Annexure

Comments/ Suggestions on the Staff Paper on Pricing

Preliminary suggestions

Role of the OTC Platform in creating an alternate market place to develop a deeper power market

1. The high prices in the Day Ahead Market on the exchanges are driven by multiple factors. One of the most important factors which explains the increase in DAM prices is the supply side issues related to availability of the domestic coal supplies and increased prices of imported coal due to geopolitical tensions. At best, the bidding behaviour of the sellers will have played a marginal role in the increase in the prices.
   Day Ahead Market pricing methodology has been working successfully for the last 14 years. Any changes in the pricing methodology can lead to many large unintended consequences in terms of creating operational inefficiencies and risks.
   It is very likely that the amount of time taken in getting all the changes in the pricing done will be sizeable. By then this temporary price shock may have already passed away and the market participants would be stuck with an inchoate solution where they need to start revising their bidding strategies and adapt to the new pricing mechanism.
   Most importantly, uniform price matching ensures that the inframarginal sellers do not need to worry about recovering their fixed costs and the difference between the uniform price and the bidding price contributes in the recovery of the fixed charges. Under the absence of such a mechanism, the bidding strategy will be adjusted accordingly so that the sellers can recover the fixed costs.
2. **One of the factors which contributes to the build-up of prices could be non-availability of an alternate market place.** The growth of the volumes in TAM segment at exchanges, a significant shift of volumes from the collective segment to bilateral segment (TAM) upon imposition of price caps in collective segment and the need to expand the applicability of the price cap on the bilateral segment (TAM) t on exchanges was a testimony to this. **While there was no cap in the OTC Market, extension of the cap to TAM on exchanges introduces a conflicting and confusing signal.** On the contrary the regulator and the policy maker have been trying **to create enabling provisions for the high price segment to come on to the bar and ease the supply side constraints**. Introducing such segmentation in the collective segment might hamper the efficacy of the discovered prices and/or the efficiency of the price discovery process in collective transactions.

3. With OTC platform introduced in the OTC Markets, it is imperative that the institutional mechanisms are commensurate with the envisaged roles. **All collective transactions with uniform price clearing have to be at Exchanges whereas all bilateral transactions have to move towards OTC market facilitated through the OTC platform.** For example, HP Segment can be introduced through OTC platform as part of an OTC contract in line with PMR 2021, Regulation 7, reproduced below:

   Quote

   7. Contracts transacted in the OTC Market

   (1) Price discovery: The price and other terms of contract in the OTC Market shall be determined either through mutual agreement between the buyer and the seller directly or through a Trading Licensee or through competitive bidding process or as determined by the Appropriate Commission.

   (2) Delivery procedure: The application for scheduling of contracts in the OTC Market shall be made in accordance with the:

   (i) Open Access Regulations for:

   (a) Advance scheduling;

   (b) First-Come-First-Served;

   (c) Day-Ahead bilateral transaction;

   (d) Bilateral transactions in a contingency.

   (ii) Grant of Connectivity Regulations for:

   (a) Long-term access;

   (b) Medium-term open access.

   (3) Settlement Conditions: The settlement of contracts transacted in the OTC Market shall be only by physical delivery of electricity.

   Unquote

<u>Role of OTC Platform as a data repository towards facilitating resource adequacy</u>

The OTC Platform will evolve as a data repository and will be able to serve its stakeholders in an efficient manner by integrating with the NOAR, REC Registry etc. through APIs to develop a standard communication protocol between the market participants and stakeholders in the OTC Market. While on one side it will ensure seamless services to market participants it will also create an enabling framework to leverage technology to develop a digital ecosystem and back-office processes in a layered architecture commensurate with our power system architecture and system operations.

The above warrants a stronger reporting requirements and analytics to be conducted which needs to be available to the market participants and stakeholders at large. While NAME has been given the regulatory sandbox to define this, it is imperative that the regulatory reporting be formalized to be near real-time and in a manner that it does not significantly increase the cost of compliance and finally, it should move towards regulatory reporting by everyone in the value chain, starting and ending with grid connected entities. This will aid towards triangulation, verification, confirmation, nomination etc. seamlessly and also reduce the information asymmetry by improving quality of service.

