HEX Alaska: Reducing royalty aids gas output

Companys seeks to add jack-up rig, raise production

A bill that would extend a reduction of state royalty for the Kitchen Lights Unit in Cook Inlet is moving through the state House.

Currently, natural gas is being produced at Kitchen Lights by independent producer HEX Alaska under a temporary administrative royalty reduction granted last year by the state Department of Natural Resources which allowed the company to drill more gas production wells, easing dangers of a potential gas shortage during cold weather earlier this winter.

However, a longer-term reduction is needed to allow HEX to make long-term investments in infrastructure, supporting more drilling and more gas development. To do this, Rep. Zack Fields, D-Anchorage, has introduced House Bill 271. After a careful review the Department of Natural Resources granted HEX a temporary reduction of royalty under its administrative authority from 12.5% of the produced gas value to 3%. Fields' bill would extend the state's reduced royalty of giving HEX the long term fiscal stability needed to raise capital for major investments. Fields' bill moved out of the House Resources Committee to the Finance Committee on Feb. 25.

The limited drilling and support services in Cook Inlet, and the unique market dynamics makes additional development challenging. Currently there is one jack-up in the Inlet that is owned by Hilcorp Energy, and Hilcorp has in the past leased the rig to Furie but they have no obligation to do so. A second jack-up rig and more support services available would allow both companies to optimize the drilling equipment and services necessary for more oil and gas development. The current temporary royalty arrangement does not improve the economics of Kitchen Lights production enough to allow HEX to finance bringing a second jack-up rig to Alaska, however.

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The state has forecasted that without new gas production, regional gas production will fall below demand as early as 2030.

What impedes HEX is that there is a 12.5% overriding royalty in addition to the state royalty that is paid to previous owners of Kitchen Lights and other private parties. The DNR approved the creation of those private overriding royalies prior to the Kitchen Lights Unit starting production in 2015. Before the DNR reduced the state royalty last year Kitchen Lights was paying a combined 25% royalty, with the 12.5% overriding royalty put on top of the 12.5% state royalty. That was, by far, the highest royalty burden on any Cook Inlet production and it had become a serious burden for HEX in securing financing to do more drilling.

After an extensive analysis of the economics of Kitchen Lights the DNR concluded that a reduced royalty was justified and granted the reduction from 12.5% to 3%. With that, HEX still paid the 12.5% overriding royalty but the combined rate was now 15.5%. That is still high compare with the 12.5% paid by other gas producers but it allowed HEX to secure funds for drilling two more gas wells last year. The wells were successful and in the six months since being broughty on online in fall, 2025, xsadded an additional two billion cubic feet of gas for utilities in Southcentral Alaska and the Marathon Petroleum refinery at Nikiski, near Kenai.

Reduced royalties for Cook Inlet gas production have been debated for several years. Advocates of previous bills like now-State Sen. George Rauscher proposed a reduction for all Cook Inlet gas, not just one field, arguing that the public benefit of encouraging energy security for the region, with more gas production, outweighed a relatively minor reduction of state revenues that would occur because of the reduction. The state Division of Oil and Gas has forecast that without new gas production regional gas production will fall below demand as early as 2030.

This is important because natural gas provides the fuel for heating of buildings and most electric power generation across the region, where most of Alaska's population lives. Public utilities like Enstar Natural Gas Co., the natural gas distributor, and electric cooperatives like Chugach Electric and Matanuska Electric associations, are legally required to assure their customers of an adequate energy supply.

To do this the utilities are planning to either import liquefied natural gas to augment declining production from the existing gas fields, or to contract with the proposed Alaska LNG Project for gas from the North Slope. Both of those would reduce the market available for local Cook Inlet producers because for both customers would have to make long-term contract commitments.

However, producing companies like HEX say new gas can be developed in the Inlet with more drilling. They point to the track record so far at Kitchen Lights as well as by Hilcorp new gas developed at the Tyonek platform in the North Cook Inlet and the Beluga gas fields, both operated by Hilcorp. If HEX can secure a longer-term royalty reduction at Kitchen Lights it's almost a sure bet more drilling will find more gas, the company says.

— *Tim Bradner*

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