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To
The Secretary
Sanoj Kumar Jha
Central Electricity Regulatory Commission
Chanderlok Building,36
Janpath
New Delhi-110001

Sub: Comments on draft Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading licence and other related matters) Regulations, 2019

Respected Sir,

This has reference to the Draft Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading license and other related matters) Regulations, 2019 and its Explanatory Memorandum dated 24th July, 2019.

In this regard, we hereby submit our Comments/Suggestions/objections on the subject mentioned draft regulations:-

The key issues relate to the process adopted by Central Electricity Regulatory Commission (CERC), provisions for development of power market including trading, Banking, financial & commercial impact on the electricity trading as well as on the trading licensee. In this context, first of all, we would like to highlight the few statutory provisions, section/para of the Electricity Act 2003 (Act), Policy, Regulations of CERC which are given below for ready reference, which relate to functional responsibility of the electricity Regulators, particularly the CERC, in development of competitive electricity industry/ market and key role of the Trading Licensee.

Statutory Provisions

1. **The preamble of Electricity Act 2003(Act)** envisages that: -

"An Act to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalization of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies, constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto".

The Section 66 of the Act (Development of Market) envisages that:-

"The Appropriate Commission shall endeavor to promote the development of a market (including trading) in power in such manner as may be specified and shall be guided by the National Electricity Policy referred to in section 3 in this regard."

The Section 79. (Functions of Central Commission) in the Act inter-alia include the following:-

*“(1) The Central Commission shall discharge the following functions, namely:-
(e) to issue licenses to persons to function as transmission licensee and electricity trader with respect to their inter-State operations; to fix the trading margin in the inter-State trading of electricity, if considered, necessary;
(2) The Central Commission shall **ensure transparency** while exercising its powers and discharging its functions.”*

The Section 178. (Powers of Central Commission to make regulations) in the Act inter-alia include the following:-

“(1) The Central Commission may, by notification make regulations consistent with this Act and the rules generally to carry out the provisions of this Act.

(2) In particular and without prejudice to the generality of the power contained in sub-section (1), such regulations may provide for all or any of following matters, namely:-

*(y) the manner by which development of market in power **including trading** specified under section 66;”*

The Section 5.7 COMPETITION AIMED AT CONSUMER BENEFITS as notified in the National Electricity Policy:-

“5.7.1 To promote market development, a part of new generating capacities, say 15% may be sold outside long-term PPAs . As the power markets develop, it would be feasible to finance projects with competitive generation costs outside the long-term power purchase agreement framework. In the coming years, a significant portion of the installed capacity of new generating stations could participate in competitive power markets. This will increase the depth of the power markets and provide alternatives for both generators and licensees/consumers and in long run would lead to reduction in tariff. For achieving this, the policy underscores the following:-

- a. It is the function of the Central Electricity Regulatory Commission to **issue license for inter state trading which would include authorization for trading throughout the country.***
- b. Development of power market would need to be undertaken by the Appropriate Commission **in consultation with all concerned.**”*

Process adopted by Hon'ble Commission

2. The Clause 1.4 of the Explanatory Memorandum of the subject mentioned proposed draft of the Commission states that :-

“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 license and other related matters Regulations, 2009 and Fixation of Trading Margin Regulations, 2010.”

As per CERC Market monitoring report published by the Commission, in terms of volume, we are one of the leading trading licensees, even though we have not received any communication from the Commission on the said matter and have not been considered a stakeholder for involving in discussion process prior to issue of the above draft regulations. In this context, the clause 3 of Section 79 of the Act may also be referred, which states that:-

“The Central Commission shall ensure transparency while exercising its powers and discharging its functions”.

Moreover, the **Section 18 (Amendment of licence) of the Act**, states that:-

“Provided that no such alterations or amendments shall be made except with the consent of the licensee unless such consent has, in the opinion of the Appropriate Commission, been unreasonably withheld.”

It is felt that the process adopted by Hon’ble Commission is not in line with the spirit of the statutory provisions of the Act.