In light of the above it becomes imperative that the principle of reporting be changed to **reporting by everyone, every-time,** near **real-time.** Once the stakeholders report on the reporting platform, subject to obvious data protection and control protocols and the scheduling and despatch of electricity for bilateral transactions may be undertaken only after confirmation matching of the data on the reporting platform.

Clause by Clause Suggestions

3.1. **Does Pricing Methodology need a change?**

CERC might have to conduct a more detailed analysis including simulations to lend credence to the hypothesis that the bidding strategy of the sellers under the uniform pricing methodology is leading to high prices and moving to the pay as you bid strategy will lead to a lowering of the prices. We believe that large changes in the market design may only be done when there is strong evidence in their favour.

Lastly, prices may be high or low in the short term because of idiosyncratic factors. The policy makers and regulators can exercise large control over the behaviour of the medium term and long-term prices. Therefore, area of should be on ensuring that the medium term and long-term prices are fair and transparent where both the buyers and sellers' interests are protected. Ensuring fair prices in this time horizon will require focusing on resource adequacy not just in terms of electricity generation capacity but also the fuel supply for that generation capacity.

The other aspect which needs focus on is collecting and disseminating information related to **prices and the leading indicators for price changes**. This will help the CERC and the stakeholders in better managing the price shocks.

3.2. What should be the criteria for Regulatory Interventions?

The criteria for the regulatory interventions should be driven by how effective short- term interventions will be in controlling the prices vs leading to new costs in the medium terms and the long term.

The regulatory interventions in the market have to be rule based so that they are predictable, capture the behaviour and arrest the risk before it becomes systemic risk.

In this regard reference can be drawn from SEBI Regulations on circuit filter and price bands . Wwe could consider each hourly price as a scrip and rules be framed to capture movement of price either ways.

Dynamic Price bands or ratcheting type operating range based on gradient can also be adopted as a principle to suit our context.

This will help the market participants to in built these rules in their decision making. Two, this will also help the exchanges to adopt a rule based approach. The metrics which can be used are:

a. Block bid as a percentage of total bid
b. Number of block bids that can be placed by a market participant
c. the price ratio between the minimum and uranium bid. For example, the maxium quote can be upto 3 tines or 4 times or 5 times of the minimum

The price discovery function at the exchanges should introduce additional constraints to curb the volatility in prices can be introduced under periods of high and Sustained volatility on one side.

As mentioned earlier, in absence of a real time cost and pricing dataset available with CERC the information available is inadequate and insufficient to derive/observe the behavioural aspects and run few analytics, capture the impact of different interventions to decide on these important matters related to price caps, dynamic price caps, price bands and market segmentation. .

As we mentioned earlier, there needs to be solid evidence that the pricing methodology is contributing to the high prices or there is a set of generators who are able to exploit the market power and therefore have increased the markups on the variable costs. In absence of such an analysis and information it will be difficult to support any drastic change in the market design as it is bound to have multiple unintended consequences.

Lastly, it is not clear what are the timelines for implementing all these changes and will they be sufficient to reduce the prices in the short term.

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

Any administrative intervention will create unintended consequences in the market. We are of the view that CERC works on the following in the near term so that the market participants are aware of any build-up of stresses in the market, and is able to take preventive action and finally, we are ready to respond to such shocks in the near future:-

1. Create real time data on the electricity prices and the factors responsible for changes in the electricity prices so that policy makers and regulators can know in advance if there is going to be a large change in the prices. OTC platform can play a pivotal role in creating such a dataset and information.
2. Design methodologies after public consultation to identify market power in the different markets and the generators who enjoy such market power. Also identify a set of mechanisms for reducing or mitigating such market power. This may include price caps or work in tandem with the government which taxes the super-normal profits. The mechanism can have provision of auto-triggering of price caps so that generators know ex-ante that if they exercise market power then their super normal profits will be taken away. At the same time, such price caps can automatically be removed when certain price volatility and level criteria are satisfied.

3. Create a solid Resource Adequacy framework to be implemented through the OTC platform which takes into account not just the quantity of the electricity required but also the price sensitivities of a developing country like India.

4. Expand the scope of options available to market participants in terms of the contracting structure and market place. Currently, we have a monomaniacal obsession with the power exchanges in the country which could be counter-productive. Exchanges are neither responsible for a large set of problems in the electricity sector nor can they only be the solution to these challenges. CERC already has started taking steps for expanding the choice available to the participants through the setting up of an OTC platform.