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The Wholesale Electricity Market Investment Certainty Review (Initiatives 1 and 2)

1. Background

Merredin Energy Pty Ltd (MEPL) owns and operates the 82 MW open cycle gas turbine power station located in Merredin, Western Australia (Merredin Energy Power Station, MEPS). The plant is fully dispatchable and can achieve minimum generation levels within 15 minutes and maximum output within 25 minutes or faster. The main purpose of the power station is to provide critical energy security in the form of reserve capacity to ensure that supply reliability is maintained if electricity demand is unusually high and/or there are unforeseen plant outages.

In recent months, MEPS has played a critical role in keeping the lights on in WA, being dispatched by AEMO in response to network constraints or lack of reserve on numerous occasions.

MEPS is classified as a Transitional Facility under the reserve capacity regime and therefore is subject to both a price floor and ceiling until the 2030-31 capacity year. MEPS has an operating life well beyond 2031 and therefore MEPL is seeking to ensure it remains viable following the end of the transitional arrangements.

2. Proposal 1 – RCP at RCT

Set the Peak RCP to 100% of the Peak Benchmark Reserve Capacity Price (BRCP) if the number of Peak Capacity Credits issued equals the Peak Reserve Capacity Target (RCT).

Consultation Questions:

(1) Do stakeholders support setting the price to the BRCP at the RCT? If you have any concerns, please outline your reasons.

Response:

MEPL does not have any specific concerns regarding this approach.

3. Proposal 2 – RCP deadband

Set the Peak RCP to 100% of the Peak BRCP when the number of Peak Capacity Credits provided is between 95% and 105% of the Peak RCT.

Consultation Questions:

(2)(a) Do stakeholders support including a deadband in the Peak RCP curve?

(2)(b) Do stakeholders support the proposed settings for the deadband?

Response:

MEPL is supportive of both including a deadband and the proposed settings for the deadband.

4. Proposal 3 – RCP cap

Set a maximum Peak RCP at 150% of the Peak BRCP, when the number of Peak Capacity Credits issued is 85% of the Peak RCT.

Consultation Questions:

(3) Do stakeholders have any concerns about the proposed parameters for the Peak RCP cap?

Response:

MEPL does not have any concerns in relation to the proposed parameters for the Peak RCP cap.

5. Proposal 4 – RCP floor

Set a minimum Peak RCP at 50% of the Peak BRCP, when the number of Peak Capacity Credits provided is greater than or equal to 115% of the Peak RCT.

Consultation Questions:

(4)(a) Do stakeholders support a non-zero RCP floor?

(4)(b) Do stakeholders consider that a non-zero RCP floor should be recalculated each year or set based on a fixed proportion of the BRCP?

(4)(c) Do stakeholders consider that a non-zero RCP floor should allow for principal repayments, interest payments, or be symmetrical with the RCP cap?

Response:

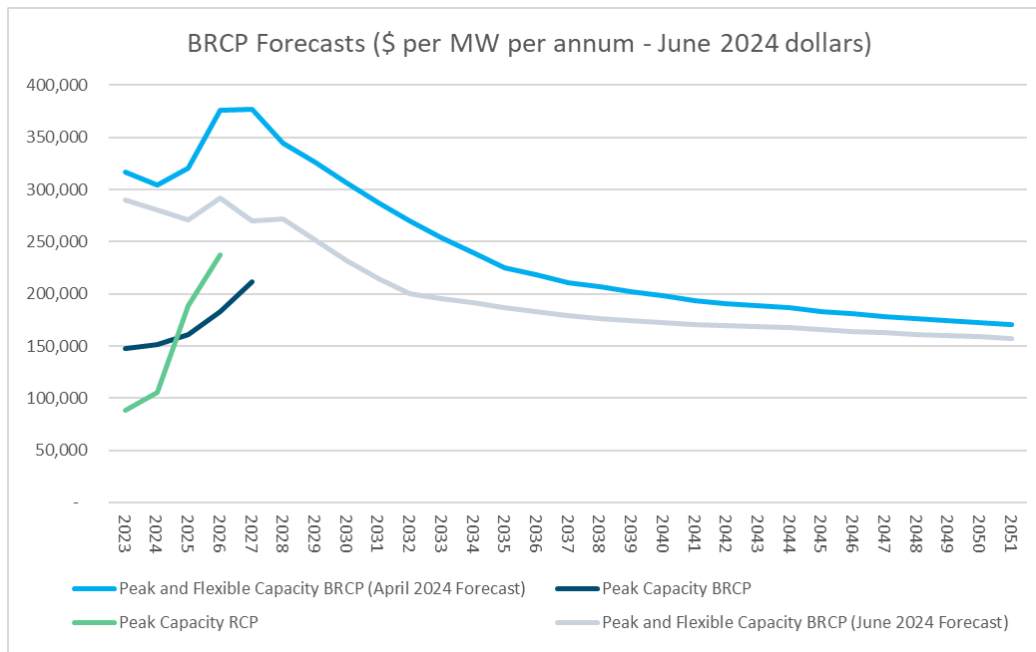
MEPL is fully supportive of the introduction of a non-zero price floor, noting that this is key to ensuring sufficient investment in reserve capacity in the WEM. This will become even more critical as the WEM transitions away from coal to Variable Renewable Energy (VRE).

