

**CENTRAL ELECTRICITY REGULATORY COMMISSION
NEW DELHI**

Review Petition No. 22/2011

**Coram: Dr. Pramod Deo, Chairperson
Shri V.S. Verma, Member
Shri M. Deena Dayalan, Member**

Date of Hearing: 22.11.2011

Date of Order: 22.5.2012

In the matter of :

Petition seeking review of Order dated 15.09.2011 appointing M/s. Poyry Management Consulting, Norway (AS) for undertaking the Audit of Trading Software Algorithm Used for Price Discovery by Power Exchanges

In the matter of :

Power Exchange of India Ltd.

..... **Petitioner**

Parties present:

Shri Hemant Sahai , Advocate, Power Exchange of India Limited

Order

The Review Petitioner, Power Exchange of India Limited has filed this petition under Section 94 of the Electricity Act, 2003 (hereinafter “the Act”) read with Regulation 103 of the Central Electricity Regulatory Commission (Conduct of Business) Regulations, 1999 seeking review of order dated 15.09.2011 in *Suo Motu* Petition No.70 of 2011 in the matter of Audit of Trading Software Algorithm used for price discovery by the power exchanges. The Review Petitioner has submitted that the Commission while passing the impugned order has not considered the objections/submissions made by the Review Petitioner in its reply dated 7.9.2011,

particularly the conflict of interest of the Auditor proposed to be appointed with the parties concerned in the audit.

2. The Review Petitioner has submitted that the Commission in its order dated 11.3.2011 in Suo Motu petition No.70 of 2011 had decided to get the 'Trading Software Algorithm used for Price Discovery' audited by a competent Audit Firm in compliance with clause (v) of Regulation 31 of the Central Electricity Regulatory Commission (Power Market) Regulations, 2010 (hereinafter "Power Market Regulations"). By the same order, the Secretary of the Commission was directed to complete the process of selecting a competent Audit firm for auditing the 'Trading Software Algorithm used for Price Discovery' within a period of two months from the date of the issue of said order. The Review Petitioner has further submitted that no further order was passed by the Commission in the suo motu petition after the order of 11.3.2011. However, the Power Market Division of the Commission vide e-mail dated 23.8.2011 informed the Review Petitioner that the Commission had appointed M/s Poyry Management Consulting (Norway) AS as the auditor for auditing the 'Trading Software Algorithm used for Price Discovery' and a 'kick off' meeting for introduction between the power exchanges and auditor was scheduled for 6.9.2011. The Review Petitioner has submitted that it wrote a letter dated 2.9.2011 to the Secretary of the Commission pointing out that appointment of M/s Poyry Management Consulting (Norway) AS as the auditor for auditing 'Trading Software Algorithm used for Price Discovery' would have a conflict of interest due to various reasons as mentioned in the said letter. The Review Petitioner followed up with filing a reply dated 7.9.2011 to the suo motu petition No.70/2011 reiterating the concerns and issues brought out in the letter dated 2.9.2011. The Review Petitioner has

submitted that the Commission without considering or addressing to its objections in the letter dated 2.9.2011 and affidavit dated 7.9.2011 passed the final order dated 15.9.2011 formally appointing M/s Poyry Management Consulting (Norway) AS as the auditor. The Review Petitioner has filed the present petition seeking review of the order dated 15.9.2011 on the following grounds:

(a) The order dated 15.9.2011 has been passed by the Commission contrary to the Doctrine of Natural Justice since the Commission while passing the said order neither considered the submissions nor even acknowledged the objections raised by the Review Petitioner.

(b) The proposed audit led by Mr Hans A Bredesen of M/s Poyry Management Consulting (Norway) AS was involved in providing advisory services for setting up of power exchanges worldwide (including India) using SAPRI platform. Mr Bredesen has been involved in advising various Power Exchanges all over the world including India on product strategies for Trading, Scheduling and Settlement of Power Exchanges. Therefore, appointment of M/s Poyry Management Consulting (Norway) AS would have serious conflict of interest with the proposed audit. Moreover, the Review Petitioner has developed an in-house 'Trading Software Algorithm used for Price Discovery' and the same has a peculiar nature which is distinct in various aspects from other Power Markets. The Review Petitioner apprehends that appointment of M/s Poyry Management Consulting (Norway) AS as the auditor will tremendously prejudice the intellectual property of the Review Petitioner's exchange. Any contractual

confidentiality commitment will be inadequate in the circumstances as that will result in imposing an additional monitoring obligation on the Review Petitioner.

(c) M/s Poyry Management Consulting (Norway) AS is not an 'independent' auditor as required to be appointed under Regulation 31(v) of the Power Market Regulations. The said company is engaged in providing consultancy services/advice to various Power Exchanges for development of power markets. Therefore, there is an inherent conflict of interest between the appointed auditor and the objects of the audit. The auditor cannot be permitted to have access to confidential and proprietary information and data of the Review Petitioner that it can potentially use for its own advantage and/or for the benefit of potential competitors of the Review Petitioner.