Broad Observations

3. Our broad observations on the proposed Draft of the Commission are shortlisted as under (elaborated in foregoing paras):

- In Chapter I, Definition of ‘Banking of Electricity’ is purposely made subjective;
- Restricting Trading Licensee to engage in Banking of electricity is prejudice in both ways, whether it covers under Electricity Act 2003 or otherwise.
- Distribution Licensees are made more unsecured by depriving them to seek the professional guidance of the licensed entities in facilitating in managing their power portfolio more efficiently and optimally.
- Interest of non-regulated entities have been fully protected over the regulated entities;
- Power Exchanges whose existence is not defined in the Act have been given high priority returns on comparatively less investment and risks. Financial cost on transaction has been increased causing extra loading on the ultimate electricity consumers.
- Changes proposed in defining the long term and the medium term contracts are not market friendly;
- All financial burden has been loaded on the Trading Licensee by making mandatory very high valued and unreasonable payment security mechanism, and in addition the stringent criteria proposed for the maintenance of net worth;
- Trading Margin proposed under various categories are not professionally designed and justified to take care of heavy expenses arising on account of maintaining net worth , O&M and various Risks including relating to payment security;
- The trading Licensees, those are regulated entities, have not been provided any protection to mitigate the financial risks from both the buyer and seller, mostly of them are non-regulated entities.

Banking of Electricity

4. In Chapter I of the proposed Regulations, Definition of ‘Banking of Electricity’, the word ‘**directly**’ appears to be erroneously inserted and thereby distorting the definition of Banking. It also leads to unnecessary limiting the role of large number of licensed market players in trading of electricity as envisaged in the Act. It is requested to remove the word ‘directly’ from the Definition.

5. **Banking of Electricity by Trading Licensee:** In the proposed draft regulations, stated that “Trading Licensee shall not engage in Banking of Electricity” is not understandable. The Act allows trading Licensee to trade Power between seller and the buyer. In large prospective drawing Power from one entity for supplying to the other entity under banking arrangement is also a form of Sale/Purchase arrangement, as the Power supplied by the first entity is protected with compensation clause which covers more than the cost of the energy supplied. Viz a viz if the second entity fails to return the Power it becomes liable to pay its cost plus through compensation clause.

Further, as per Statement of Objects and Reasons, of **Power Market Regulation clause 7.9** published by CERC states that :-

“It is expected that Electricity Traders will innovate and as markets mature introduce in future new types of products in the market like tolling agreement, banking agreement, capacity contracts, and spread contracts as standard back to back type of deals move to Exchanges”

As such, it is not logical and justified to exclude the Banking of Electricity from the scope of trading licensee in the proposed Regulations.

The concept of Banking/Swapping managed by trading licensee is an age old practice **whether in physical form or financial**. In the present context, the Energy Banking is also a process of procurement of power for optimum utilization of DISCOM resources, especially under the condition when DISCOM have no funds for short term/ day ahead/intra -day purchase of power when they badly need power to minimise power cuts and giving better services to its consumers. In practice, when DISCOM have surplus power, if sold, the funds received from sale of surplus power are usually utilized in other heads as such DISCOM always run under cash deficit when they have to purchase power. To overcome the situation, Banking of power is the most effective solution being cashless procurement and Trading Licensee’s role who have Pan India establishment and expert resources, is a vital for DISCOM to implement most economical and trouble free implementation of this mode of procurement of power.

Moreover, Commission themselves have laid onus on the trading licensee to innovate the new products like tolling agreement, banking agreement, capacity contracts and spread contracts to develop the Electricity market which the trading licensees have very well been doing since long by innovating new electricity market products, deploying technology, experienced experts and resources Pan India.

The Power Market players are well aware that the Trading Licensees are playing a key role in the development of the power market and have developed the various customized banking solutions for Utilities. The Trading licensee are facilitating the Utilities in optimizing their power portfolio by replacing energy through energy under – Intra Day, Day Ahead and/or contingency banking. This is helping the utilities:

- In managing their power portfolio by opting energy to energy transaction (banking) instead of sale-purchase through power exchanges – that too at much low margin.
- Maintaining the Grid Discipline by managing their surplus and deficit power even under contingency conditions through innovative arrangements made by trading licensees.

