No. L-7/25(50)2003-CERC

CENTRAL ELECTRICITY REGULATORY COMMISSION
NEW DELHI

Coram:

1. **Shri Ashok Basu, Chairperson**
2. **Shri K.N. Sinha, Member**
3. **Shri Bhanu Bhushan, Member**
4. **Shri A.H. Jung, Member**

Re: Fixation of Trading Margin – Statement of Reasons

Preliminary

The object of the Electricity Act, 2003 (the Act) is to consolidate the laws relating to generation, transmission, distribution, trading, use of electricity and for development of electricity industry, promoting competition even while ensuring supply of electricity to all areas, duly protecting the interests of the consumer. The Act came into effect on 10.6.2003, and recognized trading in electricity as a distinct activity. The Central Commission established under the Act has been authorized to fix trading margins, if considered necessary under Clause (j) of sub-section (1) of Section 79 of the Act. Under the Act, no person can undertake inter-state trading in electricity unless authorized to do so by a licence issued by the Central Commission. The Act also authorizes the Central Commission to make regulations consistent with the Act and the rules framed by the Central Government to carry out the provisions of the Act. In view of these provisions, the Central Commission has notified the Central Electricity Regulatory Commission (Procedure, Terms & Conditions for grant of Trading Licence and other matters) Regulations 2004 (the regulations) which were published in the Official Gazette on 6.2.2004 and are in operation since then.

2. Under the regulations, the licensee has been, *inter alia*, mandated to charge trading margin for inter-state trading as fixed by the Commission from time to time. Further, in terms of the regulations, the licensee is required to furnish the information prescribed, periodically, to enable the Commission to monitor his performance and to ensure compliance by him of the terms and conditions of the licence or any other legislative or regulatory requirement. 13 companies were issued licences for inter-state trading in electricity during 2004-05. Another 5 companies have been issued such licences during the current financial year, i.e. 2005-06 so far.

3. Periodical statements submitted by the licensees during 2004-05 were analysed at the Commission's office. It emerged that trading margin of 5 paise per unit or less was charged in respect of 10549.5 Mus of electricity, which constituted 89.05 % of the total electricity traded during the year. It was also revealed that for 35.28 MUs of electricity constituting 0.03% of the total electricity traded, the trading margin of more than 30 paise per unit was charged by the licensees. The position in this regard is summarized in the table given below:

Trading Margin (Piase/kWh)	**Volume of Electricity Traded (Million kWh)**	**% of total Volume**
<1	1.94	0.02
1	37.16	0.31
2	253.2	2.14
3	110.73	0.93
4	1725.45	14.57
5	8421.02	71.08
6-10	608.85	5.14
11-20	409.3	3.45
21-30	243.6	2.06
31-43	35.28	0.30
44-100	0.00	0.00
>100	0.00	0.00
Total	11846.53	100

4. The licensee-wise details of trading undertaken during the period in question are summarized below:

	% of Volume Traded during 2004-05				
Trading Margin (Paise.kWh)	**Total**	**Power Trading Corporation**	**NTPC Vidyut Vyapar Nigam Ltd**	**Adani Exports Ltd**	**Tata Power Trading Company Ltd**
<1	0.02	0.00	0.00	0.24	0.00
1	0.31	0.00	0.58	2.72	0.00
2	2.14	0.00	7.68	6.51	0.00
3	0.93	0.93	0.30	2.60	5.44
4	14.57	17.00	10.90	2.44	0.00
5	71.08	75.02	79.35	4.02	61.11
6-10	5.14	5.55	1.07	11.72	33.45
11-20	3.45	0.46	0.12	45.82	0.00
21-30	2.06	1.04	0.00	19.53	0.00
31-43	0.30	0.00	0.00	4.40	0.00
44-100	0.00	0.00	0.00	0.00	0.00
>100	0.00	0.00	0.00	0.00	0.00
	100.00	**100.00**	**100.00**	**100.00**	**100.00**

