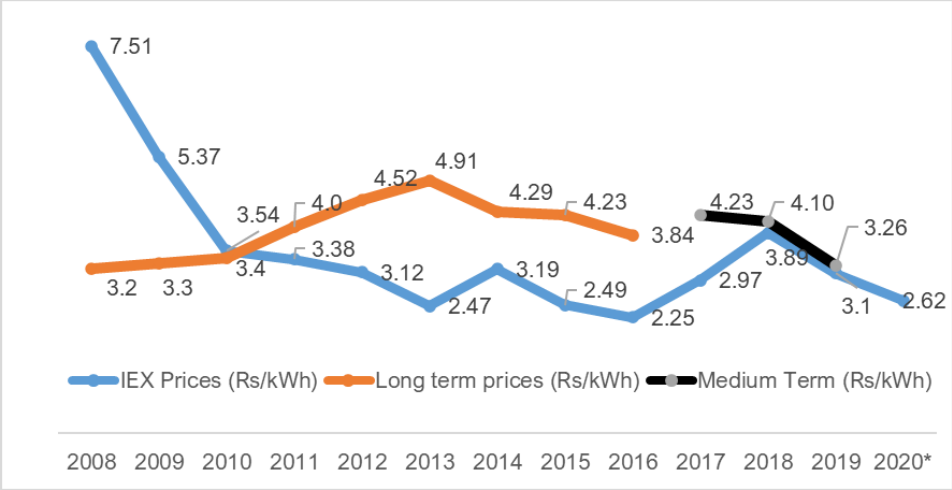
APP Comments on CERC Staff Paper on Power Market Pricing

1. Does Pricing Methodology need a change?

APP view: **We feel that Pricing Methodology does not need a change.** As correctly highlighted in the staff paper, Uniform Market Clearing Price provides correct price signals and induces sufficient investment incentives. This is borne out by the fact that in the last 8 to 10 years, average Spot market rates were lower as compared to legacy long term contracts, as illustrated in the figure below.



This provided price signals to the procurers and led to a decrease in new long term power procurement tenders in the market. On the other hand, sustained high prices in the spot markets provide accurate signals for investment in additional generation capacity. Therefore, the present pricing methodology gives accurate short-run signals and helps the demand-supply situation to balance out in the longer run.

While the Staff Paper highlights concerns regarding some generators earning windfall profits during high demand periods, it must be kept in mind that both procurers and sellers in the spot markets are exposed to various risks and incentives based on market scenarios caused by supply-demand imbalances during seasonal variations. Further, due to high ingress of variable RE supply in the grid, thermal generators are largely dependent on off-loading their capacity

even below variable cost of generation in case of back down during day hours. These occurrences are only bound to increase with greater penetration of RE power.

As has been observed in the Staff Paper, Pay as Bid mechanism would not automatically guarantee higher consumer surplus as it may simply encourage sellers to quote higher bid price, thereby distorting the market signals. When the UMCP mechanism has been tried and tested over so many years, with many procurers and consumers benefiting from the market mechanism immensely, it is not advisable to tinker with the basic market construct and reinvent the wheel because of some perceived aberrations which get balanced out over the long term.

2. What should be the criteria for Regulatory Interventions?

APP view: Regulatory intervention in the power markets should only be resorted to during exceptional circumstances. The shift away from deep regulatory oversight (cost plus projects under Section 62) towards competitive bidding and further towards power exchanges has been deliberately designed to provide a purely market driven platform for buyers and sellers. Excessive regulatory intervention would go against the basic principle and intent of setting up power exchanges. Therefore, the Regulator may first carry out a detailed factual assessment to decide whether the circumstances are exceptional enough to warrant regulatory intervention. If any intervention is deemed necessary, the Regulator must approach the issue in a holistic and balanced manner based on factual analysis, while keeping in mind the interests and concerns of all concerned stakeholders instead of taking any knee jerk steps that only look at the problem from a very narrow prism.

For instance, hastily imposed price cap ceilings on the sale of power in the open markets without accounting for the fact that the generators have to purchase coal from the e-auctions where the quantity of coal offered is limited and there are no price caps on the premium paid for such coal, or without accounting for the fact that the generators often end up selling power at below variable cost during lean periods, is an example of regulatory interventions applied without a holistic basis. It must be kept in mind that windfall profits occur only during short seasonal spikes in peak demand that only persist for a limited cycle. Such short term spikes should not be the guiding factors for regulatory intervention as these get balanced out over the

year – evidenced by the fact that the annual average price discovered on the power exchanges has remained around Rs 3/kwh for many years.

3. How do we address the negative impact of price cap?

APP view: We suggest the following:

a. First and foremost, it is our view that the current price cap should be removed as it has been introduced without detailed analysis and without taking a holistic approach.

b. If there is to be a cap on the maximum selling price, then there should also be a cap on minimum selling price so that generators can be assured a reasonable margin during lean periods when thermal generators are desperate to offload their capacity to reach technical minimum levels of utilization. A detailed analysis would need to be undertaken to determine such price caps on the basis of fuel mix, efficiency, etc. For instance, the recent price cap of Rs 12/kwh in the power exchanges resulted in imported coal based and gas based generating capacity going off the grid. As the saying goes, no power is costlier than 'no power'. The market price signals should be such that all generating assets remain available on grid at the time of need.

c. If there is to be a cap on the maximum selling price, then the Government also needs to ensure the supply of fuel at control rates. It is illogical to expect generators to source basic raw material at full market-driven prices, which are highly inflated during the current coal shortage scenario, and then subject the final output to price controls. Recent coal spot market auctions have seen premiums in excess of 400% - if a cap has to be introduced it must be applicable on the entire supply chain so that the generators do not face the brunt.

d. We support the proposal for introducing a separate High Price Market Segment within the existing day ahead market. However, the cut-off variable cost for determining eligibility for participation in the High Price segment should be sufficiently lower than the upper price ceiling in the DAM segment, in order to provide an opportunity to the seller to recover associated additional cost components (trading margin, power exchange fees, taxes, fixed

cost, STU transmission charges etc) and make some returns commensurate with the risks of trading in the open market.

e. Any price cap should be dynamic and seasonal in nature, keeping in mind the prevailing generation mix and demand-supply gap scenarios.

4. What should be the market design for incentivizing demand response and energy storage system (ESS)?

APP view: India is a developing economy and has been witnessing increased electricity demand on account of industrial activity as well as commercial development. In this backdrop, we feel that mandatory power saving measures may prove to be counterproductive. However, a push may be made towards voluntary energy saving measures and educating consumers through effective implementation of TOD/dynamic tariffs.

At the same time, we need to focus attention on the operational performance of the DISCOMs and improve efficiency by minimizing theft of power and AT&C losses. Along with demand response mechanisms, these measures would also help to push back against increasing electricity prices.

Energy Storage Systems are imperative to meet balancing requirements with the increased penetration of variable RE sources. However, at present their cost is very high, and therefore the steps taken by the Government to promote bundled RTC RE tenders is a positive move as the variability would get controlled at the generator side itself. To further promote ESS, Government will have to come up with additional financing incentives such as viability gap funding etc.