge credits for firm service a shipper requested, but the pipeline could not deliver because of a non-*force majeure* service interruption. *Force majeure* events are unexpected and uncontrollable events for which neither party is responsible. Commission policy requires both the pipeline and its shippers to share in such risk equitably, and for the pipeline to provide *partial* reservation credits to shippers. To facilitate this, the Commission has developed two options under which companies must issue credits to shippers for interruptions resulting from *force majeure* events: (1) the No-Profit Method, and (2) the Safe Harbor Method.[34] Maritimes uses the Safe Harbor Method, which provides full credits to shippers only after 10 days have passed during which a *force majeure* event has been in effect.[35]

In *NGSA*, the Commission directed all pipelines to review their tariff provisions for compliance with its reservation charge crediting policy. If noncompliant, pipelines

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[34] *See Cost Recovery Mechanisms for Modernization of Natural Gas Facilities*, 151 FERC ¶ 61,047, at P 101 (describing the two options for providing credits in *force majeure* situations), *clarification denied,* 152 FERC ¶ 61,046 (2015).

[35] In section 8.9 of its Tariff, Maritimes elected to use the Safe Harbor Method.

were given the opportunity to file revised tariff sheets with the Commission. Also, the Commission directed that the Division of Audits (now DAA), in all future audits of natural gas pipelines, review tariffs for conformity with the Commission's reservation charge crediting policy.

Audit staff reviewed Maritimes' Tariff for reservation charge crediting provisions and identified section 8.8 as containing language that was inconsistent with the Commission's reservation charge crediting policy. Under its current tariff language, Maritimes will only provide reservation charge credits to shippers when it fails to deliver less than 95 percent of a shipper's nominated volumes because of non-*force majeure* and *force majeure* events. The Commission's policy does not contemplate a threshold for reservation charge credits, but instead requires that credits be provided when any gas is not delivered due to an outage.[36]

Audit staff also reviewed Maritimes' Tariff language to ensure that non-*force majeure* events, where the outage occurred due to circumstances within the pipeline's control,[37] received full reservation charge credits and had no restrictions imposed for receiving credits relating to these events. This review identified that section 8.9 of the Tariff included several restrictions for when reservation charge credits are issued to shippers for non-*force majeure* events. These restrictions included: outages resulting from routine maintenance occurring from May 1 to November 1; outages occurring when operational flow orders are in effect; and repairs and maintenance of facilities to comply with regulatory requirements. The provisions of Maritimes' Tariff that place restrictions on receiving credits relating to non-*force majeure* events are inconsistent with the Commission's reservation charge crediting policy and the Commission's directive to pipeline companies to revise their tariffs to bring them into compliance with the Commission's reservation charge crediting policy. Maritimes' Tariff should provide full reservation charge credits for any interruption relating to a non-*force majeure* event

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[36] *See, e.g.*, *Texas Eastern Transmission, LP,* 149 FERC ¶ 61,143, at PP 51-52 (2014) (Commission's "policy of requiring full reservation charge credits for routine maintenance outages is applicable regardless of whether the outages are avoidable or attributable to mismanagement").

[37] *See TransColorado Gas Transmission Co. LLC,* 139 FERC ¶ 61,229, at P 50 (2012) ("it is reasonable . . . to include an exemption from providing full reservation charge credits, where its [the pipeline's] failure to provide service is due to the conduct of the upstream or downstream operator of the facilities at the Receipt or Delivery Point, if those operators are outside of the control" of the pipeline), *reh'g denied*, 144 FERC ¶ 61,175 (2013).

where the outage occurred due to circumstances within the pipeline's control, and Maritimes should eliminate any restrictions from this section of its Tariff.

Further, Maritimes included scheduling of routine maintenance in its *force majeure* definition under section 26 of its Tariff. Section 8.9(e) also refers to *force majeure* events as defined in section 26, which requires reservation charge credits to be provided to shippers under the Safe Harbor Method for *force majeure* events. The Commission's reservation charge crediting policy defines routine maintenance as a non-*force majeure* event.[38] Consistent with the Commission's reservation charge crediting policy and the Commission's directive to pipeline companies to revise their tariffs to be compliant with this policy, Maritimes should eliminate references to routine maintenance from its Tariff's *force majeure* definition. This will ensure that shippers receive full reservation charge credits for the entire period that a non-*force majeure* event is in effect for maintenance, rather than after 10 days have passed under the Safe Harbor Method.

