

**CENTRAL ELECTRICITY REGULATORY COMMISSION  
NEW DELHI**

**Coram:**

- 1. Shri Bhanu Bhushan, Member**
- 2. Shri R. Krishnamoorthy, Member**

**Petition No. 21/2008**

**In the matter of**

Application for grant of permission to Power Exchange India Limited for setting up and operating Power Exchange

**And in the matter of**

Power Exchange India Limited, Mumbai

**....Petitioner**

**The following were present:**

1. Shri T.Venkat Rao, PXIL/NSE
2. Shri R. Nanda Kumar, PXIL/NSE
3. Shri Arvind Pal Singh, PXIL/NCDEX
4. Shri Kaushik, PXIL/NCDEX
5. Shri B.B. Jindal, Objector

**ORDER  
(DATE OF HEARING : 24.4.2008)**

This application has been made by Power Exchange India Ltd (hereinafter referred to as "the applicant") in accordance with the guidelines issued by the Commission vide order dated 6.2.2007 in Petition No. 155/2006 (*suo motu*) (hereinafter referred to as "the guidelines") for grant of permission for setting up and operating the power exchange (hereinafter referred to as 'PX').

2. The applicant has been promoted by National Stock Exchange of India Limited and National Commodities & Derivatives Exchange of India Limited, each holding 50% of equity shares against the subscribed share capital of Rs. 5 lakh. The promoters of the applicant are said to have the experience of setting up and running of world class

electronic exchanges and the persons responsible for its management have adequate knowledge of the electricity laws. The applicant has proposed that in future shareholder base will be diversified by bringing in persons operating in power sector and the financial institutions.

3. The main objects of the applicant as stated in its Memorandum of Association are:

“(1) To carry on the business of Power Exchange and to facilitate, promote assist, regulate and manage in the public interest, dealings in electrical power of all kinds and provide specialized, advanced, automated and modern facilities for buying, selling and trading of all forms of electrical power, ancillary services, transmission rights under applicable laws and regulations, clearing and settlement thereof, and to ensure buying, selling and trading in a transparent, fair and open manner with access to all participants including producers, suppliers, retailers, traders, consumers, transmitters, exporters and importers in the electrical power markets and foreign funds, corporates and banks engaged in financing electrical power transactions from areas in or outside India.

(2) To initiate, facilitate and undertake all such activities in relation to the Exchange providing facilities for trading in electrical power, ancillary services, transmission rights etc., as are required for reliable nationwide platform to hedge electrical power and price related risks for cross-section of participants in the various forms of electrical power including producers, suppliers, retailers, traders, consumers, transmitters, exporters and importers in the electrical power markets and foreign funds, corporates and banks engaged in financing electrical power transactions from areas in or outside India; to offer hedging and other related requirements to the community at large; to provide novel and innovative mechanisms, to the market participants of electrical power; and to support, develop, promote and maintain a healthy market in the best interests of all players, market participants and in the general public and the economy and to introduce high standards of professionalism among themselves and the electrical power market in general.”

4. The Commission, in discharge of its statutory responsibility under Section 66 of the Electricity Act, 2003 (hereinafter referred to as “the Act”) has issued the guidelines vide order dated 6.2.2007 in Petition No. 155/2006 (*suo motu*) for grant of permission

for setting up and operation of the PX. As per the guidelines, the PX shall have the following broad features:

- (a) de-mutualized form of organization;
- (b) reliable, effective and impartial management;
- (c) ring-fencing between ownership, management and participation;
- (d) investment support from the investors including institutional investors;
- (e) transparency in operation and decision-making;
- (f) computerized trading and clearing system;
- (g) efficient clearing settlement and guarantee system;
- (h) effective trade information dissemination system.

5. A company incorporated under the Companies Act, 1956 or a consortium of companies, who have entered into a formal agreement on issues critical to the setting up of the PX are eligible to make application before the Commission for permission. Any person desirous of setting up the PX and fulfilling the eligibility criteria may make an application in accordance with para 6.2 of the guidelines. The person making the application is also required to publish a public notices of its application.

6. The applicant has made the present application for permission to set up and operate the PX in keeping with the guidelines. The applicant having been incorporated to carry out the business of the PX as noticed from its main objects reproduced in para 3 above fulfils the basic eligibility condition laid down under the guidelines. The applicant's proposal to establish the PX has the following objectives, namely -

- (a) to set up adequate infrastructure for trading, clearing, and settlement of electricity contracts for the Indian power sector participants;

- (b) to provide single window clearance for traded electricity contracts;
- (c) to provide a market for the distribution entities for meeting top up demand;
- (d) to augment the Government's objectives of reducing peaking power deficit;
- (e) to provide equitable market place for the new merchant capacities;
- (f) to augment existing supplies through untapped sources;
- (g) to put in place a transparent, fair price discovery mechanism which can signal massive potential investment into the electricity sector; and
- (h) to be a catalyst for the power sector to move from scarcity-based pricing to a competition-based pricing structure.

