



**Single Electricity Market  
(SEM)**

**Capacity Market Code**

**Terms of Reference for the Year 3 Market Audit**

**Decision Paper**

**SEM-21-049**

**14 June 2021**

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## 1. EXECUTIVE SUMMARY

The SEM CRM detailed design and auction process has been developed through a series of consultation and decision papers, these are all available on the SEM Committee's (SEMC) website. These decisions were translated into legal drafting of the market rules via an extensive consultative process leading to the publication of the Trading and Settlement Code (TSC) and the Capacity Market Code (CMC). An updated version of the CMC (5.0)<sup>1</sup> was published on 24 May 2021 and the most recent version of the TSC<sup>2</sup> was published on 3 November 2020.

Section B.11 of the CMC states the Regulatory Authorities (RAs) shall appoint a person or firm as Capacity Market Auditor who in turn is required to conduct an audit of the operation and implementation of the arrangements, procedures and processes under this Code at least once a Year, in accordance with the terms of reference determined by the Regulatory Authorities.

As stated under B.11.2.4 of the CMC the RAs shall specify the precise terms of reference for an audit following the consultation process under paragraph B.11.2.3 and in sufficient time to enable the Capacity Market Auditor to complete the work in a timely manner.

This paper sets out the Terms of Reference (TOR) that the SEM Committee has set for the Capacity Market Year 3 Audit Report, following the publication of the consultation paper [\*SEM-21-039 Capacity Market Code Terms of Reference for the Year 3 Market Audit\*](#).

Following the closure of the period for consultation, the RAs received two full responses and one email providing a number of comments. None of the responses were marked as confidential. Based on these responses the SEM Committee has decided to implement the following:

### 1. Timescale

The SEM Committee has decided that the Year 3 Capacity Market Audit Report will cover the 12 month period from 1 May 2020 to 30 April 2021.

### 2. Reporting

The SEM Committee has decided the Market Auditor will continue to conduct audit process under the International Standard on Assurance Engagements (ISAE 3000).

### 3. Terms of Reference

The SEM Committee has decided to implement the following TOR for the Year 3 Market Audit Report:

- Accession and Registration;
- Default, Suspension and Termination;
- Qualification;
- Operation of the auction and award of capacity;
- Secondary trading;

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<sup>1</sup><https://www.sem-o.com/rules-and-modifications/capacity-market-modifications/market-rules/Capacity-Market-Code.docx>

<sup>2</sup><https://www.sem-o.com/rules-and-modifications/balancing-market-modifications/market-rules/>

- Implementation agreements;
- SO and other Charges;
- Invoicing and Payment;
- Credit Cover management;
- Disputes;
- Modifications; and
- Design Authority / Code development and Systems Upgrade

Following the publication of this decision paper the Market Auditor will begin work on the Year 3 Audit Report. The Auditor will provide the RAs with an interim audit report in Q3 2021 and the Final Audit report will be made available in Q4 2021.

## 2. BACKGROUND

As set out under section B.11.2.1 of the CMC the Capacity Market Auditor is required to conduct an audit of the CMC, its operation and implementation of the arrangements, procedures and processes under the CMC at least once a Year.

Ahead of the Auditor undertaking the steps required to compile the report, paragraph B.11.2.3 of the CMC firstly requires the RAs to consult with Parties on the terms of reference for the audit. Paragraph B.11.2.4 requires the RAs to specify annually the precise terms of reference for the audit following this consultation process.

The purpose of this paper is to set out the SEM Committee decision relating to the TOR applicable to the Capacity Market Year 3 Auditor Report.

The first Capacity Market Audit was conducted in 2019/20 and covered the time period between 15 December 2017 and 30 April 2019. This 17 month period encompassed the following Capacity Auctions:

- T-1 CY2018/2019 – which took place on 15 December 2017;
- T-1 CY2019/2020 – which took place on 13 December 2018; and
- T-4 CY2022/2023 – which took place on 28 March 2019.

