CIRC RegTracker

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Enhancing Knowledge, Strengthening Capacity

RT.013, October-December 2013

CIRC RegTracker is a modest attempt to track the creation of regulatory institutions, their capabilities, performances and the way they interact with other institutions in shaping patterns of governance. RegTracker is a quarterly publication which has been tracking the current policy changes/policy proposals on economic regulation in the country, particularly on the dynamics of the same as and when a news report appears. It does not aim to provide an in depth analysis of the happenings, but raises some points to ponder, as food for thought and deeper analysis by policy makers and researchers.

We are pleased to share latest issue of RegTracker (RT.013, October-December 2013). It offers sector wise developments and points-to-ponder for each development. Keeping with our focus on regulatory governance in infrastructure sectors, we cover following six sectors: a) Petroleum and Natural Gas; b) Coal; c) Electricity; d) Transport; e) Telecom; and f) Water.

HIGHLIGHTS:

Developments over last quarter suggest momentous transformation in the Indian regulatory regime. The need for independent regulators in key economic sectors is being stressed, while the existing regulatory agencies seem to be proactively enforcing their mandates. The necessity for a coal regulator is further emphasised, while a separate Rail Tariff Authority is being proposed. Competition Commission of India seems to be strengthening its authority by investigating and penalising long-untouched public sector units like Coal India Limited.

Realising the limitations of state agencies, private sector participation seem to be promoted in key infrastructure sectors, as seen in the case of coal mining. Allocation and pricing are emerging as contentious issues, as seen in the case of telecom spectrum. At the same time, the existing regulators have made attempts to rationalise prices and shrink subsidies for energy commodities, valuing their vital nature and scarcity value.

While much of these developments are necessary, some might prove inefficient and may increase the complexities. For example, setting up composite regulators for interrelated sectors may be more effective than having separate regulators. It would be more effective to have a single energy regulator for all the energy sectors and make it accountable to the parliament to ensure real independence. Sectoral discussion of issues follows.

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- Competition Compliance and Role of CCI: Need to Move Beyond Advocacy
- Regulation in Infrastructure Development: The Role of Consumer Participation
- The Interface between Business Strategy and Competition Law

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1. COAL

1.1 Coal Regulatory Authority Bill introduced in Lok Sabha

The need for introducing a regulatory agency is being felt since past 6-7 months due to requirement of surplus coal and the growing imports (see RegTracker **RT.012, Sec 2.1**). Coal Secretary Mr Shrivastava gave the early signs of the bill to be introduced during winter session at a FICCI conference organised in November, where he observed that Coal India will not be able to unilaterally hike prices once the watchdog is in place.

A Bill to establish an independent regulatory authority for effective monitoring and regulation of the coal sector was introduced on December 13th, 2013. While introducing the bill in the Lok Sabha, the Coal Minister Sriprakash Jaiswal mentioned the objective of the proposed coal regulatory authority that would be to regulate the practices and methods of a monopolistic producer of coal. This authority will be responsible for ensuring transparency while fixing the price by the monopoly coal producer. The regulator will also help redress complaints between producers and consumers and also the grievances of the consumers. As per the bill, the regulatory authority will also monitor the irregularities in allocation of mines. (**FE 04.01.2013**; **Hindu 13.12.2013**; **NDTV 13.12.2013**)

Points to ponder:

In the present time, the coal sector is already in a bad state. Therefore, the Bill assumes significance amidst a plethora of problems faced by the sector including output shortfall, besides charges of irregularities in mines allocation with CAG and a challenge under the Competition Act for abuse of dominance (see the next story). This bill is to set up an independent coal regulator authority that would certainly lead to regulation of prices and uninterrupted production, along with specifying methods of testing for declaration of grades or quality, monitor and enforce closure of mines.

Although the regulatory body would not be allocating blocks or determining prices for coal, but it would lay down certain policies and methodology for fixing prices. Coal sector has always been characterised by near monopoly producers and therefore to establish consumer confidence, it needs to be regulated by agencies which are at arm's length from the government.

Our view is that instead of creating a coal regulator the government should think of one composite regulator for the whole energy sector, which has been also supported by the Planning Commission. The reasons are that an integrated energy regulator will be able to look at the subject coherently rather than independent of the other. Similarly, there could be one transport regulator and a financial regulator. Such integrated regulators should be accountable to the Parliament directly rather than a line ministry so as to provide real independence.

If at all a coal regulator is set up, it should report not to the coal ministry but perhaps the power or public enterprise ministry. Such a practices exists in many countries, and in India the Railways Safety Commission reports to the Civil Aviation Ministry and not the Railways Ministry.

