

National Energy
Board



Office national
de l'énergie

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21 January 2008

Mr. Douglas Bloom
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Dear Mr. Bloom:

**Westcoast Energy Inc. carrying on business as
Spectra Energy Transmission – West (Westcoast)
National Energy Board Financial Regulatory Audit of Years 2005-2007**

On 20 December 2007, the National Energy Board issued a draft audit report to Westcoast and invited Westcoast to comment on its contents. On 15 January 2008, Westcoast submitted its comments on the draft report to the Board.

By this letter, the Board is issuing its final audit report which includes Westcoast's comments in response to the Board's recommendations. The Board directs Westcoast to serve a copy of this letter and the attached final audit report on its shippers and interested parties. Also, the final audit report will be a public document and will be posted on the Board's website in due course.

The Board thanks Westcoast's management and staff for their cooperation and assistance during the audit.

Yours truly,

A handwritten signature in black ink, appearing to read 'Claudine Dutil-Berry'.

Claudine Dutil-Berry
Secretary of the Board

Attachment

c.c. Mr. Mel Thorp, Spectra Energy Transmission – West, Facsimile 699-1585

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NATIONAL ENERGY BOARD
Report on a Focused Audit of the Contracting and
Invoicing Practices of Westcoast Energy Inc., carrying on business as
Spectra Energy Transmission – West (Westcoast)
For the Years 2005 through 2007

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1.0 Introduction

The National Energy Board (the Board or NEB) has completed an audit of the contracting and invoicing practices for gathering and processing services provided by Westcoast's BC Field Services Division. This audit was conducted based on the results of the Board's 2007 Pipeline Services Survey, which suggested that shippers have concerns with these areas. The field work was conducted at Westcoast's Calgary office from 7 November 2007 to 16 November 2007.

The objectives and scope of the audit, as well as observations, findings and recommendations are set out below. The following definitions are relevant in the context of this report:

Finding

An area of non-compliance with the *National Energy Board Act* or applicable regulations administered by the Board and/or non-conformance with Board decisions, tariff orders, directives or the terms of a toll settlement.

Recommendation

An opportunity to improve practices, or practices that are currently deemed to be in compliance or conformance but have the potential, based on professional judgment, to lead to non-compliance or non-conformance.

2.0 Audit Objectives

With respect to Westcoast's contracting and invoicing practices for gathering and processing services provided by the Field Services Division,

1. Determine if the company has in place adequate systems and procedures to ensure compliance with the *National Energy Board Act*, Board decisions, tariff orders, other accounting and reporting directives, and provisions of Westcoast's toll settlements.
2. Maintain up-to-date knowledge of the company, including its regard for economy and efficiency.

3.0 Audit Scope

The audit was conducted pursuant to the audit plan approved by the Board on 23 August 2007. The focus of the audit was a detailed examination of the company's books, records and other documents related to its contracting and invoicing practices for gathering and processing services for the years 2005 to 2007. Where necessary, information from other years was also examined for the purpose of meeting the audit objectives.

4.0 List of Findings and Recommendations

- Recommendation 1** It is recommended that Westcoast consider implementing service standards for the time to process all new contracts, CD transfers, contract amendments, etc. When negotiations with customers are involved, the service standard would commence from the point in time when negotiations have concluded and allow for time-outs for events beyond Westcoast's control.
- Recommendation 2** It is recommended that Westcoast further develop its documented procedures for the contracting process, including clearly defined roles and responsibilities for each function and a training program for personnel.
- Recommendation 3** It is recommended that Revenue Accounting provide the Strategic Account Managers with a regular summary report of accounts that have been on interim tolls for longer than three months.
- Recommendation 4** It is recommended that Westcoast further develop its documented procedures for the invoicing process, including clearly defined roles and responsibilities for each function and a training program for personnel.
- Recommendation 5** It is recommended that Westcoast provide a more systematic and detailed explanation for the reasons for invoice corrections so that customers are clear as to why an invoice rerun occurred.
- Recommendation 6** It is recommended that Westcoast develop a system of internal controls to verify the data published in the Market Data Reports.
- Recommendation 7** It is recommended that Westcoast develop a system of internal controls to ensure that revised tolls are filed with the Board prior to being charged, in compliance with section 60 of the NEB Act.

