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April 21, 2017

To:

Shri Rajesh Kumar Sinha,
Joint Secretary, Ministry of Coal, New Delhi

Comments and suggestions on discussion paper on auction of coal mines for commercial mining

Dear Sir,

We are glad that the Ministry of Coal has sought comments on the discussion paper on auction of coal mines for commercial mining vide notice 13011/1/2017-CBA2 dated March 27, 2017 and conducted a stakeholder consultation on April 10, 2017. These are good practices being adopted by the Ministry as they will help to deepen and enrich the policy formulation discourse.

We were unable to attend the stakeholder consultation due to other commitments but are pleased to enclose our comments and suggestions with this letter. In our opinion, the approach towards introducing commercial mining should be seen in the larger context of the coal and energy sector. Our comments and suggestions are enclosed in this spirit. We hope you find these comments and suggestions useful and incorporate them accordingly. We will be happy to provide any further clarifications that you may require.

Thanking you,

Yours sincerely,

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Comments and suggestions on discussion paper on Auction of coal mines for commercial mining

Prayas (Energy Group), April 2017

The following are comments and suggestions from Prayas (Energy Group) on the discussion paper on 'Auction of Coal Mines for Commercial Mining' published by the Ministry of Coal on March 27, 2017.

Comments on the draft discussion paper

1. **Need for sectoral vision:** There are many issues facing the coal sector in the country today such as those listed below.
 - a. Demand for coal is currently subdued as evidenced by CIL's difficulties in getting buyers for its coal and the low production from captive coal blocks allocated two years ago. This trend is likely to continue given current technological trends and environmental concerns. Grid-integrated roof-top solar is already cost-competitive with the tariffs charged for more than half the electricity sold by distribution utilities in states such as Maharashtra and Gujarat. The likelihood of demand continuing to be subdued for coal and thermal power in future is reinforced by the draft National Electricity Plan published by the Central Electricity Authority and other analyst reports.
 - b. The current market structure for coal is heavily dominated by CIL and many concerns have been raised about it, including penalties imposed by the Competition Commission of India.
 - c. The domestic coal sector is currently governed by a confusing multiplicity of regimes namely old linkages and FSAs, linkages recently auctioned to some sectors, captive blocks allotted under the 2012 Rules, captive blocks auctioned (differently to the power sector and other sectors) under the 2014 Rules, captive blocks allotted to government companies under the 2014 Rules, blocks given to state companies for commercial mining and e-auctions. The draft discussion paper effectively just adds one more regime to this long list.
 - d. Concerns persist about labour safety (such as the fatalities seen recently in mines in Jharkhand and Telangana) and socio-environmental practices in the coal sector.
 - e. There is lack of clarity about the amount of economically extractable coal reserves in India.

Many reports – by committees set up by the Government and other agencies – have highlighted these challenges and suggested some solution approaches to them. But the draft discussion paper is silent about these challenges before the sector or proposed solutions to it. It is not clear how this brief draft which focuses only on some operational aspects related to introducing commercial mining by the private sector would help to achieve a competitive and effective coal sector. It is pertinent to note that a more rigorously thought out move to introduce private sector participation in the hydrocarbons sector through NELP has not resulted in a competitive sector even 17 years later and the sector finds itself caught in litigations. It should also be remembered that the poorly drafted and ambiguous New Coal Distribution Policy of 2007 (and its limited amendment in 2013) was among the primary reasons for the outcry over domestic coal shortage a few years ago, and the long series of regulatory and court battles that are still being fought in the electricity sector. Therefore, adding yet another regime and nominally introducing commercial mining without having a vision for the sector as a whole in the evolving context is not likely to improve the efficiency of the sector.

