ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON ENERGY
February 18, 2025
1:33 p.m.

MEMBERS PRESENT

Representative Ky Holland, Co-Chair
Representative Donna Mears, Co-Chair
Representative Bryce Edgmon
Representative Cathy Tilton
Representative George Rauscher
Representative Mia Costello

MEMBERS ABSENT

Representative Chuck Kopp

COMMITTEE CALENDAR

PRESENTATION(S): COOK INLET UPDATE~ HOUSE ENERGY COMMITTEE

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

JOHN CROWTHER, Deputy Commissioner
Department of Natural Resources
Anchorage, Alaska
POSITION STATEMENT: Co-presented the PowerPoint, titled "Cook Inlet Update."

WESTON NASH, Commercial Analyst
Division of Oil and Gas
Department of Natural Resources
Anchorage, Alaska
POSITION STATEMENT: Co-presented the PowerPoint, titled "Cook Inlet Update."

ACTION NARRATIVE

1:33:46 PM

CO-CHAIR HOLLAND called the House Special Committee on Energy meeting to order at 1:33 p.m. Representatives Rauscher, Mears, Edgmon, Tilton, and Holland were present at the call to order. Representative Costello arrived as the meeting was in progress.

PRESENTATION(S): Cook Inlet Update, House Energy Committee

1:36:31 PM

CO-CHAIR HOLLAND announced that the only order of business would be an update on Cook Inlet oil and gas.

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JOHN CROWTHER, Deputy Commissioner, Department of Natural Resources (DNR), co-presented the PowerPoint, titled "Cook Inlet Update" [hard copy included in the committee packet]. He noted that the department had recently given a presentation to the committee on the usage of oil and gas in Cook Inlet. He stated that this presentation would provide an overview of the current gas production and drilling activity, updating any new production profiles. He stated that the presentation would also address the recently finalized Kitchen Lights Unit (KLU) royalty modification, as this royalty modification is important to insure gas in Cook Inlet in the near term.

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WESTON NASH, Commercial Analyst, Division of Oil and Gas, Department of Natural Resources, co-presented the PowerPoint, titled "Cook Inlet Update." On slide 2, he stated that most of the oil production in Cook Inlet occurred from the 1960s to the 1980s, and currently this is the "serious tail end of production," as the resources have been largely depleted. He noted that the major usage of the gas has been for exports.

CO-CHAIR MEARS expressed appreciation that slide 2 showed the aggregate decline in the resource, as well as the decline in the different locations. She noted that Cook Inlet is "not a small area." She pointed out that infrastructure already exists in each area of Cook Inlet, and this infrastructure would need to be built to develop new areas.

MR. CROWTHER stated that many of the oil wells are located in the same fields, with peak production occurring many years ago. He continued that the chart on the slide shows that the resource is aging, even though there is still robust activity.

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MR. NASH moved to slide 3, which charted gas production by field. He noted that the startup date of each field has been included, as this reinforces the age of the fields. He pointed out that the four main fields in Cook Inlet have produced 72 percent of the total 2024 production. He noted that the average start date of these four fields had been 60 years ago or more. He stated that the committee has seen slide 4 before, but in this iteration, the exact well activity has been included. He explained that with the decline of production it would take more drilling to maintain the same production. He stated that some exploratory wells have been drilled, but these are not producing. He added that 19 wells had been drilled in 2024, but this added only 60 percent of production.

MR. CROWTHER clarified the location of the exploratory wells on the slide. In response to a question from Co-Chair Holland, he stated that last year Furie Operating Alaska, LLC, drilled one new oil well located in the area of KLU. He added that the operator would be working to drill additional wells this year. In response to a follow-up question on whether only 9 percent of drilled wells would end up producing, he stated that there are two types of wells. He explained that an exploratory well would be a well that locates a new resource. He added that exploratory drilling had not been successful in 2024. He stated that a development well would be a well drilled in a known field. He explained that development wells normally have a very high success rate; however, this past year these wells were only producing at 60 percent.

MR. CROWTHER, in response to a question from Co-Chair Mears concerning aging oil fields, explained that when a field has been in production for a long time, there is less pressure in the field. Because of less pressure, he said a new well drilled into the field would either have a lower initial production rate or a faster production decline.

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MR. NASH moved to slide 5 and discussed the Cook Inlet gas forecast. He stated that this slide has been updated with production through December, using the economic limits. He explained that when a field is economically negative, the production would be stopped. He noted that the chart on the slide has been updated with a decline curve analysis, and this

shows production coming in at a lower rate. As Mr. Crowther discussed, he pointed out that this shows a faster decline. He remarked that the slide reflects the current producing wells in Cook Inlet.

MR. NASH, in response to a question from Co-Chair Mears concerning the Plan of Development (POD) process, stated that these PODs are typically done on an annual basis, with some occurring longer. In response to a follow-up question concerning the data used for the forecast, he stated that each year during the oil forecast DNR would consult with operators.

