

**CENTRAL ELECTRICITY REGULATORY COMMISSION
NEW DELHI**

Coram:

- 1. Dr. Pramod Deo, Chairperson**
- 2. Shri R.Krishnamoorthy, Member**
- 3. Shri S.Jayaraman, Member**
- 4. Shri V.S.Verma, Member**

Petition No. 166/2008

In the matter of

Petition for seeking permission to week ahead contracts, etc.

And in the matter of

Power Exchange India Limited, Mumbai

....Applicant

The following were present:

1. Shri Ashish Bernard, Advocate
2. Shri Ravi Parkash, Advocate
3. Shri Satyajit Ganguly, PXIL
5. Shri P.K.Sarkar, PXIL
6. Shri R.Singh, PXIL

**ORDER
(DATE OF HEARING:16.6.2009)**

Through this petition, the applicant, Power Exchange India Limited has sought permission to introduce additional contracts, namely day-ahead contingency contracts, weekly contracts, monthly contracts and intra-State contracts and approval of the revised rules, bye-laws and business rules.

2. Subsequently, The applicant through an interlocutory application had also prayed to change the time block of existing and proposed contracts from 1 hour to 15 minutes. Subsequently, the applicant vide affidavit dated 10.6.2009 prayed to de-link this prayer. The I.A. for seeking the permission to introduce intra-state product has also been withdrawn.

3. The Commission vide its order dated 27.5.2008 accorded approval for setting up and operating the power exchange by the applicant. Finally, the power exchange became operational on 22.10.2008. The Commission conducted two hearings related to grant of permission to introduce additional contracts on term ahead market on 28.05.2009 and again on 16.06.2009.

Type of Contracts

4. It is felt that the term-ahead market through the power exchange is a new concept, the Commission would like to start on a cautious note and therefore, we grant permission to the applicant for the launch of the following contracts,-

- (a) Day ahead contingency contracts; and
- (b) Weekly contracts on month-ahead basis (trading one month in advance with a delivery period of one week)

5. These contracts would be for physical delivery and would be non-transferable. Financial settlement of these contracts shall not be permissible.

6. Since the term-ahead market, wherein the contracts are for a future time period and with extended delivery period, results in price and volumetric risk simultaneously, for the time being the Commission grants permission for launch of these contracts up to one month ahead only. Accordingly, the clauses, and contract specification pertaining to month-ahead, two month-ahead and three month-ahead contracts shall be omitted from the rules, bye-laws and business rules and

expression pertaining to day-ahead contingency contracts and month-ahead contracts modified accordingly.

7. The Commission shall review the performance of these contracts after 6 months.

Price Discovery Mechanism and Matching Rules to be used

8. The applicant has proposed the Pay-as-bid auction method as price discovery mechanism based on the price quoted by the buyer. Presently, the Commission has the following reservations with respect to the price discovery mechanism suggested by the power exchange:

- (a) The suggested method, by design, fails to create any buyers` surplus and rewards the sellers only. This goes against the principle of equitable distribution of the surplus and social welfare.
- (b) The process of disclosing the sellers` bids to the buyers and not vice versa fails the test of providing equal opportunity to all participants (both buyers and sellers) to maximize their profits and creates information asymmetry .
- (c) In comparison to a uniform price auction where the buyers gets power at his quoted price or a lesser price ,the buyer would be less motivated to bid in the suggested mechanism since it is assured of only his price and nothing better.

- (d) This methodology of matching rules is biased towards the sellers, and therefore it is expected that, if approved, all the sellers will flock to only this power exchange, effectively preventing competition between the power exchanges.

9. In light of the time elapsed since submission of the petition and reasons furnished by the exchange for adopting the said matching mechanism, we allow the power exchange to use its matching mechanism with some modification in the price discovery methodology. The best buyer (highest paying buyer) shall be matched against the best seller (lowest asking seller) and the mid-point of their two quotes be decided as the agreed traded price (average of the matched buyer and the seller's quoted price). The same logic shall be extended till the buyer or seller volume is exhausted.

Open Access and Scheduling

10. The approved contracts are power contracts with constant MW to be supplied during the contract period. The applicant shall abide by the Central Electricity Regulatory Commission (Open Access in Inter-State Transmission) Regulations, 2008, as amended from time to time, for open access and scheduling procedure. This shall be specified in the business rules.

