INDIAN ENERGY EXCHANGE

No. IEX/RA/010/19-20

Date: 16th Sept, 2019

To,

The Secretary
Central Electricity Regulatory Commission
3rd& 4th Floor, Chanderlok Building
36, Janpath
New Delhi - 100 001,
Fax: 011-23753923

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

Sir,

This has reference to Public Notice dated 24.07.2019 inviting suggestions and comments from stakeholders on the draft notification of Central Electricity Regulatory Commission (Procedure, Terms and Conditions for grant of trading licence and other related matters) Regulations, 2019.

Accordingly, comments on behalf of Indian Energy Exchange are attached hereto for kind consideration of the Hon'ble Commission.

Thanking You!

Yours Sincerely,

Jogendra Behra

Vice President (Market Design & Economics)

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

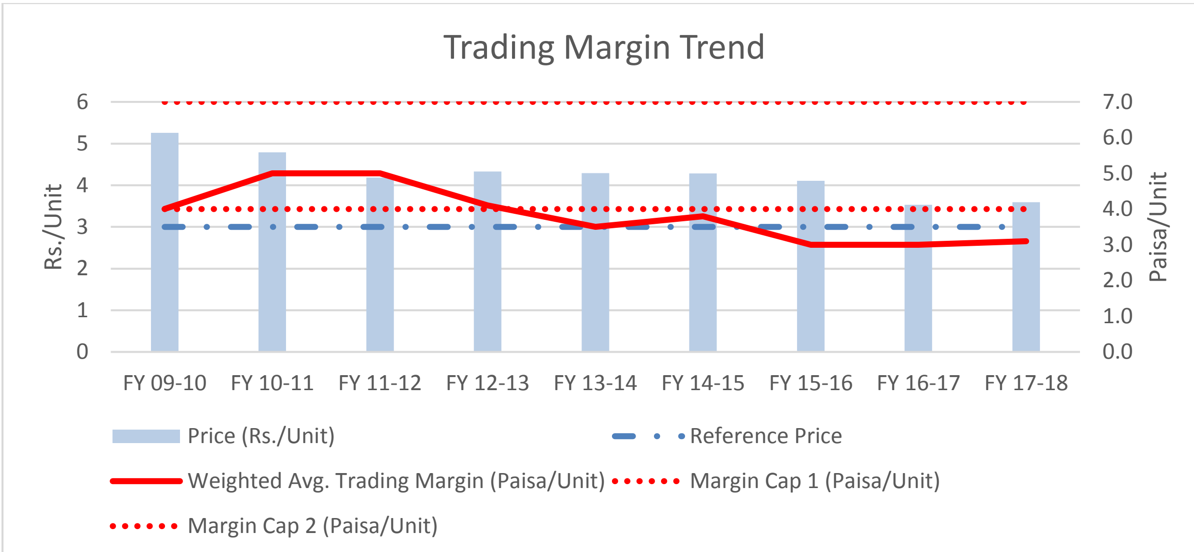
1. **Clause 8(1)(c) of the Draft Regulations is abstracted below:**

   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

   IEX comments on the proposed trading margin on short term contracts are as follows:

   i. The trading margin regulations were last enacted during the year 2010. The rationale for imposition of trading margin was provided in the Statement of Objects and Reasons of these regulations which inter-alia 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 gap prevalent in the country. In such a scenario, there was a high likelihood of deficient utilities buying power at higher than justified rates to prevent excessive load shedding. Therefore, with a view to balancing the interests of buyers as well as the traders, it was decided to prescribe a trading margin cap. Thus, the main reason of imposition of trading margin was power deficit scenario and likelihood of utilities buying costly power in such scenario**.** However, if we look at the current scenario, the demand supply scenario of the country has changed for the good. Due to significant capacity addition during all these years it has turned out to become a buyer's market with the buyer's having an edge in price negotiations.

