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Ref.No.PEG/2014/139

Date: December 20, 2014

To:

Mr. Vivek Bharadwaj,
Nominated Authority under the CM (SP) Ordinance, 2014,
Ministry of Coal, Government of India

Dear Shri Bharadwaj,

Comments and feedback regarding the approach paper for auctioning coal mines

Thank you for inviting comments and feedback regarding the approach paper to the tender document for the auction of coal mines under the Coal Mines (Special Provisions) Ordinance, 2014 through public notice dated December 17, 2014.

The time available to analyse the approach paper is quite short. Therefore, these comments are necessarily of a broad nature. Please find our comments attached to this note. We hope you will take them into consideration while finalizing the Rules.

Thanking you,

Yours sincerely,

Ashok Sreenivas
Senior Research Fellow
Prayas (Energy Group)

Feedback / comments re draft approach paper for coal block auctions under CM (SP) ordinance, 2014

Prayas (Energy Group)

1. **Scope of auctions:** The scope of the auctions is not clear from the approach paper. It would be good to state the scope clearly by clarifying whether these are only targeted at auctions (i.e. not for those to whom blocks would be allotted), what are the set of mines considered (Schedule II, Schedule II+III or Schedule I) and the kind of end-use plants targeted, particularly in case of power (see point 2 below). We sincerely believe that it would be better if the current round of auctions is restricted to only the 74 blocks that are producing or about to produce, given the many ambiguities and open questions yet to be resolved. It would be better if the other blocks are taken up after addressing these issues and perhaps after due Parliamentary approvals.
2. **Power sector end-use:** The approach paper currently lists power plants with cost-plus PPAs, case-I plants and merchant plants as potential reverse bidders (apart from forward bidding by captive power plants). However, we believe that there is no need for reverse bidding at all currently as explained below.
 - a. **Plants with cost-plus PPAs:** The ordinance permits public sector power generators and those who won tariff-based bids (under case-II bidding) to be allotted coal blocks. Therefore, the current auction need not be targeted at such power generators.
 - b. **Case-I plants:** Those who won Case-I tariff-based bids had willingly taken the risk of fuel procurement and this was the basis of the bidding. Therefore, it is not clear why they should be considered for these auctions under reverse bidding, particularly since such an option was not available to others who participated in the case-I tariff-based bidding. They could, if required, participate through forward bidding.
 - c. **Merchant capacity:** The draft approach paper allows merchant capacity to also bid for blocks through reverse bidding. Instead, it would be appropriate if they are treated on par with cement, iron and steel and captive power plants, and asked to participate in forward bidding as they have not contracted for long term power sales with any distribution utility.

Due to the above reasons, we feel there is no need for reverse bidding at all under this auction process. Without prejudice to this comment, we have provided feedback regarding specific clauses related to reverse bidding for the power sector later in this document.

3. **Transparency:** It is heartening that the Ministry of Coal has sought public comments regarding the auction rules and approach paper, and also proposes to publish pre-bid queries and responses anonymously. In the same spirit, we urge the ministry to make at least the following information publicly and easily available on a website on a permanent basis:
 - a. The list of mines to be auctioned, along with information about extractable reserves, grade of coal, peak production capacity etc. to be published before each round of auctions

- b. The templates for the tender document should be published and public comments sought before finalization
- c. The definitions of many key terms such as “intrinsic value”, “extractable reserves” and “mine life” are currently not clear or explicit. These should be made explicit and published before the auction process begins.
- d. In each auction round, minutes of the pre-bid conference should be published
- e. In each auction round and for each block, information about the number of bidders, the number of pre-qualified bidders, the names of those who participated in the final auction, details of the winning bid including the bid winner, bid price, end-use plant capacity and normative coal requirement for end-use plant (of grade available in the auctioned mine) and anonymous comparison with other bidders should be published.
- f. The Coal Mine Development and Production Agreement (CMDPA), except any financially sensitive parts, should be published.
- g. For each financial year subsequent to executing the CMDPA, the actual quantity and quality of coal mined, coal consumed by end-use plant, pit-head stock, royalty and bid price based amount paid, penalties paid if any etc. should also be published.

Making such information public and seeking public inputs will help to improve the quality of the auction process and also improve accountability of the auction and captive mining process.

4. **Tender document:** The tender document and CMDPA would be the legally binding contract between the Government and the miner. Therefore, this needs to be carefully drafted and clarify many issues such as those listed below. A draft template of this document should be published and finalized after seeking public comments.
 - a. the conditions under which force-majeure may apply
 - b. the various milestones and expected timelines for achieving these milestones
 - c. dealing with situations where estimated reserves are more / less than anticipated, and/or of a different quality
 - d. dealing with situations where the end-use plant is unable to function for whatever reason, or defaults by buyers of the end-use product
 - e. dealing with situations where the end-use plant does not get access to expected linkage coal
 - f. responsibilities for any clearances and permissions required in future
 - g. responsibilities for mine closure, restoration and any other environmental impact mitigation measures
 - h. conditions precedent and conditions consequent that have to be satisfied by the bid winner
 - i. conditions under which the contract can be terminated by either party

5. **Minimum number of bidders:** It would be prudent for clause 1.2.2 to state that at least two bidders should pre-qualify for the final e-auction to proceed. Otherwise, there may be no competition for the final auction.