5.0 Observations

5.1 *Adequacy of Systems and Procedures*

5.1.1 Contracting Practices

The systems, procedures and controls that Westcoast has in place for its contracting practices for gathering and processing services were examined. A sample of service requests was also reviewed to determine whether the timelines for processing those requests were reasonable.

The Contracting Practice section of the Framework for Light-handed Regulation (Framework) establishes the parameters under which Westcoast negotiates individual service agreements with shippers. Requests by shippers for a new service or a change to an existing service agreement

(or contract) would involve negotiations. There are also a number of service requests that are more administrative in nature and would not involve further negotiations. Examples of those types of contracting requests are summarized in the following table.

<p>CD Transfer</p> <ul style="list-style-type: none"> • Contract Demand transferred between shippers, but not price 	<p>Renewal</p> <ul style="list-style-type: none"> • Request for shipper to renew a volume of service for a period, but not price
<p>Assignment and Novation Agreement</p> <ul style="list-style-type: none"> • Contract transferred between shippers including price 	<p>Resourcing Agreement</p> <ul style="list-style-type: none"> • Shippers moving the location of their Firm Raw Gas Transmission (RGT) receipt point
<p>Assignment and Amending Agreement</p> <ul style="list-style-type: none"> • Service transferred between shippers including price 	

Westcoast typically handles in excess of 600 service requests per year. In addition, the company receives a high number of service inquiries each year that do not necessarily result in a contracting action taking place.

Several groups are involved in the contracting process, such as the Strategic Account Managers (SAM), Products & Pricing, Legal, Contracts, Accounting (credit), Capacity Management, and Revenue Accounting. Signoffs are required at each step as the contract request goes from one group to the next.

The SAM is the primary point of contact for all customer inquiries. Once the customer's needs are determined, the SAM and the customer negotiate the contract attributes and the associated prices, with the assistance of the Products & Pricing group. The length of time to complete these negotiations varies, depending on the service attributes requested by the customer and whether they fit within one of the four standard service bundles offered by Westcoast or whether they are more customized. Westcoast described the negotiation process as fluid, subject to change at any point, and typically driven by the customer's business factors, such as drilling results and capital budgets.

After Westcoast and the customer have reached a negotiated agreement, the terms of the agreement are sent to Legal, the Contract group and, if necessary, to Accounting for credit approvals. After these steps, the contract is sent to the customer for signature and then returned to Westcoast for final execution. Occasionally, the customer will return the agreement with edits which could result in further negotiations. When the agreement has been fully executed, the Contract group enters the information into the Gas Management System (GMS-SR), if not already done, and it becomes active in the system. Westcoast is not able to invoice the customer for service until an executed agreement is active in the system.

Service Standards

It was observed that no service standards currently exist for processing service requests. Given the fluid nature of contract negotiations and the fact that some events are outside of Westcoast's control, the company expressed reservations about establishing service standards. The Board questioned whether, in cases where negotiations are involved, the service standards could be set up to only cover the period of time between the successful completion of a negotiated agreement and the final execution of a contract. It was recommended at the conclusion of the audit that Westcoast consider establishing service standards for the processing of various contracting transactions.

Recommendation 1 *It is recommended that Westcoast consider implementing service standards for the time to process all new contracts, CD transfers, contract amendments, etc. When negotiations with customers are involved, the service standard would commence from the point in time when negotiations have concluded and allow for time-outs for events beyond Westcoast's control.*

Westcoast's Comments:

Westcoast will institute service standards and standardize the use of its existing log file for tracking the performance for all standard contracts by Q3, 2008. Standard contracts include new Pipeline Transportation Contracts, CD transfers, Assignment and Novation Agreements, Assignment and Amending Agreements and Renewal and Resourcing Agreements. Westcoast will continue to monitor the ongoing performance of negotiated Field Services Agreements, however the setting of service standards (similar to the aforementioned contracts) is not practical given that practice has shown that no negotiation is concluded until Westcoast receives executed contracts from the customer. Following the receipt of executed contracts, Westcoast will apply similar service standards and measures for implementation as with all other service agreements.

