

No. L-7/25(5)/2003-CERC
Central Electricity Regulatory Commission
(New Delhi)

Coram :

- 1. Dr. Pramod Deo, Chairperson**
- 2. Shri Rakesh Nath, Member (E.O.)**
- 3. Shri R.Krishnamoorthy, Member**
- 4. Shri S.Jayaraman, Member**
- 5. Shri V.S.Verma, Member**

In the matter of

Review of the Central Electricity Regulatory Commission (Fixation of Trading Margin), Regulations, 2005.

STATEMENT OF REASONS

1 The Central Electricity Regulatory Commission (CERC) is empowered under section 79 (i) (j) of the Electricity Act, 2003, to fix the trading margin in the inter-State trading of electricity if considered necessary. In exercise of these powers, the Commission had fixed the trading margin for the first time in January, 2006 through the Central Electricity Regulatory Commission (Fixation of Trading Margin) Regulations, 2006. Due to dynamic changes in the power sector, notification of new regulations relating to issue of trading licence, emergence of Power exchanges, the issue of reviewing trading margin has been engaging the attention of the Commission for some time. In order to review the issue, the Commission had appointed M/s KPMG as Consultant to conduct a study on trading margin and suggest appropriate trading margin that encourages healthy trading market and protection of consumer interest.

2. On examination of the report of the Consultant, the Commission considered that the traders are required to be compensated for the following risks inherent in the trading business:

- Default risk
- Late payment risk
- Contract dishonor risk
- Inflationary risk

3. Accordingly, the Commission evolved a proposal for revision of the trading margin in the form of draft regulations and through public notice dated 12.10.2009, invited suggestions and comments on the draft regulations on Fixation of Trading Margin for inter-State trading in electricity. The suggestions and comments have been received on the draft regulations from the stakeholders listed in the Annexure. The oral hearing was held on 2.12.2009.

4. Gist of the suggestions and objections received from the stakeholders is as under:

- To specifically exclude all transactions other than short term buy-short term sell explicitly out of the purview of the proposed regulations;
- Not to fix any margin or cap for short term buy-short-term sell and allow it to be determined by the market forces based on efforts and risks taken by trade on case-to-case basis;
- Not to specify a capping on trader-to-trader transaction and let interplay of demand and supply take care of intermediary transactions margins;
- Margin, if necessary, should be at least 2 to 3 percent of sale price;
- Instead of passing on the burden of risk to all the buyers in the form increasing trading margin the Commission may penalize only those buyers who default in payment and dis-honour the contracts;
- Instead of fixing the trading margin in percentage terms on the purchase rate of power, the trading margin cap may be in absolute terms;
- Draft Regulations provide for contracts to aggregate buyers/ suppliers. This is possible only when the trading margin is computed on average basis;
- Not to increase the trading margin to avoid burden on consumers. Rather, traders could be incentivized through lower licence fee, lower capital requirement etc;
- Trading margin should be chargeable on contracted capacity rather than actual delivery of power.

5. We have given our thoughtful consideration to the suggestions/ objections. Our views thereon are detailed in the subsequent paragraphs.

6. It has been decided that the regulations would come into effect on expiry of thirty days from the date of their notification in the official Gazette so that the stakeholders get adequate time to re-align the existing contracts, if required.

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.

8. However, as regards short-term buy and short term sell contracts i.e. contracts where the duration of the power purchase agreement and power sale agreement is less than one year, we are convinced that the market prices are currently governed to a large extent by the demand-supply gap prevalent in the country. In such a scenario, there is a high likelihood of deficient utilities buying power at higher than justified rates to prevent excessive load shedding. With a view to balancing the interests of buyers as well as the traders, it has been decided to prescribe a trading margin cap.

9. While prescribing the margin cap, we take into consideration the traders' requirements of meeting expenses incurred to mitigate risks, expenses incurred towards Operations & Maintenance and return on net worth. As per the data supplied by the traders and the subsequent analysis conducted on the data, we hold that at 7 Paise/ kWh, the trader will be able to recover all the above mentioned expenses and generate requisite return on net worth. Accordingly, we direct that the trading margin cap be fixed at 7 Paise/ kWh.

10. We are also conscious of the fact that short term power prices have witnessed significant volatility over the past two years. Since variation in price of power has a direct impact on the finances of the trader, it was proposed in draft regulations to allow trading margin to be charged as a percentage of the power price rather than in absolute terms. Some of the stakeholders like NVVN. suggested that instead of fixing trading margin in percentage term on the purchase rate of power, the trading margin may be fixed in absolute terms. In this regard it is observed that in the draft regulation percentage term was proposed with the trading margin band of 4 paise at lower level and 7 paise at higher level corresponding to a price band of Rs. 3 to Rs. 5 per unit. From the experience it has been found that, many a time, the price of the electricity traded in the market goes beyond the price band of Rs. 3 to Rs. 5 and the applicability of trading margin in the percentage term as published in the draft has little relevance. In view of

this, we direct that trading margin be fixed in absolute term @ 7 paise/kWh for the transactions having sale price exceeding Rs. 3/kWh.