In its *NGSA* order on rehearing, the Commission clarified that audit staff can work with a pipeline company to obtain voluntary compliance with the Commission's reservation charge crediting policy.[39] Maritimes acknowledged during the audit that the tariff provisions discussed above do not align with the Commission's reservation charge crediting policy. Maritimes has voluntarily agreed to revise its Tariff to be consistent with this policy as part of the audit.

Recommendations

DAA recommends that Maritimes:

21. Revise policies and procedures to establish and maintain compliance with Commission's reservation charge crediting requirements.

22. File tariff revisions made to its reservation charge crediting provisions for *force majeure* and non-*force majeure* events in sections 8.8 and 8.9 of its Tariff, and remove (i) maintenance activities from its definition of a *force majeure* event and (ii) any restrictions on non-*force majeure* events from its definition of non-*force majeure* event, in section 26 of its Tariff. File these tariff revisions with the Commission within 60 days of the issuance of this report.

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[38] *Cost Recovery Mechanisms for Modernization of Natural Gas Facilities*, 151 FERC ¶ 61,047, at P 101, *clarification denied*, 152 FERC ¶ 61,046 (2015).

[39] *NGSA*, 137 FERC ¶ 61,051, at P 23.

23. Make an informational posting to inform shippers of the revisions made to tariff sections 8.8, 8.9, and 26.

V. Other Matter

1. Tariff Penalty Crediting Provisions

Maritimes' tariff provisions for scheduling penalties and park and loan penalties contain some inconsistencies with Commission policy. Although these provisions are in Maritimes' approved Tariff, updating these provisions will better align them with Commission policy, and provide the appropriate outcomes for assessing penalties to offending shippers and crediting back penalty revenues to non-offending shippers.

Background

The Commission's regulations permit pipelines to assess penalties to offending shippers to prevent the impairment of reliable service. These regulations, however, prohibit pipelines from retaining net penalty revenues and require that all net penalty revenues collected under the pipeline's tariff be credited to shippers in a manner consistent with the pipeline's tariff.[40] During the audit period, Maritimes' Tariff allowed Maritimes to assess offending shippers three types of penalties: (1) a scheduling penalty; (2) an action alert and Operation Flow Order penalty; and (3) a park and loan penalty.

Audit staff reviewed Maritimes' Tariff and processes for assessing penalties to offending shippers and crediting penalty revenues to non-offending shippers. Audit staff's review identified that, with respect to scheduling penalties, Maritimes' Tariff expressly provided for assessing such penalties to offending shippers only when actual deliveries were *below* the tolerance threshold set forth in the Tariff. Nonetheless, the Tariff also provided for Maritimes to impose its maximum interruptible rate on portions of deliveries *above* the tolerance threshold, which in effect is a penalty, as recognized in Commission orders. However, if this occurred, Maritimes considered any activity above the threshold as a transportation revenue rather than a penalty revenue. Audit staff's review also identified that Maritimes' Tariff contained language that improperly provided penalty revenues to offending, as well as non-offending, shippers for park and loan transactions.

Scheduling Penalties

Maritimes assesses scheduling penalties through a usage outside tolerance rate when shippers' delivered volumes are above or below the scheduled quantity tolerance

[40] *See* 18 C.F.R. § 284.12(b)(2)(v) (2019) (pipeline penalty rules).

threshold as defined in section 3.2 of various rate schedules within Maritimes' Tariff.[41] As specified in Maritimes' firm service rate schedules, the usage outside tolerance rate is the maximum interruptible service rate. When deliveries are within the tolerance threshold, Maritimes assesses a firm transportation rate, which is less than the maximum interruptible service rate.

Maritimes' tariff procedures currently only require the crediting of penalty revenues to non-offending shippers when an offending shipper's delivered volumes are *below* the tolerance threshold. However, the tariff allows Maritimes to retain all revenues when delivered volumes are *above* the tolerance threshold. Maritimes' Tariff provides that Maritimes will charge the maximum interruptible service rate when delivered volumes are above the tolerance threshold. It is Commission policy that charging the maximum interruptible service rate to shippers for firm transportation indicates that a penalty has been assessed.

In *Panhandle Eastern Pipe Line, LP* (*Panhandle*) and *MIGC, Inc*., the Commission stated that charging the maximum interruptible service rate for firm transportation is a scheduling penalty that is appropriate to incentivize shippers to schedule accurately.[42] Consistent with the Commission's policy stated in *Panhandle* and *MIGC, Inc.*, Maritimes' usage of its maximum interruptible service rate as its outside tolerance rate should be considered a penalty assessed to shippers, which incentivizes shippers to schedule accurately and thereby prevents the impairment of reliable service.