7. The applicant has published the notices of its application in all editions of the Hindu and Business Line on 24.2.2008 and has also posted the application on its website. The objections to the application have been filed by one Shri B.B. Jindal, Member (Retired), erstwhile Uttar Pradesh State Electricity Board, hereinafter referred to as "the objector", vide his affidavit dated 20.3.2008 opposing grant of permission to the applicant for setting up of the power exchange. According to the objector, unplanned proliferation of power exchanges instead of benefiting the consumers would lead to higher cost to them. It has been stated that the Commission having already granted permission to set up the PX to Indian Energy Exchange who has already taken a number of steps, should reject the present application, particularly so when the staff paper earlier circulated on behalf of the Commission favoured one national level PX. The objector wants a complete moratorium on setting up of new

power exchanges for a period of five years. Another objection raised is that the applicant has not involved any person from the power sector in the process and has not identified any person to be in charge of its operations. It has been pointed out that the application does not disclose whether the approval of SEBI and FMC, the regulatory bodies of the two promoters of the applicant to set up the PX has been obtained. It has been stated that the application does not contain any details regarding the manner of operation of the PX or handling of sector specific issues or scheduling and operating procedures or even the persons to be entitled to participate in the trading at the PX. Commenting upon para 8.12.5 of the bye-laws of the proposed PX, according to which transfer of trade would be allowed in case of failure of any person participating at the PX to pay dues, the objector has urged that the transfer should not be allowed in any circumstances. Further, according to the objector, close out proposed in para 8.12.6 of the bye-laws will lead to lot of speculative trading on the PX as the buyers and sellers would not be obliged to make payment or give delivery compulsorily as any default will lead to close out.

8. We have considered the above objections in the light of clarifications furnished by the applicant. In our opinion, entry of power exchanges, manned by the persons with experience of operating other exchanges will lead to competition in the electricity sector, which is the one of the basic aims of the Act. This in our view, will ultimately benefit the consumers. It is true that the staff paper envisaged setting up of one national level power exchange but the Commission has already decided in favour of setting up of more than one national level exchanges. The staff paper circulated to generate debate and to elicit the views of the stakeholders on different aspects cannot be pressed into service by the objector since it does not reflect the decision of the

Commission on any matter covered therein. In the circumstances, the question of any moratorium should not arise. We have been re-assured by the applicant that it shall not lack in efforts to build the necessary infrastructure and to create awareness for developing transparent power market in India. In fact, the applicant will not have any escape in case it is to stay in business in a competitive environment that we propose to create through the multiple power exchanges. The applicant has the capacity and capability to achieve these objectives when considered in the light of past experience of its promoters who have made their own contribution in operation of securities and commodities exchanges. As has already been noted, the applicant intends to involve players from the power sector into equity structure as also in the management by putting up a team of competent professionals into place in accordance with the Commission's guidelines. On the question of approval of SEBI and FMC, the applicant has clarified that NCDEX, one of the two promoters has already obtained the necessary approval from FMC as far as it applies to NCDEX. The objector has not brought to our notice any provision of law mandating approval of SEBI for setting up Power Exchange. The applicant has delineated basic operating principles of the proposed PX in the Project Report forming part of its application, which spells out the auction methodology to be used. The Project Report also contains the details regarding types of contracts to be traded initially, methods of congestion management, issues critical to the functioning of the exchange such as clearing, market surveillance, risk management, etc. The Project Report also dwells upon timelines for operation of the proposed PX, congruent with the operating timelines of RLDCs and SLDCs. We impress upon the applicant to develop and finalise mechanism for different purposes by involving the stakeholders in the light of

broad outlines contained in the Project Report. We have no reasons to believe that the applicant is likely to falter on any of the parameters.

9. The objector has commented upon certain provisions of the draft rules and bye-laws which the applicant has filed as part of the application. These rules and bye-laws provide for the eligibility criteria for becoming member of the PX. These clearly bring out who can participate on the PX. In response to the objections, the applicant has urged that transfer of trade must be permitted in the event of a member being declared a defaulter. Similarly, the applicant has argued that the provisions in the draft bye-laws relating to close out of trades should also be retained since by this provision, it will be possible to impose penalties on the failing members to impress upon them and other players to fulfill their obligations in time and also act as a deterrent. For the present we are not according our approval to the proposed rules and bye-laws. Therefore, presently these issues are kept open and will be considered at the stage of approving the draft rules and bye-laws before they come into operation.