(d) Regulation 31(v) of the Power Market Regulations had limited the scope of work for the Commission regarding auditing to appointment of an agency to audit the software application used by the Power Exchanges in operation for price discovery and market splitting. Under the said regulation, the Power Exchanges are required to produce the results of test cases and scenarios provided by the Commission. However, the Commission in its order dated 11.3.2011 and 15.9.2011 has increased the scope of work of audit to be conducted which appears to be broader than that envisaged under the Power Market Regulations which the Commission may review.

3. The petition was heard for admission on 22.11.2011 after notice. The learned counsel of the Review Petitioner submitted that M/s Poyry Management Consulting

(Norway) AS is engaged in the business of developing market for power exchanges and it is the apprehension of the Review Petitioner that any information shared by it with M/s Poyry Management Consulting (Norway) AS would be used by Poyry for advising other exchanges. The learned counsel further submitted that 'Rule against bias' is a settled principle of law which states that in an adjudicatory process if there is even any likelihood of bias, then the adjudicatory authority should recuse itself from the said adjudication to ensure that justice is not only done but it should be seen to be done. The learned counsel quoted the principles of 'automatic disqualification' and 'modern adjustment to real danger test' from Administrative Law, Tenth Edition by H.W.R. Wade & Forsyth and the judgement of the Hon'ble Supreme Court in the case of P.D. Dinakaran vs. Judges Enquiry Committee {(2011) 8 SCC 380} and submitted that based on these authorities, the rule against bias can be summarized as follows, "firstly, it goes beyond the pecuniary and proprietary interests and secondly, the mere likelihood of bias also disqualifies the person adjudicating the matter for adjudication". The learned counsel submitted that in the opinion of the Review Petitioner, since the nature of work of Poyry is mainly consultancy, there is an imminent risk of information being used by Poyry to advise the emerging Power Exchanges either in India or abroad. Moreover, Poyry being a non-regulated entity, signing any non-disclosure or non-discrepancy agreement would be futile as the said agreement would pose a far greater challenge on the Review Petitioner. The learned counsel further submitted that if the details of the indigenous software being used by the Review Petitioner are shared with an unregulated entity like Poyry, then there is possibility of the same losing in intellectual property value. The learned counsel reiterated the grounds of lack of opportunity of hearing to the petitioner and enlargement of scope of audit as taken in the petition.

4. We have considered the submissions of the Review Petitioner and perused all relevant documents on record. The Commission has the power to review its own decision under section 94(f) of the Act in accordance with the provisions of the Code of Civil Procedure, 1908 (hereinafter “the CPC”). Regulation 103 of the Conduct of Business Regulations provides that the Commission may at any time, on its own motion, or on an application of any of the persons or parties concerned, within 45 days of making such decision, directions or order, review such decision, directions or orders and pass such appropriate order as the Commission deems fit. Order 47 Rule 1 of the CPC provides that review of the order can be allowed on the following grounds:

- (a) Discovery of new and important matter of evidence which after the exercise of due diligence was not within the knowledge of the applicant or could not be produced by him at the time when the order was made; or
- (b) some mistake or error on the face of the record; or
- (c) for any other sufficient reasons (which have been interpreted to be analogous to the other reasons specified above).

5. The main ground of review is that while issuing the order dated 15.9.2011, the Commission has not considered the objections raised by the Review Petitioner in its letter dated 2.9.2011 and affidavit dated 7.9.2011. The Review Petitioner in its letter dated 2.9.2011 and affidavit dated 7.9.2011 had raised two issues. Firstly, the Commission had suo-motu initiated the proceedings for appointment of an auditor and therefore, PXIL was under impression that appointment of an auditor would be done through an order of the Commission. Secondly, there is possibility of bias as the audit

team being led by Mr. Hans Arild Bredesen, who was earlier involved in development of SAPRI platform and advisory services including sale of SAPRI platform software to Indian Energy Exchange. The second ground of review is the conflict of interest between the appointment of M/s Poyry Consulting as the audit firm and the objects of audit. The third ground of review is that the order dated 15.9.2011 has enlarged the scope of audit viv-a-vis the provisions of Regulation 31(v) of the Power Market Regulations.