Audit staff determined, however, that during the audit period there was no shipper that delivered volumes outside the upper tolerance limit. Even though Maritimes did not use this provision during the audit period, audit staff strongly encourages Maritimes to

[41] Section 3.2 provides that the above tolerance threshold is when the delivered quantities are in excess of the lesser of 110 percent of scheduled quantities or 102 percent of a shipper's Maximum Daily Transpiration Quantity; the below tolerance threshold is when the delivered quantities are less than 90 percent of the shipper's scheduled quantities.

[42] *Panhandle Eastern Pipe Line Co.*, 97 FERC ¶ 61,046, at 61,271 (2001) ("a scheduling penalty equal to the interruptible rate is appropriate to provide an incentive for shippers to schedule accurately"); *MIGC, Inc.*, 96 FERC ¶ 61,042, at 61,107 (2001) (holding: "While we find that assessment of the IT rate is appropriate to provide an incentive for shippers to schedule accurately, MIGC has not provided for the crediting of these penalty revenues as required by the regulations. MIGC is directed to revise its tariff to provide that scheduling penalty revenues (net of costs) will be refunded to non-offending shippers").

review and update its Tariff to ensure that the scheduling penalty provisions are consistent with the Commission's regulations and policy.

Park and Loan Penalties

Maritimes assesses park and loan penalties when shippers fail to comply with its notifications to remove parked gas from, or return loaned gas to, the pipeline pursuant to section 8 within Maritimes & Northeast Park and Loan (MNPAL) rate schedule of its' Tariff. This rate schedule requires Maritimes to credit back penalty revenues using its fuel retainage mechanism. However, Maritimes' use of its fuel retainage mechanism as a means of returning net penalty revenue improperly allows all shippers to benefit, including the offending shipper(s).

It is Commission policy that penalties assessed under the Tariff are to be credited only to non-offending shippers. The Commission has addressed this policy in past rate proceedings, where it instructed pipelines to revise their tariffs to ensure that only non-offending shippers benefit from penalty revenues collected and credited back to shippers under a pipeline's tariff. In *Florida Southeast Connection, LLC*, the Commission held that providing penalty credits through a pipeline's fuel retainage mechanism was inappropriate.[43] By crediting penalties back to shippers through the fuel retainage mechanism, offending shippers were permitted to share in the penalty credits. This does not comply with the intent of the Commission's penalty policy, which intends for all penalties to be credited to non-offending shippers only.[44]

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[43] *Florida Southeast Connection, LLC*, 156 FERC ¶ 61,160, at P 39 (2016) (observing that "Commission policy requires all penalties to be credited to non-offending shippers" and holding that: "Sabal Trail's impracticality argument is not credible. Order No. 637 recognized that it may be difficult for some pipelines to develop or implement a penalty revenue crediting mechanism that only credits non-offending shippers. However, Sabal Trail has only two shippers. Therefore, it will not be difficult for Sabal Trail to credit only non-offending shippers."), *vacated on other grounds*, *Sierra Club v. FERC*, 867 F.3d 1357 (2017) (holding that Commission was required to reasonably estimate the amount of power-plant carbon emissions that pipelines would make possible in considering whether to issue certificate to construct project), *order on remand*, *Florida Southeast Connection, LLC,* 162 FERC ¶ 61,233 (reinstating certificate and abandonment authorization), *reh'g denied*, 164 FERC ¶ 61,099 (2018).

[44] *See Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,091, at 31,315 (1999) (cross-referenced at 90 FERC ¶ 61,109) (The Commission added a new section 284.12(b)(2)(v) establishing its policy on penalties that pipelines may not retain penalty revenues, but they must credit the revenues, net of cost,

The Commission's policy and orders stand for the principle that offending shippers should not benefit from penalty credits.[45] Even though Maritimes did not assess any penalties under section 8 of Rate Schedule MNPAL of its Tariff during the audit period, audit staff strongly encourages Maritimes to review and update the penalty crediting provision in Rate Schedule MNPAL to ensure that it is consistent with the Commission's orders and policy.