Documented Procedures

Westcoast provided a process flow chart diagram for the contracting process. This flow chart diagram was prepared in response to the requirements of the U.S. *Sarbanes-Oxley Act* to maintain an adequate internal control structure. Apart from this flow chart, it was observed that Westcoast is lacking systematic documented procedures for several of the functions pertaining to the contracting process. Westcoast would benefit by further developing its documented procedures for this process, including having clearly defined roles and responsibilities for each function and a training program for personnel, particularly new employees.

Recommendation 2 *It is recommended that Westcoast further develop its documented procedures for the contracting process, including clearly defined roles and responsibilities for each function and a training program for personnel.*

Westcoast's Comments:

Westcoast will provide further clarity and detail in its currently documented procedures, as per the recommendation. Westcoast will further ensure that the documentation identifies where exceptions may be applicable. The update to the documentation will be completed by Q3, 2008 and will be updated as required.

Processing Timelines

The timelines to process contract requests were reviewed for a sample of contracts. This review included the turnaround times for Contracts, Accounting (credit), Legal and final approval signatures by the customer and Westcoast. The turnaround times for this sample of contracts were reasonable.

The reasons why certain customers have been invoiced on an interim toll basis for longer than three months were also examined. In most cases, the SAM explained that the reason was a disagreement on tolls between the customer and Westcoast. Some of the accounts examined had been reassigned from one SAM to another, resulting in the new SAM not being fully aware of all the details of the account. To ensure that resolution of these outstanding accounts receives a high priority, it was recommended at the conclusion of the audit that Revenue Accounting provides the SAMs with a regular summary report of all accounts that have been on interim tolls for longer than three months, as was done during the audit.

Recommendation 3 *It is recommended that Revenue Accounting provide the Strategic Account Managers with a regular summary report of accounts that have been on interim tolls for longer than three months.*

Westcoast's Comments:

Revenue Accounting will continue to provide updates to Strategic Account Managers of accounts that are on interim tolls for longer than three months.

“No brokering” Clause

In response to concerns raised by certain shippers, the details on the “no brokering” clause found in RGT and Treatment contracts were examined. Westcoast explained that this clause dates back to at least 2001 and was made a standard clause in all contracts as of that year. It was introduced to reflect the fact that Westcoast is negotiating customized contracts for each and every customer. The prices in each contract reflect the customized attributes of each negotiation, including in some cases a low price because of the customer’s economic bypass alternative. The clause prevents proliferation of that low price to other customers who do not have that bypass alternative. The Board has no concerns with this explanation.

5.1.2 Invoicing Practices

The systems, procedures and controls in place for Westcoast’s invoicing practices for gathering and processing services provided by the BC Field Services Division were examined.

Because of the negotiated nature of RGT and processing services, varying composition of raw gas, and customers’ needs, there is a wide variation in tolls and services parameters (or attributes), all of which must be reflected in invoices. Invoices are a function of five key factors: service agreements, attributes, tolls, residue gas and product allocation, and nominations.

The term of service agreements may be for less than one year or for many years. Service agreements may include, but are not limited to, a delineation of receipt points, and service attributes (e.g., composition of raw gas, renewal rights, volumes, land dedication, etc. – see Section C of the Framework for a list of service parameters to which value may be ascribed). Contracts also delineate the agreed-upon tolls for RGT and processing services. If the contract includes Treatment services, then it will also include a schedule outlining tolls for processing based on various levels of acid gas.

Service agreements may be renewed or amended, and a review of invoices during the audit indicated that some contracts have been amended more than 20 times, based on requests of shippers. The cause of amendments appears to largely stem from the dynamic nature of the upstream sector.