5. Based on the subsequent reports received from PTC India Ltd and Adani Exports Ltd, among other licensees, it was revealed that the former in certain cases had charged trading margin up to 30 paise/kWh and the latter had charged trading margin up to 36 paise/kWh for some of the transactions. The Commission, by its order dated 4.6.2005 sought to ascertain the reasons from the concerned licensees for charging high trading margins. It was explained by the licensees that after adjusting for the open access charges, transmission losses, RLDC charges, etc. the actual trading margins were much less than those indicated in the order dated 4.6.2005. It was further explained that the transactions which fetched higher trading margins were for very short durations and exposed the licensees to greater payment risk.

6. On detailed consideration of the replies it was noticed that the mitigating factors narrated by the licensees for charging higher trading margin were also applicable to the transactions whereon they had charged trading margin of 5

paise/kWh or less. On consideration of the various aspects of the matter, the Commission had proposed to fix trading margin not exceeding 2 paise/kWh, excluding the charges for scheduled energy and open access. For this purpose, the Commission had published the draft regulations to invite objections or suggestions from the stakeholders. The Commission's view in this regard was conveyed to the concerned licensees through order dated 22.9.2005.

7. A list of the stakeholders who have responded to the proposals made in the draft regulations is annexed at Appendix 'A' to this statement of reasons. We propose to consider the objections or suggestions received from the stakeholders.

Preliminary submissions

8. Some of the stakeholders have raised a preliminary issue that the Commission has not disclosed any reasons for fixing trading margin of 2 paise/kWh which, according to them, is allegedly against the spirit of sub-section (3) of Section 79 of the Act which, it has been averred, casts an obligation on the Commission to ensure transparency while exercising its powers and discharging its functions. We do not find any merit in the issue raised. The draft regulations containing the proposals for fixation of trading margin were published under Section 178 of the Act to carry out the objects and purposes of the Act. Sub-section (3) of Section 178 lays down that all regulations made by the Central Commission under the Act are to be subjected to the conditions of previous publication. Section 23 of the General Clauses Act lays down the provisions applicable to making rules or bye-laws after previous publication. According to these provisions, the authority having power to make the rules or bye-laws is,

before making them, required to publish a draft of the proposed rules or bye-laws for the information of persons likely to be affected thereby. Along with the draft of the proposed rules or bye-laws, a notice is required to be published, the intention of which is to invite any objections or suggestions thereon. The objections or suggestions received by the authority having power to make the rules or bye-laws are to be considered by the concerned authority before finalizing the rules or bye-laws. It is established law that in case of subordinate legislation, as in the present case, the parent Act may itself provide for procedure in which case substantial non-observance of the statutorily prescribed mode may have the effect of invalidating the subordinate legislation. But where the legislature has not chosen to provide for any particular procedural aspect, say notice or hearing, no one can insist upon it and it will not be permissible to read natural justice into such legislative activity [Union of India Vs Cynamide India Ltd – (1987) 2 SCC 720]. The procedure laid down under the General Clauses Act does not mandate that the reasons for making rules or bye-laws should be disclosed along with the draft rules or bye-laws or the notice published. In the present case, the procedure prescribed for the purpose has been strictly followed by the Commission. Accordingly, it does not involve procedural or any other irregularity. The objections or suggestions received from the stakeholders are presently under consideration, without any oral hearing because the law does not provide for it.

Need for Trading Margin

9. The traders have questioned the need for fixation of trading margin. It has been stated that the trading margin should be left to be regulated by the market forces, particularly when in the present scenario, sale and purchase of electricity

by the traders in through the process of bidding. In the opinion of the traders, fixation of trading margin would stifle trading activity, push them out of business and will prove detrimental to the electricity sector as a whole. It has been stated by these traders that fixation of trading margin would affect their fundamental right to trade or business. On the contrary, the state utilities engaged in the generation and distribution of electricity have welcomed the proposal made by the Commission to fix trading margin, since according to them, otherwise there is manifold increase in price of electricity supplied to the consumers.