1.2 CCI tightens its grip over CIL

CCI, India's competition watchdog fined Coal India Ltd (CIL) and three of its subsidiaries a combined amount of Rs.1,773 crore because they were alleged to misuse their position of monopoly producers of coal. CCI accused them of keeping their own gain over that of buyers and fixing conditions in their favour by fixing prices and also supplying poor quality of coal.

The other Coal India units that were fined were- Mahanadi Coalfields Ltd, Western Coalfields Ltd and South Eastern Coalfields Ltd.

Coal India and its units were found to breach the provisions of Competition Act by imposing unfair and discriminatory trade conditions prior to this too, in fuel supply agreements (FSAs) with power producers for supply of non-coking coal.

The specific charges against the state-run Coal India were: supplying low-quality coal at high prices; retaining the right to unilaterally terminate contracts with buyers; not providing a fair dispute redressal mechanism; and preferring other state-owned companies over private buyers of coal. Previously too, in July 2012, CCI had ordered a probe against three CIL units: Eastern Coalfields Ltd, Bharat Coking Coal Ltd and Mahanadi Coalfields.

The penalty has been calculated at 3% of Coal India's average revenue in 2009-10, 2010-11 and 2011-12, which was Rs.52,252.09 crore, Rs.55,101.42 crore and Rs.69,952.33 crore respectively.

Coal India is set to appeal to the Competition Appellate Tribunal (COMPAT) against the penalty imposed by CCI. (**IE 12.12.13**, **MINT 11.12.13, MINT 11.12.13, MINT 10.12.13**)

Points to Ponder:

This move by CCI of penalising a public sector company is highly appreciable. In this context, CCI has indicated that a company, even if a government entity undertakes anticompetitive practices, won't be spared.

CCI's view is that CIL through its subsidiaries operates independently of market forces and therefore enjoys undisputed dominance in the relevant market of production and supply of non-coking coal in India.

CCI has now pulled up the PSU. This is not the only case against Coal India that the regulator is investigating. In the past year there were few complaints against the company; three of which were investigated by CCI, although no decision has been taken on these. In July 2012, CCI had ordered a probe against three CIL subsidiaries: Eastern Coalfields Ltd, Bharat Coking Coal Ltd and Mahanadi Coalfields.

This move of CCI will certainly boost market and foster a spirit of competitive neutrality. In terms of public policy, does it make sense to not to privatise the coal behemoth? Perhaps that is a thought in the government which is why a coal regulator is being established.

1.3 Government invites private players to mine coal and boost production

The government plans to invite bids from private sector to give a push to coal mining in a Public Private Partnership (PPP) mode. The main objective of the government behind this is to overcome the lag in coal production in recent past, which came up due to growing domestic demand for coal. According to official data, the domestic demand of coal exceeds the supply, hence causing a deficit of 204.1 million tonnes per annum, which has to be made up by costly imports.

According to the plan, coal mines and coal will remain in the ownership of the public sector; the private partner will receive some share of the coal mined. The commercial mining in PPP mode would lead to healthy competition and eliminate the monopoly of Coal India. However, it will require the government to amend the Coal Mines Act, 1973.

During early November, the coal ministry adopted a ranking system to select suitable applications for allotment of coal blocks. They are ranking companies on several parameters before a selection to avoid controversies, amid consistent allegations of irregularities in coal block allocations.

The Coal Ministry also warned the companies for moving slow in mining coal blocks allocated to them, seeking an explanation for delay. The ministry issued show cause notice to Essar Power for delays in exploiting an allocated coal block in Jharkhand. The other companies summoned by the ministry also include Hindalco, SAIL, Jindal Steel etc. (**ET 28.10.13, BS 18.12.13, BS 03.11.13**)

Points to Ponder:

There has been a demand supply mismatch in the economy regarding the domestic consumption of coal in the country. The deficit of 204 million tonne per annum had to be met by imports from Indonesia, South Africa and Australia. Seeking private sector partnership in coal mining seems to be an efficient solution, as it will surely mark the end to monopoly of Coal India and shows a ray of hope for increased coal availability in the country, which is a dire need of the hour.

Nevertheless, we do need to curb our current account deficit and reducing coal imports will help. The proposal that has been made is quite agreeable as it involves the private sector, but the ownership will remain with the State, and the private partner will receive the charge of mining. Privatisation in mining will also curb the role of the mining mafias. But the private players must be given little time to understand the dynamics of land and coal mining.

