



**FICCI's Representation on
“Draft Central Electricity Regulatory
Commission (Procedure, Terms and
Conditions for grant of trading license and
other related matters) Regulations, 2019”**

Submitted to:

Central Electricity Regulatory Commission



Recommendations on 'Draft Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading license and other related matters) Regulations, 2019'

- A) A Draft Notification on 'Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading license and other related matters) Regulations, 2019' was published by Central Electricity Regulatory Commission on 24th July 2019. CERC had invited comments/ suggestions from the stakeholders on the Consultation Paper due for submission by 16th September 2019.
- B) In this regard, FICCI's comments/suggestions are the following:

Sl. No	Clause	Views/ Comments/ Suggestions
1	<p>Chapter-IV) 7. Applicability of Trading Margin: Trading margin shall be applicable to the following types of contracts undertaken by the Trading Licensee:</p> <p>7(a) Short term contracts (where period of the contract of the Trading Licensee with either or both the seller and the buyer is upto one year including transactions undertaken through power exchanges);</p>	<ul style="list-style-type: none"> • The Draft Regulation has proposed to change the definition of short-term contracts. It shall now include all the contracts having either or both leg of transactions on short term basis. It is not very clear why the definition of short-term contracts has been considered for change; the explanatory memorandum has also not provided any reasoning for it. Apparently, it seems that the intention is to bring all those traders/ contracts under the ambit of trading margins who are circumventing it by keeping duration of one leg slightly more than 1 year. • The Power Market Regulations allows the traders to take open positions in market which means that the trader can also buy in long term and sell in short term or vice versa. As recognized in the Power Market Regulations, the traders in open positions are exposed to higher risks including that of price risk and therefore should be given the flexibility to charge trading margins as per their business & market assessment. With the change of the definition of short-term contracts and applicability of trading margin to transactions having any one leg on short term basis would discourage the trading licensees to take open positions in terms of duration of the contract. The trading licensees can bring innovation only through open position and any attempt to influence the basic requirement for innovation will be major deterrent for the market. The trading licensee will end up taking more of back to back deals with a trading margin cap of 1 paise/ unit which will affect the viability of the business. • All of these micro management is being considered only to ensure that the trading margin or cap considered under the Trading Regulations is complied with by the traders which may distort the market functioning.

		<i>It is therefore suggested that Draft Regulation should not change the ambit of short-term contracts.</i>
2	<p>Chapter-IV) 7. Applicability of Trading Margin: 7(b) Long term contracts and medium term contracts (where period of the contract of the Trading Licensee with both the seller and the buyer is more than one year);</p>	<p><i>Applicability of trading margin for back to back deals should be removed as the existing definition of back to back deals need to be reviewed.</i></p> <ul style="list-style-type: none"> • Traders are constantly at payment and operational risk. In practical situation there is no ideal back to back deals happening through traders. E.g. Despite having provision in PPA (i) PSM not provided by buyer DISCOMs (ii) DISCOMs delaying the payment (iii) No Surcharge payment by DISCOM. • Further in short term procurement, traders have to bear the Tender fee, MSTC fee, cost of EMD, cost of Contract performance guarantees and these terms are not back to back with seller. <p><i>In the existing context, back to back deals need a review as proposed trading margin cap of 1 paisa per KWh for existing back to back deals is inadequate to cover the risk of the trader as explained above</i></p>
3	<p>Chapter-IV) 8. Trading Margin: 8(1)(c) For short term contracts and contracts through power exchanges, the Trading Licensee shall charge a minimum trading margin of zero (0.0) paisa/ kWh and a maximum trading margin of seven(7.0)paisa/ 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) paisa/kWh.</p>	<ul style="list-style-type: none"> • The trading margin regulations were last enacted during the year 2010. There was a detailed study undertaken with help of a consultant for deciding the trading margin and rationale for imposition of trading margin was provided in the Statement of Objects and Reasons. The Statement of Reasons of the regulations provided reasons for prescribing trading margin and stated that 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, the market prices were governed to a large extent by the demand-supply deficit prevalent in the country. Under such a scenario, there was a high likelihood of deficient utilities buying power at higher than justified rates to prevent excessive load shedding. To, balance the interests of buyers as well as the traders, it was decided to prescribe a trading margin cap. • However, under current scenario, the demand supply deficit of the country has reduced and market has turned out to become a buyer's market with the buyer's having edge in price negotiation. • Apart from the improvement in demand-supply scenario the competition amongst the Trading Licensee has also increased manifold during all these years. Presently, around 40 traders are registered and out of 40 traders, 10-12 traders are operating in the market, and, in such a situation it is very difficult for any trader to exercise any influence over the buyer/ seller in recovering high trading margins from them. Any measures by traders to recover higher margin would result in higher cost to the buyer and would put the trader in a disadvantageous position in the present scenario and the same is getting reflected in last 5 years margins of traders.



