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indus

21 September 2023

Mr. Harpreet Singh Pruthi
Secretary
Central Electricity Regulatory Committee
3rd & 4th Floor, Chanderlok Building
36, Janpath, New Delhi 110 001

Re: Staff Paper on Market Coupling (the "Paper")

Dear Sir,

Thank you very much for the opportunity to respond with our thoughts and comments on the Central Electricity Regulatory Commission's ("CERC") Paper.

Indus Capital Partners LLC (www.induscap.com) is a US-based asset manager focused on listed equity investments in the Asian region, including India. Funds under the management of Indus Capital Partners (hereafter "Indus") have been shareholders in India Energy Exchange ("IEX") for approximately three years to present. As part of our investment analysis, Indus has undertaken a comprehensive analysis of the Indian electricity market, in particular the short-term side of that market.

Indus appreciates CERC clearly framing the issues surrounding market coupling in the paper. Having carefully studied the Paper, in particular the three core objectives of market coupling, our over-arching view can be best summarized as:

If it ain't broke, then don't try to fix it!

We believe that implementation of market coupling will provide little benefit to CERC achieving its three core goals and based on suggested implementation techniques, there could well be undesirable consequences. Furthermore, we believe that CERC can realistically achieve all or part of its core goals via alternative policy reforms.

In closing, Indus respectfully requests that the CERC allow India's short-term market to develop more robustly over the next several years before seeking to re-appraise the benefits and potential risks associated with market coupling.

Sincerely,

Leonard B. De Somma
Partner, Head of Research

Karthik Chellappa
Vice President, Research Analyst

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The Paper lays down the three important objectives for Market Coupling:

1. Discovery of Uniform Market Clearing Price
2. Optimal Use of Transmission Infrastructure and
3. Maximization of Economic Surplus.

Taking each of these objectives in turn,

There already exists a discovery mechanism for a market clearing price. It just happens to be owned, operated and maintained by a publicly listed company, IEX. Whether the discovery mechanism is privately-owned or part of the public domain should make no difference so long the discovery function is efficient. Respectfully, we see CERC comments regarding different prices being discovered on PXIL and HPX as being grossly misleading since over 99% of the volumes for the RTM and DAM markets occurs on IEX. Therefore, IEX is (for these two markets) the *de facto* market clearing price. Given their extremely low market shares, pricing data from PXIL and HPX is effectively meaningless.

If IEX's RTM and DAM trading platforms provide the market clearing price, what is the need for a separate market coupling mechanism?

Regarding optimization of transmission infrastructure, we are unfortunately not trained electrical engineers so our comments regarding CERC's second core objective must be qualified. CERC notes that certain transmission capacity remains underutilized as it has been ***reserved*** for PXIL and HPX, thus creating inefficiency as those two exchanges are not making economic use of such reserved capacity. We think this issue can be easily corrected in the absence of market coupling either by re-allocating such reserved transmission capacity away from PXIL and HPX and/or terminating the reservation system completely and simply allowing open access to all three exchanges. Market coupling does not seem to be required to correct this issue.

Maximization of economic surplus is arguably the most important of the three objectives from the standpoint of India's overall economy. However, Indus views this objective as effectively the same as the first objective, only manifested in a different question of much greater scope. As IEX's RTM and DAM markets are the *de facto* discovery mechanisms for the respective market clearing prices, maximization of economic surplus is already being achieved.

As a subset of this third objective, CERC raised the issue of the fees paid to the exchanges as a drag on the maximization of economic surplus. Empirically this is not the case as short-term market buyers' and sellers' volume growth over the past five years suggest that participants are quite content to pay the current exchange fees in order to securely, optimally and transparently meet their short-term electricity requirements. Setting that aside for the sake of argument, CERC does possess the ability to reduce the exchange fees through negotiation with the exchanges the next time the fees come up for review. As shareholders of IEX, Indus is **not** advocating for any reduction in exchange fees. Our point is merely that simpler mechanisms can be utilized to reduce exchange fees (and thereby increase economic surplus) without needing to resort to a centralized market coupling mechanism.

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Beyond the three core objectives outlined in the Paper by CERC, Indus can foresee that an implementation of centralized market coupling could easily cause unintended consequences for India's electricity market.

- CERC references the European history of market coupling, presumably to provide readers with the comfort that India is following an established paradigm. However, the European market coupling initiative was borne out of an attempt to stitch together relatively small, single-county markets into a broader trading portfolio where more efficiencies could be gained. India as a single country is significantly larger than any single EU country. With approximately an equivalent population and consumption of about 50% of that of the EU (~1,500 TWh vs. 2,900 TWh), the size of the Indian electricity market already makes it highly efficient. Therefore, Indus sees the comparison as misleading and, ultimately, risky.

- CERC forecasts that implementation of market coupling will transform exchanges from "price discovery platforms" to " platforms which merely aggregate bids". Indus agrees this by far the most likely outcome. If so, this will deter the exchanges from engaging in product innovation or new product structures or pricing models since the incentive to innovate would be completely absent. In point of fact, the burgeoning RTM market would have never been able to develop if market coupling had been implemented five years ago.

- Indus also believes that efforts by CERC, other regulators and the relevant ministries to implement a centralized market coupling mechanism and de-nude the exchange of their current viable business model would have far-reaching, negative consequences for other India businesses operating under regulatory regimes. It has been literally decades and decades since expropriation of private sector assets (whether explicitly or *de facto*) was a legitimate risk in India. In that time, India has worked hard to successfully attract and maintain investment capital, both from domestic and international sources. Indus believes that stripping the exchanges of the most key element of their business model would significantly increase the political risks associated with investing in India and thereby likely inhibit capital investments. From the perspective of the entire economy, the implementation of a centralized market coupling mechanism could be quite harmful and more than erase any small gains in economic surplus derived solely within the electricity market.

With the opportunity to have your attention, Indus would like to further add:

- We strongly believe the priority of the regulator must be to ensure steady rise in volumes of short-term power traded on the Power Exchanges. Currently only one-half of India's short-term electricity market trades transparently via the power exchanges. The other half trades opaquely through either OTC traders or bilateral transactions between discoms. These non-transparent channels do not aid CERC whatsoever in term of contributing to more transparency and better price discovery. Indus would vastly prefer CERC to consider policies which would further curtail or, even better, eliminate opaque forms of dealing in the short-term electricity market. While Indus lacks the factual evidence to make a realistic calculation, we are confident that the economic surplus lost through the dealings by OTC traders and bilateral transactors is many times larger than any minor inefficiencies currently existing at the exchanges.

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- While the original goal of awarding three exchange licenses was to foster both competition in pricing and more product innovation, the reality of the exchange business model is that there is an extremely strong tendency to a 'winner-take-all' outcome due to customers' desires to transact only where there is the best liquidity. For better or worse, that is an iron-clad law of economics – a fact which CERC itself acknowledges at several points within the Paper. While not explicitly stated in the Paper, IEX emerging as the winner appears to be somewhat unsettling to CERC which perhaps hoped for less skewed market shares between the three exchanges. However, a centralized market coupling mechanism would only serve to enshrine a monopoly while at the same time reducing all competition to zero (which is currently not the case). We do not see how this latter case is a better outcome than the current paradigm.