TESTIMONY OF DARWIN L. SUBART FOR MDU RESOURCES GROUP, INC FOR THE SENATE FINANCE COMMITTEE FIELD HEARING AUGUST 24, 2001, IN BILLINGS, MONTANA

Mr. Chairman, members of the committee, I am Darwin L. Subart, Executive Vice President and General Manager of WBI Southern, Inc. an indirect subsidiary of MDU Resources Group, Inc. (MDU). MDU is a publicly held company traded on the New York Stock Exchange and it is headquartered in Bismarck, ND. MDU provides energy, value-added natural resource products and related services that are essential to our country's energy, transportation and communication infrastructure. MDU includes electric and natural gas utilities, a FERC regulated interstate natural gas pipeline and non-regulated natural gas gathering pipelines, natural gas and oil production, utility services, construction materials and mining and energy services. Through its various business units, MDU has a strong presence in the Northern Great Plains including the states Montana, North Dakota, South Dakota, Wyoming and Colorado. MDU has been a developer, producer, transporter and distributor of natural gas in Montana for 75 years and it is one of the few states in which all of our lines of business are currently represented.

WBI Southern, Inc.'s principal operations consist of providing natural gas gathering and compression services to producers in Montana, Wyoming and Colorado. Our affiliated production company, Fidelity Exploration & Production Company is the second largest producer of natural gas in the state of Montana. My testimony will address MDU's viewpoint on changes in tax law directly related to the gathering, transmission and distribution of natural gas.

My testimony will be brief as we believe the Congress is on the right track with the tax changes proposed which have been passed in the House and which will provide substantial future economic and consumer benefits.

<u>Overview</u>

One of the most important public policy issues Congress faces is the need to ensure the continued delivery of affordable and reliable energy to America's homes and businesses.

Energy is the lifeblood of our economy and we need an energy policy that addresses our myriad economic, environmental and national security challenges. In the near future one of our greatest challenges will be expanding our energy delivery infrastructure to meet the projected growing demand for energy.

Customer demand for natural gas, for example, is expected to grow by 55-60 percent during the next 20 years. This is in large part due to America's growing awareness of the economic, environmental and operational benefits attributable to this highly efficient and environmentally friendly fuel. As a result, the natural gas industry must substantially expand its existing delivery infrastructure, while at the same time continue to maintain its current infrastructure. For America to achieve the benefits of the greater use of natural gas, the production and exploration, gathering, transmission, and distribution sectors must make substantial investments.

It is estimated that natural gas utilities and pipelines will have to invest $150 billion over the next 20 years to simply keep up with the increased demands for natural gas deliverability.

The total investment for gas transmission and storage facilities over the next ten years is projected to be over $34 billion. These expenditures are required to meet the projected gas demand increase from almost 23 trillion cubic feet (Tcf) per day in 2001 to over 30 Tcf per day by 2010. In order to attract capital to support this massive effort, Congress should allow interstate transmission pipelines to write down the cost of infrastructure investments over ten (10) years, instead of the fifteen (15) years in current tax law.

Estimates for the distribution sector alone will require capital investments of $100 billion for infrastructure with projections of a required increase in distribution system miles of 27 percent (255,000 miles). In order to raise the capital needed to accomplish this expansion, we must ensure investment in our distribution property, which is why the natural gas distribution property's tax life should be reduced from 20 years to 10 years.

This shorter depreciation life for natural gas transmission and distribution property will:

- allow needed projects to be built; meaning customers will sooner be able to obtain necessary supplies of clean-burning, domestically produced, highly efficient natural gas at long-term economic prices;

- facilitate an increased use of natural gas—especially in end-use applications in American homes and businesses—could lower oil imports, reduce overall energy consumption, and lower CO_2 emissions, while relieving the strain on the electricity grid; and

- allow for the expansion of natural gas delivery systems in order to continue to safely and reliably meet America's growing demand for natural gas.