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MR. NASH moved to slide 6, which showed the production outlook, annualized per billion cubic feet per year. He explained that this shows the amount of the resource for sale for utilities. He stated that the slide also shows that once drilling ceases, production declines steeply. He emphasized that this is based on known production.

CO-CHAIR HOLLAND pointed out the flat demand curve extending into the future, and he questioned the assumptions made that resulted in this. He suggested that there could be a rise in future demands, and new renewable projects could affect this.

MR. CROWTHER responded that DNR assumes a flat demand of the resource, and he noted the complexity around demand. He pointed out that DNR focuses more on the supply side in order to meet near-term demand. He expressed hope that there would be growth in the future, but no forecast analysis has been done on changes in demand. He discussed other solutions affecting demand, such as a large-scale gas line, which would require growth. He added that electricity demand could be met by other energy generation sources. He reiterated that, for the purpose of the forecast, future demand has not been the focus.

CO-CHAIR MEARS questioned DNR's forecast of the remaining gas in the developed fields.

MR. CROWTHER, in response, pointed to the chart on slide 6, as the blue bars represent the existing fields in production and the expected wells to be drilled up to the year 2030. He added that there are other Cook Inlet resources that could be brought to market and added to this chart.

MR. NASH moved to slide 7 and noted that the blue bars on the chart represent the same production level as seen on the previous slide, while the green bars represent the gas reserves remaining without applying the economic limit. He stated that the yellow bars represent projects that are not yet developed, explaining that this represents a combination of risk production. He stated that the light blue bars represent the production of all the projects that are soon to be developed. He noted that this chart shows that everything above the black line could be put into storage. He stated that the orange bars represent gas that would be produced in the future. He reiterated that this chart shows only the development of known resources up to the year 2039.

MR. CROWTHER expressed the opinion that this is an optimistic chart, and he advised that realism be used when considering the needed work and capital and the geological risks. He discussed the work needed to make the chart a reality. He suggested that the projection would not happen unless dynamic action is taken.

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CO-CHAIR MEARS discussed the helpfulness of the chart, as the Cook Inlet gas resource needs to be retained as long as possible for the state.

MR. NASH moved to slide 9, titled "Approved Kitchen Lights Unit Royalty Modification Summary." He stated that royalty modification for KLU was recently approved by DNR. He expressed the understanding that this modification would prolong the life of this oil and gas field. Without this modification, he suggested that the field would have a negative cash flow by the middle of the year. He discussed the details of the modification, as seen on the slide.

CO-CHAIR HOLLAND expressed the understanding that a contract between a seller and a buyer for this gas had already been made without royalty relief. He expressed the opinion that this denotes there was not "an economic cliff." He questioned the need for royalty relief for KLU.

MR. CROWTHER responded that DNR must "be careful not to speak for the operators and the market participants." He pointed out that DNR's analysis was done on the "full suite" of information it had, including capital, operational costs, field activity, and risk assessment. He explained that when there is a potential for a field going cash flow negative, this becomes a

concern. He expressed the opinion that this contract could have significant operational challenges. He emphasized that DNR takes a failure scenario seriously, and he further discussed this. In response to a follow-up question, he stated that a future slide would address the cash-flow modeling, which shows a full royalty versus a reduced royalty. He explained that a reduced royalty would still produce an incremental direct benefit to the state of $36.38 million. In response, he stated that the royalty is 3 percent, and the $36.38 million would be all state revenue, which includes some other elements. He remarked that the specific royalty amount would be seen in a future slide.

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MR. NASH moved to slide 10, titled "KLU Background – Unit Location." He went over the timeline of KLU, as seen on the slide. Per KLU's background, he showed the detailed lease information on slide 11. He pointed out KLU's unique ownership structure, noting that all the overrides were prior to unitization in 2010. He explained that the state approved this in 2010, but it has had no opportunity to approve a future assignment, and the current situation reflects this.

CO-CHAIR HOLLAND questioned whether changing the overriding structure had been discussed during the bankruptcy process of Furie Operating Alaska, LLC.

MR. CROWTHER expressed the understanding that there would be property interest associated with the Overriding Royalty Interest (ORRI), and this continues for the life of the lease, even throughout a bankruptcy process. In response to a follow-up question, he stated that DNR has the authority to approve the creation of ORRI, and when it is created it becomes a property right of its own. He continued that DNR has the right to approve the selling of the underlying lease, but this would only be the transfer of the lease interest.

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MR. NASH moved to slide 12, which addressed KLU's production history. He pointed out that the slide shows the importance of each well in the unit. He stated that KLU was producing about 9,100 thousand cubic feet per day (Mcf/d), but with the royalty modification and the additional well KLU is expected to produce about 14,000 Mcf/d. He discussed the risk that results when wells stop producing.

