BEFORE THE CENTRAL ELECTRICITY REGULATORY COMMISSION
3RD AND 4TH FLOOR, CHANDRALOK BUILDING,
36, JANPATH, NEW DELHI - 110 001

IN THE MATTER OF:

Draft Central Electricity Regulatory Commission (Power Market) Regulations, 2020

Submissions of Prayas (Energy Group), Pune

13th August, 2020

The CERC vide public notice dated 18th July 2020, invited comments and suggestions from all stakeholders on the "Draft Central Electricity Regulatory Commission (Power Market) Regulations, 2020". The present submission is in response to the said notice and we request the Commission it on record. The main aspects of our submission are summarised below:

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1 Approach and Perspective

Given the growth of surplus contracted capacity, increasing capacity addition and cost-competitiveness of renewable energy (RE), growing viability of storage options, as well as proliferation of consumers seeking open access and captive options to meet demand, revision of CERC Power Market Regulations can provide a broad framework to increase market participation, provide flexibility to buyers and sellers and ensure adequate monitoring of market developments.

Many of the proposals in the draft regulations such as provisions related to the Commission's role regarding market oversight, increasing the number of independent directors on boards of power exchanges, mandating formation of market surveillance department, regular audits of clearing algorithm and introduction of OTC platforms will go a long way in ensuring robust market development in the country. Further, the draft regulations will also facilitate
development of forward markets and needs to be seen in the context of introduction of futures and derivatives for power.

In this context, our comments and suggestions focus on ensuring effective oversight, promoting competition and efficiency in market operations and ensuring that consumer rights and consumer welfare is protected.

2 Re-examine the need for market coupling

Part 5 of the draft regulations seeks to introduce a market coupling operator (MCO) which will collect bids from all power exchanges and perform the function of bid matching and price discovery such that there is a uniform price discovered for a collective transaction contract. The introduction of market coupling seeks to ensure optimal use of transmission infrastructure and by discovery of uniform prices, maximise economic surplus in the market.

With such a mechanism, buyers and sellers with bids in two different exchanges could be contracted for transfer of power. Moreover, it seems like communication of information to the NLDC for scheduling power, ensuring market splitting to manage congestion is to be managed by the power exchanges involved in the transaction. Some issues with the proposed arrangement are highlighted below:

2.1 Lack of clarity on implementation of coupling and related implications

The explanatory memorandum and the draft regulations do not clarify several aspects of the proposal which are vital to consider. It is our submission that these processes and aspects are further detailed out or discussed by the Commission in a staff paper or in the explanatory memorandum of the draft regulations for public consultation as understanding the process envisaged is also imperative while assessing the need for an MCO to increase market efficiency.

These include:

- **Process for execution of trades**: The processes by which communication with NLDC, market splitting, payment and settlement, management of default are to be managed when the buy and sell bids are in different exchanges are not clarified. Draft Regulation 38 (1) states that the MCO shall issue detailed procedure for implementing market coupling with the approval of the Commission but the details of the proposed process are not detailed for consideration in this public process.

- **Agency to be appointed as MCO**: As per draft regulation 38, CERC shall designate an MCO but there is no clarity as whether this entity will be an existing power exchange which has been involved with price matching and settlement, a new public sector undertaking or the central transmission utility.
– **Role of MCO in market oversight and surveillance**: Draft regulation 32 on market surveillance by the power exchanges and Part 7 on Market Oversight by the Commission do not specify any role for the MCO which performs the crucial function of matching bids. With the separation of the price discovery function, effective market oversight will only be possible with a significant role being played by the MCO as well. This needs to be clarified.

2.2 **Uniform price discovery and market development**

Through various initiatives, CERC has been endeavouring to introduce measures to foster competition and innovation with the goal of deepening markets. The appointment of a market coupling operator essentially would reduce the role of power exchanges to bid aggregators who also have to ensure settlement of contracts. It would dampen competition and reduce incentives to introduce new market products (contracts, bid orders etc.) and innovate with market clearing algorithms. In addition, the involvement of a separate agency for market clearing would add an additional layer of complexity in the settlement of contracts. Having non-uniform prices also would provide consumers freedom to choose between various platforms and market instruments to meet their demand.

