Comments and suggestions on the 'Report on development of National Coal Index'

Prayas (Energy Group), February 2020

The Ministry of Coal (MoC) had made available in the public domain a report on the development of a National Coal Index (NCI) on 07.02.2020 and sought comments on it. We are pleased to share our comments on the proposed methodology and request you to consider them before finalising the NCI.

The proposed methodology aims to develop a forward-looking NCI on a monthly basis encompassing all transactions of raw coal in the domestic market, with separate indices computed for coking and non-coking coal. The envisaged NCI would be central to determination of revenue and the development of a coal market, and will also be used for the calculation of intrinsic mine value and annual escalation rates.

The Prayas (Energy Group)'s comments and suggestions highlight areas that require clarification and improvement within the methodology and propose some ideas to aid the efficient and transparent implementation of the NCI. These are listed below:

1. Index computation frequency

The draft report proposes that the NCI be computed by the Coal Controller's Organization (CCO) on a monthly basis. A provisional value of the index is first to be computed after a month of delay owing to auction data availability and the final index is to be computed after import data becomes available two months later. However, coal prices are unlikely to vary at a frequency that warrants monthly index computation. Carrying out the computations twice (provisional and final) for each month may prove to be onerous and the lags in index calculation may introduce added complications in its usage. Instead the index could be computed on a quarterly basis and used for all transactions that occur in the quarter. The delays in the availability of auction and import data can be accounted for by using a provisional index for payments in the first and second month of the quarter, which can then be trued up in the third month using the final index, once auction and import data is made available. This would ensure the computation of a comprehensive, regular index, in a realistic time frame.

2. Combined treatment of regulated and non-regulated sectors

The proposed NCI does not include a separate sub-index for the regulated and non-regulated sector, citing the lack of data and the future model of commercial mining. However, the price of non-coking coal for the regulated sector is not the same as that for the non-regulated sector[1]. Based on past trends in prices, the price of coal for the non-regulated sector tends to be higher. Moreover, since the regulated sector's coal consumption is much higher than the non-regulated sector, the NCI will be more reflective of regulated sector prices. This could have the following implications which need to be considered while finalizing the NCI.

[1] https://www.coalindia.in/DesktopModules/DocumentList/documents/Revised_Prices_in_respect_of_non-coking_coal_effective_from_30.05.2016_30052016.pdf

a) Using the combined index, as seen in the proposed NCI, for revenue sharing in coal mine auctions would make the non-regulated sector a more attractive option to miners, because the non-regulated sector would have a higher willingness to pay and thus result in higher price realisation while revenue sharing would be based on the combined index, which is more reflective of regulated prices. This would result in the maintenance of status quo for the power sector, where it continues to depend on coal from CIL and SCCL even as the miners' profitability would increase.
b) The CERC currently publishes escalation rates of coal prices for the power sector, which is used to compute the power tariffs for competitively bid plants under Section 63 of the Electricity Act 2003. These are computed based on prices for the non-regulated sector. It should be ensured that these are not overridden by the NCI, which is not representative of the price for the power sector.
c) The combined approach adopted in the proposed index would also introduce complications if a distinction between the regulated and non-regulated sector needs to be made in the future.

3. Future-proofing the NCI methodology

The proposed NCI uses notified, auction and imported coal prices for domestic transactions. However, the coal pricing regime in the country is likely to undergo significant changes in the near future with the introduction of new transactions such as through auction of mines for sale of coal and the SHAKTI linkage auctions. Additionally, the proposed index is based on price channels and sub channels, formulated on the basis of the grades of coal currently produced by different subsidiaries of CIL. This may change in the future needing new formulation of channels and sub channels currently not part of the NCI. Therefore, the methodology must be made robust and dynamic enough to deal with such anticipated changes. Otherwise, the index (and baseline) would have to be frequently recomputed.

4. Consistency with methodology for auction of mines for sale of coal

The NCI is central to the auction of coal mines for sale of coal as revenue sharing and related payments are based on it. The methodology of the auctions is yet to be finalised, and would be influenced by the definition of NCI. Given this, the proposed index and the methodology envisaged for the auction of coal mines must be made mutually consistent. For example, the NCI gives a methodology to compute an index, while the revenue sharing mechanism requires a coal price in ₹/tonne. It should be clearly mentioned how the index would be used to arrive at such a price. This should include details of which sub-index of the NCI would be used to arrive at the putative price, particularly when some or all the coal from the auctioned mine is used for coal exports, if exports are permitted (see point 6 below).