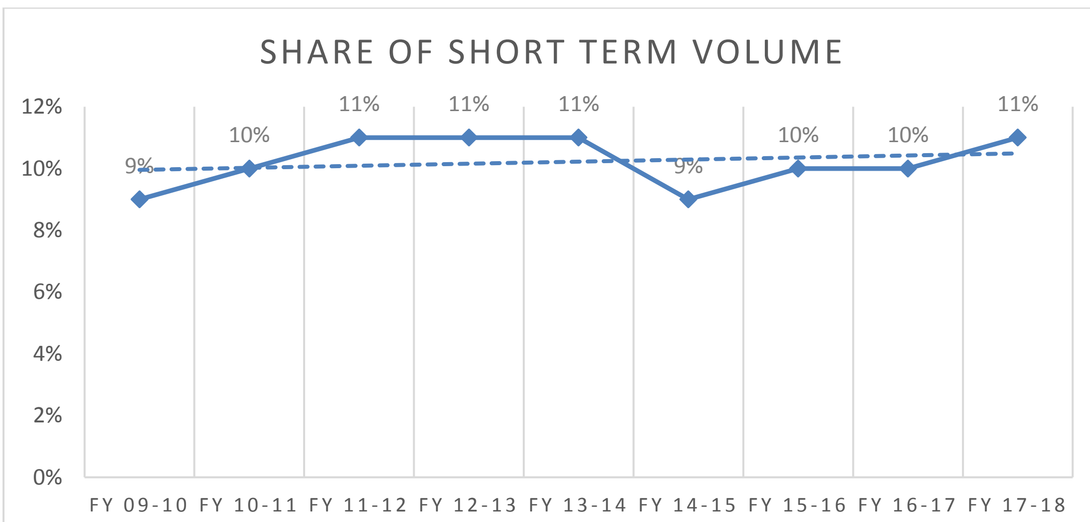
   ii. Apart from the improvement in demand-supply scenario the competition amongst the Trading Licensee has also increased manifold during all these years. Presently, around 37 traders are registered with CERC out of which at least 15 traders are actively trading in the market, and, in such a situation it is very difficult for any trader to exercise any influence over the buyer/ seller in recovering high trading margins from them. Any measures taken by a trader to recover higher margins would result in higher cost to the buyer and would put the trader in a disadvantageous position with respect to other alternatives available in the market. The same is getting reflected in last 5 years margins of traders as can be seen in the provided in the figure below.



CERC Market Monitoring Report

iii. 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 further requirement of imposing trading margins through Regulations.

iv. 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 important to draw attention to the fact 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, bring expansion the market. Accordingly, the traders should be enabled to take open positions and 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 curb the competitive forces in the market 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.



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In view of the above, it is suggested that the Hon'ble Commission should not fix any trading margin or cap or floor price for trading activity and allow it to be determined by the market forces. Instead the Hon'ble Commission may strengthen the market surveillance mechanism to avoid any kind of market dominance/abuse by the market participants.

2. **Proviso to Clause 8(1)(c) and Clause 8(1)(d) of the Draft Regulations is abstracted below:**

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.

IEX comments on the proposed trading margin lack of payment security mechanism is as follows:

i. From August 1, 2018, the Ministry of Power, Govt of India has already made it mandatory for power distribution licensees to open and maintain letter of credit (LC) as a payment security mechanism under Power Purchase Agreement (PPA). As per the new arrangement the system operators i.e. NLDC, RLDC and SLDC shall dispatch power only after they are informed by the generating company and Discoms that an LC for the desired quantum of power has been opened. The dispatch shall stop once the quantum of electricity under the LC has been supplied. The generating company shall be entitled to encash the LC after the expiry of grace period i.e. 45 to 60 days as provided in the PPA.

ii. It is submitted that since MoP has already taken steps to ensure compliance of payment security provision in PPAs, the terms of conditions suggested by MoP notification and the Hon'ble Commission's Regulations may be aligned. Further, the proposal of trading margin cap of 1 paisa/kwh where escrow arrangement or irrevocable, unconditional and revolving letter of credit is not provided by the Trading Licensee is not required, as the MoP notification has already made it mandatory for the Discoms relating it with the dispatch of electricity.

In view of the above while the clause for mandatory LC by the trading licensees should be included it should be aligned with MoP notification and the proposal to cap the trading margin to 1 paise/kWh in absence of LC should be done away with.

3. **Clause 8(1)(e) of the Draft Regulations is abstracted below:**

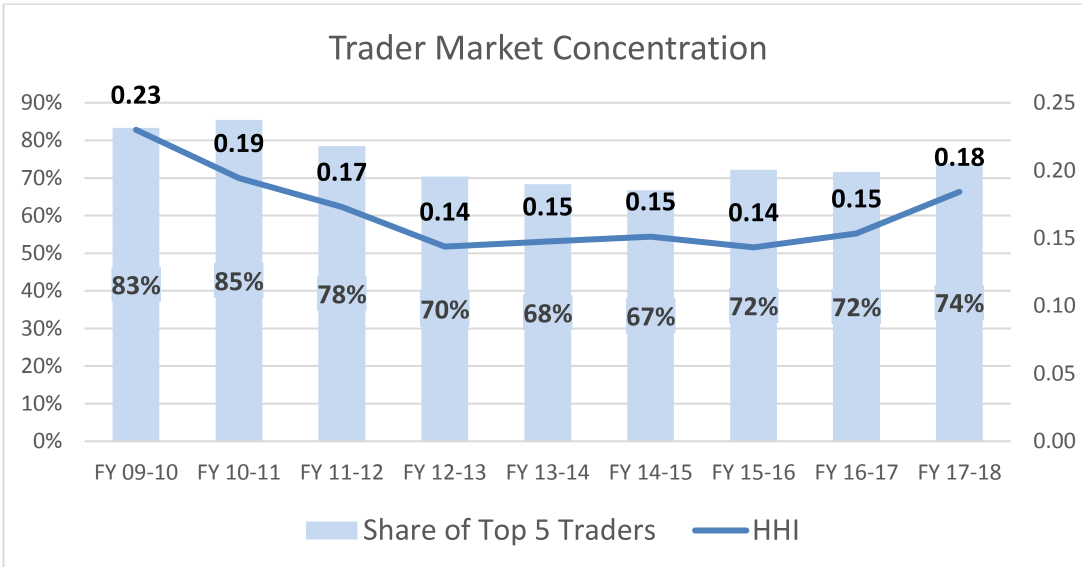
In case of Back to Back deals, the Trading Licensee shall charge a minimum trading margin of zero (0.0) paise/kWh and a maximum trading margin of one (1.0) paise/kWh.