The explanatory memorandum states that uniform price discovery is necessary for development of financial products in the electricity market. We submit that a uniform price need not be a pre-requisite for the development of financial products as the competent authority can approve separate products that are linked to the prices in each exchange. Uniform price is also stated to reduce the scope of arbitrage between DSM and the market. If such arbitrage is envisaged as an issue going forward with more power exchanges entering the fray, the DSM regulations could be amended to link price vectors on a block-wise basis, use price vectors from real-time markets rather than day ahead markets and ensure that the block-wise DSM price vector is higher than 10% of the weighted average price for the RTM contract for each block across exchanges. These changes will reduce the possibility of such arbitrage.

2.3 **Introduce MCO after medium-term examination of market operations**

Considering various changes in the sector due to structural shifts and the current proposals to deepen markets, it is suggested that the MCO be introduced after considering the impacts of introduction of new power exchanges, OTC platforms, new contracts and bid orders, trends related to congestion and market splitting and the development of electricity futures. The introduction can take place in five years with the amendment of the regulations based on public consultation with sufficient clarity on the operation of the MCO and evaluation of benefits from this arrangement. At this stage of India’s market development, it is our submission that power
exchanges be allowed to compete with price discovery as an important lever for them to use towards further innovation.

3 Performance scrutiny for eligibility of power exchanges

Regulation 35 of the Power Market Regulations, 2010, which served as an entry barrier to new exchanges has been removed. As per this regulation (which does not apply to the two existing power exchanges), a power exchange which has less than 20% market share for two consecutive financial years after its commencement shall close operations or merge with existing power exchange in a period of six months. While such a provision is quite restrictive to new players in this market, not having any performance indexed criteria to allow operations would also be detrimental to market development as there could be several non-serious players and skewed price discovery. In order to address this and to filter out consistently non-performing exchanges, it is suggested that the provision in Regulation 35 be retained with the followed suggested modifications (marked in bold).

“A Power Exchange which has less than 20% 15% 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-twelve 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.”

In addition, the performance and market share of the two existing exchanges should also be reviewed at the time when the exchanges apply for renewal of registration.

4 Regulatory approval for new contracts and bid orders

Draft regulation 25 clarifies the distinction between treatment of contracts and bid orders. In doing so, the draft regulations propose that regulatory approval is necessary for new contracts whereas no approval is needed for introduction of bid orders. In addition, the Commission can also allow new contracts in the power exchanges on its own. In the context of this proposal, we suggest that:

- **Bid orders are subject to regulatory approval after limited introduction:** While flexibility is needed to ensure market innovation, introduction of new bid orders could require changes in the price discovery algorithm and potentially result in marginal changes to the clearing price. This would particularly be an issue if an MCO is established. Therefore it is suggested that the introduction of bid orders are also subject to regulatory approval. However, in order to encourage innovation and acceptability of new bid orders, power exchanges can be
allowed to introduce new bid orders on a limited basis (limited duration and quantum) without regulatory approval after stakeholder consultation. The results and insights from the limited introduction should be submitted to the Commission when seeking approval for the bid order.

- **Audit of clearing algorithm before introduction of any new bid orders and contracts**: Draft regulation 28 (4) has a welcome provision to ensure regular audits of the clearing algorithm. In addition, the algorithm should also be subject to audits six months before and after the introduction of new bid orders and contracts to ensure a robust system and fair trades.

- **Clarification that power exchanges are free not to offer all existing contracts**: As draft regulation 25 states that the Commission can choose to introduce new contracts, the regulations should also clearly state that power exchanges are not obligated to introduce all existing contracts and can choose which contracts and bid orders they would like to introduce.

- **Clarity should be provided on regulatory treatment of green products**: Given the competitive price and proliferation of RE technologies, there has been significant interest in introducing green products in the day-ahead and term-ahead markets. Green products (bid orders or contracts that are exclusively renewable) would help increase market options and help obligated entities effectively meet statutory obligations and ensure flexible power procurement. Clarity should be provided in these regulations on the possibility of:
  
  - *Introducing ‘green’ bid orders* in the day-ahead market, where consumers can specify that they want only renewable energy power at the time of bidding. If all sell bids can be marked as ‘green’ or ‘brown’ at the time of bidding, the consumers opting for green bids can be matched with green options during market clearing.
  
  - *Provision of green attributes via RECs* such that the DAM clears at the market clearing price and renewable energy generators which clear can be provided RECs and can trade the same. The NLDC can monitor power scheduled to identify generators for issuance of RECs and RE generators can use this option by registering even part of their capacity under the REC mechanism. This will require appropriate change in REC regulations but could encourage renewable energy trades on DAM.
  