However, the key to investment certainty is having an absolute floor price as is currently in place for transitional facilities. Short term variability in the floor price that may occur if the cost of reference technology drops faster than predicted, or if alternative, lower cost technology becomes available still risks stifling investment.

An absolute floor price (escalated by CPI) should be considered that is in effect for a period of no less than 5 years from when a new entrant first becomes eligible for reserve capacity payments or from when transitional facilities are no longer covered by transitional arrangements in 2031.

The RCP floor should not necessarily be symmetrical with the cap, but consider changes in WACC, debt cost, as well as prevailing CAPEX and OPEX costs.

Using the proposed RCP Floor price, and BRCP forecast from the 2024 ISP Assumptions – Step Change scenario (July 2024 update), long range BRCP is expected to trend towards \$160k/MW per annum, resulting in a floor price of \$80k/MW per annum. At this level, the viability of facility such as MEPS (which expects to still be operational post 2040) would be challenged, particularly as it adopts green fuels such as renewable diesel. Facilities such as MEPS that can provide 14 hours of generation at 82 MW (and significantly longer with adequate fuel supply) will play a key energy security role particularly at time of extended low winds or solar resource. It is therefore considered critical that there is sufficient certainty in RCP pricing to support these type of facilities.



6. Proposal 5 – Flexible Capacity RCP curve

5.1 Allow any new facility that provides Flexible Capacity to receive (on request) a fixed RCP for ten years

5.2 Set a maximum Flexible RCP at 160% of the Flexible BRCP, when the number of Flexible Capacity Credits issued is 85% of the Flexible RCT.

5.3 Set the Flexible RCP to 100% of the Flexible Benchmark RCP where the number of Flexible Capacity Credits issued is 100% of the Flexible RCT.

5.4 Set the minimum Flexible RCP on the same basis as the Peak RCP.

Consultation Questions:

(5)(a) Do stakeholders support a higher RCP cap for Flexible Capacity than Peak Capacity?

(5)(b) Do stakeholders consider that the Flexible RCP curve should have a deadband?

(5)(c) Do stakeholders consider that Flexible Capacity should have a non-zero RCP floor?

Response:

MEPL does not have any specific concerns in relation to the proposed parameters for the flexible RCP curve, however, MEPL understands that the definition of Flexible Capacity is yet to be fully developed. The definition was discussed at a meeting of the Reserve Capacity Mechanism Review Working Group (RCMRWG) on the 21st of September 2023, with a definition was published in “*Procedure Report: Benchmark Reserve Capacity Prices [EEPC-2024-01]*” as a footnote on page 14:

“Facilities receiving flexible capacity credits must meet all the same requirements as for peak capacity credits, and the additional ramping requirements. These include a requirement for daily generation, a ramp rate of 100 per cent of capacity in 30 minutes, 30 minutes start time and minimum online generation of 25 per cent.”

MEPS meets the requirements of Flexible Capacity as per the current definition, however all requirements for Flexible Capacity should be defined in full and provided for consultation.

