

**STATE OF IOWA
DEPARTMENT OF COMMERCE
BEFORE THE IOWA UTILITIES BOARD**

IN RE: BLACK HILLS/IOWA GAS UTILITY COMPANY d/b/a BLACK HILLS ENERGY	DOCKET NOS. SPU-2015-0039 TF-2015-0352
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**AMENDMENT TO APPLICATION
FOR APPROVAL OF PROPOSED TARIFF AND OTHER RELIEF**

1. This amendment supplements the application for approval of a proposed tariff establishing minimum safety standards for farm taps as a condition of service that Black Hills/Iowa Gas Utility Company, LLC d/b/a Black Hills Energy (“**Black Hills Energy**”) previously filed on November 24, 2015. The original application (including the exhibits thereto) is not being withdrawn and is not superseded by anything in this amendment except to the limited extent necessary to remove any inconsistencies between the documents.

I. Customer Focus Groups and Workshop

2. Black Hills Energy hosted customer focus group meetings in Webster City, Waukee and Dike, Iowa, in March 2016. Approximately 30 attendees were selected randomly from a list of farm tap customers served by Black Hills Energy from its nearby offices. The meetings began with a short slide presentation to explain the current farm tap asset ownership risks and responsibilities, then explained Black Hills Energy’s proposal, and concluded with useful discussions about customer questions and concerns.

3. The following is a summary of the key customer concerns and questions discussed at the customer focus group meetings:

a. Second meter at the premises – Currently, Northern Natural Gas owns the above ground assets at the farm tap, including a meter. Many of these meters are located in fields or ditches that are inaccessible most of the year. The attendees expressed a strong preference for adding a second meter near their premises.

b. Recently replaced lines – Several attendees replaced their fuel line from the tap to the premises in the last several years and felt Black Hills Energy's acceptance of ownership constituted some form of taking of their property. They suggested some form of purchase or reimbursement of their investment if the line met the tariff tests.

c. Easements – Black Hills Energy's proposal states the customer must arrange for easements if a parcel was subdivided after installation of the fuel line, to assure Black Hills Energy will have access to the entire length of the line. The attendees understood and did not object to this requirement. In cases where a neighbor will not allow access, Black Hills Energy will work with the customer to ensure access. For example, in some situations, Black Hills Energy could run the line from the premises to the nearest road and place the fuel line in public right of way.

d. Service to neighbors – Several customers inquired whether a service line could be installed to adjacent neighbors. Black Hills Energy intends to review each situation and provide service to neighbors when it is feasible.

e. Line length replaced – Several customers asked why Black Hills Energy suggested replacement of the first 1,000 feet of line rather than some other length. Several customers also asked why they should pay any portion of the line replacement, when replacement of obsolete assets is normally paid by the utility. Three customers noted they have been paying for line replacements across the state for decades through their rates. This amended application provides two alternatives to address these concerns, so the Board can choose the approach it feels is reasonable and appropriate.

f. Customer construction – Staff asked in a workshop whether Black Hills Energy was open to allowing farm tap customers to construct the line, and then sell the line to Black Hills Energy. Black Hills Energy believes the bidding for a five-year project to replace these fuel lines will result in a competitive price that will be lower in cost than hiring local contractors to perform the work. However, Black Hills Energy is willing to work with landowners if they propose doing trenching or similar work themselves. Black Hills Energy's primary focus is replacement of the fuel line with materials that meet safety codes.

4. Several other issues are worthy of Board consideration in this proceeding:

a. If Black Hills Energy's proposals are approved by the Board, it is important that Black Hills Energy have the opportunity to perform testing and

replace unsafe lines before taking ownership of obsolete assets, so the company is not liable for assets before it can assure they meet safety standards.

b. A few customer-owned fuel lines are quite long (one is over 15,000 feet in length) because the customer has multiple buildings with lines, like a college. The “first 1000 feet” concept would not work for the few customers with these characteristics, because the customer contribution would be large.

