

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of a Petition by the  
Minnesota Energy Resources Corporation for  
Approval of Farm Tap Customer-Owned Fuel  
Line Replacement Plan, Tariff Amendments,  
and Deferred Accounting

ISSUE DATE: November 30, 2017

DOCKET NO. G-011/M-17-409

ORDER APPROVING PHASE 1 OF  
FARM TAP REPLACEMENT PROJECT  
WITH CONDITIONS

**PROCEDURAL HISTORY**

On May 19, 2017, Minnesota Energy Resources Corporation (MERC or the Company) filed a petition for approval of a capital plan to replace customer-owned fuel lines located between the interstate pipeline tap and the customer's property (farm-tap lines or farm-tap service) with utility-owned lines (the replacement project). MERC proposed a two-step process for approval of the proposed Farm Tap Replacement Project. MERC requested that the Commission approve the Company's proposed initial Planning and Design Phase and establish a procedural schedule to evaluate the petition. MERC also asked that the Commission grant deferred accounting for the scoping phase and design work so as to develop a reliable total cost estimate for the overall project. Once the planning and design phase is complete, MERC will file a separate petition to implement and install the line replacements.

According to MERC, the purpose of the proposed replacement project is to address significant safety concerns related to the existing farm-tap customer-owned fuel lines, many of which can no longer be located.

On September 14, 2017, Northern Natural Gas Company (NNG) filed comments in support of MERC's proposed safety plan and to provide additional information on the history of farm taps in Minnesota.

On September 18, 2017, the Department of Commerce, Division of Energy Resources (the Department), filed comments recommending approval of the Company's initial scoping phase, but recommending denial of the Company's request for deferred accounting.

Also on September 18, 2017, the Office of the Attorney General—Residential Utilities and Antitrust Division (OAG) filed comments recommending denial of the Company's request for deferred accounting and asking the Commission to require that notice of the proceedings and any public hearings be provided to MERC's ratepayers.

On September 28, 2017, MERC filed reply comments, and on October 10, filed supplemental reply comments.

On October 20, 2017, the Department filed supplemental comments.

On November 2, 2017, the Commission met to consider the matter.

## **FINDINGS AND CONCLUSIONS**

### **I. Background**

#### **A. History of MERC's Farm-Tap Service in Minnesota**

"Farm-tap" lines are customer-owned distribution lines for natural gas running from the interstate pipeline to the customer's property. Most of these lines were constructed at the same time as the interstate pipeline, some 85 years ago. NNG owned the pipeline, and allowed rural landowners to tap into it in return for easements. Once the interstate transmission line was constructed, NNG installed the tap (consisting of the rise, pressure regulator, and the measurement meter) and landowners installed the fuel line from the tap to the buildings to be served with natural gas. Landowners had full discretion as to the materials and installation techniques used to connect the pipeline tap to their homes and other facilities. The locations of these taps were not generally recorded, and many of these farm-tap line locations have been largely forgotten by landowners and fallen into disrepair.

In its petition, MERC provides a detailed discussion of farm-tap history in Minnesota and the progression over time of the changing corporate ownership structure and various entities, including Peoples Natural Gas (Peoples), from which MERC ultimately was formed in 2006 (MERC's Petition at 5-7 ). NNG's filing supplements the history of farm-tap evolution in Minnesota (NNG Comments at 4-7).

On April 1, 1987, NNG and Peoples executed an agreement (the 1987 Agreement) under which Peoples agreed to provide a number of services to farm-tap customers, including among other things: responding to leaks, servicing odorizers, meter reading, and record retention. Peoples agreed to provide services to farm-tap customers for a period of 30 years in return for an agreed-upon payment. MERC is Peoples' successor to the 1987 Agreement.

The 1987 Agreement stated that it could be terminated at any time after May 31, 2017 by providing six months written notice. MERC provided such notice in November 22, 2016, stating that the Company would continue to provide these services to customers on a month-to-month basis until the Commission issues a final order in this matter.

