

**CENTRAL ELECTRICITY REGULATORY COMMISSION
NEW DELHI**

**Draft Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant
of trading licence and other related matters) Regulations, 2019**

Explanatory Memorandum

1. Background

- 1.1 The Central Electricity Regulatory Commission (hereafter referred to as “the Commission”) notified the Procedure, Terms and Conditions for grant of trading licence and other related matters Regulations, 2009 in February 2009 which were thereafter amended via Amendments dated 02.06.2009, 23.10.2009, 07.06.2010, 11.10.2012, and 03.09.2013.
- 1.2 The Commission notified the Central Electricity Regulatory Commission (Fixation of Trading Margin) Regulations, 2010 in January 2010 for fixation of trading margin for inter-State trading in electricity. These regulations applied to the short term buy-short term sell contracts for the inter-State trading in electricity undertaken by a trading licensee.
- 1.3 A number of developments have taken place in the Indian power sector since 2009. New energy procurement and sale contracts like the day ahead contracts through Power Exchanges and short-term contracts through DEEP portal now form significant portion of the trading volumes. Cross border trade of electricity between India and its neighbouring countries are expected to increase in the coming years.
- 1.4 The Commission conducted several rounds of discussions with stakeholders including traders and power exchanges for seeking comments / suggestions / observations on the Procedure, Terms and Conditions for grant of trading licence and other related matters Regulations, 2009 and Fixation of Trading Margin Regulations, 2010.
- 1.5 Several issues including non-compliance of capital adequacy requirements, non-establishment of payment security mechanisms and non-submission of monthly information by select trading licensees have been brought to the notice of the Commission.

- 1.6 In this backdrop, the Commission proposes to notify the Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading licence and other related matters) Regulations, 2019 (short as "Draft Regulations") which shall supersede the Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading license and other related matters) Regulations, 2009 and Central Electricity Regulatory Commission (Fixation of Trading Margin) Regulations, 2010 as amended from time to time.
- 1.7 The Draft Regulations have been framed with the objective to specify the terms and conditions for grant of trading licence and other related matters including but not limited to capital adequacy and liquidity requirements for the applicants and existing trading licensee, obligations of the trading licensees, requirements for submission of information, penalties for contravention and non-compliance by the trading licensees and specifying the trading margin that shall be charged by the trading licensees for different types of contracts.
- 1.8 The Draft Regulations would be applicable to both prospective and existing trading licensees.
- 1.9 The salient features of the Draft Regulations are deliberated in the Section 2 below.

2. Salient Features of the Draft Regulations

2.1. Capital Adequacy and Liquidity Requirements

2.1.1. Over the past 10 years the overall volume of electricity traded has increased significantly to around 130 BUs of which around 81% is transacted by Category I trading licensees. Hence, Volume transacted by Category I trading licensees has also increased manifolds. In 2009, the net worth criteria of Rs. 50 Crore appeared sufficient to cover the risks assumed by Category I trading licensees at that time. However, as the Indian power sector has evolved in terms of size and nature of contracts, it is necessary to review the capital adequacy requirements of the trading licensees.

2.1.2. Further, as per risk mitigation norms followed by the similar markets globally, it has been observed that the net worth of trading licensees should be commensurate to the volume of electricity and nature of contracts traded by each category of trader.

2.1.3. The Commission carried upon an assessment of risk based on average volume traded daily by trading licensees, possibility of default across different segments of trade and weighted average price and arrived at the net worth requirements commensurate to the risks assumed by the trading licensees in the current market scenario.

2.1.4. The following Capital Adequacy and Liquidity Requirements have been proposed in the Draft Regulations 3 (3):

S. No.	Category of the trading licence	Minimum Net Worth (Rs. In crore)	Volume of electricity proposed to be traded in a financial year
1.	Category I	75.00	Above 5,000 MUs and upto 10,000 MUs
2.	Category II	35.00	Not more than 5,000 MUs
3.	Category III	20.00	Not more than 3,000 MUs
4.	Category IV	10.00	Not more than 1,500 MUs
5.	Category V	2.00	Not more than 500 MUs

2.1.5. In order to mitigate the risk assumed by Category I trading licensee, an additional net worth of Rs. 20 Crores would be required by Category I trading licensee for every 3000 MUs of electricity traded over and above 10,000 MUs during a financial year.