2. PETROLEUM AND NATURAL GAS SECTOR

2.1 Gas pooling mooted for non-priority sectors

The period between 2009 and 2013 saw the rise of Indian upstream activities in the hydrocarbon sector. It was during these years that more than 200 production sharing contracts (PSCs) were signed and implemented; predictions were made that the gas production would double. During earlier years of this period, oil prices were reasonable and comfortable, foreign companies were looking at Indian upstream sector with interest, however, soon the slump came. It was around this time that the need for introducing fresh policies was felt, both by the government and industry stakeholders.

In October 2013, owing to gas shortfall at the Krishna Godavari basin, gas shortage for power plants at 72 mscmd, the Ministry of Petroleum and Natural Gas (MoPNG) worked on a proposal to pool domestic and imported gas for the non-priority sector, like steel plants, petrochemicals

units and refineries. MoPNG looked into the possibility of pooling Re-Gasified Liquefied Natural Gas (R-LNG) with domestic natural gas. This would have led to a reduction in prices for the intended users and encourage them to use more R-LNG. (**BS 16.10.2013**)

Points to ponder:

Pooling of gas essentially means creating a common gas collective from different sources, domestic and international, which are managed by a common operator. This averages out the price of cheaper domestic gas with costlier R-LNG. Pooling would not help in making the price fall within reasonable limits but also help power plants which are operating at a 24 per cent plant load factor.

It should be noted that the availability of domestic gas has fallen over the last two years and at the same time R-LNG imports are raising. It is therefore needed to have provisions of pooling, to help in keeping price within reasonable limits and to enable the suffering industries run efficiently or else there is a chance that these non-priority industries will go back to importing coal. However, unlike coal pooling mechanism where accessibility was not restricted, gas pooling would be restricted since gas requires pipeline connectivity for transportation.

2.2 OilMin seeks easier nod for licences

The PNG Sector has been plagued with institutional and bureaucratic hurdles in form of clearances for exploration licensing. MoPNG is taking precautionary measures to ensure companies for not giving up oil and gas exploration blocks after the next round of NELP bidding in 2014. Recently, mining giant BHP Billiton had surrendered nine of its oil and gas blocks in India because it was not getting defence ministry clearances. The ministry has set up an expert committee, which included one ex-army man, an ex-navy man and an ex-forest official, for the next round of NELP. The committee will look into prospective blocks that could face defence and environment hurdles and try to get initial clearances in advance and also avoid sensitive blocks coming under defence areas. (**BS 15.11.2013**)

Points to ponder:

MoPNG is planning to offer around 84 blocks/areas for exploration of oil and gas in the next round of NELP. To ensure that repetition of BHP Billiton case doesn't happen, the ministry is granting initial clearances in advance for all the blocks coming under defence areas. It is a standard practice that has been adopted world over. However since the last nine rounds of NELP, this provision was never once recommended to be included in the bidding process.

Getting advance clearances will make the blocks much more commercially viable as now the bidding companies will not spend crucial initial years getting clearances. The companies will thus get longer operation period and have better efficiency that the sector needs.

For already existing blocks, the ministry has also planned to relax rigid provisions in PSC that will safeguard energy explorers' interest if the government restricts drilling in an exploration block due to defence or environment concerns. Proposed options are that the explorer can exit the block without any liability and that in case the area has to be reduced due to such non-clearances, the explorer can retain reduced block with pro rata cut in contractual commitments.

2.3 No single-stroke price rise to decontrol diesel

The other key sectoral reform that has taken place in 2013 is a gradual move towards decontrolling diesel prices through successive, small hikes in its retail prices, along with that of petrol, through the year. (**BS. 26.11.2013**)

Points to ponder:

The government has not been able to fully de-control the price of diesel yet because of the political economy constraints. The increase in the prices of diesel and petrol are largely a reflection of depreciation of the rupee against the dollar over the last 12 months, which has made imported crude more expensive in dollar terms.

According to analysts, the move is positive for HPCL, BPCL, ONGC and Oil India Ltd. OMCs are currently losing a little over Rs 9 per litre on the sale of diesel at a subsidised price. This amounts to nearly Rs 94,000 crore per annum. Given the challenges in the oil and gas sector, the government has to balance the short term approach towards the long term approach. With the spike in diesel prices, in short term inflation may go up, but if the government is able to cut down on the subsidy bill, it would help abridge fiscal deficit and its adverse consequences in the economy.

It is good that the government is addressing the subsidy regime not only in the oil sector but also the electricity sector by practicing homeopathic methods of small doses rather than one big jump which sends people marching down the streets.

