

# **Capacity Market**

## **Terms of Reference for the Capacity Market Auditor and Monitor Consultation (SEM-17-007)**

**A Submission by EirGrid and SONI**

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## 1 EXECUTIVE SUMMARY

EirGrid and SONI welcome the opportunity to respond to the consultation on the Terms of Reference for the Capacity Market Auditor and Monitor consultation paper (SEM-17-007).

Transparency and integrity of the Capacity Market are essential to promoting trust in the arrangements and ultimately to attracting the appropriate level of investment in capacity to ensure a reliable electricity supply.

While greater assurance may be provided by separate firms carrying out the monitoring and audit roles, there are also potential benefits for a single firm carrying out both roles. In this regard, separating the procurement of the services into two lots under the same procurement process enables firms to offer to act in one or both roles.

The proposed standards to be applied to the monitoring and auditing roles, namely, ISRS4400 and ISAE3000 respectively appear to be appropriate for the Capacity Market.

We suggest that a volumetric and financial materiality threshold is established to ensure that volume and price related anomalies are objectively identified. The proposed thresholds appear reasonable; however, greater clarity on their application is requested. We suggest that only material issues in the opinion of the Capacity Auction monitor are reported rather than all issues. This would ensure that the appropriate level of attention is drawn to any significant issues that may arise.

As the monitor and auditor are to evaluate outcomes against what is required under the Capacity Market Code, it follows that only activities that are under the Capacity Market Code should be considered within scope. Furthermore, which activities are to be evaluated on a 12 month basis and which activities are to be evaluated in relation to an auction should be clarified to avoid inefficient auditing of the same activity. Consideration should also be given to the treatment of the capacity auction algorithm in the audit (considering its technical nature) and whether approaches similar to that used in the SEM in relation to the MSP Software could be applied here.

## 2 INTRODUCTION

### 2.1 EIRGRID AND SONI

EirGrid holds licences as independent electricity Transmission System Operator (TSO) and Market Operator (MO) in the wholesale trading system in Ireland, and is the owner of the System Operator Northern Ireland (SONI Ltd), the licensed TSO and MO in Northern Ireland. The Single Electricity Market Operator (SEMO) is part of the EirGrid Group, and operates the Single Electricity Market on the island of Ireland.

Both EirGrid, and its subsidiary SONI, have been certified by the European Commission as independent TSOs, and are licenced as the transmission system and market operators, for Ireland and Northern Ireland respectively. EirGrid also owns and operates the East West Interconnector, while SONI acts as Interconnector Administrator for both of the interconnectors that connect the island of Ireland and GB.

EirGrid and SONI, both as TSOs and MOs, are committed to delivering high quality services to all customers, including generators, suppliers and consumers across the high voltage electricity system and via the efficient operation of the wholesale power market. EirGrid and SONI therefore have a keen interest in ensuring that the market design is workable, will facilitate security of supply and compliance with the duties mandated to us and will provide the optimum outcome for customers.

EirGrid and SONI have duties under licence to advise the CER and UR respectively on matters relating to the current and expected future reliability of the electricity supply. We have also been allocated responsibility for administering the Capacity Market Code through recent modifications to our TSO licences. This response is submitted on behalf of EirGrid and SONI in their roles as TSOs and MO for Ireland and Northern Ireland, including as operators of the Capacity Market.

### 3 EIRGRID AND SONI VIEWS ON THE CONSULTATION TOPICS

*5.1.1 The RAs welcome response on any part of the Terms of Reference for both the Capacity Market Auditor and the Capacity Auction Monitor. Where possible, responses should include supporting evidence and/or alternative proposals.*

EirGrid and SONI, as the System Operators tasked with the operation of the Capacity Market, welcome the proposals in relation to the Terms of Reference for the Capacity Market Auditor and Monitor. Transparency and integrity of the Capacity Market are essential to promoting trust in the arrangements and ultimately to attracting the appropriate level of investment in capacity to ensure a reliable electricity supply.

It is important to strike a balance between the level of assurance provided to the market and the associated costs related to the monitor and audit activities. We believe that the proposals set out in the paper strike the appropriate balance.

#### **Procurement of the Monitor and Auditor**

*5.1.3 The CRM 3 Decision allowed the Auditor and Monitor roles to be carried out by the same person. This would potentially realise procurement synergies, but some concerns have been raised about lack of cross-over in expertise. In this context, the RAs would note that the same person currently acts as the Market Auditor under the TSC and as the Monitor for the GB capacity market. Do respondents have any specific concerns about the same person performing both roles?*

While we recognise that synergies may be provided by allowing the Auditor and Monitor roles to be provided by the same person, we note that this is not standard practice and that greater assurance may be provided through separation of the roles.

On the other hand, while the role of the monitor is to provide assurance whereas the role of the auditor is one of fact finding, there is potential for overlap in the scope of their work and the two roles may be filled more cost effectively by a single firm.