II. Black Hills Energy’s Original Proposals

5. Customer-owned farm tap fuel lines have not been regularly pressure tested; do not have records to show location, material type or age or cathodic protection; cannot be registered in the Iowa One Call database; and cannot be located for excavation. These conditions create a safety hazard for Black Hills Energy employees, customers and the general public. The proposals set forth in Black Hills Energy’s application as amended herein are intended to improve the safety of customer-owned fuel lines by ensuring that the lines (i) are currently safe by passing a pressure test; (ii) are constructed of approved material; (iii) have a tracer wire to ensure they can be located; (iv) have mapping data and other records; (v) are accessible to Black Hills Energy technicians; and (vi) will be registered in the Iowa One Call database.

6. The original application filed by Black Hills Energy on November 24, 2015, included the following proposals:

a. Continued natural gas service to farm tap customers will be conditioned upon five tests: (i) passing an MAOP test (assuming approximately 20% of the lines will be tested per year); (ii) the customer-owned fuel line must be constructed of approved materials; (iii) the line must be locatable; (iv) Black

Hills Energy must have access to the property; and (v) the customer must have easements if the line runs across neighboring property and must allow Black Hills Energy to access the line.

b. If the proposed tariff is approved and the line passes the foregoing tests, Black Hills Energy will: (i) assume ownership of and liability for the fuel lines; (ii) provide ongoing maintenance; and (iii) register the lines with the Iowa One Call database.

c. If the proposed tariff is approved and the line fails to pass the foregoing tests, Black Hills Energy will (i) replace the first 1,000 feet of line at Black Hills Energy's cost, and the customer will pay the remainder; or (ii) the customer will have the option to convert to propane or another fuel source.

III. Black Hills Energy's Amended Proposals

7. Based on feedback from the customer focus groups and the workshop, Black Hills Energy hereby amends its proposals set forth in the original application as follows:

a. Continued natural gas service to farm tap customers will be conditioned upon five tests: (i) passing an MAOP test (assuming approximately 20% of the lines will be tested per year); (ii) the customer- owned fuel line must be constructed of approved materials; (iii) the line must be locatable; (iv) BHE must have access to the property; and (v) the customer must have easements if the line runs across neighboring property and must allow Black Hills Energy to access the lines.

b. If the proposed tariff is approved and the line passes the tests above, Black Hills Energy will: (i) assume ownership of and liability for the fuel lines; (ii) provide ongoing maintenance; (iii) register the lines with the Iowa One Call database; and (iv) *if the customer can prove the line has been replaced in the prior five years, Black Hills Energy will purchase the fuel line at a fixed price of \$5 per lineal foot times the line length as measured by Black Hills Energy technicians using tracer location measurements.*¹

c. If the proposed tariff is approved and the line does not pass the tests above, Black Hills Energy will: (i) replace at Black Hills Energy's cost the first 1,000 feet of line *or the length of line approved for replacement by the Board as provided in ¶ 9 below* and the customer will pay the remainder; or (ii) the customer will have the option to convert to propane or another fuel source.²

IV. Line Replacement Alternatives

8. When Black Hills Energy replaces obsolete or unsafe pipe in towns, it pays the entire cost of the asset replacement. Line extension feasibility studies assume new revenue to the system and are not appropriate for the proposed farm tap line replacements, because there is no new revenue associated with the replacements. Black Hills Energy proposed to replace the first 1,000 feet of customer-owned line simply because most of the lines are less than 1,000 feet in length. Black Hills Energy is amenable to replacing whatever portion of customer-owned fuel line the Board deems appropriate. However, Black Hills Energy is not open to replacing a portion of the lines (e.g., 300 feet from the premises) and leaving old pipe from that point to the tap,

¹ The italicized language is a new proposal that was not included in the original application.

² The italicized language is a new proposal that was not included in the original application.

because such an approach does not eliminate the safety risks noted above and continues to place BHE technicians in positions where they cannot locate the customer-owned portion of lines.

