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Tuesday, 21st February 2017

Dear Karen, Thomas,

Re: Terms of Reference for the Capacity Market Auditor and Monitor, Consultation Paper, SEM-17-007

Bord Gáis Energy (“BGE”) welcomes this opportunity to respond to the Consultation on the Terms of Reference (“ToR”) for the Capacity Market Auditor (“the Auditor”) and the Capacity Market Monitor (“the Monitor”).

The roles of the Auditor and Monitor in our view are central to ensuring a well-functioning capacity market. While the activities proposed in the ToR are necessary and appropriate, we have identified a number of areas where we believe the ToR could be improved. These are summarised below and detailed in the Consultation Question section of our response.

1. Locational Constraint Issues

Locational issues are a significant aspect of the Capacity Market which will likely have material effects on consumer costs and capacity clearing prices. While the methodology for setting locational constraints may be beyond the scope of the roles of the Auditor or Monitor, market participants should be fully engaged in the process of determining the relevant methodology to ensure that there is full transparency in the process. We would then expect that the Monitor’s role would encompass oversight of the ongoing management of the locational issues by the TSOs and correct application of the methodology in determining locational constraints. We also believe that the Auditor should have a role in auditing the award of locational constraint capacity to ensure that the agreed methodology and processes have been adhered to correctly.

2. The Auction Monitor and Auditor cannot be the same entity

The roles and duties of the Auditor and Monitor in the Capacity Market are part of a governance system which ensures a transparent and well-functioning market. Working backwards from the end of the process, the Auditor’s function is an ex-post determination of whether all processes in the Capacity Market (including the Monitor’s activities) have been carried out appropriately and in line with the Rules of the Capacity Market Code (CMC). The Monitor’s function is an ongoing process which ensures that the TSOs are conducting their role in the Capacity Market in line with the Rules of the CMC. By allowing the auction Monitor and Auditor to be the same entity, we are concerned that the integrity of each of their functions will be undermined due to the conflict of interest it creates, i.e. the Auditor would be effectively carrying out an audit on themselves when assessing whether they have conducted their monitoring activities appropriately. To avoid this conflict and to ensure market participants have confidence in the Capacity Market, we believe that the roles of the Auditor and Monitor should be performed by different entities.

3. The ToR of the Auditor should be extended to include the activities of the Capacity Monitor in its audit

We believe the scope of the Auditor should cover all aspects and processes in the Capacity Market. While the list of activities proposed in the Consultation is extensive, we believe a key element is missing from the audit scope, namely an audit of the activities of the Auction Monitor. The Monitor has a key role in the capacity process which is to ensure that the TSOs are appropriately carrying out their role in the market while adhering to the Rules of the CMC. Therefore, in the interests of ensuring confidence in the market, we believe assurance should be given on this activity by including an audit of the activities of the Monitor in the Auditor's scope.

4. The ToR of the Monitor should be extended to include the Secondary Trading market in its activities

The Monitor's role, as mentioned above, is to ensure that the TSOs are appropriately carrying out their role in the Capacity Market while adhering to the Rules of the CMC. In order to ensure that all processes are being monitored, we believe the Monitor's activities should extend to the Secondary Trading market (section H of the CMC) also. An effective Secondary Trading market will be a critical risk-management tool for RO capacity contract holders and we therefore believe confidence in its correct operation is necessary.

5. Auditor/ Monitor reporting

Finally, we believe it is important that market participants are made aware as soon as reasonably possible of any issues identified by either the Auditor or Monitor when carrying out their activities. Therefore to improve the governance arrangements in the transitional period, we believe the Auditor should conduct their audits and report on their findings on a rolling basis, i.e. after each full auction process (e.g. from qualification to auction results) has been completed. For transparency, these findings should be published to market participants, subject to confidentiality provisions. Similarly, the Monitor should report and publish all issues identified as and when they arise.

I hope you find the above comments and our answers to the Consultation questions useful. Please do not hesitate to contact me should you have any queries on any of the above.

Sincere regards,

Brian Larkin
Regulatory Affairs – Commercial
Bord Gáis Energy

{By e-mail}

Consultation Questions

Q1: Do respondents have any specific concerns about the same person performing the role of both Monitor and Auditor?

The roles and duties of the Auditor and Monitor in the Capacity Market are part of a governance system which ensures a transparent and well-functioning market. Working backwards from the end of this process, the Auditor's function is an ex-post annual determination of whether all processes in the Capacity Market (including the Monitor's activities) have been carried out appropriately and in line with the Rules of the CMC. The Monitor's function is an ongoing process which ensures that the TSOs are conducting their role in the Capacity Market in line with the Rules of the CMC. By allowing the Auction Monitor and Auditor to be the same entity, we are concerned that the integrity of each of their functions will be undermined due to the conflict of interest it creates, i.e. the Auditor would be effectively carrying out an audit on themselves when assessing whether they have conducted their monitoring activities appropriately. To avoid this conflict and to ensure market participants have confidence in the capacity market, we believe that the roles of the Auditor and Monitor should be performed by different entities.