2. **Market structure:** Introducing commercial mining without addressing the current market structure explicitly is unlikely to eliminate existing distortions. Consumers have raised concerns about the one-sided nature of the Fuel Supply Agreement offered by CIL and the Competition Commission of India has passed strictures against it. It is not clear how a proposal to introduce commercial mining that requires revenue sharing of at least 20% of CIL's notified price and offering relatively small (compared to CIL) production quantities without addressing these concerns will lead to a competitive market. Moreover, according to the draft discussion paper mines will continue to be allotted to government companies (presumably without a revenue sharing agreement of the kind proposed in this draft discussion paper) and auctioned to the private sector – this is only likely to further fragment / distort the market.
3. **Pricing:** While the draft discussion paper states that the mine owner is free to choose its pricing strategy, it is silent on how the price discovery will be fair, non-discriminatory and transparent – all pre-requisites for a free and vibrant market. There are no provisions to prevent affiliate transactions which can distort the coal and downstream markets including the power sector. Such transactions (typically at 'below market price') can also affect government revenue. There are also no provisions to ensure transparency and information symmetry for all coal producers and consumers. Absence of clarity on these issues is only likely to lead to litigation in the future. Once again, it is pertinent to point out that, in spite of NELP containing some safeguards against affiliate transactions and so on, pricing was one of the highly contested issues there.
4. **Other aspects:** There are some important aspects that are not covered in the draft discussion paper. While some of these are pertinent to all coal mining, they become more pertinent in the context of opening up the sector. These are discussed below.
 - a. Oversight and dispute resolution: The draft discussion paper does not mention or propose any mechanism for market oversight and dispute resolution (e.g. about coal quantity, quality or other contractual aspects) which will inevitably arise. The existing forums for such issues, namely Competition Commission of India or the courts do not have the necessary sectoral expertise and are not easily accessible.
 - b. Worker interests: One of the reasons for nationalizing coal mining in India was exploitative labour practices. Even in the current nationalized regime, there is a high prevalence of contract labour whose conditions are often poor. Introducing commercial mining as proposed with the attendant disadvantages (of pricing and market structure as discussed above) is likely to encourage predatory mining and exploitative labour practices. Not imposing any additional safeguards beyond following existing laws of the land is likely to exacerbate this challenge.
 - c. Socio-environmental practices: The concerns listed above regarding worker interests also apply to socio-environmental aspects, whose governance in India has traditionally been poor. Therefore, not imposing additional checks and balances is likely to increase concerns around socio-environmental practices in these mines.
 - d. Coal export and trading: According to the draft discussion paper, the coal miner is free to sell coal to any consumer. It is not clear whether the consumer needs to be Indian, i.e. whether coal can be exported. It is also not clear if coal purchasers are restricted to only using the coal, or can they further sell it, i.e. engage in trade.

5. Specific comments:

- a. Para 5(v) regarding the successful winner having to sell only washed coal appears to be inconsistent with the rest of the document. If only washed coal is sold, then it is natural that the revenue would be calculated from the sale of washed coal. If so, is it appropriate to compare it with production multiplied by 1.2 times the CIL notified price (para 5(i))? Which CIL notified price is to be used – notified price for the power sector or other sectors?
- b. According to the draft discussion paper, the only deciding criterion in choosing among multiple bidders is the revenue share. While this may make the choice of the final winner very objective, it may have the disadvantage of choosing a bidder with lesser expertise in good mining practices.
- c. It is not clear if the clause about prior record of criminal conviction applies only to conviction under Indian laws or to the laws of any country. This would be particularly relevant if international companies (even through an Indian subsidiary) respond to the offer as is perhaps the intention of the government.
- d. The draft discussion paper talks about eliminating 50% of the applicants for the second round of bidding. It is not clear why this is proposed and why all technically qualified bidders cannot participate in the financial bidding round. In its 2016 audit report, the CAG had also raised concerns that such an auction design reduces competition.
- e. The draft discussion paper states that if the number of technically qualified bidders is less than 3, then the auction process may be annulled. It would be better to rephrase it to say the auction process shall be annulled to remove any ambiguity. It is not clear what happens if there are 3 or 4 technically qualified bidders, since the paper states that a minimum of 5 technically qualified bidders are required to proceed to the financial bidding round.
- f. It is not clear why the miner is restricted to at least producing a minimum amount of coal relative to the peak rated capacity, particularly given the uncertain outlook for coal demand. Would it better to give the miner the freedom to decide how much to produce (up to the PRC) subject to not violating any labour interests? If the intention is that the mine winner should not 'squat' on a mine, then other mechanisms such as introducing some payment which is not linked to production could be considered.

Suggestions for way forward

1. **White paper for the sector:** Given the set of challenges before the sector and its current structure, the government should publish a white paper for the overall coal sector before getting into details about operationalizing commercial mining. Such a white paper should cover at least the following aspects: the current structure and challenges before the coal sector, the likely role for the coal sector in a changing energy scenario, the vision for the coal sector in such a changing scenario and plausible transition paths towards the desired coal sector from the current one. For example, if coal demand is not likely to increase significantly (and indeed may decline gradually in a decade or two), then is it desirable to open up the sector at this juncture, or would it be better to focus on how to make CIL more efficient and accountable? If a competitive coal sector is indeed what is desired, then what is the transition path to get there from the current concentrated structure? The proposed white paper should be finalized only after widespread discussions and obtaining public feedback.