9. Black Hills Energy respectfully asks the Board to consider and determine what portion of a customer-owned fuel line Black Hills Energy should replace at its own cost and what portion should be paid for by the customer. Black Hills Energy has proposed two alternatives between 1,000 feet and the entire length of customer-owned line, as described in more detail below:

a. Under Alternative 1: (i) Black Hills Energy will replace the first 1,000 feet of the customer-owned fuel line; (ii) for a customer with a line with a length less than or equal to 1,000 feet, Black Hills Energy will pay the cost of replacing the entire line; (iii) for a customer with a line with a length in excess of 1,000 feet, Black Hills Energy will pay the cost of replacing the first 1,000 feet of line, and the customer will pay the cost of replacing the remaining line at a rate of \$10 per lineal foot; and (iv) payment of the customer's share of the replacement cost would, at the customer's option, be financed by Black Hills Energy in accordance with the replacement financing terms approved by the Board on Sheets 62-63 of the proposed tariff attached hereto.

(1) The rate impacts associated with Alternative 1 are discussed in Section VI below.

(2) The advantages associated with Alternative 1 are as follows: (i) recognizes that farm tap customers have paid for statewide integrity replacement costs for decades (because the cost of new capital is

included in rates); (ii) results in cost-sharing between farm tap customers and general system customers; (iii) recognizes the higher costs associated with longer lines.

(3) The disadvantages associated with Alternative 1 are as follows:

(i) there is no simple justification for replacing only 1,000 feet of line versus any other length; and (ii) customers who own longer lines will likely drop natural gas service because the customer portion of the line replacement cost will be high. If customers drop natural gas service, the costs currently paid by these customers will need to be allocated to the general system in the company's next rate case.

b. Under Alternative 2, Black Hills Energy will replace the entire customer-owned fuel line.

(1) The rate impacts associated with Alternative 2 are discussed in Section VI below.

(2) The advantages associated with Alternative 2 are as follows: (i) socializing the full cost of line replacement is consistent with integrity replacements; and (ii) the total cost is not materially different from what it would be under the first alternative.

(3) The disadvantage associated with Alternative 2 is that it results in high replacement costs for relatively low volumes and margin.

V. **Abandonments and Customer Notice Requirements**

10. If the Board selects Alternative 1, replacement of 360 customer-owned lines will involve payment of a customer contribution, and it is likely that most of those

customers will abandon service due to the cost. In those instances, Black Hills Energy will work with Northern Natural Gas to assist conversion to propane. A customer notice to all General Service customers will not be required because no rate change will occur. A prudence review of the investments made as a result of this proposal can be undertaken in Black Hills Energy's next rate case. Also, earnings on the proposed investments would not be collected until after the next rate case, so no change in rates will occur until after the next rate case.

VI. **Cost Recovery and Rate Impacts**

11. Black Hills Energy has attempted to propose a ratemaking solution that covers the cost of this large, complex, multi-year project, while recognizing established regulatory principles and balancing the interests of affected parties. To commit to these additional investments, Black Hills Energy must secure full recovery of its capital costs. Black Hills Energy is proposing two specific options for accomplishing that and requesting that the Board select the appropriate alternative. Black Hills Energy will accept either alternative or any other reasonably similar option.

12. In addition to capital carrying costs, Black Hills Energy will experience a substantial increase in operations and maintenance expense related to the MAOP testing of approximately 350³ customer-owned fuel lines per year. Black Hills Energy estimates that the fully loaded cost of a two-man crew and vehicle needed to perform the tests will be about \$425 per test. This represents approximately a \$150,000 annual increase in O&M costs to perform the required tests. Black Hills is not requesting immediate recovery of these costs but respectfully asks the Board for authority to defer

³ This number is calculated by dividing the number of farm tap customers (1,757) by the number of years for completion of the project (five).

them in an account for subsequent recovery over a 36-month period following Board review and approval at the conclusion of Black Hills Energy's next rate case. The tab "Accounting Entries" in Exhibit 3 provides sample accounting entries to demonstrate how Black Hills Energy proposes to book the carrying charges each month until the next rate case and how the deferred costs (investments and O&M costs) would be recovered through a 36-month customer charge increase after the next rate case.

