

REVENUE AND TRANSPORTATION COMMITTEE

December 2, 2005

Presentation by John Alke

On behalf of the MDU Resources Group, Inc.

Thank you for the opportunity to provide input into the Committee's deliberations on House Joint Resolution 44, the study of the property taxation of oil and gas properties. To really understand the issues facing the Committee today, I believe one needs to be familiar with the history of the regulation of natural gas pipelines and gas producers. That history vividly explains why natural gas distribution utilities, pipelines companies, and natural gas producers are separate companies, which cannot, and should not, be treated for property tax purposes as if they were a single integrated operation.

There are many gas producers in the state of Montana, and only three of them are centrally assessed by the Montana Department of Revenue. Those three companies are Fidelity Exploration and Production Company, an indirect subsidiary of MDU Resources Group, Inc., together with Encana and Omnimex, which now own the gas production properties of the former Montana Power Company. The property tax rate for these three companies is 12%. The property tax rate for every other producer of oil and gas in Montana is 3%. That kind of discrimination is not sustainable, from either a legal or public policy perspective.

NATURAL GAS PIPELINE INDUSTRY TIME LINE

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| 1938 | Congress passes the Natural Gas Act, 15 U.S.C §§ 717 et seq, and the regulation of interstate pipeline companies begins. |
| 1954 | The U.S. Supreme Court issues its decision in <i>Phillips Petroleum Company v. Wisconsin</i> , 347 U.S. 672, and the direct regulation of the wellhead price of natural gas begins. |
| Mid-1970's | Severe gas shortages in certain regions of the United States, including that served by Montana-Dakota |
| 1978 | Congress passes the Natural Gas Policy Act of 1978, part of President Jimmy Carter's broad energy policy initiatives. The deregulation of the wellhead price of new natural gas reserves begins. |
| 1985 | Williston Basin Interstate Pipeline Company (WBI) established by the Federal Energy Regulatory Commission (FERC). The pipeline transportation and gas production functions are separated from the gas distribution utility function. The pipeline and gas production functions become WBI and the gas distribution function remains as Montar |

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- 1985 FERC issues its Order 436. The Order requires all interstate pipeline companies, including WBI, to offer unbundled transportation service. Interstate pipeline companies no longer have a monopoly position on sales of gas at wholesale to gas distribution utilities.
- 1989 Congress passes the Wellhead Decontrol Act of 1989, deregulating the price of old gas reserves by 1993.
- 1992 The FERC issues its Order 636. The Order effectively prohibits bundled wholesale sales from pipeline companies to gas distribution utilities. It requires interstate pipeline companies to operate as common carriers. Along with subsequent FERC orders, it requires interstate pipeline companies, such as WBI, to effectively spin off their production properties.
- 1998-2000 MDU acquires CBM properties in Montana and northern Wyoming. It also acquires gathering lines owned by other companies in Montana, Wyoming, Colorado, and Kansas. It completes the proper segmentation of its business interests in the energy sector.

COMPANY BY COMPANY SUMMARY

Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc.

This company is a distribution utility providing natural gas and electric service in a four state service territory. It was formed in the early 1920's, and serves eastern Montana, western North Dakota, northeastern Wyoming, and northwestern South Dakota. It is regulated by the public service commissions of each state in which it does business.

County Presences - Montana-Dakota facilities are located in Big Horn, Carbon, Carter, Custer, Daniels, Dawson, Fallon, McCone, Phillips, Powder River, Prairie, Richland, Roosevelt, Rosebud, Sheridan, Stillwater, Valley, Wibaux, and Yellowstone counties. Montana-Dakota does not contest that it should be centrally assessed under current Montana law.

Williston Basin Interstate Pipeline Company

This company is an interstate pipeline company regulated by the Federal Energy Regulatory Commission (FERC). It was formed in 1985, and transports and stores natural gas in the same four state area served by Montana-Dakota.

County Presences - Big Horn, Carbon, Carter, Custer, Dawson, Fallon, McCone, Phillips, Powder River, Prairie, Richland, Roosevelt, Rosebud, Stillwater, Treasure, Valley, Wibaux, and Yellowstone counties. Williston Basin does not contest that it should be centrally assessed under current Montana law.

Bitter Creek LLC

This company owns gas gathering lines in gas fields located in Montana, Wyoming, Colorado and Kansas. Gathering lines are unregulated facilities used in the transport of gas

from the well head to central locations in the gas field where the gas can be treated for injection into a gas pipeline. This company was formed after gathering lines were acquired in 1999-2000.

County Presences - Big Horn, Phillips, and Valley counties. Bitter Creek has not yet protested the application of central assessment under current Montana law.

Fidelity Exploration and Production Co.

This company is extensively involved in the production of natural gas and oil in numerous producing regions in the United States. It owns oil and gas production properties in Montana, North Dakota, Wyoming, Colorado, New Mexico, Texas, Oklahoma, Arkansas, Louisiana, Mississippi, Alabama, and offshore in the Gulf of Mexico. It is now by far the largest producer of natural gas in the State of Montana, producing 40.6 billion cubic feet of natural gas in Montana in 2004.

negotiations not involving associated gas, the Commission will very carefully scrutinize any contract involving 100 percent take-or-pay provisions. As regards future off-line sales, the Commission would heartily endorse any such sales made to the Montana Power Company and will, within reasonable limits, provide all possible assistance in facilitating such sales.