6. **Extractable reserves:** Clause 2.2.1(b) states that extractable reserves in the coal mine should not exceed 150% of annual coal requirements of the end-use plant taken over 30 years. The rationale for 150% or 30 years is not clear. In case of power plants, both PPAs and FSAs are for 25 years – so 30 years seems generous. Similarly, considering 150% of annual coal requirement also seems generous. Even if there is need to provide a buffer for some error in estimation of extractable reserves, it may be prudent to revise this clause to say that extractable coal reserves should not exceed 110% of annual coal requirement over 25 years.

In case of power generation as the end-use, the coal requirement should be estimated only for the long-term PPA contracted capacity of the end-use plant and not the entire capacity. The clause may be reworded accordingly. This will also eliminate the need for clause 2.4.2 (g) and enable merchant capacity to compete through forward bidding.

7. **Bid price escalation:** Clause 2.4.1 (and 2.4.2) mentions that the intrinsic value of coal would be calculated using a discount rate, while bid price escalation would be estimated based on the wholesale price index. It should be ensured that the room for arbitrage between these two rates is minimized.
8. **Royalty on coal mined:** Clause 2.4.1 states that royalty would have to be additionally paid on the coal mined. It should be clarified whether this royalty would be based on bid price or CIL notified price in case of ad-valorem royalty. The approach paper should also clarify whether royalty payment would be applicable to clause 2.4.2 also, i.e. power companies that win coal blocks. It is currently silent on the matter.
9. **Run-of-mine cost of coal:** Clause 2.4.2 (f)-II states that the “Appropriate Commission shall review the quoted energy charge keeping in view that the actual bid price of coal as being equivalent to the run-of-mine cost of coal ...”. It appears that the intent is to state that the Commission should treat the bid price as the ROM cost of coal – perhaps the wording could be simplified and clarified.
10. **Change in law:** Clause 2.4.2(f)-II states that allocation of coal under these provisions should be treated as “Change in Law”. It is not clear why this should be considered a “Change in Law” since no coal was promised to Case-I bid winners and the risk of coal procurement was with them. The cancellation of block allocations to such companies, if any, is part of that risk. However, if case-I bidders must be permitted to participate in reverse bidding and a “Change in Law” provision must be introduced, then the last sentence of clause 2.4.2(f)-II should be reworded to the following effect to ensure that consumers do not have to pay higher tariffs: “For this purpose, the allocation of coal mine under the new provisions shall be treated as “Change in Law” to enable the Appropriate Commission to revise the tariff in accordance with the provisions of PPA subject to the condition that the resultant tariff does not exceed the tariff in the PPA.”

11. **Merchant capacity:** As discussed in point 2 above, and with the suggested rewording of clause 2.2.1(b) in point 6 above, merchant capacity need not be allowed to participate in reverse bidding. Therefore clause 2.4.2(g) can be deleted.
12. **Captive coal blocks and linkage:** Clause 3.1.3 states that a preferred bidder will not be allowed to bid further after its eligibility for coal is “covered”. The term “covered” needs to be defined properly. In particular, it should also consider any linkages the preferred bidder may have. Similarly, captive block ownership should also inform the linkage granting process and subsequent FSAs.
13. **Change in control:** Clause 3.3 deals with “change in control” of bidders during the bidding process. However, the word “control” is not defined. Rewording this clause would be advisable to remove any ambiguities.
14. **Performance security:** Clause 3.7 deals with performance security and states that the “amount of Performance Security may include 14% of the peak capacity of the mine ...”. It may be better to reword the phrase “may include” and state simply what the minimum performance guarantee would be.

The clause in its current form does not provide any means to replenish or renew the performance guarantee though it says that it would only be valid for two years (for schedule II mines) and until peak rated capacity is achieved (for schedule III mines). There should be a mechanism in the CMDPA to ensure that the mine owner is held accountable to performance throughout the mine lease period by appropriately strengthening the performance security clauses.

Performance security is currently linked only to production shortfall. It should also be linked to other performance parameters expected through the life of the mine such as overburden removal, compensatory afforestation, environmental compliance and resettlement and rehabilitation.

15. **Sale of excess coal mined:** It is not clear if CIL is mandated to purchase such coal being offered under clause 3.8. In the case of excess coal from forward bidding blocks, for which CIL’s purchase price is likely to be higher than its sale price, CIL is unlikely to be interested in purchasing such coal. Moreover, it is possible that this coal would be at a remote location without proper evacuation infrastructure, particularly if the end-use facility is a pit-head facility. This would further disincentivize CIL from purchasing such coal.

It should be noted that there could be a potential conflict between clauses 3.7 and 3.8. Clause 3.7 effectively mandates the block owners to produce coal at peak capacity. However, if such peak capacity is lower than its end-use requirements, its incentive to produce extra coal will be low since selling such coal to CIL may be difficult as discussed above. Therefore, the issue of dealing with excess coal and/or producing at peak capacity perhaps needs more thought.