CO-CHAIR HOLLAND pointed out the new types of wells created in Cook Inlet and questioned whether the testing of these new wells would create a risk.

MR. CROWTHER responded that the Alaska Oil and Gas Conservation Commission has the responsibility of conducting these tests, and he deferred the question to this commission. He noted that DNR's main interest would be the recovery of the resource.

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MR. NASH moved to slide 13 and pointed out the results of the various scenarios listed. He noted that the baseline used had no royalty modification. He reviewed each scenario, noting the royalty amount to the state and the projected end of each field's life. He noted the variables that contributed to the viability of each scenario.

CO-CHAIR HOLLAND, concerning the state's royalty revenue, expressed the understanding that ratepayers would be paying this. He questioned DNR's stance on this, as this could be an argument for royalty reduction.

MR. CROWTHER responded that DNR has a constitutional and statutory mandate to maximize royalty value to the state. He discussed the profitability of this mandate concerning the North Slope and for past Cook Inlet wells. He noted the different paradigm that now exists in Cook Inlet; however, he pointed out that DNR's statutory directive has not changed. He stated that this is the legal justification for the royalty modification. In addition, he expressed the importance of the additional gas supply the royalty modification would provide. He expressed the understanding that the legislature would decide any future approach for a Cook Inlet royalty. In response to a follow-up question on what the legislature could do, he stated that currently the governor has not brought forward a proposal. He stated that currently the department is using its authorities to do everything in its power to "bring gas forward."

REPRESENTATIVE RAUSCHER questioned whether there is a model that shows royalty loss versus ratepayer loss.

MR. CROWTHER responded that DNR does not do consumer-cost models, as it does not have the authority to assess and protect the impact on consumers. Instead, he stated that DNR would only consider this when making resource decisions. He noted that

other agencies would have more responsibility to consumers, such as the Regulatory Commission of Alaska and the utilities. In response to a follow-up question concerning royalty loss, he expressed the understanding that field production would be smaller, as larger production in the field would risk a closure. He expressed the opinion that this is not a royalty loss, but a modification that leads to more supply, less consumer price impacts, and more state royalty. In response, he expressed the opinion that the modelling for royalty modification was robust. He pointed out that the cost of operations would drive the life of the field. He stated that when the life of the field ends, so does the royalty for the state. He reasoned that if the life of the field were extended, the royalty to the state and the gas supply would also be extended.

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MR. NASH moved to slide 14, titled "Quantified Benefits of Royalty Modification." He stated that the slide shows how the royalty modification would help the continued development of KLU, as it quantifies the real benefits to the state. He paraphrased from the slide, as follows [original punctuation provided]:

- 14.36 million (NPV 12.5) more in State royalty
- 10.5 years of KLU field life extension
- 63,228 million cubic feet of additional gas
- $5.89 million (NPV 12.5) more in production tax
- $16.13 million (NPV 12.5) more in State's share of property tax
- $36.38 million (NPV 12.5) incremental direct revenue to the State

CO-CHAIR HOLLAND questioned whether these revenues would be subject to development tax credits.

MR. CROWTHER expressed the understanding that the tax credits have expired or been repealed by the legislature; therefore, no tax credits could be applied. In response to a follow-up question on the amount of the overriding interest and the amount the state would be losing, he stated that to get this amount, the $14.4 million on the first bullet on the slide would need to be multiplied by 4.

MR. NASH clarified that the royalty modification of 3 percent interest is only in place until the gross revenue target is met,

which would be in roughly eight years. He added that there would also be a decline in the production tax.

CO-CHAIR HOLLAND questioned how much of the $14.4 million would be included before the gross revenue amount is reached.

MR. CROWTHER responded that this would be a complex calculation limited by data confidentiality. He expressed the understanding that after the royalty modification was met, there would be some continued production.

MR. NASH moved to slide 15 and stated that this is in reference to the ENSTAR Natural Gas contract that Furie Operating Alaska, LLC, signed in 2024. He stated that the slide summarizes the facts of the contract. He noted that the price would be different if royalty relief had not been granted.

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CO-CHAIR MEARS thanked the presenters and made closing comments.

CO-CHAIR HOLLAND questioned DNR's current view of what could be expected in the future concerning more royalty relief requests. He questioned what the legislature could do to help producers develop more gas and oil fields. He expressed the understanding that royalty relief is one of the tools to facilitate development.

MR. CROWTHER responded that DNR foresees a variety of activities. He noted that many fields have development commitments, and DNR would look at these, field by field, to ensure developers are making the most aggressive proposals so there would be production sooner. He stated that DNR plans to hold the developers to these proposals. He discussed specific examples and DNR's authorities.

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CO-CHAIR HOLLAND thanked the presenters and made closing comments.

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ADJOURNMENT

There being no further business before the committee, the House Special Committee on Energy meeting was adjourned at 2:45 p.m.