IEX comments on the proposed trading margin on back to back deals are as follows:

i. As provided under the Power Market Regulations, traders can enter into OTC contracts either through back to back deals or open position or through aggregation of suppliers/buyers and sell/buy to a one or more buyers/sellers. A trader may choose the contract type depending upon the market conditions and its own assessment of the risk/return involved in such decisions. The imposition of trading margin of 1 paise/unit will influence the decision making of traders – it will add to the existing risks of the traders thus disincentivizing the traders from entering into back to back deals which eventually would be affecting the dynamics of the market. Such imposition of trading margin will also restrict the choices of traders even though these are available under the provisions of Power Market Regulations.

ii. The imposition of trading margin for a specific type of contract i.e. back to back deals would provide a perverse incentive to the traders to evade the provision by making cosmetic changes in the contract. It would also be difficult on the part of the Commission to ascertain whether the above provision is complied with by the market participants or not.

iii. It may also be noted that although there are nearly 37 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 along with moderate HHI. The imposition of trading margin of 1 paise/unit on back to back deals would make the business further unviable for smaller traders who are, as such, not in a position to take open positions or aggregate buyers/suppliers. As a result, possibilities are there that the market may get further skewed towards larger players thereby reducing the competition in the market.



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In view of the above, it is suggested that the Hon'ble Commission should not fix any additional trading margin or cap or floor price on the trading activities undertaken through back to back deals.

4. **Clause 7(a) of the Draft Regulations is abstracted below:**

Trading margin shall be applicable to the following types of contracts undertaken by the Trading Licensee:
Short term contracts (where period of the contract of the Trading Licensee with either or both the seller and the buyer is up to 1 year including transactions undertaken through power exchanges)

IEX comments on the proposed change in definition of short-term contracts are as follows:

i. The Hon’ble Commission 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 to change; the explanatory memorandum has also not provided any reasoning for it. Apparently, it seems 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.

ii. 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. The ability to take open positions in the market would incentivize the traders to bring innovation in its offerings thereby making the short-term market more efficient for the market participants. 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. However, with the change in 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. As a result, 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.

iii. Regarding the risk-taking ability of the traders, it is pertinent to mention here that the Hon’ble Commission is appropriately considering revision of net-worth of traders to make it commensurate with their trading volume. In case a trader is willing to take risks through open positions then it should be allowed to do so as long as the net-worth requirement is complied with. If required, the networth may also be linked with the open position of trader.

iv. 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 is imprudent way of looking at the market. In case the trading margin is removed then such issues would not arise and trading activities/market shall get strengthened.

In view of the above it is suggested that the Hon'ble Commission should not change the ambit of short-term contracts. It is further reiterated that the Hon'ble Commission should refrain from fixing any cap or trading margin on the trading activities given the growth of competition in the market in recent times.

5. **Clause 9(24) of the Draft Regulations is abstracted below:**

Trading Licensee shall not engage in Banking of electricity.

IEX comments on the proposed changes w.r.t banking of electricity is given below:

i. The Hon'ble Commission has proposed to prohibit traders from involving in banking transactions in electricity on the pretext that 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.

ii. The Commission observation in this regard is appreciated. The banking transactions is like a bartering arrangement between two entities which is an age-old practice and should not be promoted. 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.

iii. It is understandable that banking was allowed when the alternatives were not available to the buyers/sellers to fulfill their requirements. In the present scenario there are two power exchanges providing platform to procure power on a day ahead 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 which will provide further opportunities for the market participants to buy/sell power.

iv. However, while barring the trading licensees from participating the banking of electricity it should also be considered to not allow the Discoms to do the banking. Discoms are carrying out the banking of power as deemed trading licensee provided under Section 14 of Electricity Act 2003. The Hon'ble Commission has proposed to disallow traders from undertaking banking of electricity in the pretext that it is not a trading activity, the same set of argument should also be considered in the case of Discoms. It may also be noted that banking is not recognized under the Electricity Act. Further, banking of electricity being an inter-state activity is within the jurisdiction of the Hon'ble Commission.

In view of the above, while we welcome the proposal of the Hon'ble Commission to prohibit traders to involve in banking transactions for the same reasons the Discoms should also be prohibited from undertaking the banking transactions.