Contingency and grid disturbances

11. In case of contingency or grid disturbance, the directions of the load despatch centers (NLDC/RLDC) shall be followed to ensure grid security.

Risk Management System and Margin Requirements

12. The exchange is the counterparty to all transactions and is exposed to the risk of financial non-fulfillment of contracts. The adequacy and effectiveness of risk management is of paramount importance for power exchanges. The condition becomes further complicated in case of the power exchanges since electricity prices have high volatility, the term ahead market being contracts for a future time period and with an extended delivery period, have price and volumetric risk embedded in them. A well thought out risk management system and margin requirement able to handle these two risks needs to be put in place by the power exchange. The power exchange shall keep sufficient and prudent margin in order to ensure adequate payment security. The margin and the methodology for calculating the same shall be disclosed to the participants before they enter into any trade.

13. Notwithstanding the approval of the rules, bye-laws and business rules by the Commission, the persons enrolling themselves as members or clients of the power exchange or transacting business thereon in any capacity shall do so after satisfying themselves of all the commercial aspects covered under the rules, bye-laws and business rules, uninfluenced by the fact that the Commission has approved them since these matters are primarily the concern of the parties. The observation in this para shall be notified by the applicant to its existing members as also to the persons seeking enrolment as members or clients in future.

Default and Penalty

14. There should be sufficient deterrent built in the settlement system for any commercial consideration motivated default by participant due to market price

variation. This is needed to maintain the sanctity of the contracts. Penalty for willful default to profit from better price in other markets shall be treated severely.

15. The applicant has sought permission for providing Over-the-counter (OTC) clearing and settlement services. At this nascent stage of market development, the Commission is of the view that the exchange should focus on the price discovery and clearing and settlement of contracts traded on its own platform. Therefore, the OTC (bilateral) clearing and settlement services shall not be provided by the power exchange.

General

16. The following observations/discrepancies are observed in the rules, bye-laws and business rules for further submission after necessary correction are listed below:

(a) It has been submitted that the membership criteria and member-client relationship shall be the same as in the case of day-ahead market. However, a provision shall be made in the business rules clarifying the membership criteria including membership fee details to distinguish between day-ahead market and term-ahead market membership for information of all concerned.

(b) Contracts Specification- The applicant has sought flexibility in contract specifications for creating a responsive place. The power exchange need not take approval on the following parameters of the contract specification,

- (i) Basic contract specification except minimum bid volume which shall be as per the relevant regulations under Electricity Act, 2003.
- (ii) Trading hours and bidding session: The power exchange shall submit an overall plan on details like start and end date of the trading window before the launch of different kinds of contracts by preparation of a trading calendar pertaining to each kind of contract. The contract launch calendar for the next 3 months shall be published by the power exchange to create an environment of certainty and planning activity for the participants,
- (iii) Margins;
- (iv) All kinds of penalties;
- (v) Settlement of trade;
- (vi) Minimum volume quotation step;
- (vii) Minimum value quotation step;
- (viii) Trading time on the contract day;
- (ix) Transaction fee;
- (x) Revision Charges; and
- (xi) Default in Payment.

17. The rules, bye-laws and business rules shall be amended in accordance with the directions given above and submitted to the Commission for information and record.

18. Subject to the compliance of above directions, approval is hereby accorded to the rules, bye-laws and business rules submitted by the applicant and the applicant

is permitted to launch these contracts. The rules, bye-laws and business rules approved are applicable to the contracts approved with the flexibility given to amend certain parameters of the contract specifications as given above. In case the applicant intends to start any other type of contract, it shall obtain prior approval of the Commission.

19. In order to ensure equal opportunities, it is desirable that both the running power exchanges, namely applicant and India Energy Exchange (the applicant in Petition No. 120/2008) start their operations in the term-ahead market simultaneously. Therefore, it is ordered that both the power exchanges shall commence their operations prospectively, on or after 15.9.2009, after complying with the directions given above.

20. With the above, petition is disposed of.

Sd/= **(V.S.VERMA)**
MEMBER

Sd/= **(S.JAYARAMAN)**
MEMBER

Sd/= **(R.KRISHNAMOORTHY)**
MEMBER

Sd/= **(DR.PRAMOD DEO)**
CHAIRPERSON

New Delhi dated the 31st August 2009