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HGP

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Subject: Strategic Proposal for 20 GW of New Natural Gas-Fired Power Generation in Texas over 5 years

Dear Governor Abbott and the Office of Economic Development & Tourism,

On behalf of HGP, we would like to propose a strategic initiative aimed at addressing Texas's growing energy demands by ensuring the development of new natural gas-fired power plants. Given the current market challenges, including the extreme low power prices driven by the 2024 storm Beryl, it is clear that innovative approaches are necessary to secure the financing and construction of these critical energy assets.

Market Challenges and the Need for Action
The Texas market currently does not support the financial viability of new natural gas (NG) plant construction without substantial assistance. Even with the Texas Energy Fund's (TEF) 3% debt provisions, it has been estimated that over 65% of a project's debt must be at this coupon rate for the project to merely break even.

Proposed Financial Mechanisms
To overcome this barrier, HGP proposes the following financial mechanisms:

1. Increase in Severance Tax on Natural Gas: Texas could increase the severance tax on natural gas production by 10%, 20%, or 30%. Based on 2022 figures, such increases could generate additional annual revenues of $440 million, $880 million, and $1.32 billion respectively. These funds can act as a revenue guarantee, or "revenue put," to support new NG power plants. By providing this revenue floor, the state would enable these projects to raise both debt and investor equity more effectively, ensuring their financial viability. Depending on the tax rate, this approach could subsidize approximately 550 MW to 1,650 MW of new generation capacity annually.

2. Implementation of a Tax on LNG Feedstock: Another option is to impose a tax on LNG feedstock entering Texas-based LNG export facilities. A tax of $0.10, $0.25, or $0.50 per MMBtu could generate approximately $365 million, $912.5 million, and $1.825 billion annually. These revenues could also be allocated as a "revenue put" to ensure that new NG capacity is financially sustainable, potentially supporting the construction of 456 MW to 2,281 MW of new capacity each year.

Best-Case Scenario: Maximizing New Generation Capacity
In a best-case scenario, using the highest proposed tax rates (30% severance tax increase and $0.50 per MMBtu LNG feedstock tax), the combined annual revenues could reach approximately $3.145 billion. This could subsidize the construction of up to 3,931 MW of new natural gas-fired generation capacity each year. This substantial increase in capacity would significantly enhance Texas's energy infrastructure and help ensure a reliable and affordable energy supply for years to come.

Strategic Benefits

The funds generated from these initiatives, acting as a revenue guarantee, would secure a revenue floor for newly built combined-cycle gas turbines (CCGTs). This would absorb record-high Texas natural gas production, encourage increased production, and reduce flaring in the field. The additional production incentivized by these taxes would likely offset the tax increases, ultimately benefiting mineral rights holders and working interest owners. Furthermore, midstream intrastate pipelines would benefit from increased throughput, enhancing their operational efficiency and profitability. Additionally, the increased generation capacity would benefit all ratepayers within the ERCOT market by helping stabilize electricity prices and ensuring a reliable power supply.

Democratic Access to the Texas Energy Fund (TEF)

This approach is inherently more democratic, as it opens the field for access to the TEF to a broader range of firms, including those that do not already possess brownfield sites that can be repowered at half the cost of new builds. By providing a revenue guarantee, this initiative levels the playing field, allowing firms without existing infrastructure to compete and contribute to Texas's energy future. This not only promotes a more competitive market but also encourages innovation and diversification in the state's energy sector.

Inclusion in Legislative Framework

To solidify this proposal and ensure its implementation, HGP recommends including this approach in the legislative framework, specifically within the context of [Senate Bill 2627] (https://capitol.texas.gov/tlodocs/88R/billtext/pdf/SB02627F.pdf#navpanes=0). Incorporating these financial mechanisms and the associated programs into SB 2627 would provide the necessary legal and regulatory backing to support the development of new natural gas-fired generation in Texas, aligning with the state's broader energy policy objectives.

Program Parameters

To ensure the program is effective and responsive to market conditions, HGP proposes that it be implemented for a limited time, with periodic reviews to assess its impact. The program would be designed to pause automatically in the event of any natural disaster, ensuring that it does not exacerbate crises. Furthermore, the tax on LNG feedstock would apply only to LNG destined for international markets and would not affect interstate LNG shipments, thereby avoiding conflicts with federal regulations.

Sunset Provision and Refund Mechanism

To further enhance the program's flexibility and fairness, HGP suggests incorporating a sunset provision for these additional taxes. This provision would automatically phase out the taxes once the power market can independently support new natural gas plant construction. Moreover, entities that paid into the new fund would be eligible for a refund if market conditions render the revenue guarantee unnecessary, ensuring that the program remains equitable and market-driven.

Request for Action

HGP urges the Office of Economic Development & Tourism to work with the Texas Railroad Commission, the Texas Comptroller of Public Accounts, and other relevant agencies to explore these proposals. By doing so, Texas can secure its energy future, support economic growth, and continue to be a global leader in energy production.

Thank you for considering this proposal. HGP is available to discuss further details and assist in any way necessary.

Gregory A. Forero
President
HGP