13. Alternative 2 assumes Black Hills Energy replaces all of the customer-owned fuel line. As shown by the data in the spreadsheet in the attached Exhibit 3, (Farm Tap Support), the lineal footage of customer-owned fuel line totals 1.36 million feet, and the projected capital cost for replacement is estimated to be \$13.6 million. To calculate an appropriate capital cost for these replacements, Black Hills Energy has used the following assumptions to reflect current market capital costs: a 52/48 equity-to-debt capital structure; a 4.4 percent current actual cost of debt; and a 9.6 percent return on equity, which is the average approved rate of return on equity for natural gas local distribution companies reported in 2015 by SNL Research (formerly Regulatory Research Associates). These assumptions result in a 7.08 percent weighted average cost of capital and carrying charges of \$5,204,299 over the five year program. Black Hills Energy proposes to hold these costs in a regulatory asset account until the company's next rate case and thereafter recovered in the form of a \$0.94 higher monthly customer charge for 36 months.

14. Alternative 1 assumes Black Hills Energy replaces the first 1,000 feet of each customer's fuel line and the customer pays the remaining costs. As shown in the table below and by the data in Exhibit 3, the total lineal footage relating to the first 1,000

feet of customer-owned fuel line equals 1.12 million feet and the projected capital cost for replacement is estimated to be \$11.22 million. Black Hills Energy has used the same assumptions and calculation method for both alternatives. These assumptions result in total carrying charges of \$4,417,278 over the five-year program and an \$0.80 higher monthly customer charge for 36 months at the conclusion of the Black Hills Energy's next rate case.

15. Under both Alternative 1 and Alternative 2, Black Hills Energy has proposed a weighted average cost of capital using a 52/48 equity-to-debt capital structure, Black Hills Energy's current cost of debt, and a market average rate of return on equity. This approach is a reasonable approach that reflects current capital costs and will provide full recovery of Black Hills Energy's capital costs and depreciation Black Hills Energy's management believes these investments will be paid using approximately 52 percent retained earnings, and that any rate below that level would not fully cover Black Hills Energy's costs. At this time, Black Hills Energy does not plan to file a rate case in Iowa during the next several years, and Black Hills Energy would like to avoid increases in regulatory lag that might accelerate the need for a rate case. For this reason, Black Hills Energy is asking the Board to recognize that this project is unique, will require ratemaking flexibility, and will significantly reduce risks to landowners and the general public, and that for those reasons it is appropriate to approve Alternative 1.

16. The deferral approach discussed above results in a pool of costs that will be recovered over three years in the form of a \$0.94 increase in the monthly customer charge under Alternative 2 and a \$0.80 increase in the monthly customer charge under

Alternative 1. The deferral approach also represents a significant financial contribution by Black Hills Energy to the replacement program.

WHEREFORE, Black Hills Energy respectfully requests that the Board:

A. Determine the appropriate length of a customer-owned fuel line that should be replaced at no customer cost.

B. Approve Black Hills Energy's proposed tariff (attached to the original application) that establishes the rights and responsibilities of farm tap customers, including (1) a safety testing program and (2) a line-replacement program for lines that do not meet safety standards.

C. Authorize Black Hills Energy to implement its proposed alternative ratemaking mechanism, including (1) deferral of capital costs (return on investments and depreciation) until the conclusion of the next Black Hills Energy rate case with subsequent recovery by means of a surcharge or higher customer charge for 36 months, and (2) deferral of testing costs and recovery over 36 months as proposed for capital carrying costs.

D. Authorize inclusion of the capital investments in rate base in Black Hills Energy's next rate case.

E. Waiver of Board rules as necessary for approval of Black Hills Energy's application as hereby amended.

Dated April 25, 2016.

Respectfully submitted,

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d/b/a Black Hills Energy**

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