
STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS
FROM: KRISTEN EDWARDS, BRITTANY MEHLHAFF, MARY ZANTER, AND PATRICK STEFFENSEN
RE: Docket NG16-____ - Commission Staff's Petition for Declaratory Ruling
DATE: November 9, 2016

Commission Staff (Staff) submits this memorandum in support of its Petition for Declaratory Ruling. Staff engaged in numerous conversations in-person, over the phone, and via email with both NorthWestern Energy (NorthWestern) and Northern Natural Gas Company (Northern), as well as other jurisdictions including the Federal Energy Regulatory Commission (FERC) and the U.S. Department of Transportation (DOT) Pipeline and Hazardous Materials Safety Administration (PHMSA), in order to gain insight into the farm tap¹ issues and understand both sides of the story. The purpose of this memorandum is to provide the Commission with the information Staff learned. The information contained in this memorandum represents Staff's view of the facts and opinions regarding the farm tap issues and not necessarily those of Northern or NorthWestern, although Staff has done its best to portray accurate information as it has been presented to us.

BACKGROUND

When Northern built its pipelines in South Dakota, easement agreements with rural landowners included a farm tap provision. Northern agreed to install a farm tap on the interstate pipeline in exchange for easements so the pipeline could cross a landowner's property. These agreements date back to the 1950s. The landowner was responsible for installing, owning, and maintaining the service line from the farm tap to the house.

Initially, Northern provided natural gas service to these farm tap customers per the easement agreements and subsequently established a local distribution operating division designated as Peoples Natural Gas (Peoples) which provided service to the farm tap customers. In 1980, Northern changed its name to InterNorth, Inc. and designated Peoples as an operating division responsible for the local distribution of natural gas, and Northern as an operating division responsible for the interstate transmission and sale of natural gas in interstate commerce. In 1985, Peoples was sold to Utilicorp United Inc. and continued to provide services to the farm tap customers as Peoples.

No longer affiliates, Northern and Peoples executed an agreement in 1987 to document the services Peoples agreed to provide on behalf of Northern regarding the farm tap customers (1987 Agreement). These services include responding to any reported gas leak, servicing farm-tap odorizers, meter reading,

¹ PHMSA defines a farm tap as "industry jargon for a pipeline that branches from a transmission or gathering line to deliver gas to a farmer or other landowner."

and billing services. According to the 1987 Agreement, Peoples may terminate the agreement at any time after May 31, 2017 by providing six months' prior written notice to Northern.

Minnesota Energy Resources Corporation (MERC) acquired Peoples' farm taps in South Dakota and Minnesota in a 2006 transaction including assignment of the 1987 Agreement. In 2011, in conjunction with acquiring the Milbank pipeline from Northern, NorthWestern agreed to a partial assignment of the 1987 Agreement, providing services to the South Dakota farm tap customers.

NorthWestern's responsibilities under the partial assignment of the 1987 Agreement include emergency response, filling the odorizer annually, billing monthly², reading the meter annually, locking the tap if needed, and nominating gas. There are currently 197 farm tap customers³ served pursuant to the partial assignment of the 1987 Agreement.

CURRENT ISSUES

As previously stated, the 1987 Agreement allows for termination any time after May 31, 2017 with six months' written notice to Northern. NorthWestern has indicated to both Staff and Northern that it intends to exercise its right to terminate the 1987 Agreement. No formal notification has been provided at this time.

NorthWestern has relayed to Staff several concerns with continuing the 1987 Agreement. NorthWestern believes it is not adequately compensated for the legal liability and financial risk associated with providing the limited services to the Northern farm tap customers, and thus, continuing the contract is not in the best interest of the company and its customers. NorthWestern and Northern have not been able to negotiate acceptable terms in order for NorthWestern to agree to continue this contractual relationship.

In order to understand NorthWestern's concerns with serving these farm tap customers, it is important to understand the differences between a farm tap customer and an average distribution customer. Normally, NorthWestern owns the distribution facilities, including the service line, all the way to the customer meter which is generally located adjacent to a customer's house. For the farm taps in the 2011 assignment situation, however, NorthWestern does not own any of the facilities. The customer owns the service line from the meter (which is owned by Northern) to the house and Northern owns all of the piping prior to the meter. This arrangement can create many problems.

Most importantly, this service arrangement can have major safety impacts. Since the customer was responsible for installing the service line, this was done either by the customer or by a customer-hired contractor. There are no records of the materials used, exactly where the line is located, and it is unknown how much maintenance has been done on the line. If a leak occurs on a customer's service line, it may potentially go undetected for months, especially if the customer is not reading his or her

² The customer is responsible for reading his or her meter each month.

