

**CENTRAL ELECTRICITY REGULATORY COMMISSION
NEW DELHI**

Petition No. 101/ MP/2011

**Coram : Dr. Pramod Deo, Chairperson
Shri S. Jayaraman, Member
Shri V.S. Verma, Member
Shri M. Deena Dayalan, Member**

**Date of Hearing: 21.4.2011
Date of Order: 27.10.2011**

In the matter of:

Petition to grant additional time to the petitioner to comply with Regulation 18 (i) of the Power Market Regulations 2010, such additional time being 3 years from the notification of the said Regulations

And in the matter of:

Power Exchange of India Ltd. Petitioner

Parties present:

Shri Hemant Sahay, Advocate for the petitioner
Shri S Venkatesh, Advocate for the petitioner
Shri Gyan Mohan, PXIL
Shri Pawan Aggarwal, PXIL

Order

Regulation 18 (i) of Central Electricity Regulatory Commission (Power Market) Regulations, 2010 (hereinafter "Power market Regulations") provides as under:

"18 (i) A Power Exchange shall always have a minimum networth of Rs.25 Crore

Provided that the Power Exchange shall always maintain the above networth and in case the same depletes due to payment made by the Power Exchange to sellers/ buyers in default including by the usage of the SGF impacting its networth, the Power Exchange shall increase its networth to comply with the above networth criteria within 3 months from the date of depletion.

Provided that if and when a Power Exchange separates its clearing function to a Clearing Corporation, it shall be required to have a minimum networth of Rs.5 Crore.

Provided further that the Commission may, by general order, review the networth criteria from time to time.”

2. The petitioner had previously filed Petition No. 134 of 2010 seeking extension of time to raise additional equity share capital to achieve the prescribed net-worth. The Commission vide its order dated 25.5.2010 had allowed PXIL a period of one year from the date of notification of Power Market Regulations i.e. till 20.1.2011 to achieve the prescribed net-worth criteria. The Petitioner filed the present petition on 5.4.2011 praying for additional time of 3 years to achieve the specified net-worth. The petitioner has submitted that in compliance with the order of the commission dated 25.5.2010, it had initiated the following steps:

(a) After approval by the Board of the company in its meetings held on 26.5.2010, 24.9.2010 and 15.12.2010, the petitioner has:

- i. made additional equity offer on preferential basis to National Stock Exchange of India Ltd, National Commodity & Derivatives Exchange Ltd and Power Finance Corporation Ltd.
- ii. increased the Authorized share capital of the company which was subsequently approved by the Shareholders of the company at the 2nd AGM of the Petitioner held on 24.9.2010.
- iii. decided to offer equity shares on preferential basis to existing and other strategic investors.

- iv. allotted equity shares to National Commodity & Derivatives Exchange Ltd and MP Power Trading Company Ltd.
- v. decided to offer equity shares to a strategic investor at a premium. Though the petitioner was in negotiations with investors to offer and issue equity at a price, the transactions could not be finalized due to regulatory uncertainties relating to ownership pattern of Exchanges.
- vi. allotted equity shares to National Stock Exchange of India Ltd. and extended further time to one of the PSU shareholders to subscribe additional equity shares in the petitioner as the said shareholder is in the process of getting presidential approval for the equity infusion. It also states that the process is lengthy and time taking in case of PSUs and state owned utilities.

(b) The Petitioner has taken significant steps to achieve the networth requirement which is evident from the fact that the paid up capital of the Exchange has increased from Rs 34.34 crores in March 2010 to Rs 40 crores in March 2011 after the Commission's order.

(c) The Petitioner is in the process of launching new products such as Intra Day, Any Day, Monthly Products and Energy Efficient Certificates etc. in the near future which will help petitioner to achieve the networth.

(d) The Petitioner has taken significant steps to promote Renewable Energy Certificates (REC) and spent significant time & energy as well as money in the development of this platform.

3. The Petitioner has elucidated the following reasons which are not attributable to the petitioner, but have contributed to the Petitioner's inability to achieve networth criteria.

(a) Regulatory Uncertainty - The petitioner could not launch 'Month Ahead Contract' despite Commission's approval due to litigation at Hon'ble Mumbai High Court on the Electricity jurisdictional issue. Due to ambiguity in the market, the petitioner's business is severely impacted and hence is unable to meet the prescribed networth.