10. Having considered and disposed of the objections, we now proceed to examine the broad features of the proposed PX, as under:-

(a) **De-mutualised form of organization:** - In a demutualised form of organization, the ownership and management is segregated from the trading rights of the members. According to the applicant, the objective of demutualisation is proposed to be achieved through a diversified shareholding base by involving power sector stakeholders and financial institutions. It has been stated that majority stake holding of at least 52% would be held by promoters and not more than 1/4<sup>th</sup> number of Board of Directors will be from

the trading participants of the PX. We are of the view that at least fifty-one percent of the equity share capital of the PX should be held by the public other than the shareholders having the trading rights in the exchange in order to maintain the demutualized character of the organization. Further, we consider it appropriate that participation within the trading and non-trading groups should be diversified in order to discourage monopolistic situations, and to facilitate emergence of professionally managed organization in the interest of power sector.

**(b) Ring-fencing between ownership, management and participation:-**

The applicant has stated that the proposed PX will have clear demarcation between the ownership, management and trading participants by ensuring that the entities having a shareholding in the company would not be able to interfere in the day-to-day management and operation of the PX. The Board of Directors of the PX will comprise of representatives of the promoters having vast domain knowledge and will be persons of repute.. An independent specialized and competent management team would be constituted with a Managing Director and CEO to run the day-to-day operation of the PX. The management team will report to the Board about the progress of the PX at periodic intervals and take broad directional inputs regarding the functioning of the exchange. We have been assured that complete ring-fencing between owners, management and the trading participants will be achieved and that the management will insulate itself from day-to-day functioning of the PX.

(c) **Reliable, effective and impartial management:-** The applicant has stated that the affairs of the PX will be overseen by its Board of Directors who will decide its policies and determine its compliance. The day-to-day affairs of the PX will be managed by a team headed by a Managing Director and CEO. The management team will be constituted of professionals with relevant technical background and work experience. In our view, the applicant should put in place effective HR and regulatory structures to ensure that there is no conflict of interests in the PX and any violation would be dealt with through a suitable disciplinary mechanism and legal procedure

(d) **Funding sources:-** The applicant has submitted that the total project cost of the PX will be funded by the promoters as equity in the company along with other stakeholders proposed to be involved from financial institutions and power sectors. The authorized capital of the company have been proposed to be Rs.25 crore. The applicant has proposed to increase its authorized capital and infuse further capital depending upon needs during the implementation and operation of the PX. At this stage all we can say is that the functioning and operation of the PX should not be allowed to suffer on account of non-availability of funds and resources and the applicant shall be required to take necessary steps to generate the resources.

(e) **Membership of the PX:-** The applicant has proposed to provide an open market place for the participants which will include those involved in trading electricity, distribution licensees, generating companies, consumers and other stakeholders would be admitted as members. The PX proposes to have trading

members. The PX will satisfy itself regarding the financial and technical competence of the members before their registration. The members will be required to submit “no objection certificate” from the SLDC, RLDC, STU and CTU, as the case may be, in support of their connectivity with the grid.

(f) **Transparency in operation and decision making:** - It has been proposed that the participants can trade, the day before, standard hourly contracts and block contracts that commit them to (schedules for) injecting into or drawing power from the grid a volume of electricity at a given hour at a market price. The time line for trading has been indicated by the applicant as under:

- (i) 1000 hrs : Collection of Available Transmission Capacity (ATC) from NLDC/RLDCs and display the information on website of PX
- (ii) 1000-1200 hrs : Receipt of bids from members

We accept “in principle” the applicant’s proposal for receipt of bids for day ahead trading between 1000 hrs to 1200 hrs. Interface design and procedure for coordination are matters of details for which the applicant would have to interact with the NLDC/RLDCs and arrive at a mutually acceptable and reasonable arrangement.

(g) **Clearing and Settlement of Contracts:** - The applicant has proposed to have a clearing house to monitor and perform all activities relating to funds settlements and scheduling, as being followed by its promoters. The applicant should specify the banks which shall be authorized for electronic transfer of funds between clearing members (i.e. members of the Clearing House) and

exchange and also the process, procedures and operations which will be followed by every clearing member for participation in the clearing and settlement activities.

(h) **Transmission capacity, transmission charges and losses:-** The applicant has discussed two scenarios for transmission charges - one as per the existing regulation and the other as per the discussion paper floated by the Commission for revision of transmission charges. The transmission charges, operating charges and the transmission losses shall be applied by the PX to its schedules as per the Commission's regulations and orders issued from time to time. The PX shall be responsible for making payments to the NLDC/RLDC/SLDC for the transmission charges and operating charges.