The second, Year 2, Capacity Market Audit covered the period from 1 May 2019 – 30 April 2020. This 12 month period incorporated the following capacity Auctions:

- T-1 CY2020/2021 – which took place on 26 November 2019;
- T-2 CY2021/2022 – which took place on 5 December 2019; and
- T-4 CY2023/2024 – which took place on 27 April 2020.

The basis of the Auditor's Opinion was also conducted under the International Standard on Assurance Engagements (ISAE 3000).

### 3. PROPOSED YEAR 3 AUDIT REPORT SCOPE

On 4 May 2021 the RAs published the Consultation Paper on the proposed TOR for the Year 3 Capacity Market Code Market Audit (SEM-21-039). The key proposals for scope are outlined below.

- The Year 3 audit will cover the 12-month period of 1 May 2020 – 30 April 2021. This audit report will incorporate the T-4 CY2024/25 Capacity Auction which took place on 21 January 2021.
- The Capacity Market Auditor's Opinion will continue to be conducted under the International Standard on Assurance Engagements (ISAE 3000);
- Taking the following into account that there have not been any changes to processes within the CRM as yet (aside from the inclusion of the Secondary Trading Process which will be covered in this period), the SEM Committee propose that the Year 3 audit report will mirror the Terms of Reference covered in both the Year 1 and Year 2. This includes:
  - ❖ Accession and Registration;
  - ❖ Default, Suspension and Termination;
  - ❖ Qualification;
  - ❖ Operation of the auction and award of capacity;
  - ❖ Secondary trading;
  - ❖ Implementation agreements;
  - ❖ SO and other Charges;
  - ❖ Invoicing and Payment;
  - ❖ Credit Cover management;
  - ❖ Disputes;
  - ❖ Modifications; and
  - ❖ Design Authority / Code development and Systems Upgrade.

### 4. RESPONSES TO SEM-21-039

This paper includes a summary of the responses made to the Capacity Market Code Terms of Reference for the Year 3 Market Audit consultation paper which was published on 4 May 2021 and closed on 18 May 2021.

Two full responses and one email outlining a number of brief comments were received by close of the consultation period and none were marked confidential. The respondents are outlined below and copies of each response can be obtained from the SEM Committee website.

- Bord Gáis Energy
- Energia
- SSE (response in the form of a brief email)

Each of the respondents welcomed the opportunity to provide commentary on the proposed TOR for the Year 3 Market Auditor Report.

### **BGE Comments**

In principle, BGE welcomed that the Terms of Reference for the audit of Year 3 operations of the Capacity Market Code will mirror those that covered the audit in the previous 2 years. Elaborating, they advised that consistency of approach and reporting is important to ensure the operation of the CMC within its scope and in line with requirements.

Similarly, BGE advised that the retaining of the requirements set out in SEM Committee Decision Paper SEM-17-023 support continuity in the approach, roles and completion of the audit process including the application of recognised international standards.

They highlighted that they continue to support the independent oversight of the CMC operations played by both the Auction Monitor and Auction Auditor. BGE state their position remains that these two roles should remain separate and be performed by different entities to avoid any potential undermining of the integrity of each role due to perceived / actual conflicts of interest that may arise.

BGE believes it is important that the upcoming audit on the Year 3 operations examines the success of Auction Format D against its expectations given its introduction for the Capacity Year 2024/25 T-4 capacity auction. They stated that they would welcome views in the audit report on whether the use of Auction Format D provided increased benefit to the market over the Interim Auction Solution Methodology (IASM) which was utilised in the auctions covered under the Year 2 audit process. They have also asked that a worked example of the application of Auction Format D is presented to participants to provide a guided explanation on the working of Auction Format D in capacity auctions as this information would facilitate their understanding of the increased benefit or not over the IASM.

BGE advised they would also welcome a view in the audit report on the operation of the Secondary Trading Arrangements under the CMC. Elaborating, BGE advised they appreciate that analysis of the Secondary Trading Process is a point of request by the RAs within the TOR for this Year 3 Audit and ask that the audit reviews all aspects of the process to see it meets its design and operational requirements or otherwise identifies any potential improvements needed. They have further asked that this includes requirements for full and timely information publication and transparency (inclusive of the need for both counterparties to a secondary trade to be named on the register). They have also requested that a liquidity assessment is made of the secondary traded capacity market to consider if there are any design or operational limitations impeding it given the very poor liquidity seen to date in secondary traded capacity.