(b) Loss caused due to Congestion in Transmission Corridor- Transmission Corridor congestion has increased leading to significant loss of business owing to matched volumes being less than scheduled volumes. The impact of congestion was severely felt in curtailment of weekly trades.

(c) The petitioner has incurred significant legal expenses and continues to incur such costs to defend its position at various judicial forums such as Electricity Appellate Tribunal and Mumbai High Court on the matters of principles of natural justice and correct interpretation of the Electricity Act, 2003 and the Regulations made there under.

(d) The petitioner is playing an important role in creating a national level electricity market and has also stepped forward to assume responsibility for mandated

products like RECs. Therefore, in the interest of development of power market, the petitioner has prayed for sufficient time to grow its revenue and profitability.

4. The Commission had directed the petitioner in the Record of Proceedings for the hearing on 21.4.2011 to submit an affidavit on the steps being taken by the petitioner to improve its profitability, particularly its detailed business plan to address the problem. The petitioner has submitted its Business Plan for the FY 2011-12 & FY 2012-13 on 23.5.2011. The petitioner has submitted that its Business Plan was discussed and approved by the Board at its Board Meeting held on 13.5.2011. Summary of the Business Plan is given below:

- (i) The petitioner is expecting increase in revenue in all segments such as Day Ahead Spot (DAS), Week Ahead trades, REC trades, trainings and capacity building and membership etc. These are based on conservative growth assumptions that are consistent with historical growth trends.
- (ii) The petitioner is expecting increase in its PBT for the coming FY 2012-13 due to combination of increased revenues and rationalization of costs.
- (iii) The total outflow/expenditure will be managed substantially from the FY 2012-13 as the operations of the company is expected to be stabilized and going forward, as compared to FY 2010-11 and 2011-12.
- (iv) Petitioner is thus focusing on breaking even at the earliest as per the Business Plan so as to arrest the further erosion of capital.
- (v) Additional capital infusion is also expected from the investors during Quarter 2 to Quarter 4 of the FY 2011-12, which will help the Petitioner to shore up its

networth. The networth of the company after adjusting for losses and after infusion of additional capital to the tune of Rs. 40 crores, it is expected that the Exchange will be able to attain the minimum networth of Rs. 25 crores in FY 2011-13. However considering the fact that the Breakeven will be achieved only towards the end of FY 2011-12 as also the fact that the fund infusion from investors may not happen in the single tranche, the Exchange may end up attaining the networth of Rs. 25 crores in FY 12-13.

- (vi) The Petitioner also intends to launch new products such as Any Day Ahead as well as Intra Day in the physical delivery segments which will add further to the revenues.
- (vii) The Petitioner also expects to earn higher revenue once it commences trading in future/ forward products and Energy Saving Certificates which are being developed by the Bureau of Energy Efficiency.
- (viii) The petitioner had considerably increased its Membership and Client base the FY 2010-11 and it also expects to continue the same. This will not only result in increasing Exchanges revenues from membership but also result in overall increase in its trade/volume from all products.
- (ix) The petitioner intends to be a thought leader in providing training and capacity building in the power and allied space in the coming financial years thereby increasing its revenue. Petitioner is awaiting operationalisation of the Power System Development Fund (PSDF) which will give a further boost to the training and capacity building activities.

(x) The petitioner is working hard to increase the market size by adding more open access consumers on the Exchange and putting in place a strong marketing team for this.

5. The petitioner has submitted that with the above measures targeted towards boosting revenue and rationalizing expenses so as to ensure an early breakeven as well as efforts being made to bring in strategic or other investors, the petitioner reasonably expects that it would be in a position to meet the regulatory norms pertaining to Net worth within FY 2012-13.

6. In response to a further query of the staff of the Commission made on 9.6.2011 to submit a detailed Business Plan, the petitioner has submitted on 17.6.2011 a supplement to the Business Plan filed on 23.5.2011. The summary of the supplement to the Business Plan approved by the Board of Directors at its meeting held on 13.5.2011 is given below:

(a) Continued growth in Volumes and Revenue Generation: The trading revenue i.e. transaction fee has significantly grown from the year FY 2008-09 to FY 2010-11. Such exponential growth in revenue is expected to grow further during next couple of years due to continued efforts made by the Exchange to increase its number of members, widen its geographical reach and deepen its market penetration. The market has been estimated to grow at a rate of 20% annually which is likely to increase the volume of DAS and weekly contracts. It has been the market leader in Week Ahead and REC and has been making efforts to

strengthen its position in DAS product. PXIL market share is expected to be significant in the REC market . Various factors likely to fuel volume growth of PXIL in existing products and shift in trade from bilateral contracts to Power Exchanges include provisions of transparent platform, improved visibility, addition of long term products, Power Exchange getting same preference in scheduling along with other mechanisms, tightening of frequency bands making UI unattractive, lower price discoveries compared to bilateral, improved liquidity, increased open access and synchronization of Southern grid with new grid.

