

Comments on Draft CERC Regulations for Prevention of Adverse Effect on Competition, 2012

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- 1. Approach to Address Market Abuse:** An approach to address market abuse should be based on a strategy of Avoidance, Remedy and Deterrence. Information disclosure is one of the effective tools to avoid market abuse as this comes under watchful attention of sector stakeholders, consumers, NGOs as well as the academic/research community. Need for period information disclosure on key aspects should be made available by respective stakeholder through CERC website. A credible penalty structure should provide adequate deterrent (this is discussed later). Remedial actions may include compensation to affected parties and actions to ensure that similar situation does not arise in future. This may include review/revision of these regulations as well.
- 2. Objectivity of Regulations - Regulation 5(2), 6(4), 7(3):** The factors mentioned therein are quite subjective as these use terms like 'extent', 'level', 'degree', 'likelihood', 'possibility' etc. Without any objective means of establishing these terms or a methodology/framework to ascertain the same, the burden of proof would lie on the investigating officer. This may often be subject to legal debate. The draft regulations are often vague and leave enough room for creative interpretation.
- 3. Meaningful Penalty Structure:** Part XIV of the Electricity Act 2003 does not explicitly define penalty in the context of market abuse. The reference to Penalty in Electricity Act 2003 is only with reference to the directions issued by a Commission. Such directions may be issued subsequent to a market abuse, the Act does not specify penalty for market abuse itself. This gap needs to be addressed through an amendment to Electricity Act 2003. Section 60 also does not refer to a consumer who could also be part of market abuse / gaming. Further, the 'applicable' penalty (specified in Section 142, read with Section 60) does not exceed Rs. One Lakh. In case of a power market where gains can often run into crores of rupees, such low penalty would not be a deterrent for market abuse. The penalty should be a credible deterrent to market abuse.

The regulations should provide for the minimum level of penalty to be twice of the gains made or loss caused, whichever is higher. In case of multiple parties, apportionment of the penalty can be made on the basis of the relative role of such parties. In case of failure to pay penalty, the actions should include revocation of license under section 19 of the EA 2003 and consequence thereupon. This may also provide for personal liability.

- 4. Transmission and Distribution Access as a factor - Regulation 5(2), 6(4), 7(3):** While considering adverse impact on competition in the context of Agreement, Dominance and Combination respectively, there should be a reference to access to transmission and distribution

network. These three conditions can influence the ability of a market player to access transmission and distribution network and hence adversely affect competition.

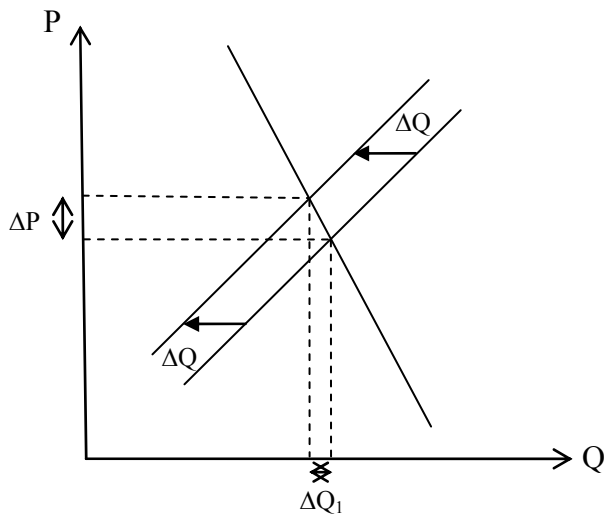
5. **Influence of Adverse Impact on Prices - Regulation 5(2), 6(4), 7(3):** Price as a factor to determine Anti-Competitive Agreement: Adverse impact on price is one of the key outfall of compromised competition. 'Price' does not find mention in the list of factors mentioned in this regulation. While considering adverse impact on competition in the context of Agreement, Dominance and Combination respectively, there should be a reference to influence on price. A reference to 'price' in Regulation 6(3) only refers to the same being 'imposed' under the condition a dominant position.
6. **Context of Power Purchase Agreement (PPA):** Should a power purchase agreement (PPA) be construed as anti competitive? In theory, this is true as prices are negotiated rather than discovered in the market. Can relevant product market include 'power procured through a PPA'?
7. **Subsidy and Cross Subsidy:** How would the regulations deal with situations involving subsidy and cross-subsidy surcharge, both of which can tilt the situation in favour of those receiving benefits of the same?
8. **Action of 'State':** How should regulations address a situation if action of 'state' leads to anti-competitive outcome? For e.g. decision of a state utility to invite limited bids for short-term power procurement or on non-transparent terms that favour a potential bidder. What if negotiated terms gain precedence over competitive procurement process?
9. **Role of Power Exchange (PX) and System Operator (SO):** There could be conditions under which actions of power exchanges or a system operator may also compromise competition due to its actions. These may include certain kind of disclosures by a PX especially in a market characterized by poor liquidity or withholding information regarding system status and transmission availability by a SO.
10. **Role of Franchisee: Regulation 4(3):** In case of issues arising out of retail supply to consumers, role of a franchisee should be brought into consideration as well. Actions on the part of a Franchisee can upset retail competition (upto the extent distribution open access is permitted or when full retail competition is introduced in future). A Franchisee can influence access to distribution network and availability of associated facilities or charge unfair wheeling charges or charges for services like metering and billing. A franchisee can enter into agreements or understanding to adversely influence the market outcome. Hence, role of franchisees should be recognized vis a vis a situation of 'Agreement', 'Dominant' Position' and 'Combination'.
11. **Regulation 4(3), 4(4):** The reference to 'conditions of substitutability' and 'conditions of homogeneity' should be clarified with respect to electricity markets be defined in the draft regulations.
12. **'Tacit' understanding rather an 'explicit' Agreement - Regulation 5(1):** A number of anti-competitive outcomes are of a result of 'tacit' understanding rather than 'explicit' agreement. Lack of proof of existence of such an 'agreement' between market participants or stakeholders, may often frustrate the basic objective of the regulation to inhibit anti-competitive behaviour.