2.4 Uniform rise in gas price for producers likely soon

The foregoing year saw price instability for petroleum, natural gas and petroleum products. The highlight of the year in terms of policy decision making has been the acceptance of the fact that prices of natural gas must rise to make the sector more attractive for companies to invest. Consequently, a new market-linked formula for gas price was accepted. A firm decision has been taken for the enhancement of gas price by the Cabinet Committee on Economic Affairs, which will be effective in April, 2014. It will apply to all upstream energy companies in the state and private sectors without any exception. (**ET 27.11.2013**)

Points to ponder:

The gas price under the new formula, to come into effect on April 1, 2014, will be approximately double of what it is at present to begin with and will gradually move in tandem with international market prices. This, considered a bold move, is likely to attract investments into the upstream oil and gas sector.

The revised gas price would be far lower than the going rates for imported liquefied natural gas, which is about a third of the total domestic gas demand. The ground reality is that there is a huge unmet demand of gas and we need to incentivise and expedite its production. Therefore the need for developing policies for market with gas-on-gas competition for price discovery, by ramping up domestic gas production and transportation, including, potentially, pipelines from across our borders. However, pending reforms in other segments of the industry--especially diesel price hike-- this may benefit only private firms. This hike is estimated to increase government's subsidy outgo close to Rs. 11,300 crore.

3. Electricity

3.1 Power watch dog growls at tariff cut

Delhi's electricity regulator has said the government cannot interfere in fixing tariff though it can subsidise consumers, highlighting the potential difficulties facing Arvind Kejriwal, the new Delhi CM, whose party has promised to halve electricity prices in the Capital. "The government cannot interfere in tariff fixation. It is a regulatory issue," P. D. Sudhakar, chairman, Delhi Electricity Regulatory Commission, told ET. (**ET 30.12.2013**)

Points to ponder:

State efficacy in setting the tariff for electricity service has been an issue of contention for long, predominantly during 1990s. Driven by the global trend, consequently, India chose to detach the governments from tariff fixation duty. The whole objective of setting up 'independent' electricity regulatory commissions was to separate electricity tariff from politics and political process, and ensure tariff fixation on economic principles.

Thanks to our regulatory settings, the regulators are barely independent from the political process and are still far from achieving a rational tariff arrangement. However, the current proposal of the new government of Delhi will certainly have damaging effects by altering the minimal success achieved so far. At one end, it will hamper the regulatory efficacy. At the other end, it will have serious financial consequences for the utilities. If the utilities loss their revenue, they will not be able to ensure quality of supply that has certainly improved in recent years. Moreover, if the utilities lose revenue and go bankrupt, in medium run it will be a stress on state exchequer.

As the regulator has suggested, the government can subsidise the tariff through adequate subventions. Given the financial state, be it Delhi or any other Indian state, are the state governments in a position to subsidise domestic electricity tariffs? However, the demand for audit of discoms is a fair middle ground which may bring transparency in the tariff setting process and would make any price revision socially and politically acceptable.

3.2 Discoms set conditions to accept higher tariff

Power utilities saw light at the end of the tunnel with the central regulator allowing them a compensatory package for the steep rise in Indonesian coal. But their customers, the state-run power distribution companies are playing hard ball, putting forth some tough conditions that they want to be fulfilled before opening their pockets to pay more for power.

Punjab and Haryana have declined to accept the compensatory package suggested by Deepak Parekh-led committee after Central Electricity Regulatory Commission allowed a compensatory package for Tata Power Company's Mundra Ultra Mega Power Project. Maharashtra, Gujarat and Rajasthan have agreed to the package "in principle", albeit with some riders.

The outcome of this will set precedence for other projects, belonging to Reliance Power and Adani Power, which are also seeking a higher compensation for their Indonesian coal based projects. "State discoms have told us that they

don't want to increase their burden. They want us to consider all options to ensure the power purchase cost does not go up. They have put forward some demand and we are looking at it," a top executive from CERC told ET. (**ET 23.12.2013**)

Points to Ponder:

This is a complex situation that requires the regulators to balance competing interests of stakeholders. The compensatory package is a fair decision and a necessity to keep the private players in generation and a signal to attract new players. (In the case of mobile telephony we had seen policy changes from a lumpsum licence fee to a revenue share model in 1999 because operators could not cope and may have had to shut down. Similarly many highway projects are seeking changes in their contracts because of the unviability of contracted conditions). The challenge is whether the discoms are in a position to bear the consequences (raise in wholesale tariff). It will depend on whether the regulators (and governments) will allow the discoms to transfer the cost to the end consumers. Raising the retail electricity tariff to reflect the input costs has been a challenge and politically infeasible in India. The situation requires the regulators to spread the cost across the stakeholders.