74. Finding of Fact No. 5 of Order No. 4742a in Docket No. 80.10.87, MDU's last tracking case, states that "...until such time as persuasive evidence to the contrary is presented the appropriate gas mix on which to base a tracking procedure is that mix last approved within the confines of a general rate case." Although the Company has shown the actual level of produced gas for 1979 to be 3,631,749 Mcf (Schedule G-10, Applicant's Exhibit No. 19), Applicant's exhibit referred to on page 49 of the transcript shows the estimated produced gas quantities for 1981 to be 6.4 Bcf. The Commission finds this latter figure to be the most appropriate level of produced gas on which to base the Company's future tracking applications.

COMMUNITY ENERGY MANAGEMENT

75. The Commission is impressed with the work being accomplished in Yellowstone County toward Community Energy Management, and wishes to reinforce the cooperative efforts by MDU's Energy Conservation Personnel. To further assist the community effort on an experimental basis the Commission is amenable to authorizing a direct contribution by MDU of up to \$20,000 in support of a Community Energy Management effort. The Commission views such a contribution as an important part of energy conservation and the development of localized energy sources in the state of Montana. The contribution is authorized only on the conditions that the effort have a

2004 Top Gas Producers

(Includes operators with over 10,000 MCF of gas produced during the calendar year.)

Company	MCF	Company	MCF
① Fidelity Exploration & Production Co.	40,694,269	51 Porker Oil	31,786
2 Devon Louisiana Corporation	18,183,453	52 Stephens & Johnson Operating Company	31,162
3 Klazuba Oil & Gas, Inc.	6,934,708	53 Northland Holdings, Inc.	29,812
4 Noble Energy, Inc.	5,538,005	54 Reserve Operating Corp.	28,409
⑤ Omimex Canada, Ltd.	3,848,751	55 Chandler Energy, LLC	28,208
6 Helis Oil and Gas Company, LLC	1,842,050	56 Self, E. M.	26,927
7 Brown, J. Burns Operating Company	918,899	57 Solomon Exploration Inc.	26,423
8 Croft Petroleum Company	761,894	58 Prairie Dog Exploration, LLC	26,355
⑨ EnCana Energy Resources, Inc.	554,985	59 Cavalier Petroleum	25,486
10 Luff Exploration Company	493,144	60 Quicksilver Resources, Inc.	20,102
11 Jurassic Resources Development NA LLC	487,733	61 Hardrock Oil Company	19,655
12 Fulton Fuel Company	472,549	62 TMR Exploration, Inc.	19,272
13 T.W.O. (Taylor Well Operating)	468,577	63 Cardinal Construction, LLC	18,988
14 Somont Oil Company, Inc.	460,378	64 A & G Oil & Gas	17,726
15 Western Natural Gas Company	444,283	65 Galuska Exploration & Production LLC	17,530
16 Branch Oil & Gas	429,700	66 Slow Poke Production-George L. Dobson Db	17,316
17 Keesun Corporation	330,630	67 Potlatch Oil & Refining Co	16,801
18 Ranck Oil Company, Inc.	320,205	68 McOil Montana One LLC	16,547
19 Macum Energy Inc.	290,136	69 Lease Technicians, James S. Brandt Db	16,234
20 AltaMont Oil & Gas Inc.	228,953	70 McCarthy, Lawrence J.	15,930
21 Fulton Producing Co.	186,020	71 Tensas Delta Exploration Company, LLC	15,203
22 Griffon Petroleum, Inc.	181,667	72 Shadco	14,927
23 Nance Petroleum Corporation	160,526	73 Decker Operating Company, L.L.C.	13,675
24 Northwestern Energy, LLC	160,312	74 Rincon Oil & Gas LLC	12,071
25 Mountain Pacific General Inc.	156,749	75 K2 America Corporation	11,679
26 Athena Energy LLC	149,782	76 ST Oil Company	11,295
27 Constitution Gas Transport Co., Inc.	143,636	77 Petroleum Engineering & Management Corp.	10,168
28 Citation Oil & Gas Corporation	122,717	78 Denmark Resources Inc.	10,021
29 Saco, Town Of	119,768		
30 Sands Oil Company	113,629		
31 Unit Petroleum Company	113,068		
32 G/S Producing, Inc.	111,312		
33 Montana Heartland LLC	108,006		
34 Montana Land & Exploration, Inc.	100,409		
35 Balko, Inc.	90,794		
36 Great Northern Drilling Company	90,023		
37 Blackstone Operating	81,914		
38 Topaz Oil & Gas Inc	80,098		
39 Sector Resources (II) Ltd.	79,253		
40 Coolidge, G. B., Inc.	76,767		
41 Bald Eagle Resources, Inc.	74,517		
42 Robinson Oil Company, LLC	73,749		
43 Bowers Oil & Gas, Inc.	67,708		
44 Rimrock Colony	61,026		
45 Sagebrush Operating, LLC	51,723		
46 MCR, LLC	49,172		
47 Equity Oil Company	47,083		
48 Parsell, R. W.	42,514		
49 Whiting Oil and Gas Corporation	39,003		
50 Cut Bank Gas Company	36,751		

Pipeline Injection Point

	Well head		City Gate	Consumer
	Flow line/gathering line	Treatment & Compression	Pipeline	Distribution Utility
National Model	Separate Company		Separate Company	Separate Company
MDU- 1984	All		One	Company
MDU- 2000	Bitter Creek LLC		Williston Basin Interstate Pipeline Co	Montana-Dakota Utilities Co

↑ Wells Owned by Fidelity E&P

FIELD PIPELINES AND GAS COMPRESSION

(COLLECTION SYSTEM FROM WELL TO SALES)