10. We consider the matter from the perspective of the comments made by the traders. Electricity is of intrinsic importance to the building of the nation and to the common man in general. Any increase in prices of electricity has a multiplier effect on the country's economy. The increase in price of electricity sold to the Electricity Board or the distribution licensee has serious impact on every institution and individual consuming electricity. Electricity which has become an essential commodity, is required for running industry, commercial activity, agriculture and for the domestic use. Through increase in price of electricity, every category of consumer has to pay more, resulting in cascading effect of increasing the price of every commodity. In this manner, the common man is affected and increase in price has a substantial effect on the cost of products of vital importance and service to the public. This underlines the urgent need to make electricity available at reasonable price.

11. The position in regard to trading margin charged by the licensees during the period April-September 2005 culled out from the periodical reports received from them is extracted hereunder:

Trading Margin (Paise.kWh)	% of Volume Traded during 2005-06 (April to September 2005)					
	Total	**PTC**	**NNVL**	**AEL**	**TPTCL**	**RETL**
<1	1.64	1.68	0.00	2.51	0.00	7.25
1	0.18	0.00	0.00	1.02	0.00	0.00
2	0.39	0.21	2.86	0.00	0.00	0.00
3	3.74	5.08	4.86	0.07	0.00	0.00
4	0.89	0.28	0.00	3.77	0.77	0.00
5	24.86	17.68	90.85	4.10	53.80	44.98
6-10	47.73	70.71	1.43	4.13	6.41	32.60
11-20	13.86	2.87	0.00	54.21	32.08	15.17
21-30	2.59	1.49	0.00	8.10	3.04	0.00
31-43	0.55	0.00	0.00	1.96	2.87	0.00
44-100	2.51	0.00	0.00	14.01	1.03	0.00
>100	1.06	0.00	0.00	6.12	0.00	0.00
	100.00	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

12. The position in this regard is summarized further in terms of percentage of electricity sold at varying trading margins:

Description		**2005-06 (April-September 2005)**
Volume traded in the margin of	≤ 5 paise/KWh	31.7 %
	6-10 paise/KWh	47.73%
	≥ 11 paise/KWh	20.57 %
Weighted Average trading margin		10 paise/KWh

13. There is an overall power shortage in the country and the scenario is likely to continue for quite sometime. However, there are short time surpluses mainly in Eastern and Northeastern Regions which are being tapped by traders for selling power to deficit States of Northern and Western Regions. Traders by themselves are not producers, and competition among them to capture the meager surplus power for sale has resulted in raising the prices rather than bringing them down. At present some Discom/SEBs are involved in limited purchase or sale of electricity through bilateral trading in order to mitigate shortage or to optimize their operation as the case may be. These entities know each other quite well and traders have a very little role to play other than rotation of the payment from the buyer to the seller. They would have an important role to play when there are

large number of open access consumers looking for alternate source of supply through open access route.

14. In the light of above-stated position, we have carefully evaluated the response from the stakeholders and the emerging trend of charging an increasingly higher trading margin by the traders. We have noted that about 89.05% of the volume traded was with margin of 5 paise per kWh or less during 2004-05 and the same has come down to about 31.7% in the first half of 2005-06. The weighted average trading margin which was about 6 paise per kWh in 2004-05 has gone up to about 10 paise per kWh in first half of 2005-06. The highest trading margin in a single transaction charged in the year 2004-05 was 43 paise per kWh by Adani Exports Ltd., and 128 paise per kWh in the first half of 2005-06 also by Adani Exports Ltd. We do not find any logical justification for this sharp increase in trading margin. The trend clearly indicates that the traders have taken advantage of the deficit situation prevailing in most parts of the country. Profiteering by itself, is retrograde. Profiteering in scarce resources of the community is doubly so. It is a practice which needs to be fettered . Therefore, the fixation of trading margin is necessary to avoid arbitrary exercise of power by the traders to fix their own margins of profit and to avoid keeping the consumers at the whim and vagary of the traders. In order to achieve the objectives given in the statement of objects and purposes of the Act, there is a need to ensure that the traders do not take undue advantage of the deficit situation. In our considered view, the objectives of the Act can be achieved by fixing a reasonable trading margin. While participating in the process for purchase and sale of electricity, the traders will make their offers after taking the trading margin into consideration, being fixed presently.