6. As regards the first ground of review, it is noted that the Commission issued an order dated 15.9.2011 informing all concerned about the appointment of M/s Poyry Consulting as the auditor. Therefore, the issues raised by the Review Petitioner in its letter dated 2.9.2011 and affidavit dated 7.9.2011, regarding the appointment of an auditor should be through an order, stands addressed. It may be noted that the appointment of Poyry has been made as per procedure for appointment of consultants and through a transparent international competitive bidding process. The Commission in compliance with clauses (iv) and (v) of Regulation 31 of Power Market Regulations in order dated 11.3.2011 decided to get the 'Trading Software Algorithm used for Price Discovery' audited by a competent audit firm and directed the Secretary to complete the process of selecting an audit firm for the purpose. The order dated 11.3.2011 further contained the scope of the audit and the directions regarding the cooperation expected from the power exchanges. The order dated 11.3.2011 has not been challenged by any party including the Review Petitioner. The Power Exchanges were informed about the appointment of M/s Poyry Consulting for IT audit of Power Exchange through order dated 15.09.2011. As regards the alleged conflict of interest of Mr. Hans Arild Bredesen in the audit process, the same was separately being examined by the Secretary of the

Commission. This issue has been addressed along with the second ground of review in the succeeding paragraphs.

7. The second ground of review is the conflict of interest between the appointment of Poyry Consulting as the audit firm and the objects of the audit. The various issues involved in the allegation of conflict of interest along with the action taken by the Secretary have been considered as under:

1. *Composition of the audit team wherein Mr. Hans A Bredesen ,the lead Project Manager was earlier professionally associated with SAPRI trading platform and Nordpool Consulting which provided advisory services for setting up power exchange worldwide and which resulted in IEX procuring SAPRI platform. - M/s Poyry Consulting was asked to submit a detailed resume of Hans A Bredesen which was received on 13.09.2011 .It is observed that in 1992 – 1996 period, Hans was involved in the development of SAPRI platform at M/s Institute for Energy Technology. Poyry Consulting in its declaration has categorically denied Hans's involvement in the sale of SAPRI system to IEX. Poyry has disclosed that Hans Bredesen's interaction with IEX was limited to giving speeches in two general seminars organized by IEX. As a precautionary measure and to allay any concerns of PXIL, CERC advised M/s Poyry Consulting to distance Hans Bredesen from the core audit team vide letter dated 24.10.2011. M/s Poyry Consulting has complied with the same and has intimated CERC vide letter 26.10.2011, that Hans Bredesen shall function only as an International Market Expert in the Audit process. Intimation regarding the audit team reorganization has been sent to both exchanges through email on 02.11.2011.*
2. *Apprehension of loss of confidentiality and access to intellectual property of proprietary software indigenously developed by PXIL since the auditor M/s Poyry Consulting also provides consulting services in several other energy markets worldwide. This concern of the petitioner has been addressed through the following safeguarding measures :*

- a) Various confidentiality safeguard clauses were been built in the Request for Proposal (RFP) published for invitation for competitive bids for selection of the auditing agency. The RFP also forms a part of the contract agreement signed by Ms/ Poyry Management Consulting (Norway) .

- i. Confidentiality Clause 1.19 (5) of the RFP states clearly,

“1.19.5 Confidentiality Clause: During the course of the audit, the auditor may get access to certain confidential information. The auditor is bound to maintain confidentiality of such information, and shall ensure that all staff employed on the project by the selected bidder and its sub-contractors adhere to the same. The auditor is responsible for knowing what information is strictly confidential and protecting it. These restrictions will not apply to any information which:

i) Is or becomes generally available to the public other than as a result of a breach of an obligation under this Clause; or

ii) Is acquired from a third party who owes no obligation of confidentiality in respect of the information; or

iii) Is or has been independently developed by this recipient or was known to it prior to the receipt of the contract

Notwithstanding Clause (i) mentioned above, either party will be entitled to disclose strictly confidential information of the other (1) to its respective insurers or legal advisors, or (2) to a third party to the extent that this is required by any or where there is a legal right. Duty or requirement to disclose, provided that in the case of sub- Clause(ii) (and without branching any legal or regulatory requirement) where reasonably practicable not less than 2 business days notice in writing is first given to the other party.

The auditor shall, under no circumstance, disclose the findings of the audit to any party except with the explicit permission of CERC. Any disclosure of strictly confidential information in condition other than those clarified above would lead to termination of the contract and forfeiting the PBG, and may lead to blacklisting.”

that the auditor, its employees and sub contracts if any is bound to maintain confidentiality and protect the confidential information. Also, it was clarified in written in the pre bid conference that all the data used in the audit has to be handed back to CERC or destroyed after completion of the audit process.

- ii. Declaration Form (3.1.5) of RFP – As a pre qualification criteria a declaration has been taken from the company that the company or its subsidiaries has not been involved in the development of software algorithm used at Power Exchange. The relevant portion is quoted below :

*“**Sub:** Declaration that the bidder has not been involved in the development of software algorithm used at Power Exchanges registered with CERC and currently in operation.*

Dear Sir,

We confirm that our firm or any of its subsidiaries was/has not been in the development/maintenance of the software algorithm used for price discovery by power exchanges registered with CERC and currently operating.

