

CENTRAL ELECTRICITY REGULATORY COMMISSION



Explanatory Memorandum to
the Central Electricity Regulatory Commission (Procedure, Terms
and Conditions for grant of trading license and other related
matters) (First Amendment) Regulations, 2012

Introduction

A need has been felt for making amendments to the Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading license and other related matters) Regulations, 2009. This has been necessitated in the light of the following:-

- To update the regulation and make it relevant in a dynamic market condition.
- Address certain gaps and discrepancies in the regulations.
- To look at traders' risk holistically and improve risk monitoring of traders.
- To classify various possible violations of the Electricity Act 2003, regulations or orders of Commission into categories and provide for the regulatory mechanism to deal with these violations.

1. Combined Volume of Inter-State and Intra-State Transactions for Network Requirement

1.1 Prudent credit risk management necessitates capital adequacy requirement of the applicant for trading licence to be ascertained while granting licence to the trader. Since an inter-State trading licensee is also permitted to undertake intra-State trading in terms of Rule 9 of the Electricity Rules, 2005 without having to take an intra-State trading licence, it is essential to look at a traders' risk in a holistic manner. The additional credit risk to an inter-State trader emanating out of intra-State trading also needs to be covered by the capital deployed (net worth in this case) by the trader. A default in any segment of the trader's business, whether inter-State or intra-State would erode his capital base and negatively impact his risk profile. Hence, the total transaction volume of inter-State and intra-State trading needs to be considered while stipulating the network requirement of the trading licensee. Accordingly, definition of intra-State trading has been introduced and the definition of inter-State trading has been modified.

1.2 The Commission is aware that one of the important factors for the measurement of risk is market price and price volatility and hence turnover (in ₹. crores rather than MU) or open position is a better representative of risk than the mere volume of trade in MU as

prescribed presently. The Commission may consider introducing these parameters to ascertain the networth for various categories at appropriate time.

1.3 The Combined Volume of inter-State and intra-State transactions for networth requirement may necessitate certain traders to enhance their networth which may result in change of category of existing licence. It has been proposed to allow the existing trading licensees time upto 31st July 2012 to submit the information about the “Volume of electricity proposed to be traded in 2012- 13” along with the special balance sheet as on 31st March 2012 for the said purpose.

2. Reporting of intra-State Trading to CERC by inter-State traders

2.1 The total combined monthly volume of all intra-State transactions undertaken by an inter-State trader in all States taken together needs to be reported to the Market Monitoring Cell of the Commission. The rationale to reintroduce intra-State transaction reporting arises from transaction volume vis a vis networth compliance perspective. As a general principle, higher transaction volume entails higher risk and hence a higher networth requirement to cover the risk. This is in alignment with Point 1. However, Central Commission will not monitor buyers or sellers, power price or trading margin of intra-State trades since intra-State trading margin does not fall under the purview of the Central Commission.

2.2 Distribution Companies are deemed trading licensees in accordance with provisions of section 14 of the Act. Therefore, the Distribution Companies shall report their monthly inter-State transactions to the Commission in the same formats for the purpose of monitoring of inter-State trading transactions.

2.3 New formats to separately report long term trades, inter-State, intra-State trade, trades on power exchange in day ahead and term ahead markets, open position of traders have also been introduced to improve the analysis undertaken by Market Monitoring Cell of CERC. In all, there are now 19 formats for reporting for trades executed by trading licensees. The formats are enclosed as annexure to the draft regulations. It is expected that monthly reporting will be automated in the next six months with implementation of Regulatory Information Management System, which will ease the process of reporting.

2.4 Traders including discoms shall also submit annual return of inter-State transactions detailing volume transacted (in MU and Rupees), total trading margin earned (in case of licensed traders), complete list of Buyers and Sellers (as applicable) and total volume transacted in intra-State transaction (in MU and Rupees), certified by a Chartered Accountant, by 30th April every year, starting from the year 2013.

3. Mutually exclusive networth to be declared in case a trader approaches a State Commission for grant of intra-State trading licence

3.1 It has been stipulated that the networth declared while applying for inter-State trading licence should be exclusively for the purpose of inter-State licence. This should not be used again while applying for intra-state licence to any other State Commission. Use of the same capital for the purpose of calculating the networth for inter-State as well as intra-State trading licence would undermine the capital adequacy requirement of inter-State licence as a higher amount of risk would then be undertaken against the same capital. This would be imprudent from systemic risk perspective.

4. Electricity trading as the core activity

Electricity Trading should be mentioned as the main activity to be undertaken by the applicant in the Memorandum of Association of the Company. This will ensure that the company is authorized to undertake the inter-State trading in electricity.

5. Up gradation / Down gradation of trading license category

A provision for up-gradation/downgradation of category of licence has been introduced. A licensed trader can approach the Commission for upgradation or downgradation of its licence to a particular category if he fulfills that networth and other requirements of such category in accordance with the regulations.

6. Equitable treatment for existing and new companies applying for trading licensee

As per the prevailing regulations, an existing company is required to submit the balance sheets for the last three years whereas a new company has to submit special balance sheet as on the date of application. The capital adequacy requirement has been modified to ensure that an existing company and a newly incorporated company are at equal footing in the matter of calculation of networth. It is proposed that for both new and existing companies, the net worth on the date of application would be considered as criteria for granting trading licence.