### **II. MERC's Petition**

In Phase 1 of its proposed plan, MERC requested Commission approval for the initial engineering planning and design phase of the proposed farm-tap project and approval of a procedural schedule, including a customer communication plan for public hearings for the project.

## **A. Planning and Design Phase**

MERC proposes to complete engineering planning and design work on a statistically significant sample of farm-tap lines to develop a more reliable total cost estimate. MERC plans to refine the project scope and costs estimates before returning to the Commission to request approval of the total project. The Company plans to hire a design and engineering firm to scope the current load infrastructure for about 300 randomly selected farm-tap customers. This team would meet with customers to consult on existing load. Once designs are complete for the 300 farm taps selected, MERC will estimate construction costs to implement the infrastructure and design necessary. From that data, MERC plans to extrapolate costs to its remaining 1,500 farm taps.

MERC's petition also proposes to socialize the costs of replacing the customer-owned lines, asserting that these customers have been paying for rate base for decades, and charging them for the replacement costs of these lines would be cost prohibitive.

## **B. Safety Concerns**

MERC asserted that its proposed replacement plan is justified. The Company estimated that at least 90 percent of the farm-tap lines are not locatable, with no extant record as to the material type, age, or cathodic protection used. Farm-tap lines have also had numerous leaks over time, and are inspected less frequently and thoroughly due to the difficulty of locating them. Federal and state safety standards for gas infrastructure are not generally applicable to farm-tap lines. MERC stated that its proposed replacement project will address such concerns by standardizing pipe materials with new, locatable lines that will be regularly maintained by MERC.

## **C. Alternatives Considered**

Before filing its proposed replacement project, MERC explored three alternatives: 1) termination of the 1987 Agreement; 2) extension of the 1987 Agreement; or 3) continuation of service to customer-owned lines. MERC rejected each alternative, noting that the termination of the 1987 Agreement would likely result in the loss of natural gas service to some 1,800 MERC farm-tap customers, while extending the 1987 Agreement or continuing service to customer-owned lines would not address the significant safety concerns raised.

## **D. Implementation Phase**

MERC states that once the planning and design phase is complete, it will request approval of the implementation phase. MERC projects replacement over a three-year period, beginning in late 2018 or 2019, at an estimated cost of some \$45 million. MERC's proposal will cover replacement of lines to buildings currently receiving service. MERC indicated that while it will not purchase the existing lines, it will allow customers to opt-out of its replacement plan if they no longer wish to maintain natural gas service.

### **III. Planning and Design Phase**

#### **A. Phase Positions of the Parties**

##### **1. The Department**

The Department agreed that MERC's proposed replacement project is superior to the three identified alternatives in resolving important safety issues. The Department agreed that there has been a high number of farm-tap leaks, with a strong possibility that more have not been detected due to not being locatable and/or the infrequency of inspections. The Department noted that these factors pose a significant risk for contractors or land owners doing any work that requires digging.

The Department discussed the handling by other states (Iowa, South Dakota, and Nebraska) of farm-tap replacement issues. The Department recommended that the Company conduct an examination of the costs of requiring a maximum allowable operating pressure test (MAOP), as is required in Iowa, during the implementation phase of this project. The Department also recommended that the Commission consider allowing customers who have replaced their lines within the past 10 years to be reimbursed by MERC for some portion of the cost of the line, as is done in Nebraska.

##### **2. OAG**

The OAG argued that MERC failed to consider options other than the three alternatives mentioned in the petition and failed to provide a cost estimate for those alternatives. The OAG recommended that the Commission require the Company to develop cost estimates for Company maintenance and inspection of customer-owned lines to enable comparison with MERC's cost estimates for the proposed project. The OAG also recommended that MERC provide cost estimates for the conversion of farm-tap customers to propane.

##### **3. MERC's Reply Comments**

MERC agreed to collect additional information, provide an estimate of the cost to complete MAOP testing on potentially locatable lines, and further evaluate the usefulness and viability of MAOP testing during the planning and design phase, in response to the Department's stated concerns. While continuing to voice safety concerns with this approach, MERC also agreed to gather information regarding compensation of farm-tap customers for lines installed within the last ten years.