11. We are also not unmindful of the fact that there are times when cheap short term power becomes available for sale. In such cases the trading margin @ 7 paise/unit may not be justified as the investment requirement of the traders is comparatively less. It is in the interest of the sector that such power gets utilized. It has therefore, been decided that for cheap short term power of price less than or equal to Rs. 3/ kWh, the trading margin applicable would be an absolute quantum of Paise 4/ kWh. Needless to add that the traders are free to charge a lower margin if they so desire.

12. The stakeholders have also pointed out various power swapping or banking transactions for which a cap of 4 paise applies as per present regulations. It has been submitted that if the margin is linked to percentage, it will become difficult for the traders to do these types of transactions since the margin would be zero. We are of the view that swapping/banking transactions have been able to check the rise in rates of power and also insulate the parties from market rates fluctuations and provide energy security during period of high demand. Our decision to fix the trading margin on absolute term takes care of this concern as well. 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.

13. In principle, we are in agreement with the suggestion received from some of the stakeholders regarding not passing on the burden of risk to all the buyers in the form of increasing trading margin, but penalizing only those buyers who default in payment and dishonour the contracts. However, it is important to realize that currently there are few buyers and sellers of short term power and every trader tries to get a share of business from these buyers and sellers. Until the trading market gains depth in the form of a larger number of buyers and sellers, it would be practically difficult for the traders to set up a differential pricing regime that incentivizes/penalizes buyers depending upon the promptitude of payment and honouring contracts. We are afraid that till such time, such costs may be socialized in the market.

14. As regards the suggestion that the draft regulations provide for contracts to aggregate buyers/ suppliers which is possible only when the trading margin is computed on average basis, we are of the view that calculation of trading margin on an average

basis might lead to cross subsidization of one buyer at the cost of another buyer. In such a scenario, buyers with greater market power might be charged margins that are non compensatory for the traders while buyers with less market power might have to pay higher than justified margins. We therefore hold that margins should be charged on contract basis rather than on an average basis. However, the Commission would welcome any proposal from the traders on any robust mechanism that allows aggregation of buyers/ suppliers and at the same time eliminates the possibility of cross subsidization among buyers as discussed above.

15. It was suggested by some of the stakeholders that trading margin should be chargeable on contracted capacity rather than on actual delivery of the power. Many a times, the actual delivery of power differs from the contracted capacity resulting in reduction in trading margin for the traders. By that time, the trader would have incurred all the expenses in execution of the contract. If the contracted quantity does not flow, trader may incur huge losses. This issue needs consideration as there is a merit. However, bonafide intention of the contracting parties can be judged by the quantity of electricity scheduled. Therefore, after due consideration, it has been decided that trading margin should be applied on the scheduled quantity of electricity rather than contracted quantity or delivered quantity.

16. Selling of power from the trader to trader is not prohibited under the Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading licence and other related matters) Regulations, 2009. In such cases, there is a possibility of increase in price of the electricity traded in the market due to pan-caking. In order to avoid cascading effect of the trading margin to be charged by various traders on the same transactions, it has been decided that sum or the total of the trading margin charged by all the traders in the chain of transactions between generator and ultimate buyer i.e. to say trading in case of multiple trader to trader transactions shall not exceed the ceiling trading margin specified under these regulations.

17. We direct that the regulations published in draft form be published in the official Gazette after incorporating the changes as decided in the foregoing paragraphs of this Order.

(V.S.Verma)
Member

(S.Jayaraman)
Member

(R.Krishnamoorthy)
Member

(Rakesh Nath)
Member (E.O.)

(Dr. Pramod Deo)
Chairperson

New Delhi, dated the 11th January, 2010

Annexure

Stakeholders who have responded to the Draft CERC (Fixation of Trading Margin) Regulations 2009.

Sl. No.	Stakeholders	Address
1	Shri Kunal Kaistha	3 rd Floor, 39, Ambazari Layout, Nagpur 440010
2	Maharashtra State Electricity Distribution Company Limited (MSEDCL)	5 th Floor, Prakashgad, Plot No. G-9, Bandra, Mumbai – 400051
3	PTC India Ltd. (PTC)	2 nd Floor, NBCC Tower, Bhikaji Cama Place, New Delhi-110066
4	NTPC Vidyut Vyapar Nigam Limited (NVVN)	NTPC, 7 th Floor, Core-3, Scope Complex, 7 Institutional Area, Lodhi Road, New Delhi-110003
5	CUTS Centre for Competition, Investment & Economic Regulation (CUTS C-CIER)	D-217, Bhaskar Marg, Bani Park, Jaipur 302016
6	Tata Power Trading Company Limited (TPTCL)	Tata Power Mahalaxmi Receiving Station, Senapati Bapat Marg, Lower Parel, Mumbai-400013
7	GMR Energy Trading Ltd.	IBC-Knowledge Park, Phase-II, 9 th floor, Tower-D, 4/1, Bannerghatta Rod, Near Dairy Circle, Bangalore-560029