(b) Ensure Maximum Participation of the Utilities: The Petitioner will work closely with participating utilities to emphasize the need to participate equally on both Exchanges and help them optimize their portfolios. Also help them balance the portfolio between Day Ahead and Weekly contracts to ensure the availability/dispatch of power. The Petitioner has been the pioneer in introducing the direct membership to utilities. To support utilities Petitioner is appointing the advisors.

(c) Increased Open Access (OA) participation: In the States where OA is already a reality, the Petitioner intends to widen its OA customer base through concerted efforts like focused workshops, appointing advisory members, opening regional offices for coordination and improved client service, training programs on trading, improve visibility by participating in forums as speakers/ sponsors and promotional campaign.

- (d) Optimizing the reach: With the objective of optimizing the geographical coverage, the front end business development (BD) team structure has been revised. Market is gradually turning retail and, therefore, the Exchange has revised its BD team structure, size and responsibility matrix and is recruiting more personnel.
- (e) Product Development: Renewable Energy Certificates (REC) was developed and launched. The Petitioner is awaiting approval of its new products viz Intra Day and Any Day. Introduction of new products will give further fillip to the projected figures.
- (f) Capacity building and utilities specific training: PXIL conducts several training programs for power sector professionals in association with leading academic institutes. It is also providing training at utilities specific level. It was awarded a mandate from the Bureau of Energy Efficiency for rendering end to end advisory services on implementation of perform, achieve and trade (PAT) mechanism under national plan on climate change. It has received financial grant from Centre for Clean Air Policy and is conducting capacity building programs under PAT mechanism.
- (g) Progress in Revenues & Turnover: In terms of revenue from training and consulting activities, Petitioner has been making steady and healthy progress since the conceptualization of the idea in FY 2009-10. The petitioner has enclosed the key highlights of its historical performance since its operation.

- (h) Human Resources: From an employee base of 20 in 2008-09, the Exchange has grown to 45 as on 31st March 2011. In the next couple of years the employee base is likely to grow significantly. The Exchange has filled up some key senior management positions and is recruiting personnel from leading management institutes.
- (i) Economy in Operations: The expenses have been controlled and these have increased at a much lower pace as compared to revenues. The petitioner has submitted the data in support of the same.
- (j) Infusion of funds and raising Equity and Networth: The petitioner has been working rigorously on raising equity from existing as well as potential investors. The petitioner had made an additional equity offer on preferential basis to National Stock Exchange, National Commodity & Derivatives Exchange Ltd and to Power Finance Corporation Ltd. The Exchange has taken several steps that has been mentioned in para 3(A) (a) earlier. The promoters and existing shareholders have full confidence in PXIL growth story and they are supporting the management in crossing the Breakeven point. PXIL had appointed a professional advisor to bring in strategic and/ or financial investors. PXIL had been in talk with several investors through the professional advisors. PXIL initiated discussions with private equity players and is in advance stage on equity placement issue. PXIL management is confident that it will be able to garner substantial sum by the way of issuance equity shares at a premium to strategic/ financial investors in the next few quarters.

(k) Growth in Membership & Client base, Leveraging IT: The total number of members (including clients) stood at 206 as on 31.3.2011 compared to 48 last year and is projected to grow significantly by end of FY 2011-12. The membership fee will significantly grow due to this. IT infrastructure has also been strengthened to ensure quality response in meeting regulatory requirements and increased flexibility for bidding.

(l) The Petitioner has also annexed documents from prospective investors along with the supplement to Business plan.

7. The Commission in its order dated 1.8.2011 observed that in the absence of Breakeven Analysis (Targeted Revenue/ Transaction Volume) required to cover its fixed and variable costs, it would be difficult to comprehensively assess the sustained viability of the Exchange and directed the Petitioner to submit Breakeven Analysis and the time period required for achieving this breakeven point.