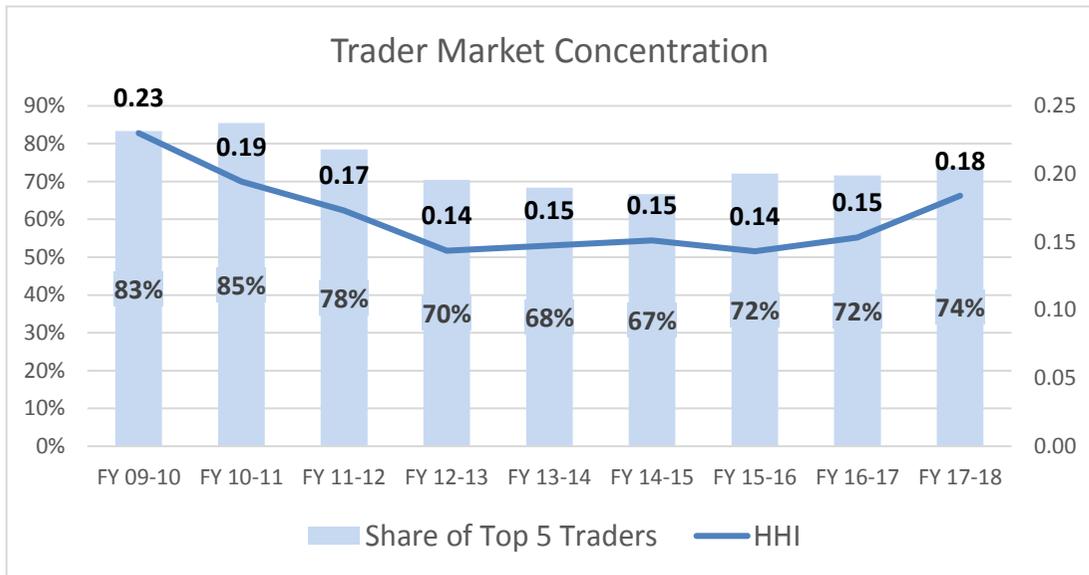
Source: CERC Market Monitoring Report

- The efficacy of competitive forces in play is reflected in the price of electricity and the trading margins charged by the traders. In the figure shown above it can be observed that both the electricity prices and the trading margins (weighted average) are showing a declining trend over the last decade. Further, it can be observed that during last 5 years the weighted average trading margins are well below the trading margin imposed by the Trading Margin Regulations. From the above, it can be surmised that the market forces are acting efficiently and has taken care of the issues associated with high electricity prices/trading margins in the short-term market. There is no requirement of imposing trading margins through Regulations.
- The promotion of competition in electricity sector is one of the core objectives of the Electricity Act, 2003 wherein under Section 66 the Hon'ble Commission has been entrusted with the mandate to develop market including "trading". In this context it is pertinent to mention that the traders play an important role in the development of electricity market particularly the short-term power market. The traders are expected to take risks and offer market solutions to both buyer/sellers fulfilling their requirement and, in the process, expanding the market. Accordingly, the traders should be enabled to take open positions and

