

**Power NI Energy Limited
Power Procurement Business (PPB)**

I-SEM Capacity Remuneration Mechanism

Terms of Reference for the Capacity Market Auditor and Monitor

Consultation Paper

SEM-17-007

Response by Power NI Energy (PPB)

21 February 2017.



Introduction

Power NI Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the consultation paper on Terms of Reference for the Capacity Market Auditor and Monitor functions for the I-SEM Capacity Remuneration Mechanism).

We have been concentrating our efforts on the response to the consultation on the Capacity Market Code (CMC) that is due later this week and some of our comments in that response overlap with the issues raised in this consultation.

We also note references that “*The paper assumes that development of the Code was robust and subject to appropriate technical challenge*”. This is incorrect given the scope for rigorous challenge during the RLG process was limited. In addition, the CMC consultation paper itself acknowledges that a lot of the drafting has had limited review having only been presented to the last RLG meeting and included in the draft CMC unadjusted. The ESP Stocktake report also noted shortcoming with the RLG process and the degree of scrutiny possible and the comfort that could be derived. Hence the assumption is flawed and the ongoing concerns must be recognised.

General Comments

Role of the Market Monitor and Market Auditor

We have a general concern with the decision that the same person could be engaged as both the CRM Auditor and Monitor. As noted we are commenting on this in our response to the CMC consultation and repeat some of those comments below.

In order to ensure the success of the Capacity Market, including regulatory oversight, it is essential that the regulatory role of the Capacity Auction Monitor and the Capacity Market Auditor are clearly defined and delimited. We have some concerns that the role of the Capacity Auction Monitor is not sufficiently or precisely circumscribed. We have concerns in particular that certain provisions of the draft CMC may be interpreted as requiring the Capacity Auction Monitor to exercise a regulatory compliance role which properly belongs to only the Regulatory Authorities (RAs). We will be suggesting that the wording of paragraphs B.10.2.1 and B.10.2.4 of the CMC are amended to make it clear that any obligation of notification of suspected non-compliance arises may only arise in the context of the discharge of the Capacity Auction Monitor’s function and does not extend to a regulatory compliance obligation.

We are particularly concerned in this regard that it is proposed that the notification obligation is not primarily concerned with issues arising with the conduct of a Capacity Auction but extends to all issues of "suspected non-compliance with this Code". This would include, in the current draft CMC, issues of market manipulation, adding yet another layer of oversight and further potential for diverging interpretation as regards a Participant’s obligations under the various rules which apply. For this reason also, we believe that the Code should not include such rules which are redundant with pre-existing obligations of general application. Nor should the System

Operators (TSOs) be able to request recommendations from the Capacity Auction Monitor on the most appropriate course of action in respect of suspected or potential non-compliance without the express involvement of the RAs.

A final concern is that the drafting indicates that the TSOs would be responsible for publishing the Market Monitor and Market Auditor's reports. As these reports are commissioned by the RAs, it would be more appropriate that they publish the reports directly.

Independence of the Roles

The Capacity Auction Monitor and the Capacity Market Auditor play different roles in ensuring the integrity of the auction process. We do 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. Any "procurement synergies" would not make up for the loss of having assurances being provided on the operation of the I-SEM Capacity Market by a person who is entirely separate and independent of any persons directly involved in the workings of the capacity market, including the Monitor, being involved as regards its monitoring of the processes associated with the auctions. 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.

For these benefits to be achieved, it is also necessary that the Auditor and Monitor are independent of the TSOs. While we recognise that there are a number of provisions to that effect in the Code, we believe that the entitlement of the TSOs to attend meetings between the Regulatory Authorities and the Capacity Auction Monitor call such independence into serious question. This is particularly the case where Eirgrid is a Participant (through its ownership interest in EWIC). We believe that such an entitlement is excessive and unjustified.

Contractual Arrangements and Payment of Fees

We are also concerned with the proposition that the TSOs pay the fees and costs of the Capacity Auction Monitor and the Capacity Auction Market Auditor and we consider that the tri-partite contractual arrangement is inappropriate. This is a particular concern given the scope for conflict of interest arising from Eirgrid also being a participant in the CRM Auctions which is materially different to their role through SEMO under the Trading and Settlement Code.

The best approach would be for the RAs to pay such fees directly (recovered as part of licence fees). Any obligations with respect to information exchange, confidentiality, etc. can be established for the TSOs under their licences and any corresponding obligations on the Market Monitor and Market Auditor can be addressed under their contract with the RAs. If, notwithstanding this objection, the TSOs remain obligated to pay such fees then the contractual arrangements must be established such that

they do not give the TSOs any right including rights of oversight, approval, termination etc. over the Contracts or under the CMC.

Scope of Auditor's assurances

The scope of Auditor's assurances includes references to:

- System Operator and other Charges;
- Invoicing and Payment; and
- Credit Cover Management

We do not believe that such charges and processes are merited under the CMC and suggest that the TSOs costs be incorporated into the regulated TSO price control entitlement and recovered as part of TUoS charges or else under the TSC charging arrangements. Such an approach removes all these financial transactions from the CMC and hence would remove them from the scope of the Capacity Market audit.

Systems and Processes to be Audited and Monitored

Given the consultation of the CMC has not yet concluded, it is difficult to comment on Sections 3.9.3 to 3.9.8 and 4.7.3 to 4.7.7 of the consultation paper which cross refer to sections of the CMC that are required to be audited and/or monitored. This would be better revisited when the CMC is complete.

ToR for the Capacity Market Auditor

In relation to materiality, one concern we have is that while a volumetric approach is proposed, it isn't clear how such an approach interacts with a sloping demand curve that means the volume isn't precisely preset and hence the volume affected could be somewhat fluid. In addition, the proposals make no reference to consideration of the locational requirement in addition to the total requirement and this must be part of the audit. Beyond these issues, the remaining approach seems reasonable although it is difficult to estimate if it will be sufficient in practice. It will therefore be important that the materiality thresholds are carefully monitored and re-assessed in light of experience.

In paragraph 3.4.3, it isn't clear if "operational management" relates to the TSOs or the RAs. We consider this should be the RAs.

We have already noted above our concerns with the TSOs' attendance at meetings and on the contractual and fee arrangements.

With regard to interaction between the TSOs and the Capacity Market Auditor, as we outline above we believe such matters can be addressed for the TSOs through their licence obligations and for the Capacity Market Auditor under the contractual terms.

ToR for the Capacity Market Monitor

In relation to materiality, we agree that the Capacity Market Monitor should report all issues identified during their monitoring of the auctions.

With regard to interaction between the TSOs and the Capacity Market Monitor, as we outline above we believe such matters can be addressed for the TSOs through their licence obligations and for the Capacity Market Monitor under the contractual terms.

Finally, we are also surprised that the scope doesn't mention any monitoring of the Secondary Trading arrangements which we consider should also be subject to monitoring by the Capacity Market Monitor.