We also encourage you to establish a statutory seven (7) year recovery period and a class life of ten years for natural gas gathering lines. It will also end the conflict between members of the natural gas gathering and processing industry and portions of the Internal Revenue Service over the proper depreciation of these assets. Recently, the 10th Circuit Court of Appeals held that natural gas gathering lines owned by non-producers falls within the scope of seven (7) year recovery period. Establishment of a statutory 7 year recovery period for natural gas gathering lines will achieve the objectives as set forth above related to the shorter depreciation life on natural gas transmission and distribution property and it will prevent unnecessary time being spent by the courts, government agencies (IRS) and industry in further arguing this issue.

Regional View

The regional natural gas industry must substantially expand its existing delivery infrastructure in order to meet the growing demand, while at the same time continue to maintain its current infrastructure, especially for Montana, North Dakota, South Dakota and Wyoming. Critical to the economic viability of this region is reliable, economically priced energy, of which natural gas is a key component. The tax policy we propose will assist in achieving this long-term goal.

A challenge we experience in our rural areas is retaining our younger people, attracting industry to provide jobs to allow these younger people to stay. In our operating area, we are seeing the smaller rural communities declining in population, either through old age attrition or people retiring and moving to the few large communities existing, to be closer to medical facilities and other conveniences most of us take for granted or due to there not being jobs for younger people near their homes.

What effect does this have on our natural gas distribution business? It leads to facilities in these small communities becoming less viable as there are fewer and fewer customers to serve. However, in the majority of these communities the cost of continued distribution service is increasing. This is due to the fact that the distribution infrastructure is aged and we are constantly repairing and replacing facilities in order to provide safe and reliable service. Likewise, as more and more people relocate from small communities to a Billings, Montana or Bismarck, North Dakota additional infrastructure is required to provide service in these cities. Thus, you end up with the same number of customers but with more facility investment to operate and maintain. The proposed change in the tax depreciation life for natural gas distribution property to ten (10) years will assist in securing capital for facility investment and ultimately minimizing the costs to the consumer.

The limited market for natural gas in the states of Montana, North Dakota, South Dakota and Wyoming means that as new natural gas supplies are discovered in these areas, additional natural gas transmission infrastructure is needed to transport the natural gas to other interstate pipeline systems. The existing regional interstate transmission pipelines suffer the same issues as the distribution companies, increasing costs with fewer customers. Again, as the rural population continues to decline and aged infrastructure needs to be replaced and maintained, more investment is necessary with the same or fewer customers. Congress needs to also allow interstate transmission pipelines to write down the cost of infrastructure investments over ten (10) years, instead of the fifteen (15) years in current tax law. This would have a positive effect on Montana and enhance future natural gas industry related developments within the state.

To meet the projected demand growth will require development of non-conventional sources of natural gas, like tight sands, shale, coal seam, etc. Our region has untapped resources, but individual wells generally will not be large volume producers. What that means is a need for a large number of wells and related gathering and compression infrastructure to move the natural gas to the few regional interstate pipeline systems available.

A seven (7) year tax life for gathering pipeline will encourage infrastructure development of these non-conventional natural gas sources.

Finally, the proposed extension and modification of Credit for Producing Fuel From a Non-Conventional Source (Section 29 credit) would also greatly benefit this region to encourage additional development of non-conventional natural gas sources. We support language in H.R. 4, as passed by the House. These provisions would extend the Section 29 credit for currently qualified wells through 2006 and apply the credit to the first 200 Mcf per day of production for new wells drilled between passage of a bill and 2006. We strongly believe this legislation would provide economic incentives as well as significant economic and natural gas development opportunities for rural Montana and this region.

Conclusion

Federal tax policy plays a critical role in directing capital to flow toward the natural gas industry for production and transmission, gathering and distribution infrastructure development. Congress can take steps to seek a more stable energy supply to preserve Montana's and the nation's economic stability by approving these tax modifications. The proposed modifications are good for the long-term economy of this region and the entire nation.