In response to the OAG, MERC agreed to provide a high-level cost estimate of the cost of converting farm-tap customers to propane, but disagreed that this is a viable option for current farm tap customers. MERC stated that any attempt to impose additional inspection and safety standards on current farm tap-lines would inevitably be compromised by the continuing inability to locate such lines.

## **B. Procedural Schedule**

MERC included a proposed procedural schedule with its filing to serve as a guide for the proposed farm- tap replacement project. MERC estimated that the planning and design phase would be completed during the coming winter/spring of 2018, with a proposed implementation phase request to be filed with the Commission in May 2018. Finally, MERC proposed to provide customer and public hearing notices for consideration by the parties and the Commission with approximately 10 public hearings to occur in August 2018.

## **C. Customer Notices**

Along with its proposed procedural schedule, MERC requested approval of the following:

- Notice to farm-tap customers regarding the project;
- Notice to a sample of farm-tap customers who will be asked to provide access to their customer-owned fuel lines for testing during the initial planning and design phase of the project; and
- A schedule for public hearings.

The Department supports the proposed customer notification of the planning and design phase, with the final language to be developed after consultation with the Commission's Consumer Affairs Office.

The OAG argued that MERC should, in addition to the notice to farm-tap customers, develop and send a separate notice to all of MERC's ratepayers. The OAG reasoned that since MERC is proposing to socialize the costs of replacing the farm-tap lines across the Company's entire customer base, a broad notice to ratepayers is warranted.

MERC agreed with the OAG about the need to send notice to all ratepayers regarding the public hearings. MERC proposed to submit the proposed notice of public hearings on completion of the planning and design phase, when more complete cost information will be available for inclusion in the notice.

## **D. Commission Action**

It is clear that there is cause for concern about the continuing safety and sustainability of the privately-owned farm-tap lines serviced by MERC. These lines were installed some 85 years ago, and a significant percentage of the lines are not able to be located. As a result, the lines have not received regular maintenance or care, and presumably have fallen into disrepair. MERC is ultimately responsible for providing safe natural gas service to these customers, and in this docket has proposed a plan to reasonably begin to address the issues raised.

Having considered the written proposal for the planning and design phase plan by the Company, and the responses of the parties and arguments raised at the hearing, the Commission will take the following actions.

The Commission will approve MERC's proposed planning and design phase for the farm-tap program, but will impose additional requirements, as suggested by the parties and agreed to by MERC. It is impossible to finally determine, at this early stage, whether MERC's proposal to replace all the non-conforming customer-owned fuel lines with Company-owned mains and service lines will prove the most prudent and reasonable approach. With the additional actions required herein, a sufficient record should be developed to evaluate the merit of MERC's proposal *vis a vis* the other alternatives raised.

The Commission will require MERC to provide a cost estimate, as recommended by the Department, of requiring a MAOP test on a small number of locatable lines, and the potential savings that could be realized if the Company were to assume control of the lines with acceptable MAOP rather than replacement.

The Commission will also require MERC to provide a cost estimate to reimburse farm-tap customers for lines they have replaced within the last 10 years that meet MERC's safety standards for the farm-tap program, which the Company would plan to take over and maintain as part of the farm-tap program. Finally, the Commission will require MERC to provide a cost estimate of converting current farm-tap customers to either propane or electric service.

The Commission would also find it useful for the Company to provide the following information for later evaluation, and will require MERC to:

- a. Provide an estimate of what farm-tap customers would pay for the new service lines assuming MERC applied its current tariff for service line extensions;
- b. Provide an estimate of what farm-tap customers would pay under MERC's current service extension tariff assuming a greater free footage allowance due to farm tap customers having longer service lines than the typical firm customer; and
- c. Provide an analysis of other rate design options MERC has considered that would allow for possible recovery of the program's costs directly from farm-tap customers to reduce the costs to be socialized across MERC's entire customer base along with a description of the cost implications of those options.

