

SEM Committee Paper

Trading and Settlement Code

Terms of Reference for the Market Audit 2014

Consultation Paper

24 April 2014

SEM-14-031

1. Background

The Trading and Settlement Code (“TSC” or the “Code”), requires an audit of the Code, its operation and implementation, and the operations, trading arrangements, procedures and processes under the Code to be performed on an annual basis. The Code also requires the Regulatory Authorities (“RAs”) to consult with Parties on the terms of reference for the audit and to specify annually the precise terms of reference.

In 2007/08 and 2009 the Market Audit represented an audit of compliance by the Single Electricity Market Operator (“SEMO”) and, in so far as it related to the calculation of Modified Interconnector Unit Nominations (“MIUNs”), the Interconnector Administrator with their requirements under the Code. The scope of this Market Audit excluded discrete components of the MSP Pricing Engine (unit commitment, economic dispatch and the calculation of Shadow Prices) as it was considered that the benefits of performing audit work over these components were outweighed by the costs and disruption in the initial period of market operation.

For the second Market Audit relating to year 2009, the scope was extended to include a review of the decision process and approvals for using the Mixed Integer Programming (MIP) solver instead of Lagrangian Relaxation (LR) in MSP. The RAs took the view that the resulting opinion provided the Market with a report that was both comprehensive and of value to participants, given the constraints of what is practically feasible at a reasonable cost and without undermining the ongoing operation of the Market. Subsequently, the Market Operator raised a Modification Proposal on the Solver Policy (Mod_27_11) which was approved by the SEM Committee on 7 March 2012.

In both these Market Audits, the scope excluded activities undertaken by the System Operators (“SOs”), Meter Data Providers (“MDPs”) and other participants as set out in the Code and Agreed Procedures.

However for the 2010 Market Audit, options were put forward setting out potential extensions that would involve the Market Auditor assessing compliance of the MDPs and SOs with their obligations under the Code or conducting a limited examination of the accuracy of source data provided by the MDPs and SOs. Following consultation, the scope for the 2010 Market Audit was extended to include a limited examination of certain activities of the MDPs and SOs including generation metering and dispatch instructions performed on an Agreed upon Procedures basis, with factual findings and any exceptions being reported to the RAs and Parties separately. The 2011 Market Audit included Agreed-upon Procedures which examined key interval meter demand side feeds. In 2012 the Market Audit consisted of a Core SEMO Audit with an early examination of Intra-Day Trading. 2013 saw a Core SEMO Audit with limited expansion to cover key MDP Demand Side Data Feeds.

The RAs took the view that the resulting opinion provided the Market with a comprehensive report that was of value to participants, given the constraints of what is practically feasible at a reasonable cost and without undermining the ongoing operation of the Market.

2. Proposed 2014 Audit Scope

Three options are outlined for the 2014 Market Audit, as follows:

Option 1 Core SEMO Audit

As in previous years, this audit will provide a reasonable level of assurance to the RAs and market participants that market pricing and settlement activities are being carried out by SEMO in accordance with the TSC and its Agreed Procedures. The audit work will focus on the activities and processing performed by SEMO. This contained scope excludes activities undertaken by the TSOs, Meter Data Providers and other participants as set out in the TSC and Agreed Procedures.

As with previous Market Audits, it is intended to exclude the operation of certain components of the MSP Pricing Engine from the scope of the Market Audit. The excluded components are the operation of Unit Commitment, Economic Dispatch and calculation of Shadow Prices.

Option 2 Core SEMO Audit plus follow-up of all previous AuP findings

The 2010, 2011 and 2013 Market Audits included examination of certain activities of MDPs and SOs in relation to provision of dispatch instructions and meter data for generation, interval and non-interval metering on an Agreed upon Procedures basis. This work identified a number of findings and recommendations. Although these were followed-up in subsequent years to some degree given the commonality of processes across in particular interval and non-interval metering, this option would see a formal follow-up and reporting on actions taken by MDPs and SOs in responses to the previous audit findings. Where appropriate this would include testing on a sample basis of any new processes and controls to assess their operating effectiveness. It may also be appropriate to include some focused testing over specific process areas across all MDPs/SOs in areas of common findings to provide a new 'baseline'. This work would be performed on an Agreed upon Procedures basis.

As with previous Market Audits, the RAs are mindful of the overall cost of audit work and not duplicating relevant audit work which is already carried out within the MDPs. Before making a final decision on this the RAs would consider whether there has been any follow-up of previous AuPs.

Option 3 Core SEMO Audit plus limited expansion to cover Dispatch Instructions

In addition to the core SEMO Audit, this would include examination of the activities of the SOs in relation to the issuing of dispatch instructions. This would be different to the scope in 2010 (which focused on the capture and completeness of Dispatch Instructions provided to SEMO) and would focus on the processes in relation to making dispatch decisions including deviating from the market schedule, priority dispatch, managing short term issues such as unit trip etc. This additional scope would be undertaken on an Agreed upon Procedures basis.

3. Proposed Decision

Given the likelihood of significant changes to the market in 2016 and the short timeframe to implement any required changes before then, the SEM Committee proposes that Option 1 is pursued for 2014, namely a Core SEMO Market Audit.

A SEMO Core Market Audit will minimise costs and operational burden on the participants involved while providing a reasonable level of assurance to the RAs and Market Participants that market pricing and settlement activities are being carried out by SEMO in accordance with the Trading and Settlement Code and its Agreed Procedures.

The RAs see merit in the follow up on AUPs in Option 2 but are of the view that this follow up can be progressed in house in the first instance as opposed to engaging the Market Auditors. It is for this reason that the RAs are proposing not to pursue Option 2.

Views on this proposed Decision and on other the options put forward in this consultation document are welcomed from interested parties.

4. Consultation and Next Steps

In presenting this paper for consultation, the SEM Committee seeks views on the merits of the above options for the Market Audit Scope for 2014.

Responses to this consultation are requested by the close of business on **Thursday, 22 May 2014** and should be in writing and submitted, preferably via email, to:

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The Exchange
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The RAs intend and prefer to publish all comments received, but are prepared to facilitate those respondents who wish for certain sections of their submission to remain confidential. Accordingly, respondents that so wish should submit these sections in an appendix that is clearly marked “confidential”.

Further to their consideration of the comments received, the RAs will publish their decision on the terms of reference for the SEM Market Audit for the period January to December 2014.