To
The Secretary,
CERC,
GoI
30th Sept 2023

Subject: Thoughts on staff paper for introduction of Market Coupling for power exchanges in India

Dear Sir,

We take this opportunity to share our response to the proposed market coupling regulation in power exchanges to enable uniform price discovery. We are minority shareholders in IEX and therefore our view may be construed as biased towards our portfolio holding.

The note lays out rationale behind investing in IEX, draws your attention to investors observations and experience investing in other sectors and thoughts on the longer-term implications of any regulatory outcome on the sector. **The comments submitted hereunder are only to facilitate you in your decision making and in no way be viewed as advocating any recommendations to policy pronouncements.**

In summary, our view is that market coupling is not market oriented. Price discovery cannot be centralized. Our reading of other sectors suggests, price discovery must be organic, driven by demand and supply. That is where market forces have a role to play - helping discover demand and supply at various price points. If you take out this function, a marketplace has no relevance, whatsoever. If you centralize the function, how do you convince markets that price discovery is efficient? In most businesses that we have seen its mostly a "winner takes it all" system, the second player is rarely as large as the first, this is because of network effects, and it is by design. So, if you take out the marketplace function and leave only the passive-aggregation function, what is the incentive for a marketplace to exist? Had MBED been introduced, the trading volumes would have catapult to justify IEX's investments even in the wake of sacrificing some commissions. We are of the view that power market development was enabled by IEX - its investments, transparency, consistency, and orderly conduct of business were enablers and corner store of the market development. To limit its potential is to kill the goose that lays golden eggs. Ahead we share the example of BSE that has been able to gain market share due to launch of differentiated products in derivatives. The key is to introduce newer products, encourage competition to enable market development, not disrupt market-making function.

The interest on IEX was pinned on the favourable regulatory changes that promised an outsized opportunity for efficient incumbents and IEX's superior market positioning. The Indian Electricity market had evolved over time to become one of the largest electricity markets in the world. The regulatory landscape had also evolved in sync to take care of the evolving electricity market needs. The redrawing of the electricity architecture meant an outsized scope for power exchanges. Thus, for minority investors, the investment meant participating in a structural story on increasing penetration of short-term power trade theme in India. The Electricity Act 2003 beckoned to encourage 'efficiency' in the sector. The investment also meant that participating in the most efficient (capital efficient, transparent, innovation focussed, offering economic solutions to fix some of the fundamental problems ailing the sector) space within the power market value chain.

IEX and its peer PXIL started operations almost around the same time in 2010, so it was an even keel in terms of scope and market opportunity. An analysis suggests IEX and PXIL spent money in technology upgradation and buying out of software and hardware's. The workings extrapolated to date suggest, **IEX has expensed 47% of its cumulative Ebitda between FY14-23** towards materially improving its platform infrastructure and services. In contrast **PXIL has spent only 27% of its cumulative Ebitda between FY14-22** on similar infrastructure and capability creation. PXIL with low market share is extremely profitable as well. As exchange businesses by design have a cash stashed balance sheet (IEX, PXIL included) the comparison was done at the EBITDA level than PBT. It was thus inferred that IEX's platform efficiency, network effects and monopoly status was therefore an outcome of its massive spending in enabling its superior positioning in the market. Doesn't this suggest that IEX enabled short term exchange market development?

Across equities, commodities, and power market some incumbents have been able to garner a near monopoly stature among other things due to differentiated product offerings, technology and/or service. Thus, when power exchanges were introduced, it was laid out that if a Power Exchange which has less than 20% market share for continuously two financial years falling after a period of two years of commencement of its operations shall close operations or merge with an existing Power Exchange within a period of next six months. (For this purpose, Market size is defined as the total Annual Turnover in Million Units of all contracts transacted in all the Power Exchanges in each financial year) Provided that this regulation shall not apply if there are only two Power Exchanges in operation. Also, it was mentioned that exchanges would have a licence validity for 25 years. All this policy dictates have given confidence to investors that there would be no uncertainty to their investments for presumably a long period of time. Investors look for such concoctions (progressive sector + strong company). As IEX met many investment tenets, an allocation here became plausible!

As capital market participants, most evaluate sectors that straddle the entire spectrum of businesses ranging from government owned to regulated to private to international and therefore reasonably understand the imperatives of multiple stakeholders. For a greater community good, there is no better mantra than enforcing competition. It would be worth to share an anecdotal experience of investing in Telecommunication industry. The telecom industry in India is one of the largest in the world in terms of subscriber base, investments, and profits, yet it is so efficient that it also ranks the most affordable in terms of tariffs. The Indian government awarded 18 licenses to multiple operators to encourage competition and reduce tariffs in the sector. Eventually the stifling competition in the Indian telecom industry got so fierce that it consolidated itself without any regulatory intervention. Regulatory actions encouraged competition and market consolidated on its own!

Taking a leaf from an investing experience in the Indian fertiliser industry…As market prices were capped, the difference between cost of sales (cost of total production + profits) and market price was reimbursed to the industry by way of subsidies. This often came with a lag. Thus, changes in input cost had a bearing on subsidy outstanding and servicing the delay had a financial implication. This is sometime in 2010 the KG D6 was flaring gas (key feedstock for making urea) at its peak and companies at the mouth of the basin had lower delivered cost. This meant that some companies had an undue benefit due to their proximity to the gas fields and some others were disadvantaged due to them being far off in the hinterlands. To simplify the subsidy workings and have a uniform price for domestic gas, the GoI proposed pooling of domestic gas prices for fertiliser use. This made sure that no company benefitted unduly due to its proximity and energy efficiency was the only barometer on which they earned any significant gains. Point is efficiency was encouraged; proximity was democratised!