7. Liquidity ratio , Current ratio and Networth definitions

The definitions will be strictly as per the audited balance sheet prepared under Companies Act, 1956. This is being added as it was observed that applicants for trading license sometimes calculate the financial ratios differently which is incongruous to the prevalent standards. The companies should also disclose any other undischarged liabilities or guarantees it has given.

8. Violation of the provisions of the Act, regulations or orders of the Commission by licensed traders

In order to ensure that the amount of penalty for violation of the provisions of the Act, or Rules or Regulations or any other law or orders of the Commission by a licensed trader is commensurate with the gravity of violations, certain penal provisions have been proposed in the light of Section 19(4) and Section 142 of the Electricity Act 2003. Violations by licensed traders have been graded into serious and non-serious category of offences depending upon the gravity of the violation. Any willful, repeated and persistent violations of non-serious nature shall be considered to be as serious offence. These will help the Commission to fairly and effectively handle the violations by licensed traders.

9. Delay in Payment of license fee by trading licensee

In case of non-payment of license fee within the date stipulated in the payment of fee regulation, the licensee shall be liable for penal action for contravention of the payment of fee regulations. Where any proceedings has been initiated for non-payment of fees, the licence shall remain suspended till the payment is made or any directions for revocation of suspension is made by the Commission.

10. Regulatory Audit of trading licensee

The Commission at its discretion may direct a regulatory audit into the affairs of the licensee. The cost of such audit shall be borne by the trading licensee.

11. Process for revocation of licence

It has been proposed that a trading licensee shall go through a publication process while making an application for revocation of his license. This is to ensure that his clients and

public at large are made aware of this and any undercharged liability of the trader is brought to the notice of the Commission before the license is revoked.

12. Mandatory disclosure by trading licensee

Traders shall disclose the transaction details of inter-State transactions as well as petitions filed by it and orders of the Commission related to it for the information of its clients and prospective clients. This will bring more transparency in the system and help the clients in making informed decisions.

13. Code of Conduct for trading licensees

A code of conduct for the trading licensees has been introduced to encourage fair and transparent trading practices.

Reporting Formats:

A. Short Term Transactions:

1. Interstate Transactions

- i) Bilateral
 - a) Contract period of trading licensee with both the seller & the buyer is upto 1 year. (Form-ST1)
 - b) Contract period of the trading licensee with the seller is more than 1 year and with the buyer is upto 1 year. (Form-ST2)
- ii) Banking
 - a) Contract period of trading licensee with both the seller & the buyer is upto 1 year. (Form-ST3)
 - b) Contract period of the trading licensee with the seller is more than 1 year and with the buyer is upto 1 year. (Form-ST4)

2. Cross Border

- i) Bilateral
 - a) Contract period of trading licensee with both the seller & the buyer is upto 1 year. (Form-ST5)
 - b) Contract period of the trading licensee with the seller is more than 1 year and with the buyer is upto 1 year. (Form-ST6)

3. Intrastate Transactions

- i) Bilateral
 - a) Contract period of trading licensee with both the seller & the buyer is upto 1 year.
&
Contract period of the trading licensee with the seller is more than 1 year and with the buyer is upto 1 year. (Form-ST7)
- ii) Banking
 - a) Contract period of trading licensee with both the seller & the buyer is upto 1 year.
&
Contract period of the trading licensee with the seller is more than 1 year and with the buyer is upto 1 year. (Form-ST8)

4. Transactions on Power Exchange:

- i) Day Ahead Market (Form-DAM)
- ii) Term Ahead Market (Form-TAM)

B. Long Term Transactions:

1. Interstate Transactions

- i) Bilateral

- a) Contract period of trading licensee with both the seller & the buyer is more than 1 year. (Form-OST1)
 - b) Contract period of trading licensee with the seller is upto 1 year and with the buyer is more than 1 year. (Form-OST2)
 - ii) Banking
 - a) Contract period of trading licensee with both the seller & the buyer is more than 1 year. (Form-OST3)
 - b) Contract period of trading licensee with the seller is upto 1 year and with the buyer is more than 1 year. (Form-OST4)
- 2. Cross Border
 - i) Bilateral
 - a) Contract period of trading licensee with both the seller & the buyer is more than 1 year. (Form-OST5)
 - b) Contract period of trading licensee with the seller is upto 1 year and with the buyer is more than 1 year. (Form-OST6)
- 3. Intrastate Transactions
 - i) Bilateral
 - a) Contract period of trading licensee with both the seller & the buyer is more than 1 year.
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Contract period of trading licensee with the seller is upto 1 year and with the buyer is more than 1 year. (Form-OST7)
 - ii) Banking
 - a) Contract period of trading licensee with both the seller & the buyer is more than 1 year.
&
Contract period of trading licensee with the seller is upto 1 year and with the buyer is more than 1 year. (Form-OST8)

C. Open Position of contracts:

- 1. Quarterly Reporting (Form-OPN)