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to non-offending shippers. Penalty revenues should be credited to non-offending shippers to prevent offending shippers from recouping penalties they have paid to provide an incentive for shippers to avoid incurring penalties), *clarified*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099 (cross-referenced at 91 FERC ¶ 61,169), *reh'g denied*, Order No. 637-B, 92 FERC ¶ 61,062 (2000), *aff'd in part and remanded in part sub nom. Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002), *order on remand*, 101 FERC ¶ 61,127 (2002), *order on reh'g*, 106 FERC ¶ 61,088 (2004), *aff'd sub nom. American Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005), and *Corpus Christi Liquefaction, LLC*, 149 FERC ¶ 61,283, at P 83 (2014) ("consistent with our regulations, we will require Chenier Pipeline to credit all penalty revenues to all non-offending shippers"), *reh'g denied*, 151 FERC ¶ 61,098 (2015), *order vacating in part certificate authorization*, 154 FERC ¶ S61,163 (2016), *order further vacating in part certificate authorization*, 169 FERC ¶ 61,241 (2019).

[45] *See Florida Southeast Connection, LLC,* 156 FERC ¶ 61,160, at P 39 ("Commission policy requires all penalties to be credited to non-offending shippers"); *Corpus Christi Liquefaction,* 149 FERC ¶ 61,283, at P 83 ("we will require Chenier Pipeline to credit all penalty revenues to all non-offending shippers").

VI. Company Response

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October 30, 2020

Via Electronic Mail

Kristen Fleet
Acting Director
Division of Audits and Accounting
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street NE, Room 51-59
Washington, DC 20426

Re: *Maritimes & Northeast Pipeline, L.L.C.*
Docket No. FA19-9-000
Maritimes' Responses to the Draft Audit Report

Dear Ms. Fleet:

Maritimes & Northeast Pipeline, L.L.C. ("Maritimes") hereby responds to the draft audit report dated October 15, 2020 ("Draft Report") of the Federal Energy Regulatory Commission ("FERC" or "Commission") Office of Enforcement, Division of Audits and Accounting ("DAA"). The audit covered the time period from January 1, 2017 to December 31, 2018 and evaluated Maritimes' compliance with: (1) accounting requirements of the Uniform System of Accounts Prescribed for Natural Gas Companies under 18 C.F.R. Part 201; (2) reporting requirements of the FERC Form No. 2, Annual Report for Natural Gas Companies, under 18 C.F.R. § 260.1; and (3) select provisions of Maritimes' FERC Natural Gas Act Tariff ("Tariff").

Maritimes has reviewed the Draft Report and does not contest the Findings and Recommendations as outlined in Section IV of the Draft Report. While not contesting those Findings and Recommendations, Maritimes wishes to provide additional clarification with respect to the extent of the review DAA performed in the audit and the corporate structure changes that occurred during the audit period. Maritimes also provides clarification with respect to Findings Nos. 2, 3, 6, and 7, set forth in Section IV of the Draft Report. Finally, Maritimes confirms that it is taking into consideration the Other Matter set forth in Section V of the Draft Report, and that it reserves certain rights related to the implementation of the Draft Report's Recommendations.

Maritimes appreciates DAA's assistance, oversight, and input during this process, and recognizes the benefits of DAA's collaboration with Maritimes' staff while Maritimes worked in parallel to identify and resolve accounting issues on its own accord. Maritimes respectfully provides the following comments to the Findings in the Draft Report.

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With regard to the description of the scope of the audit in the Draft Report, Maritimes appreciates DAA's extended and comprehensive review, noting that in addition to the items addressed in the Draft Report, the audit scope also included a detailed review of Maritimes' written compliance program, including the role of senior management in compliance; process and procedures in place; training programs; billing and invoice processes; various provisions of the Tariff and implementation of such provisions; Maritimes' internal audit department; pipeline operations; and tax filings. Maritimes notes that the vast majority of the topics reviewed during DAA's audit did not result in any findings.

With regard to the Background section in the Draft Report, Maritimes would like to note a critical additional fact that Maritimes believes is relevant to the audit findings. Notably, the timing of DAA's audit period fell during a unique two year period in Maritimes' history. In February of 2017, early in the audit period, Spectra Energy Corp (formerly one of Maritimes' ultimate parent companies) became wholly owned by Enbridge Inc. ("Enbridge") through a stock-for-stock merger transaction in which a subsidiary of Enbridge merged with and into Spectra Energy Corp (the "Merger"). The Merger required two of the largest pipeline companies operating in the United States at that time to combine their employees, operations, and accounting systems. While the Merger occurred in February of 2017, legacy accounting systems remained in place throughout the year. Enbridge began internal process change implementation in 2018, during DAA's audit period.