Section 40 of the Electricity Act 2003 should also provide scope for 'tacit' agreement for market abuse as most abuses do not have an underlying 'explicit' agreement. Market surveillance is one

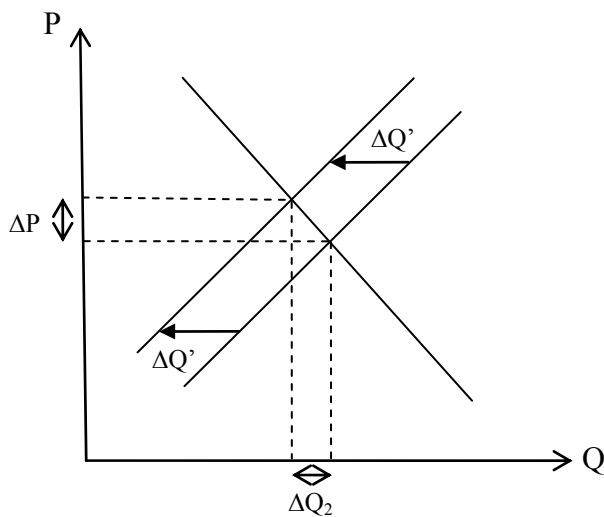
of methods to identify ‘tacit agreements. Hence, the above changes should be coupled with a improved framework for market monitoring than currently in place.

- 13. Market Surveillance:** Trading and Power Exchanges (PXs) currently contribute a small share of total power transaction in the country. This share is expected to grow in future. Due to increase in overall size of the power transactions in the power sector, total amount of transactions would growth significantly even if share of trading and PX does not growth significantly. In the emerging scenario the ‘market monitoring’ activities of CERC should, in the near future, graduate towards “Market Surveillance”, similar to the approach adopted by The Securities and Exchange Board of India (SEBI). A number of instances of market abuse can be best detected by the regulator itself than other stakeholders who would have poor access to data/information.
- 14. Information Disclosure:** Availability of information in the public domain often avoids situations that may lead to abuse of market power. Regulators should rely on this as a primary tool to ward off anti competitive behaviour. It is expected that interested stakeholders including civil society would be able to identify actions / situations that are anti-competitive in nature. The draft regulation should also specify minimum periodic information disclosure by market participants (some of these are covered under other regulations like those for trading).
- 15. Factors having Adverse Effect on Competition - Regulation 5(2):** The following factors should be included explicitly
 - a. Ability of existing players to access the market (through denial of access to transmission or associated facilities)
 - b. Hoarding transmission capacity or unjust denial of the same.
 - c. Gaming between a generation company or licensees (transmission, trading, distribution or supply) or users of electricity.
- 16. Regulation 5(2):** While other factors listed here have negative connotation, the following one has a positive one and needs to be appropriately modified,

“Improvements in generation or distribution of electricity or provision of services, promotion of technical, scientific and economic development by means of generation or distribution of electricity or provision of services;” (emphasis added)
- 17. Regulation 6: Abuse of non-dominant position:** While market dominance is expected to adversely affect competitive outcome, it may not always be necessary to adversely affect the market. In case of elastic demand, a small capacity withdrawal (by a non-dominant player) from the market can cause significant increase in price (see figure below). This could be one of the avenues of gaming in such conditions. Further, proof of dominance is itself a debatable exercise and may often lead to legal debate in absence of clear definitions.



(a)



(b)

Figure: Influence of Non-Dominant position on prices

Note that in above figure that a smaller change in supply in case of elastic demand (ΔQ_2) can cause as much increase in price as a 'dominant' plant in the case of a relatively less elastic demand.

18. **Role of System operator:** System operator plays an important independent role in power markets. In case of an aberration wherein role of a system operator is questionable and that adversely affects the market outcome, the regulations should recognize and address the same.
19. **Inadequate consideration to demand side:** Market abuse is not only a supply side issue. There could be situations wherein complicity of demand (especially large consumers availing open access) cannot be ignored. Apart from distribution licensee, a large consumer can also

influence the market outcome by gaming with other consumers, generation company or licensee. Hence, role of consumers (especially large consumers with Open Access) should be recognized vis a vis a situation of 'Agreement', 'Dominant' Position' and 'Combination'.