		<p>bring innovation in their offerings through structured product etc. Any cap on the trading margins (both upper & lower limit) would limit the risk-taking capabilities of the trading licensees and hence reduce the opportunity to further grow eventually affecting the short-term power market in India. As a matter of fact, the short-term power market has almost remained stagnant (approx. 10% of the market) in the country during last few years despite having an elaborate regulatory framework in place.</p> <div data-bbox="846 422 1944 954" data-label="Figure"> <table border="1"> <caption>SHARE OF SHORT TERM VOLUME</caption> <thead> <tr> <th>Fiscal Year</th> <th>Share (%)</th> </tr> </thead> <tbody> <tr> <td>FY 09-10</td> <td>9%</td> </tr> <tr> <td>FY 10-11</td> <td>10%</td> </tr> <tr> <td>FY 11-12</td> <td>11%</td> </tr> <tr> <td>FY 12-13</td> <td>11%</td> </tr> <tr> <td>FY 13-14</td> <td>11%</td> </tr> <tr> <td>FY 14-15</td> <td>9%</td> </tr> <tr> <td>FY 15-16</td> <td>10%</td> </tr> <tr> <td>FY 16-17</td> <td>10%</td> </tr> <tr> <td>FY 17-18</td> <td>11%</td> </tr> </tbody> </table> <p>Source: CERC Market Monitoring Report</p> <p><i>In view of the above, it is suggested not to fix any trading margin or cap or floor price for trading activity and allow it to be determined by the market forces. For effective market operations, it is suggested to strengthen the market surveillance mechanism to avoid any kind of market dominance/ abuse by the market participants.</i></p> </div>	Fiscal Year	Share (%)	FY 09-10	9%	FY 10-11	10%	FY 11-12	11%	FY 12-13	11%	FY 13-14	11%	FY 14-15	9%	FY 15-16	10%	FY 16-17	10%	FY 17-18	11%
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4	<p>Chapter-IV) 8. Trading Margin:</p> <p>8(1) (d) For long term contracts and medium-term contracts, the trading margin would be decided mutually</p>	<p><i>It is proposed not to put any such condition of Payment Security Mechanism/ Escrow for charging trading margin for long term/medium term contract in favour of seller only. In such cases, it is also required to ensure that buyers also issue PSM/ Escrow in favour of trader, failing which trader can be allowed to charge any trading margin.</i></p>																				



	<p>between the Trading Licensee and the seller:</p> <p>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.</p>	<ul style="list-style-type: none"> • Such conditions would increase the monitoring by CERC and there is no certainty that non-compliance will result into penalty because on many instances particularly in failure of timely form IV submission, no strict action was taken against trader in the past. • It is further suggested that since PSM/ Escrow is part of PPA, failure of issuing PSM/ Escrow should be dealt as per terms of the PPA only.
5	<p>Chapter-IV) 8. Trading Margin: 8(1) (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.</p>	<ul style="list-style-type: none"> • As per definition provided herein in this Draft Regulation, back to back transaction shall have the same meaning as is assigned to it under Power Market Regulations, 2010 as amended from time to time. Further, Power Market Regulations (PMR) defines back to back transaction as "<i>The interstate transaction in which an electricity trader buys a specific quantity of power for a particular duration from one party and simultaneously sells it to another party on same terms and conditions. Such transaction does not expose the trader to any price risk. It may expose the trader to credit risk and operational risk</i>" • As per the definition of back to back transaction as provided under Power Market Regulations (PMR), a trader is exposed to credit risk and operational risk. It is very difficult to monetize the cost incurred by the traders, and in this context no justification of capping trading margin to one 1 paise/kWh can be provided. Back to back transaction also involves EMD, performance security etc. which has to be borne by the trader at their own cost and risk, which cannot be recovered from 1 paise/kWh. • Substantial amount is involved on part of the trader including cost of EMD, CPG/BG etc. is involved, which is being exposed with no security as most of the utilities are debt ridden and generators are running their power plant with uncertainty. In such a situation, fixing a trading margin of one 1 paise/kWh is patently arbitrary and without any due regards towards the risk at which traders are being exposed to. If the regulation is notified, traders would be prevented from entering into such transaction and would be a major setback for the electricity market. • It may also be noted that although there are nearly 40 trading licensees the trading business is concentrated amongst the top 5 traders. It can be observed from the figure below that there is a high concentration of trading volume amongst top 5 traders with moderate HHI. The imposition of trading