15. One of the grounds urged by the traders to oppose fixation of trading margin is that risks involved in each transaction are different and cannot be factored into a uniform trading margin. They have pointed out that they have to reserve the transmission path through open access between a buyer and seller by paying up- front charges corresponding to 100% contracted power but in real time the trade often takes place much below the contracted amount due to default either by the seller (due to generation failure at its end) or by the buyer (due to load crash at its end). Due to low volume of energy traded, the open access charges increase in terms of per kWh and the traders have to absorb the excess amount paid for open access. This exposes them to considerable risk and causes reduction in their profit. In this connection, we would like to point out that the risk of open access charges was taken care of by the Commission while publishing the draft regulations when it was proposed to exclude these charges for computation of trading margin. While the trader can pay the charges for open access up-front based on contracted power, a suitable provision can be incorporated in the agreements for purchase/sale of electricity for recovery of the open access charges in case of default by any party. Another risk pointed out by the traders is the penalties payable to the buyer due to default in supply by seller and vice versa. On this issue, the Commission feels that the appropriate commercial arrangements between the traders and sellers/buyers of electricity can take care of the risk perceived.

16. The traders in their responses have also sought to be insulated against the transmission losses. In this regard, it is to be mentioned that as per the scheduling procedure in force, transmission losses are loaded to the buyer in kind and taken care of in the schedules. The same are not to be borne by the

trader. The commercial responsibility on account of default of overdrawal by the buyer or under generation by the seller does not lie with trader as per the Unscheduled Interchange (UI) settlement mechanism already in force. Therefore, the traders are exposed to a minimal risk, if appropriate conditions have been incorporated into the agreements with sellers and buyers.

17. The traders have pointed out the risk of recovery from the SEBs/distribution licensees buying power from them because of the latter's precarious financial position. For this reason, the traders have opposed fixation of trading margin. All that we can say is that the risk perceived is purely imaginary. The Commission's regulations on inter-state trading specifically lay down that trading should be carried out bilaterally between the parties by entering into appropriate contracts and all trading arrangements shall be through the LC or with any other superior instrument. These provisions take care of risk of the persons selling to the traders as also of the traders themselves. Therefore, there will not be any risk of recovery, unless the traders choose to ignore the provisions made in the regulations. If they do so, they do at their own peril.

18. Some of the stakeholders have suggested that trading margin should be fixed in specific cases where the Commission finds that a licensee is abusing its position and is charging exorbitant trading margins and the proportion of transaction with high trading margin is very high. It has also been suggested that the trading margin should be as a percentage of total transaction value rather than per unit. Some of the licensees have suggested that the trading margins should be applicable only to those traders who have captured bulk of the trading business and small traders should be exempt from trading margins. In our

opinion, it will be difficult to segregate the transactions on the lines suggested by the traders and may be impossible to implement in practice. In case the margin is fixed on overall volume, retrospective adjustment may be required to bring it back within the limited period. Therefore, we do not take into account these suggestions.

19. AES feels that for a trader, who assumes higher risk in signing long-term PPA without a back to back arrangement, plays a development role and therefore, there should be no limit of trading margin for such trading. At present, the power is being traded on short-term contracts of less than one year other than international trade, which is not under our domain. Accordingly, we feel that under the present circumstances regulations for fixation of trading margin should be applicable to all short- term transactions not exceeding one year.