2. **Fair and efficient market:** If a competitive market is what is desired for the coal sector, then issues of fairness and efficiency of the market become very important to ensure that benefits are not restricted to a few. This includes dealing with issues of pricing, coal sale contracts, concessions and a fair and trusted oversight and dispute resolution mechanism. Some suggestions in this regard are as follows:
- a. Pricing: In order to promote a fair pricing regime, a common electronic platform could be used to discover the coal price for all long term and short term contracts. This could be an improved version of the platform used by CIL to auction linkages in 2016. The draft discussion paper mentions a platform to “capture all coal trade/transactions in the country”. This platform could also be used if its function is extended to also “discover all coal prices” and it is developed in a time-bound manner. Using such a platform will provide the assurance to all sellers and buyers about the fairness of price discovery and eliminate any information asymmetry.
 - b. Sale contracts: The government should develop a model Coal Supply Agreement (CSA) based on widespread consultation, which is fair to both suppliers and consumers, and clearly provides checks and balances for supply of coal of the right quantity and quality, and dispute resolution mechanisms. There could be different model CSAs for long term and short term contracts. These model CSAs should be published and all coal supply in the country should be mandated to follow the model CSA structure with the only differences being in specifics such as the location, quantity, quality and price. Given the country’s current energy poverty and the potential role of coal in addressing it, export of coal should not be permitted at least for the near term.
 - c. Concessions: Granting coal mining concessions should be done transparently through a fair process. For this, international best practices should be studied and an Indian model evolved. Some specific suggestions in this regard include:
 - i. The bid evaluation criteria could involve a composite set of criteria that also include mining expertise, socio-environmental management and mine development program in addition to revenue sharing. This is somewhat similar to the approach adopted by the erstwhile NELP and the current HELP. This will help to encourage adoption of world class mining practices in India by giving due value to mining expertise.
 - ii. Revenue sharing could be broken into two components – a fixed rental/lease component and a production-linked component, so that block winners are discouraged from squatting on coal blocks.
 - d. Oversight and dispute resolution mechanism: A dedicated, fair and trusted agency, such as an independent and accountable regulator, to oversee market functioning and resolve contractual disputes is essential if the market is to function smoothly. Since CIL is likely to be a significant player in any future scenario (and CIL is likely to continue to be a predominantly government owned company), such an oversight agency should ideally be independent of the Ministry of Coal. Whether a new regulatory institution needs to be set up or the powers of an existing regulator (such as the CERC) can be expanded to include regulating coal markets should be discussed. Oversight also becomes important since revenues to the government depend on coal production and sale, and it is not clear whether the Coal Controllers’ Organisation (CCO), which is currently responsible for mining oversight, has the necessary capacity and resources to fulfil this responsibility effectively.

- e. Level playing field: The draft discussion paper proposes to continue to deal differently with government and private companies (allotments and auctions respectively). This is likely to skew the market and eliminate incentives to government companies to improve their efficiencies. Therefore, it is necessary to devise a time-bound transition path by which government companies are supported to become more efficient and can compete on a level playing field with private companies to eliminate this distortion.

- 3. Transparency and Accountability:** Transparency and other accountability measures are essential to ensure fair markets without any information asymmetries and to make the sector accountable to citizens (who are the real ‘owners’ of the natural resource with the government acting as a custodian). To promote such transparency, some suggestions are given below:
- a. Template documents: All template documents, such as the model CSA, the offer document and the mining agreement, should be published in draft form, comments sought and the final version published.
 - b. Common portal: A single, publicly accessible portal should provide information about all coal mines in India irrespective of the regime of its allocation (thus including those given to CIL, SCCL etc.) such as its owner, operator, status, reserves, quality, production profile, summary of contracts, government revenue and so on. There should also be a publicly accessible portal with information about various kinds of bidding (for mines and contracts) that is likely to be seen in the sector, including number of bidders, clearing price and name of the winner.
 - c. Company website: For each mine owned by them, all mine owners (including CIL, SCCL and captive mine owners) should be mandated to publish information on their website such as the Environmental Clearance (with all associated conditions), the Consent to Operate, the Environmental Management Plan (EMP), the compliance report to the EMP, and the safety and health record of the mine.

Initiating commercial mining without addressing the issues highlighted above is unlikely to address the challenges faced by the sector or attract significant interest from genuine parties. It is hoped that the suggestions presented above can help in the transition to a healthy and vibrant coal sector that can support the country’s energy sector. This could potentially require some legislative changes and is likely to be a gradual process. However, such a calibrated transition is more desirable than an ad-hoc experiment at introducing commercial mining in the manner proposed.

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