  - *Introducing term-ahead contracts via continuous trades* such that buyers are able to select RE generators in the term ahead markets to meet their demand.

Such clarity would reduce uncertainty for market players who want to introduce products focussing on this segment.
5 Eligibility and regulatory treatment of OTC platforms

In order to increase transparency in bilateral trades, the Commission has proposed to allow multiple OTC platforms that seek to provide information to potential buyers and sellers to assist their decision making process. In order to ensure such platforms are effective in deepening and broadening markets, it is suggested that:

- **Net worth for eligibility should be increased significantly:** Draft regulation 44 (1b) states that the net worth of the OTC platform application is Rs. 50 lakhs. Even though the service provided is limited, it is imperative that the entry barrier be higher to discourage ‘fly-by-night’ operators and non-serious players. It is suggested that the net worth requirement be increased to ensure serious participants to say, Rs 5 crores.

- **Clarity needed on the status of the DEEP portal:** The DEEP e-Bidding Portal managed by MSTC Limited, PFC Consulting Limited and the Ministry of Power also provides information to DISCOMs, traders and generators to assist with their procurement. However, contrary to the specifications in Regulation 47, the portal, in accordance with the short-term bidding guidelines is involved in execution, clearance or settlement of the contracts. Given Ministry of Power's proposal to allow open access consumers and generators on the DEEP portal and given the need for transparency in short-term contracts signed by utilities, the Commission should clarify as to whether the DEEP platform would require to be registered as an OTC platform. If so, the steps required to ensure that the short-term bidding guidelines are complied with should also be specified.

- **Need to ensure grievance redressal:** Similar to the power exchanges, OTC platforms should also be mandated to have an independent grievance redressal forum with details of complaints lodged by members regarding the functioning and obligations of the OTC platform and the status of the resolution of the grievance being published on their website.

- **Process required to flag multiple instances of false reporting or default:** The OTC platform must also be obligated to report to all buyers and sellers any dispute the registered buyer and seller has with any other registered buyer or seller in the OTC platform. This can be based on the information voluntarily submitted by the aggrieved buyer or seller and can be proactively sought by the OTC platform on a regular basis. Instances of repeated, reported defaults should also be flagged on the system to reduce risk taken by market participants.
6 Severity of penalties for market manipulation

Part 7 of the draft regulations deal with market oversight by the Commission. While the process and the suggested actions to be taken by the Commission’s seem appropriate, it is not clear if penalties prescribed would deter market manipulation. As per the current legal framework, for grave actions such as insider trading, cartelisation, abuse of dominant position, circular trading which increase volatility and risk to all market participants, it is likely that penalties will be imposed under Section 142 or Section 146 of the Electricity Act, 2003. Here, the penalties are limited to Rs. 1 lakh and seem insufficient. To ensure adequate deterrence it is necessary that the Electricity Act, 2003 be amended to stipulated specific penalties for market manipulation. CERC could communicate this necessity to the Ministry of Power.

7 Statutory data requirements and publishing data

The draft regulations have several welcome provisions to ensure timely reporting as well as dissemination of data and information. To further strengthen these processes the following changes are suggested:

– **Data submissions as per draft Regulation 31(5) to be publicly available:** The power exchanges are mandated to submit information in Forms I-XIV of the draft regulations. As the information is not of a commercially sensitive nature and records past trades, it is suggested that the submissions to the Commission be available on the website of the exchange as well as the Commission in an easily accessible, downloadable format. This would be useful to understand trends given that trading licenses also report statutory data submissions on their websites.

– **Suggestions to improve data formats:** In addition to the information being provided as per Regulation 31, it is suggested that the following be reported:
  
  o **Collective transactions:** contract-wise, **block-wise** data on prices (constrained and unconstrained), volumes (constrained and unconstrained) and historic prices of power traded along with number of buy bids and sell bids in each block should be reported on the website of the Power Exchange and should be in downloadable format. It is essential that new power exchanges also provide this information and thus should be stipulated in the regulations.

  o **REC transactions:** Data summary on category-wise RECs bought and sold. Indicative categories can be DISCOM, OA, CPP, Voluntary etc.

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1 In fact, names of buyers and sellers for each day are already being reported by some news aggregators.
- Collective and continuous trade: Data summaries for volume and price on a daily basis for each contract. The data can be summarised fuel wise (coal, hydro, solar, wind), based on buyers (DISCOM, Open Access, trading licence), type of seller (DISCOM, open access generator, state-owned generator, trading licence). This would be similar to formats prescribed for reporting by trading licensees.