2.1.6. Further, the trading licensee shall ensure a minimum Current Ratio of 1:1 and a minimum Liquidity Ratio of 1:1 at all times. The Net Worth, Current Ratio and Liquidity Ratio specified in this regulation shall be computed on the basis of the audited special balance sheet prepared in accordance with the financial reporting framework prescribed under the Companies Act, 2013.

2.1.7. For the calculating the net worth requirement, following transactions traded by an existing trading licensee or proposed to be traded by an applicant in a financial year shall be included in the volume of electricity:

- Long term transactions
- Medium term transactions

- Short term transactions
- Transactions through power exchanges
- Cross Border Trade of electricity

2.2. Trading Margin

2.2.1. Trading Margin Slabs

2.2.1.1. The Commission had notified the trading margin regulation vide Central Electricity Regulatory Commission (Fixation of Trading Margin) Regulations, 2010 in exercise of powers conferred under Section 178 of the Electricity Act, 2003. The relevant clause for trading margin is as follows:

“4. Trading Margin: The licensee shall not charge trading margin exceeding seven (7.0) paise/kWh in case the sale price is exceeding Rupees three (3.0)/kWh and four (4.0) paise/kWh where the sale price is less than or equal to Rupees three (3.0)/kWh. This margin shall include all charges, except the charges for scheduled energy, open access and transmission losses. The trading margin shall be charged on the scheduled quantity of electricity.

Provided that trading margin specified under these regulations shall be the cumulative value of the trading margin charged by all the traders involved in the chain of transactions between the generator and the ultimate buyer, that is to say, trading margin in case of multiple trader-to-trader transactions shall not exceed the ceiling trading margin specified under these regulations.

Explanation: The charges for the open access include the transmission charge, operating charge and the application fee.”

2.2.1.2. In the aforementioned regulation the Commission had specified two slabs of trading margin based on the sale price. It has been brought to the notice of the Commission that prices of short term transactions have been predominantly discovered above Rs 3/ kWh as evident from the table below.

Financial Year	Indian Energy Exchange Market Clearing Price (Unconstrained) (INR / MWh) ¹
2008 - 2009	7294.42
2009 - 2010	5187.29
2010 - 2011	3564.82

¹ Source: <https://www.iewindia.com/marketdata/areaprice.aspx>; Yearly prices are simple average of non-zero prices in (No of days in an year*24*4) no of 15 minutes time block of respective year.

Financial Year	Indian Energy Exchange Market Clearing Price (Unconstrained) (INR / MWh) ¹
2011 - 2012	3536.32
2012 - 2013	3487.47
2013 - 2014	2801.89
2014 - 2015	3511.3
2015 - 2016	2731.93
2016 - 2017	2414.4
2017 - 2018	3255.55
2018 - 2019	3858.57

2.2.1.3. It has further been submitted by the stakeholders that owing to various macro-economic factors, the short term power prices are expected to increase in medium to long term horizon. Thus the slabs in trading margin for short term contracts should be reviewed.

2.2.1.4. In order to align the trading margin with the current power prices and allow increased participation in the market, the Draft Regulation proposes to remove the slab in the trading margin for short term contracts and contracts through power exchanges. The following regulation is proposed:

“For short term contracts and contracts through power exchanges, the Trading Licensee shall charge a minimum trading margin of zero (0.0) paise/kWh and a maximum trading margin of seven (7.0) paise/kWh”.

2.2.2. Trading Margin in Long Term Contracts

2.2.2.1. Clause 7 of the Statement of Reasons to the CERC (Fixation of Trading Margin) Regulations 2010 provides for no capping on trading margin of long term contracts. Relevant extract is below:

“7. The Commission is cognizant of the fact that the traders are providing different types of products by entering into contracts on long-term, medium-term and short-term basis. The risk profile of each of these contracts is different. Accordingly, the Commission is of the view that where traders enter into long term power purchase agreements of duration exceeding a year, the risks cannot be completely mitigated through a trading margin. Also, since the long term power procurement market is witnessing competitive forces at work, the Commission feels that the determination of an appropriate trading margin be best left to the market forces”