(i) **Transmission Congestion Management:** - The applicant has proposed to manage transmission congestion through market splitting. This is acceptable in principle. The applicant would be required to create bid areas for market splitting as per the requirement of NLDC from time to time. This issue will also be examined further at the time of approval to the rules.

(j) **Surveillance :** The applicant has proposed to have a Market Surveillance department which will ensure continuous supervision of market participants' behaviour regarding trading and compliance with the rules. The applicant should ensure that the market surveillance team is well equipped and empowered to deal with the possible price manipulation by vested interests. Necessary provisions should be made in the bye-laws or rules of the PX.

(k) **Dispute Resolution:-** The applicant has proposed that in case of disputes arising between the members of the PX or the client and the members, the dispute resolution will be done through arbitration committee to be appointed. In the event of a dispute involving the PX and NLDC/RLDCs, the dispute will be referred to the Commission. The Commission is of the view that the arrangement is acceptable and necessary provisions to that effect should be made in the rules of the PX.

(l) **Bye-laws, rules and regulation of the PX:-** The applicant has enclosed draft bye-laws and rules of the proposed PX. The bye-laws deal with contracts, trading on the exchange, trading system, clearing house, margins, clearing and settlement, settlement guarantee funds, code of conduct of members, arbitration and conciliation. Similarly, the rules only deal with the management and membership of the PX. We are of the view that the bye-laws and rules of the PX should be developed in accordance with sub-paras (g) and (h) of the paragraph 6.2 of the guidelines and submitted for scrutiny by the Commission.

11. In view of the above discussion, we are satisfied that the applicant prima facie meets the requirements of the guidelines for setting up of the PX. Accordingly, we accord 'in principle' approval to the applicant to set up and operate the PX in accordance with the guidelines and keeping in view our above observations. The 'in principle' approval should enable the applicant to concretize the design of power exchange.

12. The PX shall start as a platform for scheduled, day-ahead trading of electricity. There shall be no fictional trading in the PX. All settled trades shall be compulsorily advised to the NLDC for being scheduled, subject to transmission capacity availability.

13. The requirements specified by us as given hereunder shall be complied with by the applicant:-

- (a) The day-ahead power exchange platform to be developed by the applicant shall facilitate scheduled trading of electricity, subject to transmission constraints, if any, in accordance with the procedure of scheduling of collective transactions specified under the Central Electricity Regulatory Commission (Open Access in Inter-State Transmission) Regulations, 2008.
- (b) The time-line of exchange activities shall conform to that to be specified in the procedures for scheduling for collective transactions.
- (c) For interface design and procedure for coordination with NLDC/RLDC the applicant shall interact with the NLDC/RLDC and decide on the mutually acceptable and reasonable arrangement.
- (d) The applicant shall further develop and evolve the methodology for handling transmission congestion in consultation with NLDC/RLDC and submit to the Commission for approval.

- (e) The applicant shall endeavor to expand the electricity market by facilitating trading by all the entities entitled to buy or sell electricity in accordance with law, including the intra-State entities.
- (f) The transmission charges, operating charges and transmission losses shall be applicable to the power exchange schedules in accordance with the Regulations and other orders of the Commission in force from time to time.
- (g) The PX shall be responsible for making payment to the NLDC/SLDC for the transmission charges and operating charges, whereas the transmission losses shall be absorbed by the buyers and sellers as specified in Central Electricity Regulatory Commission (Open Access in inter-State Transmission) Regulations, 2008.
- (h) While finalizing the design, rules and bye-laws, it shall be ensured that price rigging, price manipulation and other market abuses are not possible. A surveillance unit shall be created in the PX which will independently monitor this aspect. In order to ensure market integrity and to avoid market abuses, the PX shall use various on-line and off-line surveillance tools. The Commission shall be kept informed of the steps taken in this regard.

- (i) The applicant's suggestion regarding curtailment of schedules by NLDC in case of transmission constraints would be taken into account while finalizing the procedures of scheduling for collective transactions.

14. The rules and regulations of the exchange should reflect such dynamic market driven changes for which operational freedom should be allowed to the applicant. We have a sincere desire that the PX should emerge as a market-guided institution with minimal regulation. The applicant shall take necessary steps to finalize the PX design, its bye-laws and rules in accordance with our observations made in this order and submit the same for approval of the Commission before starting the operation of the PX.

Sd/-  
**(R. KRISHNAMOORTHY)**  
**MEMBER**

Sd/-  
**(BHANU BHUSHAN)**  
**MEMBER**

**New Delhi, dated the 27<sup>th</sup> May 2008**