#### **IV. Request for Deferred Accounting**

##### **A. MERC's Request**

MERC requested deferred accounting for an estimated \$2.3 million in expenses that the Company expects to incur for regulatory processing of its petition and costs to conduct the farm tap planning and design phase (Phase 1), as set forth below:

Legal Services to participate in regulatory approval process	\$1,000,000
Agency Assessments for regulatory process	\$650,000
Design and mail customer notices and publication of public hearing notices	\$500,000
Engineering Services for design of 300 customer line replacements	\$150,000
Totals	\$2,300,000

MERC argued that its request for deferred accounting satisfies the Commission’s criteria, in that the costs sought to be deferred are:

- 1) Related to utility operations for which ratepayers have incurred costs or received benefits;
- 2) Significant in amount;
- 3) Unforeseen, unusual, or extraordinary, and
- 4) Subject to review for reasonableness and prudence.

MERC relied on the following considerations to support its request for deferred accounting for the farm-tap costs for possible rate recovery in a Company rate case:

- Completion of the planning and design phase is a necessary first step to ensure the safety of the farm-tap lines; MERC argued that the costs will be incurred as part of the Company’s efforts to further the safety of its natural gas system, thereby reducing the risk to landowners and the public and consistent with important public policy objectives;
- MERC estimates the initial costs for the planning and design phase to be approximately \$2.3 million, which MERC stated is significant to the Company’s natural gas distribution business;
- MERC cautioned that the precise level of costs to be incurred is unknown, as the Commission added certain requirements not included in the Company’s initial calculations at the hearing;
- The farm-tap costs are unique and new, in that they are one-time costs, substantial in size, not representative of normal expenditures or previously incurred with the farm-tap program, and could not have been foreseen; and
- The farm-tap costs will require ratemaking flexibility.

Finally, MERC argued that the recovery of the deferred costs will be subject to a review for reasonableness and prudence in a future rate case.

## **B. Positions of the Parties**

### **1. Department**

The Department recommended denying MERC's request for deferred accounting, arguing that the Company has not satisfied the criteria articulated by the Commission in prior dockets. The Department asserted that MERC fails to satisfy this test, in that it has not satisfied two of the requirements: that the costs requested for deferred accounting are not clearly tied to MERC's regulated operations, and the costs are not unusual and should have been foreseen.

The Department initially argued that MERC does not own any infrastructure at the farm-tap lines, and they are not part of MERC's operating system. In addition, this action is not required by any state or governmental authority, as has been true in the past. The Department later conceded, however, that MERC's proposal is arguably tied to MERC's utility operations, in light of Minn. Stat. § 216B.04, which states that "[e]very public utility shall furnish safe, adequate, efficient, and reasonable service. . . ." The Department also agreed that the projected \$2.3 million dollar cost is significant relative to MERC's utility operation.

The Department took issue with whether the costs were unforeseen or extraordinary. Since MERC took over Peoples' operations in 2006, it was on notice of the expiration date of the 1987 Agreement. And the majority of the costs that comprise the \$2.3 million cost figure are typical regulatory costs, and not unusual or extraordinary.

The Department further argued that the estimated Phase 1 planning and development costs will occur within MERC's pending rate case test year, thus the requested deferral is inconsistent with the out-of-test-year provision for deferred accounting requests. The Department reasoned that the Company made a choice as to the timing of its rate case as well as this petition, and that the costs in this matter are not new or unforeseen costs.

Finally, the Department argued that the Company could seek to recover its incurred evaluation costs going forward, if approved by the Commission, through the Federal Energy Regulatory Commission (FERC) Account 183.2–Other preliminary survey and investigation charges.