20. We are not convinced that fixation of trading margin affects any person's fundamental right enshrined under sub-clause (g) of Clause (1) of Article 19 of the Constitution of India, on the ground that it puts unreasonable restrictions on the traders' right to occupation, trade or business. The fact that the Act has a specific provision for fixation of trading margins by the Appropriate Commission indicates the clear intention of the legislature on the issue. Besides, it is a well-established proposition of law that where restrictions are imposed on a citizen carrying on a trade or commerce in an essential commodity (as mentioned in para 10), the aspect of fair and equitable distribution of the commodity to the consumer at a fixed price leaving a reasonable margin of profit, is a consideration which does not make the restriction unreasonable. In such cases even if the margin of profit is slashed that would not make the restriction unreasonable.

[Laxmi Khandsari Vs State of UP – (1981) 2 SCC 600]. The trading margins are proposed to be fixed in the overall interest of the country's economy and in the interest of the consumers of electricity to secure availability of electricity at a fair and reasonable price. At the same time, reasonable profit to the trader is proposed to be ensured. Therefore, fixation of trading margin will not affect anyone's fundamental right to carry any occupation, trade or business.

21. The tariff policy notified by the Central Government in pursuance of Section 3 of the Act, while emphasizing the need to promote trading in electricity for making the markets competitive also envisages fixation of trading margin by the Appropriate Commission to ensure that the electricity traders do not indulge in profiteering in situation of power shortage.

22. For the foregoing reasons, we have decided to proceed with fixation of trading margin as there is nothing in law to deter us from such adopting such a course.

<u>Trading Margin</u>

23. In the draft regulations a trading margin of 2 paise/kWh was proposed. The traders and some other respondents have generally felt that the trading margin of 2 paise/kWh is not adequate and does not cover the actual costs. It has been suggested by some of them that the Commission should carry out an elaborate cost study similar to that carried out for fixation of tariff for a regulated utility, in order to find out a reasonable trading margin.

24. We feel that in the field of electricity trading where competition is likely to intensify, hands-off regulations in the form of ceiling on trading margin is favoured option rather than an intrusive cost-based regulation applicable for determination of tariff for sale and transmission of electricity.

25. Where the statute has prescribed the factors which should be taken into consideration and which should guide the determination of fair price, it has to be ensured that these considerations are kept in mind. In other cases, it is open to the subordinate legislating authority to prescribe and adopt its own criteria. The subordinate legislating body is under no obligation to adopt the method adopted by the income-tax authorities in allowing expenses for the purpose of ascertaining income and assessing it. There may be many items of business expenditure which may be allowed by income-tax authorities as legitimate expenses, but which may not be considered for price fixation. There is no law or any statutory provision laying down the criteria or the principles which must be followed or which must guide the Commission in the determination of trading margin. It must also be noted that trading margin is not to be fixed keeping in mind the requirements of the traders alone. We have to be fair to the consumers as well, particularly when a trader buys power for re-sale, without making any value addition. In fixing trading margin, the only consideration should be to allow a reasonable return on 'net worth' and cover any incidental charges.

26. Since open access charges and transmission losses are excluded as noted earlier, there are two main type of expenses which the trader has to bear:

(a) Banking Charges for Letter of Credit, and
(b) Operating expenses (Rent, transport, salary, communication etc)

27. The banking charges are roughly of the order of 0.5% of value of traded electricity. However, these charges could be less or more depending on the credibility and standing of the trader. Further, except for the requirement of two experts, one in the field of power system operation and commercial aspects of power transfer and another in the field of Finance, commerce and accounts, the regulations do not have significant impact on operating expenses. Thus, in the present scenario, the trader has an opportunity to optimize the operating expenses. Any attempt to standardize operating expenses of traders may led to inefficiencies. Also, it may not be practically possible to standardize operating expenses of electricity trader just as the operating expenses of any other trade cannot be standardized.

28. It is seen that margin of less than 5 paise/KWh was a voluntary practice for the year 2004-05. It is also to be noted that the Commission had granted 13 trading licence during 2004-05, which indicates that industry expectation of trading margin was being met with the prevailing trading margin.