8. The Petitioner has submitted in its affidavit dated 16.8.2011 the projected income statement of the exchange with expected revenue, expense and PBT which indicates that breakeven shall happen in first quarter of FY 2012-13 taking into account various assumptions of growth and regulatory interventions. In the worst scenario, the breakeven could be delayed to end of FY 2012- 13. Summary of the affidavit is given below:

a) Petitioner has submitted projected income statement for FY 2010-11, FY 2011-12 & FY 2012-13 with budgeted volumes, revenues (trade/ non-trade),

expenses (operating expenses/ depreciation) & final PBT figures. In this projection, Petitioner has assumed that the overall Exchange market size will grow exponentially in the next two years and Electricity Derivatives would become operational towards the end of FY 2012-13. Based on this scenario the Petitioner is expected to achieve Breakeven in the first quarter of FY 2012-13. The above projections are largely dependent upon the pace of growth in the short term market in general and volumes on Exchanges in particular. Further, the projections would be influenced by the regulatory interventions which reflect the volume on Exchanges, interalia on the following factors:

- i. Frequency control to international standards
- ii. Introduction of new short term deliverable contracts on the Exchange, harmony between demand and supply of electricity
- iii. Regulatory prescriptions which promote market driven pricing and increased volume on Exchanges
- iv. Adequacy of transmission corridors to deliver power through Exchanges
- v. Development of effective power markets by Hon'ble commission as envisaged in Electricity Act 2003
- vi. Realization of NEP objectives to make electricity available to all and prevention of power cuts
- vii. Open Access becoming a reality to widen the markets

- viii. Wiping out of cross subsidies as prescribed in EA-2003
- ix. Conversion of Electricity deficit market into an electricity surplus market to promote competitive market

b) The petitioner has submitted another scenario in which it is expected to Breakeven in the second or third quarter of FY 2012-13. This is based on a situation where it is presumed that volumes at PXIL will be constrained in the FY 2011-12 but grow during FY 2012-13 due to market getting strength from regulatory interventions.

c) In the worst case scenario if the overall market remains sluggish and regulatory uncertainties persist over the longer tenure products, the Breakeven could be further delayed but the Petitioner would make best efforts to achieve the prescribed networth latest by the end of FY 2012-13.

d) Projected budgets for the FY 2011-12 and FY 2012-13 submitted by the Petitioner had been duly approved by the Board of Directors of the Petitioner.

9. We have perused and analysed the business plan and the projected income statement submitted by the petitioner. We note that on the financial side, the petitioner has been able to infuse capital from the existing shareholders. On the operational front, the petitioner has put in place a multi pronged strategy to improve its performance and profitability. The Board of Directors of the petitioner's company is also fully backing the senior management of the company to achieve this goal. However, we note with concern

that the company is still making loss, which is eroding its network. As per the revenue projections, substantial improvement is required in the performance of the exchange to arrest the network erosion and achieve breakeven.

10. In view of the practice adopted by the power exchange in regard to risk management by collecting 100 % margin from buyers before accepting their bids in Day Ahead and REC auctions and the fact that physical deliveries by sellers are deemed deliveries in day ahead market and sellers are allowed to bid only on possession of REC, the possibility of default by participants does not arise in a normal scenario. As a second line of defense, the exchange is maintaining a Settlement Guarantee Fund to address any contingency scenario. The Risk Management Committee and the Settlement Guarantee Fund Committee constituted in compliance with the Power Market Regulations meet regularly to review these processes and their reports are being submitted to the Commission.

11. In light of these risk mitigation mechanisms put in place by the petitioner, we direct the petitioner to make sustained efforts to achieve the required network in compliance with the prudential norms on minimum net worth as early as possible but not later than 31.3.2013 as prayed for by the petitioner. The Commission intends to conduct performance review of the petitioner regularly in respect of its efforts to enhance its network. Accordingly, we direct the petitioner to submit its budgeted revenue/cost versus the actual revenue/cost figures with the detailed analysis for a

performance review every six months commencing from the half year that ended on 30th September 2011.

12. This petition is disposed of in terms of the above directions.

Sd/-
(M.Deena Dayalan)
Member

Sd/-
(V.S.Verma)
Member

Sd/-
(S.Jayaraman)
Member

Sd/-
(Dr. Pramod Deo)
Chairperson