BGE stated they would welcome the auditor's validation of the efforts made by the SO to reduce the scale and duration of delays to information being publicly available in auction processes and publications.

They referred to the reiteration by the SEM Committee of their minded-to position in the decision paper SEM-21-003 published in January this year on this topic and they would welcome an update on the efforts, successes and opportunities of the System Operator to address any residual delays in capacity auction publications or processes.

Further, BGE stated that Participants look to the System Operator to publicly provide information on all market participants for transparency in a timely manner. They are of a view that high levels of transparency of information are increasingly important for market participants, especially now with the implementation of the Alternative Secondary Trading Arrangements for capacity contracts and the reliance on up-to-date Capacity Contract registers.

### **Energia Comments**

Energia welcomed the opportunity to respond to the SEM Committee Consultation Paper SEM-21-039 and highlighted that the purpose of the Capacity Market Audit is to provide independent assurance on the operation of the Capacity Market and is intended to cover a wide scope of activities as outlined in the Consultation Paper.

Within their response, Energia advised that they have concerns with E.7 of the CMC and it is their view that has been inadvertently excluded from the scope of the Market Audit. They highlighted that the Qualification and award of contracts to New Capacity which subsequently fails to deliver can materially distort market outcomes whilst compromising security of supply. They further elaborate that it is important to ensure that the qualification process in section E.7 of the CMC is suitably robust and within the scope of the Market Audit.

Energia state that this would include E.7.2.1 (f) which requires the System Operators to consider rejecting an Application for Qualification where “they consider the delivery of a part or all of any New Capacity proposed in the Application for Qualification is not feasible (either technically or in the applicable time frame)”. Energia believe this needs to be addressed in the final Terms of Reference.

Energia have referred to the consultation paper, which that the TOR for the upcoming Year 3 Audit is to include the same scope as that used in previous audits, which includes Qualification. However Energia advise that it is worth noting that Qualification was not included in the Year 1 Market Audit, with the Audit Report stating that “*those areas already assessed and reported on by the Capacity Auction Monitor are not required to also be assessed by the Capacity Market Auditor – in broad terms...this excludes from the Auditor scope the activities relating to Qualification...*”. They have assumed that Qualification will be excluded from the scope of the Year 3 Capacity Market Audit on the basis that it has already been included in the Capacity Monitor Report for the T-4 CY2024/25 auction.

In terms of this, they note that B.10.3.1 (b) of the CMC requires the Capacity Auction Monitor to produce a Report on the Qualification Process which “states whether or not the Capacity Auction Monitor considers that the Qualification Process was conducted in accordance with this Code”. However, following a review of the Capacity Monitor Report for previous auctions, they note that section E.7 of the CMC is not included within these Monitor Reports.

## **SSE Comments**

SSE advised they didn't have any substantive comments to provide. However, they highlighted that it would be prudent to include the delivery of the audit to the agreed and required milestones and deliverables under the CMC, within the scope of the audit report.

They stated that through their analysis performed across the various auctions to date, they realised that in a large number of cases, values such as the capacity requirement has been set in the IAIP.

They believe the CMC is clear that this should be a final value, but are of the view that in some way the value has been conditional, or subject to adjustment, before the auction. SSE consider this is a serious enough auction operation feature that should be included in the audit to consider from an independent perspective, whether the rules of the auction have been consistently applied.

## **5. SEM COMMITTEE RESPONSE**

### **Reporting based on Auctions Format**

In their response to the consultation, BGE requested that the Year 3 Audit Report examines the effectiveness of the auctions in meeting the CMC requirements under the auction format(s) used.