With respect to Finding Nos. 1, 4 and 5, Maritimes accepts the recommendations.

With respect to Finding No. 2, Maritimes accepts the recommendations. Regarding Recommendation No. 5, Maritimes in its latest Form No. 2 filing implemented corrections resolving the finding that it had "aggregated maintenance expenses with operating expenses in Column G (Operating Expenses), rather than separately reporting those expenses in Column H (Maintenance Expenses) on Pages 217-217a" of its Form No. 2.[1] The 2019 Form No. 2 filing separately identified Maritimes' Operating Expenses and Maintenance Expenses.

With regard to Finding No. 3, Accounting for Nonoperating and Unrelated Expenses, the Draft Report notes that the DAA's audit "prompted Maritimes … to perform a review" of cost centers and accounting procedures.[2] Finding No. 3 identifies challenges that appeared in calendar year 2018 due to the Merger and the integration of two complex companies. The accounting systems being used are interim systems and processes while Enbridge is working towards the ultimate integrated corporation robust system. Accordingly, at the time of the audit, Maritimes was in the process of an ongoing review

[1] Draft Report, p. 27.
[2] Draft Report, p. 31.

of its allocation procedures to include in the integrated corporation system. While the audit prompted Maritimes to expand the scope of its ongoing review related to these accounting procedures, the review was not initiated due to the audit. Maritimes wants to acknowledge that the 2017 processes for accounting were robust, however, there were some challenges faced in the conversion from the legacy system to the new system which resulted in the issues identified in the finding.

Maritimes accepts the recommendations related to Finding No. 3 and notes the following with respect to certain recommendations related to Finding No. 3. The sampled items identified in Finding 3 totaled $280,000. As discussed with DAA, due to the working environment during Covid-19, Maritimes will collaborate with DAA with respect to the scope, methodology, and timing of the required analysis to be proposed in the implementation plan for Recommendation No. 10.

With respect to Finding No. 6, Fuel Retainage Quantity Filings, Maritimes observes that while Maritimes' Tariff does provide that Maritimes will factor in LAUF in its annual projected FRP calculation, Maritimes does not agree that a negative amount constitutes LAUF. LAUF is defined as lost and unaccounted for gas and not *gained* gas. Accordingly, Maritimes clarifies that Maritimes' own Tariff language does not provide for the inclusion of negative LAUF in the FRP calculation. Nevertheless, Maritimes accepts and will implement the recommendations as stated in the report.

Maritimes accepts Finding No. 7, Reservation Charge Crediting, and the Draft Report's recommendations. Maritimes reserves the right with respect to Recommendation No. 22 to draft and submit revised tariff language consistent with comparable tariff language drafted and approved by the Commission for other pipelines related to reservation charge crediting.

Finally, Maritimes will continue to review and evaluate the Other Matter set forth in Section V of the Draft Report. Upon initial review, Maritimes respectfully offers the following clarifications and provides that the scheduling provisions in its Tariff discussed in this section are in compliance with the Commission's policies and procedures. When Maritimes assesses its maximum interruptible rate in accordance with its Usage Charge Outside Tolerance for deliveries that are in excess of 110% of scheduled volumes, such charges are not penalties. In such an instance, the customer received transportation service from Maritimes and is simply paying for the service received. The Commission accepted this explanation of why such Usage Charge Outside Tolerance is acceptable as provided for in the Maritimes Tariff in its Order on Rehearing and Compliance Filings issued on June 9, 2003 in Docket Nos. RP00-474-001, *et al.* during Maritimes' Order No. 637 proceeding.

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Maritimes will submit for DAA's review its compliance plan for implementing the recommendations consistent with the Final Audit Report, within the required timeframe of its issuance. Maritimes intends to accurately complete the recommendations while being diligent to adhere to the timeframes proposed by FERC Staff. Due to the unprecedented nature of Covid-19 and its impacts on the working environment, Maritimes would like to acknowledge that unforeseen circumstances may result in proposals to allow additional time and methods be considered for implementing the recommendations.

Maritimes has been and remains committed to maintaining a culture of compliance. Maritimes appreciates DAA's guidance provided throughout the audit process.

Respectfully submitted,

/s/ Jennifer Rinker
Jennifer Rinker
FERC Chief Compliance Officer
M&N Management Company, LLC

/s/ Megan Miller
Megan Miller
Manager, FERC Compliance
M&N Management Company, LLC

cc: Brian Harrington
Kevin Senko
Jessica Hunt
Michael Casper