20. Cross Border Electricity Trade: India currently exchanges electricity with Nepal and Bhutan. New transmission links with Bangladesh are under consideration. Cross-border trade can grow significantly in future provided there are appropriate regulatory and policy initiatives. Such market integration would also open up avenues for market abuse by participants located elsewhere in the region and often in cooperation with entities located in India (including the company's enjoying corporate relationship through a variety of ownership structures). How can regulations cover this aspect? Care should be taken to incorporate this in a regional framework if formulated in future.

21. Regulation 6(3) (b), (e):

Reference to 'influence the market' should be inserted appropriately.

“(e) uses its dominant position in one relevant market to enter into, or protect, influence other relevant market.” (word “influence” may be inserted)

22. Regulation 6(4) (b): Resources means financial or physical resources?

23. Regulation 6(4), 7: Also need to consider 'relationship' with generation companies or licensees through group ownership, related companies and cross-ownership as per the definition under the Companies Act 1956 or other relevant legislation.

24. Regulation 6(4) (n): What is construed by relative advantage: Should access to cheap fuel or better technology be considered as relative advantage. In fact the former would be a critical issues in the context of power markets.

25. Criteria for Inquiry: Regulation 8(3): A process to be adopted by the Central Commission to decide 'if there is a prima facie case' should be indicated. For e.g. this may include scrutiny of the case by a committee on market abuse with members from CERC/SERC and other independent organizations. The committee should frame broad guidelines / rules for taking decision on the complaints and the same should be available for public information. Further, in case CERC does not find a prima facie case, a right to appeal for reconsideration of the complaint should be available with the complainant.

In case the Central Commission opines that there exists no prima facie case, the deliberations of the process should be made available for public information for the sake of transparency.

26. Public Access to Report of Inquiry: Regulation 8(5): The report of enquiry should be placed on CERC website within one week of the finalization of the same and an online archive of such reports should be maintained.

27. Cases under Consideration with CCI - Regulation 8(1): In case of existence of a reference to Competition Commission of India (CCI), the regulations should provide for its parallel scrutiny under these regulations as well. Given the specific characteristics of the power sector,

- 28. “Cancellation of License”– Regulation 9(1):** Directions by the Central commission should provide for 34. “Cancellation of License” as provided under as per Section 128 (6) of EA 2003. The referred section empowers the Central Commission to cancel a license on receipt of a report under sub-section (1) or sub-section (5) of Section 128 of the Act. Hence provision for ‘Cancellation of License’ be included specifically as one of the directions listed in Regulation 9(1) of the draft regulations.
- 29. ‘Investigation Authority’ in lieu of ‘Investigating Officer’ – Regulation 11(1) :** Market abuse is a significant matter that need necessary power to investigate the matter. It would be pertinent to appoint an ‘Investigation Authority’ under section 128 of the EA 2003 rather than an ‘Investigating Officer’ under Section 97 of the EA 2003. The former would have much more significant power of investigation than the later.
- 30. Appointment of ‘Consultant’ to the Investigating Officer – Regulation 11(5):** This can be assisted by a “consultant”, who shall give an undertaking that it has not been doing business with the parties and their related entities last involved for the 3 years and also will not take business with them or their related entities for the next 3 years. Further that such consultant doesn’t have any interest in any of the parties involved. Further that such consultant will give an undertaking of their “independence” in the matter concerned. If required appropriate amendment should be made to the Central Electricity Regulatory Commission (Appointment of Consultants) Regulations, 2008.
- 31. Access to Private Records Regulation 11(2)(d):** Shouldn’t the investigating officer get access to private records. Most of the public records would not be sufficient to assist the investigation into the matter under private records pertaining to management/operations of the parties involved are also scrutinized.
- 32. Issue of Plagiarism - Annexure to Explanatory Memorandum (EM):** The Annexure to the Explanatory Memorandum contains large sections of text which is a verbatim reproduction of the contents of European Electricity Transmission System Operators (ETSO) report on “A Review of the Monitoring of Market Power” prepared by Newbery, Green, Neuhoff and Twomey in 2004. Ironically, reference to this report is missing from the Explanatory Memorandum. The same should be rectified urgently. The above mentioned report is attached for your reference.

Table: Plagiarism: Reference match between EM and ETSO Report

S. No.	Page Number in Explanatory Memorandum	Page Number in ETSO Report
1	24	23
2	25	23
3	31	26
4	32	27 - 28
5	33	28
6	38	35
7	39	36, 37

- 33. Explanatory Memorandum: Period for the small but significant non-transitory increase in price test (the SSNIP test):** The explanation to use a 12 month period for testing ‘permanent’ increase in price is rather too lax. A period of even days or weeks is sometimes more than sufficient to translate into large returns for market abuse.