Whilst the Year 3 TOR does include the operation of the auction and award of capacity, it should be noted that this has been previously viewed by the Capacity Auction Monitor. The SEM Committee also note that the role of the Market Auditor is to ensure that the processes within the auction have been performed as required. The scope of the Audit report is to flag any issues, or failings in terms of the processing of the T-4 CY2024/25 Capacity Auction, and not to perform an in-depth analysis of the differences between previously utilised auctions formats and Auction Format D.

The SEM Committee note that the utilisation of Auction Format D is a requirement of the State aid approval, granted in November 2017<sup>3</sup>.

### **Capacity Market Auditor and Capacity Auction Monitor Roles**

In their response, BGE reiterated that it is their preference that the roles performed by the Capacity Market Auditor and Capacity Auction Monitor should remain separate and be performed by different entities.

Both the Market Auditor and Auction Monitor roles are currently performed by two different entities and are currently contracted to perform their respective individual tasks. Whilst the SEM Committee note this preference, section B.11.1.5 states:

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<sup>3</sup>[https://ec.europa.eu/competition/state\\_aid/cases/267880/267880\\_1948214\\_166\\_2.pdf](https://ec.europa.eu/competition/state_aid/cases/267880/267880_1948214_166_2.pdf)



B.11.1.5 *The same person may be:*

- (a) *both the Capacity Auction Monitor and the Capacity Market Auditor; and*
- (b) *both the Capacity Market Auditor and the Market Auditor under the Trading and Settlement Code.*

However, it should also be noted that under the TOR for the Year 3 Market Audit, the SEM Committee are not suggesting this status quo will be changed.

### **Delays to the Publication of System Operator Papers**

In their response, BGE stated they would welcome the auditor's validation with regards to the efforts made by the SOs to mitigate the scale of delays to the publication of documents relating to Auction processes.

Following the completion of the Year 1 Audit report the SEM Committee had raised the issue of delays, not only in regards to publications, but delays in terms of processes also, with the SOs. As part of the Year 1 report, the SOs has set out how they intended to mitigate issues experienced within that audit process. In setting the Year 2 TOR the SEM Committee adopted the minded-to position cover the same TOR in the Year 2 report as in the Year 1 report to ensure that issues experienced did not become perennial. The RAs have been working closely with the SOs to ensure that all milestones, inclusive of all relevant publications, are delivered as required and on time. This is a continually ongoing process.

As part of the Audit report, the Auditor's role is to retrospectively report on how the SOs have performed and delivered on their requirements within the Capacity Market. In the hypothetical event that the steps the SOs have introduced to mitigate delays do not work, the RAs will directly liaise with the SOs on such matters.

Given that the Year 3 Audit process is to be initiated ahead of the completion of the Year 2 process, the SEM Committee are of the view that the areas highlighted under the Year 1 report, and included in the Year 2 TOR, are to be covered in the Year 3 TOR.

### **Audit Scope**

Energia stated their belief that E.7 of the CMC should be included within the scope of the Year 3 report. They have specifically referred to sub-section E.7.2.1 (f) which requires the System Operators to consider rejecting an Application for Qualification where "*they consider the delivery of a part or all of any New Capacity proposed in the Application for Qualification is not feasible*".

As with each Market Audit process, areas already assessed and reported on by the Capacity Auction Monitor are not required to also be assessed by the Market Auditor.

The requirements for qualification for the T-4 CY2024/25 Capacity Auction have already been assessed by the Capacity Auction Monitor in their qualification report, as required in section B.10.3 of the CMC.

This report states that the Capacity Auction Monitor shall provide a report to the Regulatory Authorities and the System Operators that:

- (a) confirms the list of Capacity Market Units that have been Qualified;
- (b) states whether or not the Capacity Auction Monitor considers that the Qualification Process was conducted in accordance with this Code; and
- (c) where applicable, identifies any actual or potential non-compliance with this Code or other actual or potential irregularity in the conduct of the Qualification Process together with the Capacity Auction Monitor's assessment as to the likely consequences of the actual or potential non-compliance or irregularity.