### **2. OAG**

The OAG also recommended that the Commission deny the Company's request for deferred accounting. Like the Department, the OAG argued that MERC's proposed plan is not based on any kind of public policy mandate or requirement of a governmental or regulatory body. Nor is the amount to be deferred significant when compared to the utility's overall operating expenses. Finally, the OAG's analysis did not find the planning and design costs to acquire new distribution system equipment to be out of the ordinary for a natural gas company. The OAG also agreed with the Department that the Company should have been aware of the expiration of the 1987 Agreement and the need to take action to continue to serve farm-tap lines since 2006.



### **3. MERC's Reply Comments**

MERC continued to request deferred accounting for the Phase 1 costs, arguing that even if the Commission were to find that the Phase 1 project expenses were foreseeable (which MERC disputes), the costs are significantly unusual and extraordinary so as to justify the deferred accounting treatment requested. The Company argued that the project is unique, and will require ratemaking flexibility. Importantly, it will significantly reduce the risk to landowners with farm-tap lines, as well as the general public. MERC emphasized that allowing deferred accounting treatment will help to ensure that the scope and costs of replacement, as well as the other alternative approaches recommended, will be more fully developed to provide the Commission with sufficient information to enable it to make an informed and reasonable decision on whether, and how best to proceed.

MERC reiterated its argument that the Phase 1 project costs meet the Commission's established standards for deferred accounting treatment. And, it argued, the Department's recommendation that the Company attempt to recover the costs through FERC Account 183.2 involves significant risk of non-recovery. Using the FERC account would only allow recovery of Phase 1 expenses if the Commission authorizes Phase 2 (implementation) of the project.

Finally, the Company concluded that in the event deferred accounting is denied, it would have to evaluate whether to proceed with the project or begin to explore next steps to discontinue service to farm-tap customers.

### **V. Commission Action**

Deferred accounting is an extraordinary remedy used primarily to hold utilities harmless when they incur out-of-test-year expenses that, because of their nature or size, should be eligible for possible rate recovery as a matter of public policy. Traditionally, deferred accounting has been reserved for costs that are unusual, unforeseeable, and large enough to have a significant impact on the utility's financial condition.

The Commission has carefully examined MERC's request for deferred accounting treatment of the costs to conduct the initial planning and design phase of the proposed farm-tap project, and for the following reasons finds that it is reasonable and appropriate to grant deferred accounting treatment for the planning and design project Phase 1 costs to establish a more accurate estimate of the costs to replace all farm-tap customer-owned lines with Company-owned service lines.

First the Commission finds that the Company's proposal serves an important public policy goal. This project will help ensure the continuation of delivery of safe natural gas service to farm-tap customers, which has been ongoing for some 85 years. Many if not most of these farm tap lines are no longer locatable, even by the land owners, and presumably have fallen into significant disrepair. Commencing the project of replacing this aging service with safe and reliable service, where MERC will be responsible for the placement of the lines, service, and maintenance, is prudent and reasonable.

Second, the farm-tap replacement project satisfies the Commission's criteria for the grant of deferred accounting, in that the costs sought to be deferred are:

- 1) Related to utility operations for which ratepayers have incurred costs or received benefits;
- 2) Significant in amount;
- 3) Unforeseen, unusual, or extraordinary; and
- 4) Subject to review for reasonableness and prudence.

There can be little question that completion of the planning and design phase of the farm-tap replacement project is clearly related to utility operations, of which the investigation of the need for and deployment of new utility infrastructure is an integral part. The estimated amount to be deferred, \$2.3 million, is significant to MERC's natural gas distribution business and clearly large enough to have a substantial impact of the Company's financial condition.

Further, while it would be difficult to state generally that such planning and replacement costs were not foreseeable by MERC, it is also clear that the timing and specific nature of the replacement project and the necessary costs to evaluate whether and how to proceed with the project, were not actually foreseen. And the farm-tap program and the proposed replacement project costs are unquestionably unusual and extraordinary for utility service in Minnesota.