- Removal of time-limits for data availability: There are multiple provisions in the draft regulations which specify maintenance of records which are to be made available to the Commission. However, the stipulation is time-bound as recorded below:

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<td>32</td>
<td>Related to market surveillance, data security, and audio recording of conversations of such personnel maintained by the power exchange.</td>
<td>2 years</td>
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<td>16</td>
<td>Documents and records relating to the issue or transfer of power exchange shares.</td>
<td>8 years</td>
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<tr>
<td>22</td>
<td>Documents by members for obtaining membership including compliance with power exchange criteria.</td>
<td>5 years</td>
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Since data storage is not a particular constraint with the possibility of digitisation of records, it is suggested the time-limits stated in the regulations be removed.

8 Public consultation for crucial processes

Draft regulations 12, 35, 45 and 48 should be modified to ensure that the crucial processes for grant, renewal, revocation of power exchanges and OTC platforms involve public consultation.

Similarly, draft regulation 25 should be modified to ensure approval and suspension of contracts and bid orders takes place after due public consultation.

Further, as intervention by the Commission under draft regulation 51 and 52 could potentially affect all market participants, public consultation for these processes would also be necessary.

9 Issues with definitions

Scope of regulation and OTC contracts: Over the counter contracts (OTC) are defined as “contracts transacted outside the Power Exchanges” and an OTC market is defined as “a market where OTC Contracts are transacted between the sellers and the buyers directly or through a Trading Licensee”. In this context, it is pertinent to note that Regulation 3 and 4 specify that the regulations are applicable for the OTC market and contracts in the OTC market. Given jurisdictional issues with intra-state trades, existence of long term contracts in the sector, the definition and the scope of the regulations should be more specific with respect to OTC contracts.
**Definition of real time market:** In the draft regulations, a real-time contract “means a contract other than Day Ahead Contract or Intraday Contract or Contingency Contract, wherein Collective Transactions occur on day (T) or day (T-1) and delivery of electricity is on day (T) for a specified delivery period”. In essence, it is defined in the context of other contracts rather than detailing what it entails. This should be clarified and clearly defined in the final regulations.

**10 Are Futures and Derivatives necessary in the electricity sector?**

In a sector where retail tariffs and prices for most consumers are determined based on a cost-plus basis with a guaranteed, fixed, regulated rate of return, the risk of increased price volatility, and impact of market manipulation, if any, would directly be passed onto electricity consumers rather than remain restricted to the buyers and sellers participating in the market. The introduction of futures and derivatives linked to electricity contracts will expose India’s developing market to significant price and volume risks and potential market manipulation. The need for sufficient liquidity as a pre-requisite to introduce derivatives has also been highlighted by the Commission in the past. Irrespective of these dangers and the sector complexity, if futures are being introduced in the sector, strong cooperation between the financial and electricity regulators, significant information sharing and adequate caution in introducing financial products would be imperative to protect the interest of buyers, sellers and final consumers. The competent authority must factor the market structures in the electricity sector while designing financial products. Similar submissions will be made before the competent authority while deliberating such products.

To ensure that financial products contribute to the reduction of volatility and expansion of market operations in the sector it is imperative that there is:

- **Transparency in products:** Details of all indices and products are transparently shared and developed after due public consultation and consultation with CERC.
- **Products should be available only for suitable markets:** Futures and derivatives may not be suitable for markets with low turnover and low number of transactions. For example, the term-ahead markets in each exchange have seen very low volumes over the years and there is high likelihood to market concentration. Designing financial products for such markets will only increase possibility of market manipulation and volatility. Thus, only contracts with high number of buy and sell bids and low evidence of concentration should have financial products linked to it.
- **Products should be based on delivered price:** Going forward, with increased trades on the market and the launch of financial products, it is likely that significant bidding can take place accounting for times and points of congestion in order to influence the market price. As contract annulment is possible during transmission constraints, players can influence
prices without incurring the risk of default. Therefore, it would be suitable if the products are based on actual delivered price of contracts rather than the market clearing price on each exchange.

- **Sharing of information, market oversight between regulators**: The competent authority for financial products and CERC should share reports of market surveillance and relevant analysis to track market manipulation across the two types of markets. Joint action to counter manipulation should also be planned between the regulators.

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