However, the situation offers an opportunity to hasten the initiatives on energy efficiency so that the electricity cost at end consumer level can be reduced. Consequently, the input cost can be transferred to the consumers. At the same time, the regulators need to stress the need to reduce losses at distribution level so that part of these input costs can be absorbed by the discoms. The generators also need improve their plant load factor to reduce their operational costs which may be addressed by the draft tariff determination guidelines released by CERC (see below, sec 3.3) when implemented.

3.3 CERC's draft norms likely to hit thermal power producers hardest

Investors reacted sharply to the Central Electricity Regulatory Commission's (CERC's) draft tariff determination guidelines, released on Tuesday, for central government-owned power generation utilities.

The draft guidelines for fiscal 2015 to fiscal 2019 attempt to tighten operating norms for running thermal power stations and thermal power generating utilities, including changes in the heat rate and the incentive structure from plant availability factor (PAF) to plant load factor (PLF).

PAF refers to whether a plant was available for generation or not. If it was available, it receives incentive irrespective of whether it generates power or not. PLF refers to actual generation from the plant as against its installed capacity.

Similarly, CERC proposes to link recovery of tax from the customers of power producers on the basis of actual payment of tax. In the earlier regime, if a firm managed to save on tax because of smart tax planning, it was allowed to keep such gains.

PLF may vary depending on the demand from the electricity distribution utilities, but the actual generation capability or PAF remains the same, NTPC chairman and managing director Arup Roy Choudhury told reporters in New Delhi. "The PAF is generally higher than the PLF of the plant, therefore our incentives should not be linked to PLF," he said. NTPC said it will respond to the draft regulations by CERC. (**Mint 11.12.2013**, **FE 11.12.2013**)

Points to Ponder:

The guideline is a welcome step. The conditions set in the draft guidelines may seem harsh on the ailing thermal power plants in India, but it is a need of the hour. Considering the current power scenario, rising demand and rising input cost, it is necessary to improve the PLF of thermal plants which is way below the global standards. Moreover, it is fairly economic and rational to link incentives to productivity (PLF) than linking it to capacity (PAF). At the same time, to achieve maximum productivity of power plants, the regulators will be required to align the discoms with generators in such a way that the demand meets the optimal PAF.

With all its merits the guidelines is still at a draft stage. Let's see what is being negotiated and retained in the final version.

4. TELECOM

4.1 Spectrum prices and policy delinked

After a Department of Telecommunications (DoT) committee reviewed TRAI's September, 2013 recommendations, the DOT had urged the regulator to reconsider a substantial cut in reserve price for the spectrum auction, on the basis that it did not appear to reflect the value of liberalised spectrum, the potential for use of which was much more than that of 2G. TRAI, in its reply in October, reiterated its earlier recommendations on pricing of spectrum, rejecting the Telecom Commission's request to reconsider key suggestions.

The regulator reaffirmed its recommendation of 60% reduction in the base price for 900-MHz spectrum in the Delhi, Mumbai and Kolkata circles; and a 37% cut in 1,800-MHz spectrum. It has also left unchanged its key recommendations on introduction of a uniform spectrum usage charge (SUC) rate of 3% on all operators and auctioning the extended GSM (EGSM) band along with 800-MHz spectrum, instead of leaving it for CDMA operators. Besides, the regulator had recommended that there should be no reservation of 900-MHz spectrum for incumbent operators and all spectrum held should be vacated to be put up for auctions. (**BS 24.10.13, BS 07.11.13**)

Points to ponder:

After the cancellation of 122 licenses for 2G spectrum by the Supreme Court in 2012, the investigation into the allegations is being monitored by the apex court itself which has led to policy reluctance by the government and slowdown of market operations and expansion by enterprises. Each stakeholder is asserting its response to policy deliberations with reasoned and forceful legal and economic arguments, taking a cautious approach by engaging in extensive discussions with each other.

As high price recommendations from TRAI have failed on multiple occasions, the Telecom Commission proposal for a middle path on spectrum price may work. However, the critics feel that the Commission does not seem to be in sync with the market realities.

While the government looks to maximize revenue the industry looks towards sustainability, yet all these conflicting interests have to translate into one cohesive policy framework. It is not surprising therefore to see extensive discussions over derivation of the final parameters for spectrum auction and the accompanying policy dispensation to incentivise this.