While the definition of Flexible Capacity may have some impact on RCP for MEPS, MEPL’s primary concern relates to proposed penalties for high emissions technologies. Different regimes have been proposed for Peak vs Flexible Reserve Capacity by the WICRWG, some of which would result in MEPS no longer being eligible for RCP from 2030, given it currently operates on diesel. While MEPS is continuously seeking to identify lower carbon fuels such as renewable diesel, these are currently unavailable in Australia in sufficient quantity and it is unclear when sufficient supply will become available in WA. Given this uncertainty, MEPL considers it premature to implement a regime where diesel fired generation is ineligible to provide reserve capacity by 2030. This is well illustrated by the reliance of South Australia on diesel in recent months due to extended periods of low wind.

MEPS can provide 82 MW or capacity for a period of 14 hours. A BESS of this capacity and duration would require an RCP far greater than is currently being proposed.

7. Proposal 6 – Review of RCP curve parameters

Include review of the RCP curves in the Coordinator’s regular review of the BRCP reference technology.

Consultation Questions:

(6) Do stakeholders agree that the RCP curves should be considered in conjunction with the BRCP reference technology? If you have any concerns, please outline your reasons.

Response:

As per the response to Proposal 4, MEPL considers that introducing more variability into the RCP calculation that could result in materially lower pricing in the future will result in investment in reserve capacity being stifled.

8. Proposal 7 – Transitional pricing arrangements

7.1 Adjust existing transitional pricing arrangements to include a lookback adjustment for actual inflation.

7.2 There will be no new transitional arrangements for existing facilities not already subject to transitional pricing arrangements.

Consultation Questions:

(7)(a) Do stakeholders agree that existing transitional pricing arrangements should consider actual outcomes in addition to forecasts?

(7)(b) Do stakeholders agree that new transitional pricing arrangements are not necessary?

Response:

Use of forecast CPI has resulted in the RCP for transitional facilities now being materially lower than actual CPI (with the difference currently estimated to be ~8%-9%). Given all operating costs have increased at CPI or above, the current approach of using forecast CPI with no lookback correction is inappropriate and not in accordance with the intent of the CPI adjustment for transitional facilities. MEPL is therefore fully supportive of considering actual CPI.

While MEPL does not consider that new transitional pricing arrangement are not necessary, an appropriate floor price is critical to ensuring adequate investment in reserve capacity (See Response to Proposal 4)

9. Proposal 8 – Eligibility for RCP guarantee

8.1 Allow any new facility that provides Flexible Capacity using a renewable fuel source to receive (on request) a fixed RCP for ten years.

8.2 Require renewable-fuelled facilities seeking the ten-year fixed RCP to provide in each Reserve Capacity Cycle evidence of 100% renewable fuel supply.

Consultation Questions:

(8) Do stakeholders support the proposed new fixed price option? If you have any concerns, please outline your reasons.

Response:

MEPL does not have specific concerns regarding 10-year fixed RCP for facilities using renewable fuel sources in principle. However, MEPL has concerns about the practical implementation of this for facilities that use liquid fuels such as MEPS:

- MEPL can accurately predict the amount of fuel required for ongoing testing (including Reserve Capacity tests) and could contract for renewable fuel for this quantity (once it is available)
- Fuel used as a result of dispatch is highly unpredictable, varying from zero in some years where the facility is not dispatched at all, up to 1.43M litres in FY24. The timing of the fuel usage also can't be forecast
- Contracting 100% of fuel demand on a firm basis would therefore be challenging given current and medium to long term supply challenges, with the expectation that a take-or-pay type arrangement may be required, significantly increasing MEPS' operating costs

MEPL would recommend that an agreed quantity of renewable fuel is used as a basis, with some allowance for use of fossil fuels to supplement where the level of generation is above an agreed threshold.

10. Proposal 9 – Duration requirement

Require a facility requesting the ten-year fixed RCP to provide evidence that it can provide firm output for at least 120% of the prevailing ESR Duration Requirement.

Consultation Questions:

(9)(a) Do stakeholders support the proposed duration requirement for the new fixed RCP option? If you have any concerns, please outline your reasons.

Response:

MEPL does not have specific concerns regarding this proposal

11. Proposal 10 - Implementation

The WICRWG proposed longer duration ESR facilities requesting a ten-year fixed RCP together with proposed floating price facilities for Network Access Quantities (NAQ) purposes.

Consultation Questions:

(10) Do stakeholders support the proposed treatment of Facilities with the new fixed RCP option? If you have any concerns, please outline your reasons.

Response:

MEPL does not have specific concerns regarding this proposal

Yours sincerely,

Wacek Lipski

CEO

Merredin Energy