Interestingly, most of all Trading Licensees have been engaging in Banking of electricity since last 12 years in all States throughout the country, which all the time remained in cognizance of Commission. On the contrary now stating that Banking of Electricity is out of purview of the Trading Licensee is

very surprising, and insertion of clause (24) of regulation 9 of the draft regulations, "Trading Licensee shall not engage in Banking of Electricity", has no justification and legality.

In view of above, it is requested to remove Clause (24) of regulation 9 of draft regulations. Even otherwise, if it is established that Banking is not a part of sale/purchase business and thereby do not come under the purview of trading, then various proviso of the proposed Regulations for Grant of Trading Licence shall be limited to only sale-purchase activities, and banking chapter should not find place in the regulations. In that case, any company, including trading Licensee, registered under Companies Act is free to engage in any business other than as stipulated in these regulations and the Commission has no jurisdiction to restrict Trading Licensee, not to engage in a particular business not in the purview of the proposed Regulations.

Moreover, **Section 17 of the Act** regarding Licensee not to do certain things is reproduced below. **It may be seen that the Act also does not debar the licensee from Banking of power.**

"Section 17. (Licensee not to do certain things): ---

(1) No licensee shall, without prior approval of the Appropriate Commission, -

(a) undertake any transaction to acquire by purchase or takeover or otherwise, the utility of any other licensee; or

(b) merge his utility with the utility of any other licensee:

Provided that nothing contained in this sub-section shall apply if the utility of the licensee is situate in a State other than the State in which the utility referred to in clause (a) or clause (b) is situate.

(2) Every licensee shall, before obtaining the approval under sub-section (1), give not less than one month's notice to every other licensee who transmits or distributes, electricity in the area of such licensee who applies for such approval.

(3) No licensee shall at any time assign his licence or transfer his utility, or any part thereof, by sale, lease, exchange or otherwise without the prior approval of the Appropriate Commission.

(4) Any agreement, relating to any transaction specified in sub-section (1) or sub-section (3), unless made with the prior approval of the Appropriate Commission, shall be void."

6. Functioning of Power Exchanges:

The Section 14 (Grant of Licence) of The Act cover the following for grant of Licence which include the electricity trader (but not the Power Exchanges).

"Section 14. (Grant of licence): The Appropriate Commission may, on an application made to it under section 15, grant a licence to any person –

(a) to transmit electricity as a transmission licensee; or

(b) to distribute electricity as a distribution licensee; or

(c) to undertake trading in electricity as an electricity trader, "

We understand that the Commission notified the Central Electricity Regulatory Commission (Power Market) Regulations, 2010 in exercise of powers conferred under Section 66 the Act which came into effect from 21.1.2010. The section 66 of the Act envisages the development of market (including Trading) in power.

It is not clear under which proviso of the Act, power exchanges were established. The exchanges are neither in the business of Transmission, nor in Distribution and nor in Trading of electricity.

CERC in the statement of reasons vide order dated 03.04.2014 stated that :-

“All existing power exchanges which were in operation as on 21.1.2010 were deemed to have been registered under the Power Market Regulations. Two Power Exchanges namely, Indian Power Exchange Limited and Power Exchange of India Limited, are functioning at present under the regulatory oversight of the Commission. These Power Exchanges are being operated by companies registered under the Companies Act, 1956. A company's Board of Directors play an important role in the company's corporate governance. Therefore, a company's Board of Directors should consist of persons with financial integrity and probity in public life. This requirement is all the more important in case of market infrastructure institutions like the Power Exchanges. Though Power Market Regulations contain provisions for appointment of Independent Directors, they are silent regarding the appointment of Directors in the Board of the Exchange and their qualifications/disqualifications.”

Currently power market is being developed by the traders (licensees) through innovative models/products. The Exchange is simply discovering the market clearing price through their software. The participation in the Exchange (Non-licensee) apart from few other entities directly, is by traders (Licensee) who facilitate in promoting the market by aggregating the Generators, OA customers (Buyers & Sellers), Utilities (Licensee). Further the process of scheduling and dispatch etc. is completely managed by independent apex organisation of MoP i.e. NLDC, POSOCO. As such, NLDC can very well discover Maximum Clearing Price (MCP) wherein the various market players can place their bids directly. This process apart from being economical, is being adopted and managed by the System Operators in USA (PJM Market) who have federal system like in India.