³ 17 of the 197 farm taps are inactive.

meter every month⁴. There is also no periodic leak survey done on the customer's service line. The most serious implication of an undetected leak is, of course, an explosion or fire resulting in injury to the customer or others. Fortunately, Staff is unaware of any leaks resulting in injury. However, the risk is certainly there.

Besides the safety risks, an undetected leak has financial implications. NorthWestern's billing practice on farm taps is to have each customer do a monthly meter read and NorthWestern does an annual read. On occasion, a customer has had a leak, didn't read his or her meter, and the leak went undetected for months until NorthWestern did the annual meter read. The leak was fixed and the customer was sent a bill for the additional amount owed, since the customer had only paid for estimated usage. Since farm taps are sometimes used for seasonal usage such as grain drying, the estimated usage may not be accurate. Such bills can be thousands of dollars. Often times, the customer does not understand or recall that he/she is responsible for the leak since they own the service line, not NorthWestern. NorthWestern has found itself stuck between Northern and the customer, and NorthWestern and its customers have been stuck with the bill when the customer refuses to pay. If a customer doesn't pay his or her bill, NorthWestern cannot disconnect the customer like it would any other utility customer, because the meter is not NorthWestern's property. It is Northern's property and Northern is the one to shut off the meter. With minimal margins, when one or two customers do not pay their bills, NorthWestern loses money.

Additionally, when a customer does have a leak on his or her service line, it is very difficult for NorthWestern to identify where the leak is occurring since the location of the line is unknown and is often not traceable with traditional locating methods. The time involved investigating a leak on a customer's property can involve many hours of labor.

Due to the nature of a farm tap, these meters and service lines are not always in easily accessed locations. Since the transmission line crosses entire sections of land, the meter is located a significant distance from the location of the gas usage. It has been observed that these meters are often located in corn fields, bean fields, pastures, feed lots, and swamps.

Furthermore, 55 out of the 197 farm tap customers are located outside of NorthWestern's service area. The distance creates additional costs and travel time when a NorthWestern employee needs to read the meter or must respond to a customer request. In case of an emergency, it may take an extended time for a NorthWestern employee to get to a customer's property.

Due to these issues, NorthWestern relayed to Staff that it is not in the best interests of its customers to continue serving the farm tap customers under the status quo of the 1987 Agreement.

Are there terms under which NorthWestern could serve the farm tap customers and eliminate these concerns? NorthWestern engineers conducted a study to see what it would cost for NorthWestern to replace necessary service lines and take over ownership so that the service lines could be maintained

⁴ If a customer does not read his or her meter, NorthWestern sends a bill based on estimated usage.

safely. The total estimated project cost is \$3 million. This comes to approximately \$12,000 to \$30,000 per service. This cost would either have to be borne by each farm tap customer or shared among NorthWestern's customers. This becomes a question of rate shock versus customer class inequity. Also, even if the Commission were to determine an appropriate rate recovery plan associated with this project, the project would not solve all problems. Fifty-five customers would still be outside of NorthWestern's service area, raising safety and financial concerns.

RESPONSIBILITY AND JURISDICTION

One important question raised during Staff's review of the farm tap customers is whether Northern or NorthWestern is responsible for serving the farm tap customers or whether either company has any obligation at all.

According to the 1987 Agreement, NorthWestern can terminate the contract after May 31, 2017. The cover letter and order in Docket NG11-001 states that NorthWestern will serve this group of customers through December 31, 2017. However, Northern contends that NorthWestern is obligated to provide service unless the Commission allows service to be abandoned pursuant to SDCL 49-34A-2.1.

SDCL 49-34A-2.1: No public utility may, except in cases of emergency, fail to provide, discontinue, reduce or impair service to a community, or a part of a community, except for nonpayment of account or violation of rules and regulations, unless permission has been first obtained from the Public Utilities Commission to do so.

SDCL 49-34A-1(12) defines a public utility as "any person operating, maintaining, or controlling in this state equipment or facilities for the purpose of providing gas or electric service to or for the public in whole or in part, in this state. However, the term does not apply to an electric or gas utility owned by a municipality, political subdivision, or agency of the State of South Dakota or any other state or a rural electric cooperative as defined in § 49-21-1 for the purposes of §§ 49-34A-2 to 49-34A-4, inclusive, §§ 49-34A-6 to 49-34A-41, inclusive, and § 49-34A-62. The term, public utility, does apply to a rural electric cooperative which provides gas service".