29. It is also to be seen that when trading margin of 5 paise/kWh or less was being charged by the traders during the period 2004-05, they were exposed to the following risks:

(i) Transmission charges payable to transmission licensees and operating charges payable to Load Despatch Centres were not refundable even if the transaction could not last for the contracted duration due to default either by seller or buyer, and

(ii) Transmission charges, Operating Charges and application fees were paid by the traders up-front, which were built into pr kWh selling rate by the trader so as to recover this amount. If actual energy transacted was less than the originally expected the trader was not able to recover the open access charges paid up-front.

30. The first of the above mentioned risks was minimized when the Commission issued amendments to the regulations on open access in inter-state transmission in February 2005, applicable from 1.4.2005. The amended regulations provide that a short-term open access customer can surrender the reserved transmission capacity and for that it will be required to bear transmission charges and operating charges for only 7 days or the balance period of reservation for transmission capacity, whichever period is shorter. Also, the earlier reservation of corridor could not be less than 24 hours. Now, as a further facility, after amendment of these regulations, the corridor can be reserved for 6 hours, 12 hours or 24 hours.

31. In the draft regulations on trading margin, it is clearly defined that the margin is exclusive of transmission charges, operating charges and application fees. It has also been clarified in this order that such charges, even if paid up-front by trader, shall be recoverable from either buyer or seller through appropriate provision in the agreement. This arrangement will eliminate the second of the two risks mentioned above, that is, risk associated with up-front payment of certain charges made by the trader.

32. The fact that risks and returns go hand in hand is well established in the field of business and economy. Thus, having removed the major risks faced by the traders during the period 2004-05, when they were charging trading margin of 5 paise/kWh or less, we have come to conclusion that trading margin should be less than 5 paise/kWh. Therefore, we have decided to fix ceiling for trading margin at 4 paise/kWh.

Conclusion

33. Based on the above discussions, we are satisfied that it would be reasonable to limit trading margin to 4 paise/ kWh including all charges except the charges for scheduled energy and open access. As already brought out, the transmission losses and UI charges are not applicable to electricity traders. We order that the final regulations on fixation of trading margin shall be notified accordingly.

Sd/-	Sd/-	Sd/-	Sd/-
(A.H. JUNG)	**(BHANU BHUSHAN)**	**(K.N. SINHA)**	**(A.K. BASU)**
MEMBER	**MEMBER**	**MEMBER**	**CHAIRPERSON**

New Delhi dated the 23rd January 2005

Appendix `A' to the Statement of Reasons

A. Traders

1. PTC India Ltd. (PTC)
2. Reliance Energy Trading Ltd. (RETL)
3. Tata Power Trading Company Ltd. (TPTCL)
4. NTPC Vidyut Vyapar Nigam Ltd. (NVVNL)
5. Adani Exports Ltd. (AEL)
6. GMR Energy Ltd. (GMR)
7. Karam Chand Thapar & Bros(s) Ltd. (Thapar)
8. Lanco Electric Utility Ltd. (Lanco)
9. Jindal Steel & Power Ltd. (Jindal)
10. Instinct Advertising & Marketing (P) Ltd. (INSTINCT)

B. SEBs/Discoms

1. Chhatisgarh State Electricity Board (CSEB)
2. Maharashtra State Electricity Distribution Company Ltd. (MAHADISCOM)
3. Rajasthan Rajya Vidyut Prasaran Nigam Ltd. (RRVPNL)
4. Madhya Pradesh State Electricity Board (MPSEB)
5. Gujarat Urja Vitran Nigam Ltd. (GUVNL)
6. Punjab State Electricity Board (PSEB)

C. Regulator

1. Rajasthan Electricity Regulatory Commission (RERC)

D. Generator

1. Haryana Power Generation Company Ltd. (HPGCL)
2. Neyveli Lignite Corporation Ltd. (NLC)

E. Others

1. Dr. K.K. Das, Former Director, CEA
2. Shri K.M. Manoj
3. Shri R.K. Kapoor, Power Consultant
4. Dr. Anoop Singh, IIT Kanpur
5. AES (India) Private Ltd. (AES)