



**Response by Energia to SEM Committee  
Consultation Paper  
SEM/17/007**

***I-SEM: Capacity Remuneration Mechanism  
Terms of Reference for the Capacity Market Auditor  
and Monitor***

**21 February 2017**

## **1. Introduction**

Energia welcomes the opportunity to respond to this SEM Committee consultation on the Terms of Reference for the Capacity Market Auditor and Capacity Auction Monitor (SEM/17/007). Our response to this consultation should be read in conjunction with the relevant section of Energia's response to the recent CRM Capacity Market Code consultation (SEM/17/004). This response is structured to provide some general comments before addressing the specific questions posed in the consultation paper.

## **2. General Comments**

Energia rejects the core assumption contained in this consultation that the development of the (draft) Capacity Market Code was robust and subject to appropriate technical challenge. The validity of this assumption is highly questionable and certainly cannot be based on the rigour of scrutiny applied through the RWG process. This is because development of the Code through that process was accelerated and predominantly completed over a cycle of only four Rules Working Groups in conjunction with the TSC development and a very high number of substantive I-SEM consultations running in parallel, leading to consultation overload. These shortcomings of the RWG process are recognised by ESP in their Stocktake Report<sup>1</sup>:

*[T]he design has been developed in consultation with the industry, who have also been part of Rules Working Groups scrutinising that design - albeit recent workload at the Rules Working Groups has inevitably impacted the level of scrutiny of rules by participants, and hence the level of comfort that can be derived from this process...*

Furthermore, notwithstanding these shortcomings, the consultation on the Code is ongoing and we are some time away from a decision by the SEM Committee. In light of this ongoing process, assuming industry comments may still be taken on-board by the SEM Committee, it is not possible to provide any meaningful comment on Sections 3.9.3 – 3.9.8 and Sections 4.7.3 – 4.7.7 of the current consultation, which refer to sections of the Code that are required to be audited and/or monitored. Energia considers it necessary for the SEM Committee to further consult on both this consultation, following determination of the Code, as well as on the Code itself, pursuant to the comments already made in respect of the process to date.

In addition to these points, Energia does not agree with the SEM Committee view that the assessment criteria, as amended to the procurement of capacity and as tailored to the detailed design elements of the CRM, have been applied, at all or in part, to the development and publication of the draft Code.

On the comparison in this consultation, and elsewhere, with the GB market, we caution against the use of such casual references where there are fundamental underlying differences between the GB market and the proposed I-SEM market(s).

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<sup>1</sup> ESP Consulting, November 2016, 'I-SEM Programme: Stocktake Report', p.24

without detailed assessment, the use of a particular approach in GB should be of no relevance to the deliberations in respect of the correct approach for I-SEM.

While Energia accepts that the TSOs will be fully involved in both the Monitor and Audit processes, however it is also necessary that the Auditor and Monitor are independent of the System Operators. We note that there are a number of provisions to that effect in the Code, we believe that the entitlement of the System Operators to attend meetings between the Regulatory Authorities and the Capacity Auction Monitor call such independence into serious question. This is particularly the case where one of the System Operator is a Participant (through its ownership interest in an Interconnector). We believe that such an entitlement is excessive and unjustified. There is no reason why the full participation and involvement of the TSOs cannot be ensured through an alternative mechanism that is appropriate to this particular context and with general principles of good governance (e.g. licence condition), including the question of payment for the Monitor/Auditor addressed herein. Should these proposals go unaltered and preferential access is granted to the TSOs (a market participant), equal access should be provided to all market participants on a similar basis; to do otherwise would unnecessarily discriminate between market participants, particularly where a number of alternative approaches could be adopted.

Finally, the SEM Committee's assumption of an 'Informed User' is vague and does not give market participants any degree of comfort that the person/entity will have sufficient knowledge and experience to provide appropriate assurances. Furthermore, given this question and the proposed absence of independence between the Auditor and Monitor, and between both of these parties and the TSO, as well as for good legal and regulatory reasons, such a person/entity should not be imbued with regulatory and/or quasi-regulatory powers that duplicate existing requirements and/or functions of the RAs, or to provide recommendations on potential course(s) of action in respect of suspected or potential non-compliance to the TSOs without the involvement of the RAs. Effectively, if such powers are conferred to such an entity, notwithstanding the need to better define the term 'Informed User', it would appear anomalous for the SEM Committee to seek to rely on the lack of such expertise as a reason to exclude Local Capacity Constraints from the scope of both the Auditor and Monitor.

### **3. Consultation Questions**

The responses to these questions should be read in conjunction with both the general comments provided herein and the relevant sections of the Energia response to the CRM Capacity Market Code consultation (SEM/17/004).

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

*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?*

In the context of I-SEM, Energia has concerns about the same entity/person performing the roles of monitor and auditor. There is a potential for conflict of interest if both monitor and auditor roles are carried out by same entity. These important functions need to be separate and independent, and this should be reflected in both the Capacity Market Code and the Terms of Reference for the Capacity Market Auditor and Auction Monitor.

The Capacity Auction Monitor and the Capacity Market Auditor play different roles in ensuring the integrity of the auction process. Energia does not believe that there are any synergies which would arise from having the same person or firm acting as both Monitor and Auditor. Instead, we believe that the role of the Capacity Market Auditor will be significantly undermined if it is not independent of the Capacity Auction Monitor. We believe that there are significant additional assurances as regards the functioning of the market which arise from having a fully independent Auditor. This is an essential aspect in the context of an entirely new market and will significantly assist in ensuring trust in the processes and the market in general. Furthermore, it is necessary that both the Auditor and Monitor functions are fully independent of the TSO(s).

#### **Nature of Opinion**

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

No comment on the proposal at this time.

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

No comment on the proposal at this time.

#### **Materiality**

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

Energia agrees, in part, with the proposal that the Capacity Market Auditor should report based on volumetric materiality but we question the practicability of the proposal, specifically in relation to locational volumes and the relevant reference volumes proposed under this option. In the context of the Auditor's work and primary function of the Code, it appears necessary that some financial or quasi-financial test of materiality be developed and applied.

*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?*

Subject to the comments provided in response to the previous question, Energia has no specific issue with the proposed thresholds but again we note the need for a practicable proposal in relation to the calculation of the suggested thresholds.

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

Yes.

**Governance and reporting**

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

Further to the general comment on the need for full independence of the Monitor/Auditor function from the TSOs, Energia considers the proposed governance and reporting proposals contained in the consultation paper to be inappropriate and/or inadequate. Furthermore, in the interests of transparency, accountability and independence it is not appropriate for the TSOs to fund regulatory costs. The Regulatory Authorities should recover costs through their own budget or through Licence Fees in a transparent manner.

**Timing issues**

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

No comment on the proposal at this time.

**Scope**

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

Similar to the comment made herein with respect to regulatory costs, we do not consider a number of the items proposed to be within the scope of the Auditor's assurance to be appropriate for the Capacity Market Code and hence within scope for the Auditor; e.g. System Operator and other Charges, Invoicing and Payment, and Credit Cover Management.

In respect of the proposed exclusions, Energia does not consider the SEM Committee's reason for excluding Local Capacity Constraints as a valid one, it is considered to contradict the 'Informed User' assumption.

Furthermore, Energia consider it necessary that the Secondary Capacity Market be within the scope of the Auditor's role.

**Transitional Arrangements**

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

No comment on the proposal at this time.