Invoices must also reflect the volumes and composition of gas that is gathered and processed. Therefore, the residue gas, energy and by-products from a processing plant must be allocated upstream to the relevant receipt points, production sources, and individual shippers. Essentially, the plant allocation process consists of the following three distinct processes:

- (1) Residue gas, energy and by-products are allocated from each processing plant to the receipt points within each plant’s RGT system;
- (2) Residue gas, energy and by-products are allocated from each receipt point to the production sources behind each receipt point; and
- (3) Residue gas, energy and by-products are allocated from each production source to the individual shippers based on the splits determined by the Receipt Point Operator.

Lastly, invoices must reflect volumes nominated or scheduled daily.

Invoices are typically posted on the Westcoast website on the 20th of each month and payment is due in five business days. For example, on November 20th an invoice for each customer is posted with an “estimate” billing for the production month October; an “actual” billing for the production month September; and any “corrections” (or re-runs) for a previous production month (e.g. July).

Corrections to invoices for previous production months are a function of three factors. First, the most common reason for corrections to invoices is a shift from interim to final tolls or as a result of contract amendments. Second, corrections to invoices could be driven by corrections to the plant allocation. While the occurrence of these types of corrections is relatively few, one allocation correction may result in corrections to all invoices upstream of either a receipt point or a plant. An example of an event that could cause a correction in allocation is if the orifice plate at a meter of a receipt point is inaccurate. An allocation correction must meet a materiality threshold before the correction is flowed through to invoices.

Although there may be more events of toll changes or contract amendments, the cascading effect due to a re-run based on an allocation correction may result in more invoice corrections. Therefore, it is difficult to conclude which results in the most invoice corrections.

The third factor that causes invoice corrections is errors or contract misunderstanding. Although it appears that this factor results in the least amount of invoice re-runs, recent staff turnover has contributed to an increased incidence of such errors.

Documented Procedures

Errors that are introduced by inexperienced staff may be mitigated by enhanced process and procedure documentation. Presently, the invoicing process is documented for the purpose of satisfying the U.S. *Sarbanes-Oxley Act*; however, this documentation, which primarily consists of annotated process schematics, is complex and may not be ideal for training or as reference material.

While no formal procedures manual exists that describes the invoicing process and individual procedures, limited informal procedures do exist that have been prepared by proactive staff to assist in knowledge transfer and training. Training is primarily accomplished through a knowledge transfer that is affected through learning-by-doing and assisted by job-shadowing. However, there is periodic formal training on the contracting and invoicing system known as CONVOI.

Recommendation 4 *It is recommended that Westcoast further develop its documented procedures for the invoicing process, including clearly defined roles and responsibilities for each function and a training program for personnel.*

Westcoast's Comments:

Westcoast will expand its SOX documentation regarding procedures on invoicing by Quarter 3 in 2008. It has been Westcoast's experience that the biggest challenge in staff turnover is the transfer of knowledge with regard to the details on contracts. In 2007 a process was started whereby the Strategic Account Managers and Revenue Analysts review all Field Services contracts and summarize the detail of each contract on a one page summary. This increased the effectiveness and efficiency of understanding and the transfer of knowledge to new staff, and will continue annually.

Explanation for Corrections

When invoices are corrected, there is currently no systematic approach to provide a brief explanation for the correction. At present, Westcoast's practice involves the provision of a reason for re-runs motivated by an allocation correction. However, when invoice corrections result from other reasons, the provision of an explanation is discretionary. The explanations reviewed from a sample of invoices suggest that the notation may be overly brief and difficult to understand. It is noted, however, that Revenue Analysts communicate frequently with customers concerning their invoices.

Nevertheless, it would be good business practice to expand the explanation to give customers a better understanding of why their invoice was changed. It would also be good business practice to put in place a process and procedures that force the provision of an appropriate explanation for all invoice re-runs.

Recommendation 5 *It is recommended that Westcoast provide a more systematic and detailed explanation for the reasons for invoice corrections so that customers are clear as to why an invoice correction occurred.*

Westcoast's Comments:

Westcoast will provide a summary explanation on invoices as to the reasons for any corrections or, if the space is not sufficient, provide an attachment.