4.2 No final call on Spectrum Usage Charges

On October 23, TRAI had justified its initial September 9 recommendations of a higher SUC at a rate of 3% of AGR. The DoT had referred the matter back to TRAI based on the view that SUC charges could not be made uniform across users of spectrum since license terms for Broadband Wireless Access (BWA) Providers disallowed a change in its terms, one of which warranted a 1% SUC.

Claiming that the 'notice inviting applications' (NIA) for BWA licenses gave enough headroom to the government to alter, change and modify the rules/rates from time to time, TRAI stated that the "*SUC charge lies in the policy domain and there can be no estoppel by virtue of what is written in the NIA against the exercise of sovereign policy privilege*".

TRAI clarified that its primary aim was to enable a gradual transition from a slab-rate system to a uniform SUC regime over time. The transition to a uniform rate would not only simplify the levy structure but also enable the policy initiatives on merger & acquisitions and sharing and trading of spectrum to be implemented without inherent disincentives.

With the hope to satisfy both ends of the debate the regulator added that it would have no objection in the event the Government applied a uniform SUC of 1%, as long as it was uniform for all users of spectrum.

(**BS 24.10.13, BS 07.11.13, ET 31.10.13, BS 13.12.13, BS 27.12.13, FE 27.12.13**)

Points to ponder:

Currently, telecom operators pay anywhere between 3-8% of their AGR as SUC. The move to a uniform SUC will allow operators to pare costs and trim financial outflows while simultaneously creating a level playing field amongst all operators in the market. This is a view supported by the regulator as well.

It is interesting to see meanwhile that the singular broadband wireless access (BWA) licensee (Reliance) has ensured that the reduction in SUC and its uniform application is kept in abeyance by challenging the legal validity of the variation in its NIA terms, having secured a legal opinion to this effect as well. Nevertheless, TRAI has smartly put the ball back in the government's court by identifying the sovereign powers of the executive to exercise uniformity in SUC while at the same time clarifying that the proposed SUC may be brought in line with the BWA rate of 1%.

4.3 CDMA tussle results in extensions

On 9 September, TRAI recommended spectrum in the 800 MHz band be reserved for extended GSM and not be auctioned, in response to which the DoT formed an internal committee that considered these recommendations and asked TRAI to change its stance regarding the 800 MHz air waves. TRAI reiterated its recommendations on 23 October, 2012 stating that there was a vast difference between the opportunity cost of 800-MHz spectrum in the proposed EGSM band and the price at which it was sold in the previous round of

auctions. The adoption of EGSM band will add 25% spectrum in the 900-MHz band, even if 5 MHz spectrum in 800-MHz is kept aside to accommodate CDMA growth.

Subsequently the Telecom Commission again asked TRAI to reconsider its recommendation and derive a new formula to determine the base price of the band. To which, TRAI replied by inferring the TRAI Act whereby its recommendations would be binding after two referrals, which in this case were on 9 September and 23 October and indicated that the matter was now beyond discussion. After a series of communication with the department of telecom (DoT), TRAI invited views of interested entities on valuation of CDMA spectrum proposed to be sold through auction, vide a consultation paper. (**BS 24.10.13, BS 07.11.13, MINT 19.11.13, FE 16.12.13**)

Points to ponder:

The insistence by government to auction CDMA spectrum has raised concerns, when clearly only one player (Reliance) is interested in the auction (with Tatas having returned some unused spectrum for its original allocation). Instead of creating the EGSM band to incentivize 4G/LTE data heavy operations, the move is being seen as clear manipulation to secure a cheaper base price for additional CDMA spectrum, due to lack of auction competition. Furthermore, with no policy clarity and a new tier of consultation through the TRAI paper, the government's date for January auctions, would at the least not involve CDMA spectrum.

4.4 Merger & Acquisition Rules

Continuing its push for policy clarity across regulatory verticals in the telecom sector, the Merger & Acquisition rules for telecom companies were reworked, clarified and sent to the Cabinet for approval. The process began with the Telecom Commission broadly accepting and forwarding the proposed guidelines for the telecom M&A policy to the EGoM.

The TC had agreed to increase the cap of market share up to 50 % for each circle for the merged entity from 35% proposed earlier. A merged entity can have up to 50% market share in a circle and can retain up to 25% of the total spectrum assigned which could translate to a combined retention of up to 25 MHz of 2G spectrum and 10 MHz of 3G spectrum. However, if a merged entity breaches this 50% ceiling in any circle, the companies will get a year to lower the share to below 50%.

