Market for Power

Scope for trading in spite of economic downturn

The setting up of power exchanges is an important step towards sector reforms. These exchanges are expected to resolve demand-supply mismatches by allowing power-surplus regions to trade power at optimal prices with buyers. A few months into exchange-based trading, *Power Line* speaks to industry experts for their opinion on the impact of the economic slowdown as well as regulatory proposals on the trading scenario in the country...

What, according to you, has been the impact of the economic slowdown on power trading?

Amulya Charan

In spite of the economic slowdown, the demand for power continues to be higher than its availability. For two months, peak power rates had dropped and there were few takers of night power; but rates have shot up once again and enough supplies are not available to meet the demand.

Jayant Deo

With the economic slowdown, the number of businesses operating on night shifts has seen a decline. This has, in turn, reduced the demand for power. For instance, in February, from 12 a.m. to 5 a.m., the price discovered on the ex-change was Rs 1.50 to Rs 2. But despite such low prices, there were no takers. States' balances have also been affected and even if they do face shortages, they have no money to buy power, which is otherwise abundantly available. Of course, this may also have been on account of the winter.

R.K. Madan

The economic slowdown has affected development activities globally including those in India, leading to a reduced need for power. However, there has been no reduction in the power needs of the country's agricultural and domestic sectors. As a major part of India has been facing power-deficit conditions, the power trading business has not been affected so far. As a matter of fact, power prices have come down marginally. Since the national planners are making all efforts to revive the economy, and power availability being a basic input in this regard, in my view, the power trading business needs to get a further boost.

Rupa Devi Singh

The global economic slowdown may not have a significant or immediate impact on the structure of the power sector in India. This is on account of the fact that a reduction, if any, in industrial production and a consequent reduction in power requirement from the grids has only been evident to a limited extent right now. This could also be because a large part of the industrial consumption of power is taken care of by captive units. In fact, there have been various instances where captive generation capacity has been freed up due to reduced industrial production, leading to power availability in the short-term trading market.

However, the negative global financial scenario has affected the financing of some of the new and ongoing power generation and transmission projects, with doubts looming over their viability with the added risk averseness of lenders.

Most of the new generation projects – in both the public and private sectors – have earmarked a certain part of their capacities for trading on a merchant basis. Since these capacities were expected to constitute a major source of liquidity for short-term power markets, delays due to the slowdown may impact liquidity in the power trading markets. Delays and difficulties in developing generation capacity would eventually affect all components of the sector including power trading.

T.N. Thakur

The capital markets have become extremely risk averse due to the economic slowdown. As a result, lending to power projects may witness protracted negotiations and delays in financial closure. This would definitely have an impact on the availability of capacity in the medium to

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long term. However, there has not been any visible impact on power trading due to the economic slowdown. In fact, as things stand, we expect to register the highest growth in short-term power trading during fiscal year 2008-09.

Do we need multiple power exchanges?

Amulya Charan

It is good to have some competition in every sphere.

Jayant Deo

Competition between power exchanges is necessary but the entry of exchanges should be spaced out. Multiple power exchanges would provide more choice to market participants. However, unless sufficient volumes for trading are available, multiple exchanges would not foster the required competition.

R.K. Madan

Trading in electricity, an accepted business practice in power markets all over the world, sets the stage for efficient generation and transmission regimes. Since it helps in providing stability, secures the functioning of regional grids and reduces the demand-supply gap, power trading is the need of the day. Power exchanges are required so that these emerge as market-based institutions for providing price discovery and price risk management to generators, distribution licensees, traders and consumers.

However, in view of the quantum of power available for trading, a single power exchange offering appropriate and transparent representations to all classes of players will serve the needs of the power sector in a better way. It will also be easier for regional load despatch centres and the national load despatch centre to deal more efficiently with one exchange. When trading volumes increase substantially over the coming years, multiple power exchanges can be planned.

Rupa Devi Singh

Power exchanges are institutional infrastructure dedicated to the development of the country's power sector. They operate as neutral platforms for the discovery of fair prices in the short-term market, and bring about efficiency in power trading. However, a power exchange involves operation costs as well as expenses in setting up the necessary infrastructure. These are borne by the participants themselves, thus making it imperative for the exchange to be a commercially viable investment avenue. This viability is brought about through the participation of power sector entities; by attaining adequate trade volumes; and through regulatory and policy support. What needs to be evaluated is whether the costs involved in the duplication of infrastructure or those incurred as a result of fragmentation of the market, actually work towards the envisaged objective of value addition to the sector.

T.N. Thakur

Setting up a power exchange is a purely business decision to be taken by those willing to bear the risks associated with developing such exchanges. Whether we need a single national power exchange or multiple power exchanges eventually depends on the availability of adequate trading volumes and market reactions to such developments. In fact, the market is the arbitrator in such matters. As long as the market accommodates multiple exchanges and developers are ready to take risks, there should not be any curbs through policy or regulation.

Where do you see trading prices going in the short- to medium-term markets?

Amulya Charan

This is really a function of the demand-supply balance and the ability of buyers to foot their bills in cash. Prices are currently very high, and it is difficult to say how long they will remain this way.

Jayant Deo

In the last two or three days of February 2009, states like Andhra Pradesh experienced an unprecedented heat wave. This increased power demand. This is the time of the year when crops need to be watered, which creates demand for power. Moreover, with school board examinations taking place this month, states have made efforts to ensure uninterrupted power supply. The upcoming elections are generating additional demand for power. After the elections, power prices are expected to stabilise at lower prices. In the coming months, prices are also expected to come down because of wind-based generation in the southern states. If the monsoons reach early, hydel generation should pick up and result in lower prices.