5.1.3 Code of Conduct

The procedures and controls that Westcoast has in place to ensure compliance with its Code of Conduct were reviewed. It was observed that Westcoast has training packages in place to familiarize its employees with rules and policies regarding items such as the Code of Business Ethics and affiliate rules. Employees take annual online training modules that include exams which must be passed before completion is recognized by Human Resources. No concerns were raised by this review.

5.2 Updating Knowledge

5.2.1 Corporate and Business Structure

Since the last NEB audit, Westcoast's corporate and organizational structure has continued to evolve. While Westcoast Energy Inc. remains an operating and holding company, it is now an indirect wholly-owned subsidiary of Spectra Energy Corporation (Spectra) and is carrying on business as Spectra Energy Transmission – West (SET-West). The ownership of Westcoast changed when Duke Energy Corporation announced in June 2006 its intention to spin-off its natural gas business to Duke Energy shareholders. The spin-off was completed on 2 January 2007. Spectra is a public company trading on the NYSE under the stock symbol SE.

SET-West operates four divisions: BC Pipeline, BC Field Services, Natural Gas Liquids (NGL), and Midstream. The assets of BC Pipeline and BC Field Services Divisions are owned and operated by Westcoast. The NGL Division operates a 2.4 Bcf/d Straddle Plant and a 929-kilometre NEB-regulated NGL pipeline that stretches from Burstall, Saskatchewan to markets in Regina and Winnipeg.

At the time of the last audit, Westcoast's Midstream Division consisted of the gathering and processing facilities northwest of Fort St. John owned and operated by Westcoast Gas Services Inc. (WGS), a wholly-owned subsidiary of Westcoast. In 2005, Duke Energy Corporation and ConocoPhillips restructured the ownership structure of their joint venture Duke Energy Field Service LLC (DEFS), which includes the transfer and integration of DEFS Canadian assets to Duke Energy Gas Transmission – West (now SET-West). Subsequently Westcoast sponsored the creation of the Duke Energy Income Fund (now Spectra Energy Income Fund) for the purpose acquiring DEFS Canadian assets. In late 2006 the income fund acquired WGS from Westcoast.

The Fair Dealing Policy outlined in Section B of the Framework governs the operation of relevant affiliates, such as the Midstream Division, and requires operational separation from the Field Services Division. That is, such relevant affiliates are required to have their own President and separate employees reporting to that President who in turn reports to a senior executive of Westcoast with no reporting relationship to the President of Field Services.

Under the current organizational structure of SET-West, the BC Pipeline and Field Services Divisions and the Midstream Division each have their own President and employees. The President of each Division reports to the President of SET-West. Hence, SET-West's business structure is in conformance with the Fair Dealing Policy.

5.2.2 Internal and External Audit

All internal audit reports completed during the years 2005 to 2007 were reviewed. There were no findings or recommendations in the reports that cause concern to the Board.

Internal audits are performed by Spectra's Audit Services Department. This is a functional group which performs audits for all of Spectra's businesses and reports to the Spectra Audit

Committee of the Board of Directors. This group is governed by the Audit Services Charter and Policy dated 1 January 2007.

All letters and Reports to the Westcoast Audit Committee from the external auditor for the period 2004-2006 were reviewed and no issues of concern were raised.

5.2.3 Gathering and Processing Tolls

Section D of the Framework, entitled Provision of Market Information and Confidentiality of Contracts, addressed the desire of parties to maintain the confidentiality of negotiated contracts, the provision of pricing data to facilitate a reasonable degree of price discovery and the requirement to comply with section 60 of the *National Energy Board Act*. That section mandates that a company shall not charge any tolls except tolls that are specified in a tariff that has been filed with the Board and is in effect; or approved by an order of the Board.

To meet these requirements, Westcoast files updated toll schedules with the Board for gathering and processing services and publishes quarterly Market Data Reports on its website. All Market Data Reports from 2005 to date were examined during the audit.