Nuances and discrepancies to the policy were firmed up during discussions at the TC and EGoM levels. As per the policy at the time, incumbent operators were given 4.4 MHz in GSM (in case of single technology users) and 4.4MHz GSM and 2.5MHz CDMA spectrum (in case of dual technology users) bundled with their licence, known as the administered price. As per the new guidelines, an acquirer would have to pay the difference between the market price of the target company's spectrum held and its administered price.

According to the final draft of the proposed policy, if a transferor company holds a part of spectrum which (4.4 MHz for GSM and 2.5 MHz for CDMA, or both in case of dual-tech operators) has been assigned against the entry fee paid, the acquiring company or the resultant merged entity will be required to pay to the government the differential between the entry fee and the market-determined price of spectrum, pro rata for the remaining period of the validity of the licence. Thus, if a new operator, who has bought spectrum through auction, buys an incumbent operator who had bought spectrum by paying entry fee, the resultant entity will have to pay the differential price for the spectrum held. So, for new operators, the cost of the entire spectrum holding is auction-determined. But, if two incumbents merge, the companies get the benefit of retaining existing spectrum at a much lower cost. Also, if two operators which have acquired spectrum through auction get merged, they will not need to pay anything extra.

(**BS 07.11.13, FE 07.11.13, FE 08.11.13, BS 09.11.13, ET 15.11.13, FE 21.11.13, MINT 04.12.13, BS 04.12.13**)

Points to ponder:

These measures were a welcome change since they ended the ambiguity over M&A transactions in the sector earlier, when all spectrum allocation was ad hoc and there was no articulated M&A policy. This move also encourages consolidation amongst players since in addition to spectrum; they would also get access to subscribers and infrastructure from the company they are acquiring.

But this decision did not bring cheer to the industry since an acquirer will have to pay the market rate in case it buys out a company which has got its spectrum bundled with the licence, as is the case with incumbent players. Industry players said any move to impose an additional fee on M&As would make new deals expensive, hamper the progress and roll out of capital intensive telecom projects as shareholders may not be able to invest further in

equity. Also, determination of market share has not been clarified to be either revenue share or subscriber share of the relevant market, to impose the 50% cap.

Secondly, the Telecom sector M&A issues need to exempted from the Competition Act, which has its own economy wide remit on M&As on financial thresholds rather than market shares. In a similar case failing bank mergers have been exempted under the Competition Act, which would be dealt with under the Banking Regulations Act.

4.5 Govt. looking at Rank-based spectrum allocation

The DoT had suggested a first-rank, first-served process for the allocation of contiguous radiowaves in the 1,800 MHz band to operators in the upcoming January spectrum auctions whereby bidders would be ranked based on the specific time of placing a bid, with higher rank holders being automatically eligible for spectrum allocation.

The inter-ministerial committee (IMC) set to finalise spectrum auction rules, had sought the TC's approval on a detailed 'rank-based' system for allocating contiguous spectrum asking whether bidders may be given priority to allocate contiguous spectrum ahead of other successful bidders, based on ranking parameters that include price, number of times the bidder has submitted the bid in a particular circle, total bid expenditure across all service areas, the previous highest bid, and/or a random index number.

Most of the spectrum being put up for sale in the next round of auctions in the 1,800-Mhz band is not available in contiguous blocks of 5MHz since these radiowaves were made available from the cancelled 122 licences issued to new 2G players in 2008. In only a few areas spectrum is contiguous. While non-contiguous spectrum works for offering voice services, higher technologies such as 2G, 3G or 4G need the airwaves to be available without a break since this spectrum may be used for deployment of any of these technologies. (**FE 16.11.13, FE 29.11.13**)

Points to ponder:

The methodology of 'first-come-first-serve' for spectrum auction employed in 2008 had received the severest criticism by the Supreme Court in the 2G matter and was seen as a facilitator of the scam. Therefore it is positive to see the clarity in the auction process and the fact that the process has been structured to derive maximum revenue from the exercise.

It may be noted that few other countries have also adopted the 'first-come-first-served' policy but it was done transparently and fairly, unlike what our government did in 2008. However, many countries have followed the auction method and its variance to get the best possible revenues.

4. TRANSPORT

5.1 Privatisation of Airports

The development and maintenance of airports has always been a concern, paucity of funds for infrastructure development and poor functioning, demands a new look in the airport sector.