Another interesting anecdotal data that suggests how BSE has been able to garner market share lately because of a new – differentiated product offering. BSE witnessed a significant surge in equity derivatives volumes during the month of August, with a growth rate of 154% MoM. This increase can be mainly attributed to the introduction of a weekly index options contract (SENSEX) in May 2023. As a result, BSE's market share in the equity derivatives segment reached 3.4% in August, compared to zero in May.

Market share movements in Equity markets

Figure 1: BSE gain market share in the equity derivates in Aug-23

Eq Derv Mkt Share	NSE market share	BSE
Aug-23	**96.6%**	**3.4%**
Jul-23	98.6%	1.4%
Jun-23	99.6%	0.4%
May-23	100.0%	0.0%
Apr-23	100.0%	0.0%
Mar-23	100.0%	0.0%
Feb-23	100.0%	0.0%
Jan-23	100.0%	0.0%
Dec-22	99.0%	1.0%
Nov-22	98.6%	1.4%
Oct-22	98.6%	1.4%
Sep-22	98.7%	1.3%
Aug-22	98.3%	1.7%

Figure 2: NSE market share declined to 92% in Aug-23

Cash Eq Mkt Share	NSE market share	BSE
Aug-23	**91.8%**	**8.2%**
Jul-23	94.0%	6.0%
Jun-23	92.4%	7.6%
May-23	94.2%	5.8%
Apr-23	94.5%	5.5%
Mar-23	93.0%	7.0%
Feb-23	93.4%	6.6%
Jan-23	93.7%	6.3%
Dec-22	93.0%	7.0%
Nov-22	92.9%	7.1%
Oct-22	91.6%	8.4%
Sep-22	92.0%	8.0%
Aug-22	91.1%	8.9%

Figure 3: BSE start to gain market share in the Eq Derivates

Eq Derv Mkt Share	NSE	BSE
Q1'24	99.9%	0.1%
Q4'23	100.0%	0.0%
Q3'23	98.8%	1.2%
Q2'23	98.3%	1.7%
Q1'23	98.5%	1.5%
Q4'22	97.5%	2.5%
Q3'22	96.7%	3.3%
Q2'22	95.9%	4.1%
Q1'22	93.5%	6.5%
Q4'21	99.4%	0.6%
Q3'21	99.3%	0.7%
Q2'21	99.0%	1.0%

Figure 4: BSE market share declined marginally

Cash Eq Mkt Share	NSE market share	BSE
Q1'24	93.6%	6.4%
Q4'23	93.4%	6.6%
Q3'23	92.6%	7.4%
Q2'23	92.1%	7.9%
Q1'23	93.3%	6.7%
Q4'22	92.5%	7.5%
Q3'22	92.7%	7.3%
Q2'22	92.0%	8.0%
Q1'22	92.8%	7.2%
Q4'21	92.7%	7.3%
Q3'21	94.4%	5.6%
Q2'21	94.1%	5.9%

NSE drives over 90% of equity cash trading volumes and nearly 99% of equity derivatives trading to its platform, but to this day, you haven't come across any suggestion to have a coupler in the stock exchanges. Similarly, MCX continues to be India's leading commodity derivatives exchange with a market share of over 95% in terms of value of commodity futures contracts while the NCDEX remains the leading agricultural commodity exchange, (market share of 78% in the agricultural commodity). These data points suggest that platform/exchange businesses across verticals enjoy high market shares and there wasn't any exception with the power exchanges. The data from BSE also suggests that there is an equal chance of garnering market shares with new-differentiated launches. The new power exchange - HPX has been in operation for just about a year, if it be allowed to operate for more than a year, it can perhaps with differentiated product offerings garner market share from marketplace. That allows the sector to consolidate without any regulatory intervention.

IEX has invested ~ INR 1000cr cumulatively in the last 15years in creating a robust infrastructure. The sudden introduction of market coupling without introduction of MBED would overturn and dilute the colossal effort of IEX in building its massive capabilities. This will risk IEX's competitive positioning and economic interest. With the implementation of coupling, the key function of price discovery will be taken away – materially impairing the business model, earnings, and investor confidence. This policy pronouncement also vitiates the initial investment thesis and background for investing in power exchanges. (Pls refer the attached xls for an easy read through on financials and technology spends).

Market coupling will slacken efficiency and enterprise, disincentivise innovation, and dampen the much-needed investor confidence and future investments in the sector. Competition led markets have bred efficiencies in host of the sectors. The idea of a multi-exchange model in the power sector was originally conceived with a view to encouraging competition amongst the exchanges and catering to the growing and varying requirements of market participants. Thus, it would be prudent to increase competition and invite more participants on the exchanges than democratising the efficiency of extant incumbents.

We submit to GoI's regulations in faith, spirit, and actions that benefit all stakeholders alike.

On behalf of Old Bridge Capital Management

Kenneth Andrade
Founder and CIO