Our concern is further exacerbated in the IRSR4400 Terms of Engagement whereby if the "auditor is not independent, a statement to that effect would be made in the report of factual findings" (Article 7 in the IRSR4400 Terms of Engagement). Such a statement may have an impact on market participant's confidence in the Auditor/ Monitor and would potentially weaken the findings of their reports.

Therefore on the basis of the above, we believe that the roles of the Auditor and Monitor should be performed by different entities.

Do respondents agree that the Auditor should deliver an opinion on the ISRS4400 basis?

Yes, in the interests of market confidence, rules being followed and consistency with the TSC, we agree that the Auditor should deliver an opinion on the ISRS4400 basis.

Do respondents agree that the Monitor should deliver an opinion on the ISAE3000 basis?

Yes.

Do respondents agree that the Auditor should report based on volumetric materiality, i.e. on the volume of capacity affected?

As it is difficult to audit the Capacity Market on a financial basis, we agree it may be necessary to use alternative measures for identifying material issues. Given that the objective of the Capacity Market is to procure volumes of capacity, it seems appropriate to base the report on volumetric materiality. However it is not clear how the proposed reporting on volumetric materiality will be carried out and we therefore request that examples are provided on certain audit scenarios with the right retained by the RAs to change the basis of the Auditor's report based on market experience.

Do respondents agree that the Auditor should use materiality of 0.25% for market-level reporting and one tenth of this at the Participant-level?

Given this low level of materiality and consistency with the TSC, we believe the proposal to use materiality of 0.25% for market-level reporting and one tenth of this at Participant-level is sufficient. However, we also believe that the Auditor should be aware of the possibility of a non-material issue (i.e. an issue causing less than 0.25% impact on the capacity requirement)

occurring on multiple occasions. While the issue may be insignificant on a case-by-case basis, it may become significant in aggregation. Therefore we believe that where an issue becomes significant in aggregation, it should be deemed to be meeting the materiality threshold and reported on.

Do respondents agree that the Monitor should report all issues, regardless of materiality?

In the interests of transparency and market confidence, we believe the Monitor should report on all issues, irrespective of materiality.

Do respondents agree with the proposed level of governance and reporting set out in this paper?

BGE agrees with the proposed level of governance as set out in this Consultation, however we would like to see more regular reporting particularly during the transitional period and that such reports be published, subject to confidentiality provisions. It is currently not clear from the ToR when the auditor will conduct its audit on each of the auctions during the 12-month review period (i.e. will an audit be carried out at the end of each auction or will there be a single audit at the end of the review period?). BGE would like to see these audits carried out as and when the auctions have been completed during the transitional period as a way of improving transparency in the market. The results of these audits should be published to make participants aware of any necessary issues on a timely basis and in advance of the next auction. Therefore we believe that the Auditor and Monitor should publish reports on issues on a rolling basis, which would be either during or after each auction in the review period.

Do respondents agree with the period for the appointments of the Auditor and Monitor set out in this paper?

We agree that the Auditor and Monitor should be appointed on a 3-year term and that their ToR can be specified on an annual basis.

Do respondents agree with the scope, and the exclusions, for the Auditor and Monitor set out in this paper?

We believe the scope of the Auditor should cover all aspects and processes in the Capacity Market. While the list of activities proposed in the Consultation is extensive, we believe a key element is missing from the audit scope, namely an audit of the activities of the Auction Monitor. The Monitor has a key role in the capacity process which is to ensure that the TSOs are appropriately carrying out their role in the market while adhering to the Rules of the CMC on an ongoing basis. In the interests of ensuring confidence in the market, we believe assurance should be given on this activity by including an audit of the activities of the Monitor in the Auditor's scope.

The Monitor's role, as mentioned above, is to ensure that the TSOs are appropriately carrying out their role in the Capacity Market and adhering to the Rules of the CMC. In order to ensure that all processes are being monitored, we believe the Monitor's activities should extend to the Secondary Trading market (section H of the CMC), especially given the importance of the Secondary market to mitigating RO contract risks.

With regards exclusions, while the methodology for setting locational constraints may be beyond the scope of the roles of the Auditor or Monitor, market participants should be fully engaged in the process of determining the relevant methodology. We would then expect that the Monitor's role would encompass oversight of the ongoing management of the locational

issues by the TSOs and that they are applying methodology for setting locational constraints correctly. We would also require that the Auditor would have a role in auditing the award of locational constraint capacity to ensure that the agreed methodology and processes have been adhered to correctly.

Do respondents have any additional transitional arrangements they believe should apply to the role of either the Auditor and Monitor?

It is during the transitional period that most errors are likely to arise and we believe it would be beneficial for the Monitor and Auditor to take all opportunities to carry out assessments on the market and provide confidence to market participants on its correct operation and administration. Therefore, to strengthen their roles in the transitional arrangements, we believe:

- a) The Monitor should trial its role during the mock Capacity Auction scheduled ahead of the first T-1 auction to ensure it understands in advance of the first auction how the Capacity Market will operate; and
- b) The Auditor should conduct their audits and report on their findings on a rolling basis, i.e. after each full auction process (e.g. from qualification to auction results) has been completed.