The SEM Committee note that within the CMC there is no requirement for the Qualifications report to be published, which differs to the process associated with the CAM Auction report. It should be noted that the CAM Qualifications report is provided to the RAs following an assessment of the provisional qualification results, which are subject to change. Any issues identified by the CAM at this stage will subsequently allow the SOs to rectify issues identified, ahead of the production of the final qualification results. Given this, the SEM Committee are of a view that publication of the CAM qualification report would not be appropriate, given the provisional / changeable nature of the data at that stage in the process.

However, participants do have the option to propose modifications to the CMC, if they believe there is merit in making a non-confidential version of the Qualification report publicly available.

Taking account of the fact that the Capacity Auction Monitor will have already reported on these areas, the SEM Committee have decided that it is not required that the Market Auditor revisit these areas as part of the Year 3 Audit report.

In the comments provided by SSE, they have raised concerns that certain values, such as the capacity requirement, are deemed as Final within the Initial Auction Information Pack (IAIP). SSE were of the view that in some way the values have been conditional, or subject to adjustment, before the auction and therefore this should be covered within the scope of the audit. The SEM Committee are cognisant that the Capacity Requirement is deemed 'final' within the IAIP. This value has not been amended with the publication of the FAIP. Instead, to account for a variety of effects such as reserves, uncertainties and movement in underlying variables, the demand curve has been moved. The demand curve is set as 'final' within the FAIP and this changes the way the Capacity Requirement interacts in a Capacity Auction.

In their response BGE requested the auditor undertake a liquidity assessment with regard to the secondary traded capacity market. They justified this stating that it would allow for the consideration of whether there are any design or operational limitations impeding the process. However, as stated in response to a number of comments received regarding the role of the Auditor, in this instance, the role is to review the Secondary Trading process and report any failings to the RAs and SOs. It is not within the Auditor's role to undertake an analysis piece aimed at improving the process.

## 6. SEM COMMITTEE DECISION

Following the receipt and analysis of the responses to the consultation paper the SEM Committee has decided to implement the following approach and TOR for the Year 3 Capacity Market Auditor Report:

### 1. Timescale

As set out under B.11.2.2 of the CMC the annual period covered by the audit shall be 1 January to 31 December *unless the terms of reference specify a different period*. In this instance the SEM Committee hereby state that the Year 3 Audit report will cover the 12 month period between 1 May 2020 and 30 April 2021.

### 2. Reporting

Taking account of the fact that ISAE 3000 requires the auditor to provide an assurance opinion, which is the preferred option, the SEM Committee have decided that in conducting the Year 3 Audit report, the Auditor will continue to do so under ISAE 3000.

The SEM Committee considers an assurance opinion is likely to produce the most useful information for the RAs and Market Participants.

### 3. Terms of Reference

As set out in the consultation paper, the SEM Committee proposed that the TOR for the Year 3 Audit remain as they were for the both the Year 1 and Year 2 Audit, with the exception of the inclusion of the Secondary Trading Process.

The SEM Committee are of the view that given no major changes and processes, other than the introduction of the Secondary Trading process, have been implemented within the CRM during the proposed period to be covered by the Year 3 audit report there is merit in retaining the TOR from the Year 1 and Year 2 reports. The SEM Committee are also cognisant of concerns raised following receipt of the Year 1 report, in that the issues raised in that report should not become persistent and therefore should be included in the subsequent TOR and audit reports.

It is the SEM Committee's view that the Year 3 Audit report will include:

- Accession and Registration;
- Default, Suspension and Termination;
- Qualification;
- Operation of the auction and award of capacity;
- Implementation agreements;
- SO and other Charges;
- Invoicing and Payment;
- Credit Cover management;
- Disputes;
- Modifications; and
- Design Authority / Code development and Systems Upgrade; and
- Secondary Trading.

## 7. NEXT STEPS

Following publication of this paper the Capacity Market Auditor will begin work on the audit. The Auditor will provide the RAs with an interim audit report in Q3 2021.

The interim audit results will not be published, but if major issues arise the RAs will articulate these to market participants. The final audit report will be published in Q4 2021.