		<p>margin of 1 paise/unit on back to back deals would make the business unviable for smaller traders who are as such not in a position to take open positions or aggregate buyers/suppliers. As a result, it is possible that the market may further get skewed towards larger players thereby reducing the competition in the market.</p> <div data-bbox="846 384 1935 959" data-label="Figure">  <p>Trader Market Concentration</p> <table border="1"> <thead> <tr> <th>Fiscal Year</th> <th>Share of Top 5 Traders (%)</th> <th>HHI</th> </tr> </thead> <tbody> <tr> <td>FY 09-10</td> <td>83%</td> <td>0.23</td> </tr> <tr> <td>FY 10-11</td> <td>85%</td> <td>0.19</td> </tr> <tr> <td>FY 11-12</td> <td>78%</td> <td>0.17</td> </tr> <tr> <td>FY 12-13</td> <td>70%</td> <td>0.14</td> </tr> <tr> <td>FY 13-14</td> <td>68%</td> <td>0.15</td> </tr> <tr> <td>FY 14-15</td> <td>67%</td> <td>0.15</td> </tr> <tr> <td>FY 15-16</td> <td>72%</td> <td>0.14</td> </tr> <tr> <td>FY 16-17</td> <td>72%</td> <td>0.15</td> </tr> <tr> <td>FY 17-18</td> <td>74%</td> <td>0.18</td> </tr> </tbody> </table> <p>Source: CERC Market Monitoring Report</p> </div> <ul style="list-style-type: none"> Such imposition of trading margin of 1 paise/unit will also disincentivise the traders from entering into back to back deals with added risks / return not covered. This will eventually affect the dynamics of the market. It is therefore suggested not to fix any additional trading margin or cap or floor price on the trading activities undertaken through back to back deals. 	Fiscal Year	Share of Top 5 Traders (%)	HHI	FY 09-10	83%	0.23	FY 10-11	85%	0.19	FY 11-12	78%	0.17	FY 12-13	70%	0.14	FY 13-14	68%	0.15	FY 14-15	67%	0.15	FY 15-16	72%	0.14	FY 16-17	72%	0.15	FY 17-18	74%	0.18
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6	<p>Chapter-V) 9. Obligations of the Trading Licensee: (24) Trading Licensee shall not engage in Banking of electricity</p>	<ul style="list-style-type: none"> As a welcome step Draft Regulations has prohibited traders from involving in banking transactions in electricity on the pretext 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. FICCI welcomes the proposal of the Hon’ble Commission to prohibit 																														

		<p>traders to involve in banking transactions as this does not involve any price transaction and is an adhoc arrangement. The banking of electricity does not unravel the economic value of electricity. The banking does not capture the value of time of buy/sell of electricity or the opportunity cost associated with a particular buying/selling decision and hence should be discouraged. In a monetary economy, money plays the role of a measure of value of all goods, so their values can be assessed against each other, this role may be absent in banking arrangement. The true marginal cost of meeting the demand is not known in this mechanism and gain or loss arising out of the transaction cannot be ascertained. In case of loss, it may be passed on the consumers which may affect interest of consumers.</p> <ul style="list-style-type: none"> • It is understandable that banking was allowed when the alternatives were not available to the buyers/sellers to fulfil their requirements. In the present scenario there are two power exchanges providing platform to procure power on a day ahead basis or term ahead basis. DEEP platform is also available for procuring or selling power up to one year. Going forward, new market segments viz. Real Time Market or physically deliverable long duration market etc. shall be introduced in the power exchanges providing further opportunities to buy/sell power.
7	<p>Chapter-VI) CONTRAVENTION AND PENALTIES 17 Contravention by Trading Licensee</p>	<ul style="list-style-type: none"> • Recently, as per MoP order, all DISCOMS have to ensure issuing of payment security in favour of generating company as per terms of the PPA, failing which concerned RLDCs would not schedule power to DISCOMS. <p><i>Similar to above provision, it is proposed that SLDCs/ RLDCs should be able to block the web based Open Access portal used by Traders in case of Non-Compliance.</i></p> <ul style="list-style-type: none"> • As per Regulations, traders are required to submit online Form IV and other Compliance information on SAUDAMINI e-portal every month before 15th. • It is suggested that SAUDAMINI e-portal should calculate the total trading volume and track the net-worth, in accordance with Category of traders in line with Regulations. • In case Form IV and compliance information are not submitted by 15th of the month, an auto trigger would be generated from SAUDAMINI portal and sent to all RLDCs/SLDCs along with to traders who did not fulfil the compliance requirement.



		<ul style="list-style-type: none">• Similarly, SAUDAMINI e-portal should also generate auto trigger and send email to RLDCs/SLDCs by 15th in case trading volume limit and net worth criteria for traders do not match as per Category of traders mentioned in the Regulations.• Such Traders are required to take corrective action by submitting Form IV and other Compliance information in SAUDAMINI e portal and meeting the criterial of Trading volume limit and net worth criteria, within a week time i.e. by 22nd of the month.• SAUDAMINI e portal would send auto email to RLDCs/SLDCs immediately after the corrective action taken by Traders in the e portal. Traders would also receive acknowledgment from the portal that compliance is met.• During the time period of one week i.e. up to 22nd of the month, traders may be allowed to revise the schedule as well as file Open Access application.• RLDCs/SLDCs would confirm in e-portal whether they have received Auto email from SAUDAMINI regarding fulfilment of compliance by Traders.• In case, RLDCs/SLDCs do not receive email confirmation from SAUDAMINI as mentioned above i.e. traders fail to comply within stipulated time i.e. by 22nd of the month, in such a case, user login for Web based Open Access of trader shall be blocked by RLDCs/SLDCS. This would disable such traders to submit Open Access application as well as revising/surrendering the corridor
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