R.K. Madan

Trading prices are determined by the state utilities in view of their power demand and the availability of power through competitive bidding. The power market is weather sensitive. Power-deficit conditions are being faced now. Based on these parameters and looking at the generation capacity addition plans for the next one to two years, we do not foresee much change in short-term power prices in spells of peak summer or winter.

However, in view of the planned generation capacity addition for the next five to seven years, including the thrust by authorities for utilisation of surplus captive generation and the creation of a conducive environment for free trading, prices may come down in the medium term.

Rupa Devi Singh

Power prices in the short term are affected by multiple variables such as seasonal changes, climatic conditions, technical reasons, policy scenario (for example open access), and events like examinations, festivals, elections, etc. In the short term, we expect the prices to continue in the same range as the past one or two months.

However, the transparent and efficient electronic platform provided by the exchange will lead to the unlocking of existing capacities and attract fresh investments into the sector. This is expected to be supported by a conducive regulatory and policy environment. Over time, therefore, with a greater number of participants and with more capacity transacted over efficient platforms like Power Exchange India, the prices discovered in the spot markets should rationalise.

T.N. Thakur

By nature, trading prices are volatile and depend on various factors such as seasonal variations and time-of-day demand variations. Since the Indian power sector has an inherent weakness by way of supply shortages, trading prices will naturally increase in the short term. But as the suppliers would be able to get higher prices, the trend will encourage other players to enter the arena. This should bring in competition and cause a downward pressure on the price of traded power in the medium to long term. An indication of how prices vary can be observed at the power exchange, which is a transparent trading platform. It is seen that prices vary from about Re 1 per kWh during lean periods to more than Rs 12 during peak periods.

What is your view on the regulators' proposal to put a cap on trading prices and remove the existing one on trading margins?

Amulya Charan

Capping trading prices would take us back to the days of licence permit control. Private investment, which has started coming into the power sector, will completely dry up, leading to continued shortages for a long time. This is not really good for the country, which is on the threshold of rapid economic growth. Thankfully, the proposal has been put to rest for the time being.

The cap on trading margins has already been challenged by traders and the case is pending with in Supreme Court.

Jayant Deo

Removing impediments in supply can control prices. For example, states like Tamil Nadu and Andhra Pradesh have biomass plants of a few hundred megawatts. They offered to sell power at Rs 3 per unit, even when their cost of generation was higher. Since open access was denied to them, they suffered. Had open access been granted, the power supply situation could have improved as they would have generated and at the same time, recovered their cost of generation. The ultimate goal is to increase supply. Open access enables it and also attracts investment for capacity addition.

R.K. Madan

Backed by a well-laid-out regulatory framework, power trading has, over the years, evolved into a free and transparent mechanism based on competitive bidding. This ensures a level playing field for all participants. This arrangement needs to be completely supported.

As in any market, the price of a commodity is dependent on its need and availability. This is borne out by the fact that there are sharp differentials in the price of traded power in different seasons. Any attempt to disturb the present arrangement by putting a cap on trading prices, will only bring about undesired distortions. For example, with a cap in place, all bidders are most likely to quote the ceiling price. This could give rise to unfair discriminatory practices while awarding contracts and put an end to the free and fair power trading market that has evolved over the years. In my view, this will be a retrograde step.

With regard to trading margins, even after the removal of the current ceiling, margins will necessarily be low, as otherwise, it will be difficult for power traders to get business and survive in the highly competitive market.

Rupa Devi Singh

The commission has taken a judicious view on the issue of capping trading prices and removing the cap on trading margins. We share the view that the issue of rising power prices in the short term cannot be looked at in isolation. Besides, any attempt to implement such caps would involve a plethora of issues such as optimum limits of price caps, uniform or time-differentiated caps, across-the-board caps or different caps for different sources of power/nature of participants, the relevance and effectiveness of the current unscheduled interchange mechanism and power rationing policies.

We believe that the recent notifications brought out by the commission will provide the necessary guidance to participating entities to rationalise the pricing of their commercial transactions in the short-term traded power market.

T.N. Thakur

The measures for restraining electricity prices in short-term sales/trading reflect severe conceptual deficiencies, are contrary to the letter and spirit of the law, are against the basic principle of market operation, and will severely affect capacity creation in the power sector.

In fact, the measures to cap traded power costs will result in the undoing of the capacity creation programme that is currently under way, particularly in the private sector. For the first time in the history of independent India, there is a real prospect of large capacity addition by the private sector on account of expectations of market-based returns. Enabling provisions of the Electricity Act, 2003 have also created a conducive environment for investment in all segments of the industry, for both the public and private sectors, by removing entry barriers in different segments.

Also, the wholesale market for electricity in India is completely voluntary by design and none of the market participants is obliged to operate through a restricted and compulsory market. Internationally, there are no price caps wherever voluntary electricity markets operate. Even in markets that are mandatory in nature, the price cap is set at very high levels, say, 20-25 times the average retail tariff, so as to not distort price formation in the markets.

As far as capping the trading margin is concerned, we maintain that it is a retrograde step and is not conducive to attracting investments in the power market. The matter is, however, sub judice and I shall refrain from commenting more on it. ■