Authorized Signatory:

Name and Title of Signatory:

Name of the Firm:

Address: “

M/s Poyry Consulting has submitted the aforesaid Declaration Form as a part of the bid submission.

- iii. Disqualification Clause 1.4 of RFP – CERC at its sole discretion can disqualify the bidder in case of misleading or false representation provided by the bidder in eligibility requirements
- b) The selection of the auditor has been carried out through a transparent internationally competitive bidding process during March 2011. The eligibility criteria (Clause 1.12.2 of the RFP) details the firms experience requirement and the qualifications of the key staff for the assignment. This document was in the public domain i.e. CERC website for 45 days from 14th March – 29th April 2011 and a pre bid conference was organized on 04.04.2011 which was open to all interested parties. (Notices were available on CERC website at http://www.cercind.gov.in/RFP_IT_Audit.html.) No objection was raised by the petitioner during this process. The concern has been raised as late as one day before the commencement of the actual audit work.
- c) The audit is being conducted in accordance with the provisions of Power Market Regulations, 2010 and the orders of the Commission and under the full oversight of the Commission. The auditor shall be in close interaction

with the Commission's staff while undertaking the assignment and will also be subjected to the periodic review by the Commission.

- d) The audit of trading software algorithm cannot be equated with standard accounting audits for which norms and standards on eligible firms are well laid down and certified professional associations lineage is available. The nature of the assignment is very specialized and can be carried out by a firm having substantial experience and expertise in cross functional areas including Economics and Power Markets and IT. M/s Poyry Consulting specializes in applied economics research and has to its credit several worldwide accepted models on power market pricing/ hydrology and is well suited for such a specialized assignment.
- e) As a part of the audit process, M/s Poyry Consulting is expected to develop its own working algorithm which would be run on the test data supplied by both exchanges before they physically visit the exchanges. In any case, the auditor will not audit the software codes but access the input module and output module of the trading software provided to the auditor on a test environment. This will be done so that auditor can independently input test data and extract results of the trading system. These activities shall be undertaken in the presence of the nodal officer of the power exchange who have been appointed by the power exchange for coordination of the audit exercise. The apprehension of access to confidential and proprietary information about the software is therefore unfounded.
- f) M/s Poyry Consulting is a publicly listed company and has in its clientele the Norwegian Energy and Water Regulator, System Operators in Denmark and Netherlands and possess expertise in regulatory matters. The audit team has its own independent quality assurance expert to review all results and processes as a part of the audit governance structure. The company has a well established governance structure to ensure fairness and impartiality.

- g) On the proprietary nature of the software, PXIL is only justified to claim its software codes to be proprietary in nature, since the logic for the algorithm is expected to be in alignment with the principles for day ahead market laid down in the Power Market Regulations. The software thereafter, only codifies these principles. Such algorithms and models have been used in power exchange software in Europe for over a decade and are being commercially sold by several companies worldwide for many years. Since the auditors would not be required to go into the software code of PXIL, the apprehension about the infringement of the intellectual property rights of PXIL is unfounded.

It follows from the above that all relevant factors including the conflict of interest have been taken into account in selecting an impartial and independent audit firm and therefore, the ground raised by the Review Petitioner for review of the order dated 15.9.2011 are not maintainable.

8. The last ground of review is that the scope of work has been enlarged in the order dated 15.9.2011 compared to what has been contemplated in the Power Market Regulations. The Review Petitioner has submitted that para 5 of the order dated 11.3.2011 has enlarged the scope of audit vis-à-vis Regulation 31(v) of Power Market Regulations. First of all, review on this ground is barred by limitation as the Review Petitioner has not challenged the said order of 11.3.2011 within the limitation period of 45 days as envisaged in Regulation 103 of the Conduct of Business Regulations. In para 4 of the order dated 15.9.2011, the power exchanges have been directed to extend all cooperation to the auditor in accordance with the directions in para 5 of the order dated 11.3.2011. Mere reference to the directions in an earlier order does not extend the period of limitation since the directions contained in the

order dated 11.3.2011 continue to be applicable in so far as audit is concerned. Moreover, Para 5 of the order dated 11.3.2011 pertains to the manner of cooperation which the power exchanges are required to extend to the auditor during the course of the audit to ensure that the audit is conducted in a smooth and orderly manner This only addresses procedural aspects of the audit and does not relate to the scope of the audit. Therefore, this ground of review is also not maintainable.

9. In the light of the above, we are of the view that the review petition is not maintainable as it does not satisfy any of the grounds for review under Rule 1 of Order 47 of CPC read with section 94(f) of the Act. Accordingly, the Review Petition is dismissed.

Sd/-
(M Deena Dayalan)
Member

sd/-
(VS Verma)
Member

sd/-
(Dr Pramod Deo)
Chairperson