- 2.2.2.2.** While adopting the aforementioned view, the Commission was of the opinion that the trading licensees would be required to be compensated for default risk, late payment risk, contract dishonour risk, O&M expenses and return on net worth. Since at that time the long term contracts by independent power producers were in nascent stages, enough evidence was not available to quantify the risks and hence the trading margin was left to be determined to the market forces.
- 2.2.2.3.** Over the past 10 years, several PPAs of traders and independent power producers (sellers) with a back to back PPA with a buyer/ procurer have been operationalized.
- 2.2.2.4.** Based on the submission of various stakeholders, it is evident that while the seller (generator) has fulfilled all the obligations stipulated in the PPA, the trading licensee has not performed key functions for which the trading licensee is charging the trading margin.
- 2.2.2.5.** The trading margin was left uncapped only for the reason so that the traders charge a suitable margin to insulate the sellers from all types of risks. However, in actual operations, traders have passed on all risks on back to back basis while charging a significant trading margin. There are instances of contract dishonour, where buyer Discoms have reneged contracts and Power Sale Agreements (PSAs) have not been operationalized by them, leaving sellers in a quandary. However, traders did not step into the shoes of the seller and have not off-taken power from such sellers who were constrained to sell on the spot market at a loss. Default risk and late payment risks has also not subsumed by traders as all liabilities are back to back, and payment is made by trader to seller upon receipt of funds from the buyer Discoms.
- 2.2.2.6.** The Draft Regulation proposes that the trading licensee shall ensure payment of dues upon the agreed due date to the seller through an escrow arrangement or irrevocable, unconditional and revolving letter of credit in favour of seller.

For long term contracts, where an escrow arrangement or irrevocable, unconditional and revolving letter of credit is not provided by trading licensee in favour of seller, then the trading licensee shall not charge any trading margin exceeding one (1.0) paise/kWh.

2.2.2.7. As per the Electricity Act 2003, trading is defined as purchase of electricity for resale thereof. In back to back arrangements, there is no ownership or obligation with the trader as is expected of such traders in terms of the definition of trading, such an arrangement is mere facilitation of transactions without any credit risks and accordingly shall not charge any trading margin exceeding one (1.0) paise/kWh.

2.3. Obligations of the Trading Licensee

2.3.1. Sale of same power to different entity / Diversion of power

2.3.1.1. It has been brought to the notice of the Commission that select trading licensees are engaging in diversion of power from existing short, medium and long term contracts during select hours of the day and in select seasons when power prices are relatively higher in day ahead market. The trading licensees declare a lower 'Declared Capacity' to the buyers /procurers during select hours and sell the same power on the day ahead market. This leads to direct commercial loss to buyers who have to purchase power from alternate sources at relatively higher prices.

2.3.1.2. The Draft Regulation proposes to prevent trading licensees to divert power already committed to a buyer without the prior consent of the buyer. The following regulation has been proposed:

“In the event Trading Licensee has entered into a contract for sale of power with a buying entity for a particular period, then the Trading Licensee shall not enter into any contract for sale of same power with any other entity for such period except with the prior consent of the buying entity.”

2.3.2. Payment security mechanism

2.3.2.1. Procedure, Terms and Conditions for grant of trading licence and other related matters Regulations, 2009 CHAPTER-IV regulation 7 Obligations of the Licensee (h) clearly stipulates that the trader shall ensure timely payment of dues to seller through letter of credit. Relevant extract is below:

“(h) The licensee shall carry out trading in accordance with the agreed terms and conditions, and may take such safeguards as he may consider necessary with regard to payment security mechanism from the buyers, but shall **always ensure timely payment of dues to the seller** for purchase of the agreed quantum of electricity either **through a letter of credit** or any other appropriate instrument or as may be mutually agreed between the seller and the licensee.” **(Emphasis supplied)**

However, it has been brought to the notice of the Commission that on several occasions the trading licensees have not opened letter of credit or escrow in favour of the sellers.

2.3.2.2. For short term contracts, the Draft Regulations proposes that the trading licensee shall ensure payment of dues upon the agreed due date to the seller through an escrow arrangement or irrevocable, unconditional and revolving letter of credit in favour of seller equivalent to one point zero five (1.05) times of contract value. However, in an event such payment security mechanism is not provided by the trading licensee, he shall not charge any trading margin exceeding one (1.0) paise/kWh .