5. Treatment of coal imports

As per the report, the Directorate General of Commercial Intelligence and Statistics (DGCIS) maintains records of imported coal at the transaction level, which includes details regarding quality of the coal in addition to the landed value and volume of the coal imported through various ports. However, the monthly summary of imports made available to the CCO does not include information pertaining to the quality of the imported coal. The proposed index is affected by this lack of information, and plugs in the country of origin as a proxy for the grade of coal based on data from unverified sources, instead of the gross calorific value of the imported coal. While it is understood that certain details regarding imports are sensitive and cannot be revealed, quality of the coal imports cannot be considered as one of them. We suggest that the DGCIS should be asked to share the quality parameters of the imported coal with the CCO (while hiding details such as the importer name) to enable comprehensive and reliable computation of the NCI. This would suitably enrich the index and bridge the gap between the treatment of domestic coal and imported coal in the proposed methodology.

6. Coal exports from auctioned mines

As stated in our comments on the methodology for auctioning coal mines for sale of coal, allowing coal exports when there is a focus on reducing imports and promoting competition within the domestic coal market would be counterproductive. In addition, the current definition of NCI does not lend itself to permitting coal exports cleanly. Firstly, if some or all of the coal from a mine is exported, how would the NCI be used to arrive at a suitable coal price to determine revenue sharing? Secondly, the NCI envisaged is based on coal prices in India and thus reflects the customs, insurance and freight (cif) price for imported coal. On the other hand, if exports are permitted, the miner's revenue would be based on free on board (fob) prices and thus not consistent with the price used to compute the NCI. Given these complications, we reiterate that coal exports should not be permitted from the mines auctioned for sale of coal.

7. Other points

a. Comments and insights from stakeholders are essential to ensuring a comprehensive and accountable methodology. The draft report mentions that a MS-Excel file is submitted to be shared in the public domain, to allow for public perusal and suggestions. However, no such MS-Excel file has been made available in the public domain, limiting the richness of the comments.
b. The report put out in the public domain with the invitation for comments has been published in the format of a scanned image. For ease of access and hence better engagement from the public it is recommended that such documents should be shared in a text searchable pdf format, which is fairly easy to do.
c. The proposed methodology chooses to use declared grades of domestic goal, in lieu of tested grades, for the computation of the index because it is claimed, based on discussions with CIL and the HPEC, that there is no significant bias in any particular direction. It would be good to validate this assumption with coal consumers who are more affected by this. The document also states that transaction data from 2016-17 onwards is to be used for the computation of the NCI, in its first iteration. While this is fine, it must be ensured that the declared coal grades used for NCI computation correspond to the revised grades, as applicable from January 2016.
d. As per the proposed methodology, the CCO is best placed to undertake the regular computation of the coal index. While this is true, CCO needs to be suitably strengthened to ensure that it is equipped to efficiently and reliably carry out the computation of the NCI on a regular basis. The current constitution and capacity of CCO does not lend confidence that it would be able to discharge this responsibility effectively.

e. The draft document discusses the need to revise the weights used in the computation of the NCI from time to time, in case the index loses relevance owing to dated data. Whenever such updating is undertaken, it must be ensured that the base year is also changed to reflect the change in weights, and a new series is published.

8. Conclusion

The NCI is being developed as per the recommendations High Powered Expert Committee (HPEC) constituted to study the challenges and efficacies of the fixed bid system. As envisaged, it is going to be pivotal to the determination of revenue and the development of a coal market. However, its efficacy is contingent to proper implementation of a comprehensive methodology. Toward this end we propose the following suggestions:

- Compute the NCI on a quarterly basis, instead of the proposed monthly schedule
- Consider the impact of combined treatment of regulated and non-regulated sector
- Ensure that the methodology can handle anticipated changes
- Ensure that the NCI is consistent with methodology for auction of mines for sale of coal
- Include coal import quality data in the NCI
- Disallow coal exports from the mines auctioned for sale of coal
- Make the relevant MS-Excel document available in the public domain
- Ensure that the report document be available in a text searchable pdf format
- Use the most recently revised coal grades for NCI computation
- Strengthen CCO sufficiently to undertake NCI computation
- Update the base year in accordance to revision in weights

We believe that adopting these suggestions can aid in achieving the objectives of NCI and developing a robust domestic coal market in India.

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