7. We understand that two Exchanges are deemed to be registered by CERC under power market Regulations, although there is no provision given in Electricity Act 2003 for Exchanges. In spite of this, Exchanges are charging trading margin @ 4 Paisa per unit and behave like a Trading Licensee, accordingly making a huge profit with no financial risk.
8. Since Exchange were developed by Regulatory Commission for better market development and in their transaction no financial risk involved, so in this protected atmosphere, CERC should not allow any trading margin for Exchanges and for recovery of their cost, Exchanges have to submit their Average Revenue Requirement (ARR) on yearly basis allowing them a fixed return as in the case of other utilities to avoid huge financial burden on regulated buying Entities (Distribution Companies).
9. **Regulated Trading Licensees made more un-secured:** As per proposed provision in the draft, the Trading Licensee shall make payment to the seller through an escrow arrangement or irrevocable, unconditional and revolving letter of credit equivalent to 2.1 times the average monthly bills for long term and 1.05 times of contract value for short term contracts. **Nothing is mentioned in the draft regarding providing similar financial protection to the Trading Licensee against non-performance of obligation to supply power by the seller, and non or delayed payment by the buyer.** The draft provision is one sided and pre-judice, as financial interest of the un-regulated entities, generators, have been taken care of; whereas the Trading Licensee who is performing under high risks from both ends have not been given financial protection. The Hon'ble Commission may recall that there are significant number of cases where the buyers have defaulted in timely payment to the Traders (Trading Licensees) , whereas Traders have to pay to the Sellers in time, and there are very few cases when Trader (Trading Licensees) delayed payment to the Seller. It is, therefore, proposed that all the three stake holders, i.e., Seller, Trader and Buyer be provided financial

protection at equal footings through the regulations, or alternatively, it may be left on them to make appropriate provisions in the PPA/ PSA/LOI as per mutual agreement between them. Moreover, provision of payment security mechanism is a part of commercial contract between the parties in the form of PPA/PSA/ LOI and as stated in the Power market regulation, "the risk in contracts executed in such market is managed between the parties themselves."

Anomaly in LT/MT contracts Provision

10. The proposed draft regulation 7 (b) states that :-

"Long term contract/medium term contracts (where period of the contract of the Trading License with both the seller and the buyer is more than one year)."

This provision may be applicable only in case of back-to-back transactions. However, in other cases, usually one side Agreement for more than one year is considered as Long term/medium term contracts. The other side contract may be more than one in number, truncated in volume or in term as per the Electricity Market requirement. Since, it carries significant amount of risk which the Trading Licensee takes, suitable modification in the Draft Notification is requested, **the word 'both' be replaced with 'either'**.

11. Commercial Impact

The Section 79 (J) of the Act states that:-

"to fix the trading margin in the inter -State trading of electricity, if considered necessary"

In the above context and in the competitive environment of electricity market, , the Trading Margin Cap should not be applicable when the power is traded to any non-Regulated entities (Commercial & Industrial consumers) that are buying power in open market.

In the year 2010, Fixation of Trading Margin Regulations was published when the Market was not competitive and that time, it was felt that some players might charge extra ordinary trading margin. But now the situation has changed and the market is fully competitive and in the current situation, the negotiated minimum values of Trading Margin are discovered.

Draft Regulation No. 3(3): 'Financial Qualifications-Capital Adequacy and Liquidity Requirements' Specify to maintain the minimum Net worth, Volume of electricity to be traded, ensure a minimum current ratio of 1:1 and a minimum Liquidity Ratio of 1:1 **at all times. However there is no basis or justification given for the same.**

Draft Regulation No. 8(1) specify the following 'Trading Margin'. But there are no supporting data/details & analysis in fixing the trading margin as well as study on the implications of imposing trading margin cap and its impact on the development of trading market.