2.3.2.3. For long term contracts, the Draft Regulation proposes that the trading licensee shall ensure payment of dues upon the agreed due date to the seller through an escrow arrangement or irrevocable, unconditional and revolving letter of credit in favour of seller. The revolving letter of credit shall be equivalent to two point one (2.1) times the average monthly bill amount and shall have a validity of 1 year. The average monthly bill shall be the estimated average of monthly billing amounts for three months or actual monthly billing amount for preceding three months as the case may be.

2.3.3. Banking of electricity

2.3.3.1. Clause 12 of the Statement of Reasons to the CERC (Fixation of Trading Margin) Regulations 2010 provides that banking of electricity would not fall under the purview of the trading of electricity as no re-sale is involved. Relevant part is extracted below:

“12.

We also make it clear that in the light of the definition of trading in the Act as “purchase of electricity for re-sale thereof”, swapping/banking of electricity would not fall under the purview of the trading of electricity as no re-sale is involved. As such, these transactions are out of the purview of these regulations” (Emphasis supplied)

2.3.3.2. Pursuant to the above, the Draft Regulations proposes to disallow trading licensees to engage in Banking of electricity.

2.3.3.3. It is further established that Banking of electricity shall mean and include exchange of electricity for electricity between two grid connected entities directly on mutually agreed terms.

2.4. Procedures for compliance, upgradation and downgradation of licence

2.4.1. Upgradation of licence: As soon as the trading licensee expects the trading volume may exceed the trading volume limit specified for the trading licensee’s existing category, the trading licensee shall file a petition to the Commission for upgradation of its licence to a higher category. The trading licensee shall be required to submit the audited special balance sheet to validate compliance of Net Worth requirement for higher category.

Illustrative:

Sno.	Existing Category of trading licensee	Cumulative Volume Traded from 1 st April of a financial year till close of any month of same financial year	Implication - Apply for Category upgradation immediately
1.	II	>5000 MUs	Apply for Category I licence

Sno.	Existing Category of trading licensee	Cumulative Volume Traded from 1 st April of a financial year till close of any month of same financial year	Implication - Apply for Category upgradation immediately
2.	III	>3000 MUs	Apply for Category II licence
3.	IV	>1500 MUs	Apply for Category III licence
4.	V	>500 MUs	Apply for Category IV licence

Trading Licensee shall pay license fee applicable to the higher category licence if in a particular year the licence has been upgraded.

The trading licensee would not be allowed to exceed at any point of time 110 percent of the volume of trading authorized during a year under the licence granted to him.

2.4.2. Downgradation of licence: The trading licensee may file an application to the Commission for downgradation of its Licence to a lower category at any time. The trading licensee shall be required to upload the audited special balance sheet for demonstrating compliance of Net Worth requirement for the lower category. The Commission after reviewing the application may allow the downgradation of the licence to a lower category. However, the trading licensee shall not be allowed to apply for upgradation of Licence within the same financial year.

2.4.3. Compliance of Net worth criteria for Category I Licensee

Category I Licensee shall be required to estimate the trading volume in a particular year. In case the Net worth of the Licensee is not sufficient as per the Regulation 3 to transact the estimated trading volume, the Licensee would be required to enhance the Net worth prior to transacting such volumes. For example, a Category I Licensee has already transacted a trading volume of 9000 MUs and has a Net worth of Rs. 75 Cr in a particular year. In case the trading licensee expects to trade total 12,000 MUs in the same year, then the licensee would be required to have a Net worth of Rs. 95 Cr before transacting trading volume beyond 10,000 MUs.

3. Repeal

The word ‘Amendment’ as per definition means *“The correction of an error committed in any process, pleading, or proceeding at law, or in equity, and which is done either of course, or by the consent of parties, or upon motion to the court in which the proceeding is pending. Any writing made or proposed as an improvement of some principal writing”* or to ‘make better’ existing provisions. In the present case, the Commission observes that there is a need towards alignment of the existing Regulations with the current power market of India. The commission is of the view that such proposed modifications, being of substantial manner, in a way also alters the structure of the present law, rather than aid in improvement of the same. Hence, the present modifications do not fall under the scope of amendment and therefore a repeal is being proposed. Therefore, in view of the above, it is proposed that the existing Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading license and other related matters) Regulations, 2009 and Central Electricity Regulatory Commission (Fixation of Trading Margin) Regulations, 2010 be repealed and replaced by the present Draft Regulations.