It is of paramount importance, in particular in relation to the monitor, that they have sufficient expertise to be able to conduct their monitoring activity effectively without placing undue burden on the operational team. In this regard, we would welcome the inclusion in the terms of reference a statement recognising the importance to the market of the SO's tasks being conducted in a timely way and including an obligation on the Monitor to carry out their roles and responsibilities in a manner that does not unduly interfere in the SO's delivery of its duties and obligations.

As proposed, the monitor and auditor are to be engaged for a three year period. Given the specific nature of the arrangements, a single firm may benefit from an enhanced understanding

of the arrangements due to it acting as both monitor and auditor and this may in turn lead to more effective oversight of the Capacity Market.

The procurement exercise, following OJEU requirements, can reveal any potential synergies in that can be provided. For example, it would be possible to separate the work in to two lots with tenderers able to submit offers for the first, second or both lots. The exercise should be designed to obtain the most economically advantageous solution and, for example, could therefore allow for the services to be provided as two lots, tendered simultaneously.

### **Nature of Opinion**

*5.1.4 Do respondents agree that the Capacity Market Auditor should deliver an opinion on the ISRS4400 basis?*

Building on the approach that has been adopted successfully to promote confidence and trust in the SEM arrangements to date, EirGrid and SONI agree with the proposal to apply the ISRS4400 standard during the audit.

*5.1.5 Do respondents agree that the Capacity Auction Monitor should deliver an opinion on the ISAE3000 basis?*

As the role of the monitor is one of assurance, it would seem appropriate to apply ISAE3000 standard. Consistency with approaches adopted in other market arrangements is also desirable. In particular alignment with the GB arrangements is advantageous because many participants in the SEM would also be familiar with the arrangements in GB.

### **Materiality**

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

We note that the purpose of the Capacity Market is to promote investment in capacity and therefore a volumetric measure is suggested. We can see merits in this approach e.g. it considers all capacity as equally important.

We also note comments with regard to instances where there may be anomalies in the price that are not accompanied by material changes in volume. It would be important that the materiality of these issues could be established objectively. This would suggest that some form of financial materiality threshold is required.

We would suggest a volumetric materiality threshold be applied to the capacity requirement (in MW) and a financial materiality threshold applied to other parameters, such as the product of Net CONE and the capacity requirement (in €).

*5.1.7 Do respondents agree that, in line with the current TSC Market Audit, the Capacity Market Auditor should use materiality of 0.25% for market-level reporting and one tenth of this at the Participant-level?*

The proposed thresholds for materiality and significance of 0.25% and 10% respectively appear reasonable.

However, it is not entirely clear how the participant level reporting is to be applied and we would welcome clarity in this area. For example, is it calculated as the product of 10%, 0.25% and participant's capacity or as the product of 10%, 0.25% and the Capacity Requirement? We understand the proposed approach to be the latter and it would helpful if this was clarified.

*5.1.8 Do respondents agree that the Capacity Auction Monitor should report all issues, regardless of materiality?*

We believe that the Capacity Auction Monitor should report only on issues that, in their opinion, are material in nature. In keeping with the ISAE3000 standard, *"the assessment of materiality and the relative importance of quantitative and qualitative factors in a particular engagement are matters for the practitioner's judgment"*. With this in mind, we believe that the Capacity Monitor needs to apply a reasonable common sense approach to monitoring the Capacity Market. The absence of a materiality threshold in our view does not imply that all issues are reported, more that the practitioners in their role as Capacity Auction Monitor would establish what were material issues based on their judgement and report on these.

### **Governance and reporting**

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

The paper contemplates a tri-partite arrangement similar to the current arrangement for auditing the TSC. We would support this approach and that the TSOs would pay the fees and costs of the monitor and auditor. In this regard, we should point out the expectation that these costs will be recovered from participants through our fees, or other arrangements determined through the revenue review processes.

### **Timing issues**

*5.1.10 Do respondents agree with the period for the appointments of the Capacity Market Auditor and Capacity Auction Monitor set out in this paper?*

While we broadly agree with the period of appointments, it would be important to clarify which parts of the Capacity Market Code are going to be assessed on a 12 month basis and which parts are to be considered relative to a single Capacity Auction. If clarity is not established in this regard, there is a risk that areas covered by one auditor for a particular 12 month period may be covered by another auditor for a particular Capacity Auction.

## Scope

*5.1.11 Do respondents agree with the scope, and the exclusions, for the Capacity Market Auditor and Capacity Auction Monitor set out in this paper?*

As the Monitor and the Auditor are assessing our performance against a set of rules set out in the Capacity Market Code, it follows that any process that is not included in the Capacity Market Code is outside the scope of the Monitor and Audit. We would suggest that this is made clear in the Terms of Reference.

In addition, the operation of the Capacity Auction is a highly technical area, in particular for the enduring Capacity Auction algorithm, which requires the use of a MIP optimisation engine. Currently, the MSP Software used to clear the SEM on a daily basis, is not subject to audit for this reason and instead assurance is provided in the form of certification of the system. Further consideration of this may be required.