This examination revealed that RGT demand tolls in the Fort Nelson area have increased, on a weighted average basis, approximately one percent between 2005 and 2007, while tolls for Treatment Service have declined almost four percent. Similarly, weighted average tolls for Treatment Service at the Sikanni gas plant have fallen about 21 percent. However, the minimum toll increased approximately 18 percent and the maximum toll fell about 40 percent.

In the Fort St. John area, RGT demand tolls increased approximately nine percent on average between 2005 and 2007. Over this period, the spread between minimum and maximum tolls widened as the former increased just one percent, while the latter rose 34 percent. Tolls for Treatment Service at McMahon increased an average of four percent and the minimum and maximum each rose by about three percent.

In the Grizzly Valley area, RGT demand tolls increased an average of about one percent, while the minimum and maximum increased approximately 12 and 10 percent respectively. Tolls for Treatment Service at Pine River decreased on average by about two percent. However, the spread between minimum and maximum Treatment tolls widened as the minimum decreased about one percent and the maximum increased by more than 37 percent.

The analysis of the Market Data Reports revealed a few data errors that resulted from the current system of maintaining and updating the data. The incidence of such errors could be decreased if internal controls to verify the data were enhanced. In addition, a temporary but significant spike in the demand toll for processing at one of the gas plants was identified that resulted from an amendment to an existing contract. It is unclear whether Westcoast's systems are robust enough to enable it to ensure that its tariff is revised in a timely manner to ensure compliance with section 60 of the *NEB Act*. Therefore, Westcoast should consider developing a system of internal controls to ensure that revised tolls are filed with the Board prior to being charged, to ensure compliance with the *NEB Act*.

Recommendation 6 *It is recommended that Westcoast develop a system of internal controls to verify the data published in the Market Data Reports.*

Westcoast's Comments:

Westcoast continues to review its process for generating the Market Data Report (MDR). With increased functionality and system enhancements associated with the contracting system, Westcoast has increased the amount of system generated extracts/reports to generate the MDR. Documentation will be updated and maintained to more fully explain the internal control processes used in this process and this will be completed by Q3, 2008.

Recommendation 7 *It is recommended that Westcoast develop a system of internal controls to ensure that revised tolls are filed with the Board prior to being charged, in compliance with section 60 of the NEB Act.*

Westcoast's Comments:

Similar to Response 6 above, Westcoast has a process for continuous improvement in this area and will seek improvement opportunities for generating the toll filing and MDR in a timely and accurate fashion. Toward this end, Westcoast will continue to institute process improvements where possible and provide complete documentation of the internal controls to support the generation of our toll filing and MDR. This documentation will be completed by Q3, 2008.

5.2.4 Customer Satisfaction

Westcoast has not initiated broad-based customer surveys during the audit period. It explained that the annual NEB Pipeline Services Survey is closely examined and the shipper comments in that survey are used in the planning of customer service initiatives. Some examples of those initiatives are improvements to Westcoast's website, on-line access to invoices, resolution to changing Motor Fuel Tax numbers, new SCADA system and the posting of stand-alone IT tolls on the website. Continuing and future actions items include further website improvements, the linepack/imbalance improvement initiative and work on eliminating the Field Services "estimate" invoice.

The SAM program was implemented to address customer service issues and to provide a means to implement the principles and objectives of the Framework. Each SAM is responsible and accountable for all commercial dealings between his customers and Westcoast and is the single point of contact to getting timely responses to commercial and operational queries.

Spectra recently decided to participate in the annual pipeline survey conducted by Mastio & Company by purchasing the detailed results of the next survey. As one of Spectra's business units, Westcoast will benefit from this purchase by adding the quantitative data from the Mastio results to the qualitative data that it collects through other means.

6.0 Conclusion

This audit allowed the Board to gain a greater understanding of the issues related to Field Services contracting and invoicing. While no "Findings" requiring a Corrective Action Plan were identified, the Board believes that implementation of the seven "Recommendations" identified in the report may improve the contracting and invoicing processes and address the concerns identified by shippers in the Board's Pipeline Services Survey.