“(c) 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:

Provided that in contracts where escrow arrangement or irrevocable, unconditional and revolving letter of credit as specified in clause 10 of regulation 9 is not provided by the Trading Licensee in favour of the seller, the Trading Licensee shall not charge any trading margin exceeding one (1.0) paise/kWh.

(d) For long term contracts and medium term contracts, the trading margin would be decided mutually between the Trading Licensee and the seller:

Provided that in contracts where escrow arrangement or irrevocable, unconditional and revolving letter of credit as specified in clause (10) of regulation 9 is not provided by the Trading Licensee in favour of seller, then the Trading Licensee shall not charge any trading margin exceeding one (1.0) paise/kWh.

(e) In case of Back to Back deals, the Trading Licensee shall charge a minimum trading margin of zero (0.0) paise/kWh and a maximum trading margin of one (1.0) paise/kWh.”

Draft Regulation No. 9(3) state that the Trading Licensee shall not exceed **at any point** of time 110 percent of the volume of trading authorized during a Year under the licence granted to him, which is 120 % in the existing Regulations. There is no basis given in reducing the upper cap in percentage of volume and that also state “ at any point of time during a year.”. This is fundamentally contradicts the statutory provision of Act for development of electricity trading in promoting the competitive volume in the power market.

Draft Regulation No. 9(10), ‘Obligations of the Trading Licensee’ Specify that:-

“The Trading Licensee shall make payment of dues upon the agreed due date to the seller for purchase of the agreed quantum of electricity through an escrow arrangement or irrevocable, unconditional and revolving letter of credit in favour of seller. Such escrow arrangement or irrevocable, unconditional and revolving letter of credit in favour of seller shall be equivalent to:

- (a) two point one (2.1) times the average monthly bill amount (estimated average of monthly billing amounts for three months or actual monthly billing amount for preceding three months as the case may be) with a validity of one year for long term contracts; (b) one point zero five (1.05) times of contract value for short term contracts.”*

Draft Regulation No. 9(11): ‘Obligations of the Trading Licensee’ also specify that:-

“(11) The Trading Licensee shall enter into an appropriate agreement for purchase and sale of electricity with the sellers and the buyers prior to scheduling a transaction, and that the agreement shall specify the following, namely-

(a).....

.....
(f) the liabilities of the parties (seller, buyer and Trading Licensee) in case the scheduled quantum (MW) and time of scheduling differs from the agreed terms, or in case of modification in schedule, and in the latter case, the party that will bear non-refundable part of short-term open access charges.”

Such provisions relating to the payment mechanism are normally part of the contract executed between the parties. As such it should not be a part of Regulations. More over, there is no study and correlation of its commercial impact on the trading margin cap given in the statement of

reason. The Commission may like to know these provisions contradict the provision made in the Power Market Regulations of the Commission.

It is suggested that In case of power traded through trader (trading licensee) by the seller, the buyer (Regulated Entity) should provide the LC directly in favour of seller, wherein the trader (trading licensee) can be third party in escrow account. This process would minimise the impact on the transacted electricity and on the trader (trading licensee). In case of non-regulated entity , there should be mutually agreed PPA/PSA as per PMR.

“Over the Counter Market – Over the Counter Market is the inter-State market where buyers and sellers directly transact or transact through an Electricity Trader, and where the price and terms of the contract are determined through negotiations as agreed between the parties or through competitive bidding process or through a Electricity Trader. The risk in contracts executed in such markets is managed between the parties themselves or by the Electricity Trader, as the case may be.”

The Commission is proposing to repeal the trading margin regulations by merging the same with the proposed Draft Regulations i.e. Grant of Trading license. The proposed regulations do not provide detailed justification to arrive at the Trading Margin cap. In the year 2009, the Commission carried out the detailed study through KPMG and provided the comprehensive analysis before fixing the Trading Margin cap.

Now in the proposed draft Regulations, there is no detailed analysis/assessment of the risks involved in power trading business and whether the return would be commensurate with the size & variety of the risks and the investment made by the trader (trading licensee) OR even the basic justification in arriving at Trading Margin cap.