Importantly, the Phase 1 costs to be deferred will be subject to review for reasonableness and prudence in a future rate case. The Commission considered, but ultimately rejected, attempting to amend MERC's current rate case to add the necessary testimony and exhibits needed to consider these costs for inclusion. After discussion at the hearing, the Commission concluded that amending the current rate case would be not only cumbersome and difficult to manage, but also likely to cause further complications to the rate case. The final revenue requirement awarded in the rate case should not be higher than that sought by the Company in its initial filing, which did not include these costs. Therefore, the Commission will allow deferral to continue until a future rate case, at which point the normal rigorous review can be undertaken.

For these reasons, the Commission will authorize deferred accounting treatment of the Phase 1 costs.

## **VI. Next Steps**

Finally, the Commission will require MERC to provide a detailed and specific procedural proposal for the proposed implementation of the second phase of the project (Phase 2) which should include dates, times, and locations for public hearings when the Company submits its analysis and results for Phase 1 of this project and its proposal for Phase 2.<sup>1</sup>

In preparation for Phase 2, the Commission will delegate to the Executive Secretary the authority to approve customer and other notices, bill inserts, and advertisements of any other kind related to this matter for the duration of this proceeding. The Commission will also delegate to the Executive Secretary the authority to vary time periods set forth in the Commission's orders in this matter and to establish new processes as necessary to facilitate resolution of this matter.

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<sup>1</sup> According to MERC's proposed procedural schedule, filed in its reply comments, the analysis and results of Phase 1 are to be filed in May 2018.

MERC is also required to develop a notice to send to all of its customers at the beginning of Phase 2 regarding the farm tap-project including MERC's proposal to socialize all of the costs of this project, associated customer bill impacts, and all possible alternatives. And the Commission requests all parties to this docket to submit comments within 30 days of MERC's report on Phase 1, proposed procedural schedule for Phase 2, and request for the assignment of an Administrative Law Judge to conduct public hearings. The Commission will accept reply comments within 10 days thereafter.

## **ORDER**

1. MERC's proposed Planning and Design phase for the farm-tap program is approved, with the following additional requirements:
  - a. Provide a cost estimate of MAOP testing of the small number of locatable lines, and the potential savings that could be realized if the Company were to assume control of the lines with acceptable MAOP rather than replacement;
  - b. Provide cost estimates associated with refunding farm-tap customers for lines replaced in the last 10 years that meet MERC's safety standards for the farm-tap program which the Company would plan to take over and maintain as part of the farm tap program;
  - c. Provide a cost estimate of converting current farm tap customers to either propane or electric service;
  - d. Provide a cost estimate of what farm tap customers would pay for the new service lines assuming MERC applied its current tariff for service line extensions;
  - e. Provide a cost estimate of what farm-tap customers would pay under MERC's current service extension tariff assuming a greater free footage allowance due to farm-tap customers having longer service lines than the typical firm customer; and
  - f. Provide an analysis of other rate design options MERC has considered that would allow for possible recovery of the program's costs directly from farm- tap customers to reduce the costs to be socialized across MERC's entire customer base, along with a description of the cost implications of those options.
2. MERC shall provide a detailed and specific procedural proposal for Implementation (Phase 2) (including dates, times, and locations for public hearings) when MERC submits its analysis and results from Phase 1 of this project and its proposal for Phase 2.
3. The Commission delegates to the Executive Secretary the authority to approve customer and other notices, bill inserts, and advertisements of any other kind related to this matter for the duration of this proceeding.
4. MERC shall develop a notice to send to all of its customers at the beginning of Phase 2 regarding the farm-tap project including MERC's proposal to socialize all of the costs of this project, associated customer bill impacts, and all possible alternatives.

5. All parties to this docket are requested to submit comments within 30 days following MERC's filing of its report on Phase 1, proposed procedural schedule for Phase 2, and request for the assignment of an Administrative Law Judge to conduct public hearings. Reply comments, if any, shall be filed within 10 days thereafter.
6. The Commission delegates to the Executive Secretary the authority to vary time periods set forth in the Commission's orders in this matter and to establish new processes as necessary to facilitate resolution of this matter.
7. The Commission approves MERC's request for deferred accounting.
8. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Daniel P. Wolf  
Executive Secretary



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