Is NorthWestern a public utility in this instance? If so, the Commission's order approving NorthWestern's tariff to accommodate the acquisition of the Milbank pipeline in 2011 includes an expiration date of December 31, 2017. Staff believes the Commission already gave permission to discontinue service through its order in Docket NG11-001, if permission is required. However, Staff believes that NorthWestern's involvement with the farm taps is as a third-party contractor, rather than a public utility. If NorthWestern is not a public utility, is Northern? If so, does the Commission need to approve Northern's discontinuance of service to the farm tap customers, in addition to FERC approving abandonment of the farm taps as is suggested by Northern?

Northern entered into easement agreements with the landowners. Typically, the agreements stated that the landowner would receive a farm tap in exchange for providing an easement to Northern. As the

PUC does not have jurisdiction over contracts and easements, Staff merely mentions this to provide background as to how the farm taps came to be.

In NorthWestern's view, when docket NG11-001 was discussed at a commission meeting, the Commission recognized that Northern would be responsible for arrangements to serve these customers in the event NorthWestern elected not to continue the arrangement after 2017.

Northern stated in response to Staff's questions: "The mere expiration of the 1987 Agreement does not alter whose obligation it is to provide continuing public utility service to the farm taps." Northern believes this obligation belongs to NorthWestern. Staff questions why there was a termination date in the 1987 Agreement if NorthWestern must continue to serve beyond the termination date.

FERC Order 636 took the merchant function away from interstate pipelines. Northern believes that FERC Order 636 prohibits Northern from selling gas directly to the farm tap customers. Staff seeks clarification on this issue and questions why Northern cannot form a retail gas company to serve the farm tap customers as it did when it created Peoples.

In regard to pipeline safety, are farm taps under state jurisdiction? Northern declares that jurisdiction is under FERC, making it fall into federal jurisdiction rather than state jurisdiction. PHMSA declares distribution systems to be under state jurisdiction for inspections. Currently these facilities are not being inspected by state or federal pipeline safety inspectors.

If NorthWestern services these farm taps, is NorthWestern inspected on the maintenance of the farm taps as service lines? Or is that part of Northern's inspection? Who is ultimately responsible for items such as odorization, providing customer notifications, and other U.S. DOT requirements?

Currently no one is obligated to locate these service lines as part of South Dakota One Call because they are customer property. In the interest of safety, Staff believes the lines should be located, but what entity is required to locate these lines in the future?

CONCLUSION

Given the information Staff has obtained and reviewed, Staff offers four scenarios for the future of the farm tap customers.

1. Service is abandoned. Each farm tap customer will have to convert to another fuel source to serve their needs that are currently being met by Northern's natural gas.
2. Northern creates a retail natural gas company to serve the farm tap customers or utilizes a current Northern affiliate retail natural gas utility to serve the farm tap customers.
3. NorthWestern continues to serve the farm tap customers beyond 2017.
4. Northern contracts with another retail natural gas utility to serve the farm tap customers.

Regarding option 1, presuming the alternative fuel source chosen by a customer is propane, Staff suggests that Northern could help pay for necessary furnace conversion and piping or provide a modest cash contribution to each customer.

In options two through four, the safety aspect of the current service lines would need to be addressed and appropriate cost recovery designed so the company would be able to recover the costs required to safely own and operate the service lines. Staff recommends service to the farm tap customers only continues if a utility owns and operates the service lines following pipeline safety inspections and replacements if necessary. The safety risk is too great to continue service to these customers in the current manner with customers owning and being responsible for maintaining the service lines.

The Commission and the parties involved must take into consideration the numerous issues discussed in this memorandum when making these decisions. However, before a decision can be made on whether service will continue and if so, who will provide this service, the Commission must address the issues raised in Staff's Petition for Declaratory Ruling.

Specifically, Staff petitions the Commission to issue a declaratory ruling that resolves the following issues: 1) Does the Commission have jurisdiction over the utility providing natural gas to farm tap customers taking natural gas from the transmission line owned and operated by Northern? 2) If so, which entity, NorthWestern or Northern, if either, is a public utility as defined by SDCL Chapter 49 with respect to these farm tap customers? 3) Finally, are the farm taps in whole or in part subject to state jurisdiction for the purpose of pipeline safety pursuant to SDCL Chapter 49-34B?

Upon issuance of an order regarding this Petition for Declaratory Ruling, Staff also requests guidance from the Commission on how to proceed regarding the farm tap customers.

Upon Staff's filing of this Petition for Declaratory Ruling and memorandum, NorthWestern has agreed to send letters by certified mail to all farm tap customers by November 10, 2016, so each customer may be notified and have an opportunity to intervene.