In case if the CERC consider necessary to fix the trading margin, then the trader (trading licensee) must be allowed to recover the following expenses through the trading margin apart from other expenses incurred by traders in developing and deploying state of art software/technology for efficient & effective management of the electricity market portfolio in the country.

- Return on Net worth
- Operation and maintenance expenses
 - Licence Fees
 - Office Maintenance Etc.
 - Employee Cost
 - Software and Technology Development Cost
 - Bank Charges
 - Legal Expenses
 - Traveling/Boarding/Lodging Expenses
- Expenses borne to mitigate market risks
 - Default Risk
 - Late Payment Risk
 - Contract Dishonor Risk
 - Inflationary Risk

- Regulatory Risk
- Contractual risk Interpretation Risk
- Compensational Risk
- Delayed/Non-Reimbursing Open Access Charges
- Late Payment Surcharge
- Dispute due to not accepting system constraint
- Transmission charges and Losses
- Denying/Discount on late payment surcharge
- Expenses borne to mitigate operational risks
 - Price risk
 - Volume risk

In addition to above, there have been instances, where the buyers deny to pay surcharge on the late payment or asking for discount, not reimbursing OA charges, non-supply of committed power by seller, incorporating No Surcharge condition for late payment in the tender, contractual disputes, including not accepting the system constraint condition/declaration and imposing penalty on the trader.

Moreover, our observations based on experience are that the risk associated with non-regulated entity is quite high. These risks are solely captured by trading licensees and if there are payment defaults or other defaults done by the non-regulated entities then trading licensee is always at very high risk. There are several other instances of risks such as changes in state regulations, change in regulatory charges, non-availability of transmission corridor, downward revision due to curtailment, non-grant of permission by distribution licensee etc. are always a point of dispute which non-regulated entities do not understand as their awareness & expertise on the various regulatory process are limited and thereby resulting to blockage of payment by these non-regulated entities. As such at least for non-regulated entities, trading margin should not be fixed by the CERC.

In our opinion as the market has become competitive and trading margin derived from the market force is much below the trading margin fix by the commission in the existing regulations, there is no need of fixing the trading margin by the appropriate commission rather the appropriate commission should act as watch dog to aver see the market operation and interfere only when there is any case of market abuse.

Contribution by Licensees (Traders)

12. The contribution made by various stake holders including traders to meet the objectivity of the Act as well as the development of Electricity Market have been overlooked in the proposed draft regulations. The objectivity of the opening of Electricity Market and induction of traders as envisaged in the Electricity Act have to be understood and specifically contribution made by these entities in mitigating the peak and energy shortages by deploying innovative ideas and plugging/matching the surplus and the deficit power Pan India there by filling the valley of load duration curve and thereby reducing the energy loss in the respective state/DISCOM/Pan India.

13. Concluding the above, it is apprehended that if these draft notifications are accepted in to-to, the spirit and objective of the Act would be de-railed and the process of development of competitive power market in the benefit of all the stake holders and the ultimate consumers would be reversed.

We understand that the trading licence issued by the Commission till march 2019 was about 76. The licence surrendered by traders and revoked by the Commission have been more than 50 %. AS per the Commission market monitoring report, about 75 % of total volume is being traded by top five trading licensees and about 95 % of total volume is being traded by top ten trading licensees. The analysis of these figures indicates that the trading activities even under current Regulations are not sustainable by majority of the traders. Further, imposing the restrictions in the proposed Draft Regulations would totally hampered the process of development of Electricity market.

In view of the above facts, the Commission is requested not to be restrictive and take necessary steps for the development of free, fair and competitive power market as envisaged in the Act and allowing the traders to play their role freely and bringing value added product into the market for the ultimate benefits of consumers further The Commission is requested to re-look, review and modify the proposed draft Regulations to save the spirit and the objective of the various provisions made in the Act, National Electricity Policy, Regulations framed by the Commission/Authority to promote the Electricity Market and development of electricity industry and thereby creating the fair competition. The revised draft Regulations may also provide detailed justification as has been done in the past with supporting study/analysis on each aspect including commercial and financial viability of the licensee (traders).

For Kreate Energy (I) Private Limited



Authorised Signatory

Date: 12.09.2019

Place New Delhi