In order to overcome its shortfalls, Ministry of Civil Aviation has created new scope for private investment via PPP. MoCA has invited proposals to privatise 6 airports: Chennai, Lucknow, Ahmedabad, Jaipur, Guwahati, Kolkata through an Operations Management and Transfer Agreement, on a revenue-share model with the state-owned Airport Authority of India (AAI) for a lease period of 30 years.

As a first move, MoCA has announced the request for qualification (RFQ) process for Chennai and Lucknow airports, with investment of Rs. 1,200 crore by Chennai concessionaire while Rs. 500 crore in Lucknow. The concessionaries can set up JVs, either with 100 percent equity held by private players alone or with 26 percent equity share of AAI in JVs.

But due to oppositions by various stakeholders, the move has been kept on hold and deadline for selecting private operators has been extended. (**BS 02.10.2013**, **ET 04.12.2013**)

Points to Ponder:

Due to emergent need of financing the huge infrastructure and other developments of airport, this announcement was clearly appreciated by all. On contrary, this announcement was opposed by some stakeholders.

PPP model for airports have been successful in international instances where airport operators are successful in delivering quality services and value for money. But Indian experience with initial privatisation has been mixed, due to disputes, delays, losses etc. Therefore, MoCA should open its airways sectors to private sector after complete evaluation of its pros and cons rather than in haste.

In addition, "instead of giving airports to private sector 'on plate', state-run AAI should form a subsidiary or special purpose vehicle (SPV) to grant management contract to entities who are experts

in this field"— Standing Committee on Transport, Tourism and Culture. MINT (17.12.2013)

If recommendations of the committee will be put in place then it would imply greater financial and administrative autonomy to AAI which in turn will help AAI to take decisions independently, without being influenced by other Government authorities.

5.2 An Authority to Regulate Rail Tariff

There is a serious mismatch between the rail freight charges and the passenger fares. The ratio of the average freight tariff to average passenger fare in India is one of the highest among major railways in the world. Currently, there is no regulation of freight or passenger tariffs on Indian Railways (IR).

With reference to existing needs, setting up of tariff authority was one of the budget speech announcements this year. Even though cabinet has given approval for setting up of a Rail Tariff Authority (RTA), having full power to fix and notify rail tariffs, authority may not be formed during this financial year. According to officials, the delay is due to the fact that no one in the Rail Ministry wants to take a call and discuss the topic further even though they had one round of discussion with the law ministry over the legal requirements. (**BS 07.10.2013**, **BS 06.12.2013**)

Points to Ponder:

While the Ministry of Railways has been interested in a 'strong advisory' body to fix and notify all tariffs, the formation of RTA has met with delays. The authority is expected to bring more transparency in setting rail tariffs. The RTA would suggest the floor level of tariff for both freight and passenger fares from time to time, taking into account the input costs and volatile market conditions and hence would mark the delinking of railways' financial health from politics.

If IR wants to achieve the twin objectives of improving operating efficiency and financial viability, it must allow some form of competition, so that all operators are forced to work in efficient manner and deliver the best outcome. Therefore, a regulator may then become a necessity, but for now it may add to the administrative mess that this premier transport undertaking is experiencing already.

It may be noted that container operations have been opened up for private participation and has been showing good results, though there are neutrality distortions here also.

5.3 FDI- a new approach to refurbish Indian Railways

At present, India's largest Transport network, Railways face stressed finances, and it needs huge amount of investment to modernise, improve safety and play a dominant role in transport infrastructure.

In order to meet above deficiencies, Indian Railways is now welcoming foreign direct investment (FDI) for its future ambitious plans and refurbishments. As per earlier proposal of the Department of Industrial Policy and Promotion (DIPP) foreign players were to be allowed to pick up 100 percent stake in the special purpose vehicle (SPV), but now this cap could be lowered to 74 percent in certain areas of railways. Also, foreign investment would be limited in scope, as it will be allowed only in construction and maintenance of railway projects, and not in operations. (**BS 30.12.2013**)

Points to Ponder:

At present, FDI is not allowed in railway segments other than mass rapid transport and manufacturing of components. Undoubtedly, allowing FDI in railways is anticipated to give a boost to this sector by helping in speeding up of infrastructure projects and efficient maintenance.

The government has already allowed FDI in many sectors of Indian economy, but bringing FDI is not the key to solve all problems of Indian economy. Loopholes prevail at domestic level, paucity of investment, delays in project clearance etc. Therefore domestic investment has to play vital role to revive the economy.

Instead of relying on foreign players for construction and maintenance, railways should engage with the domestic private sector, which has been chary of investing in long-gestation railway projects (ET 31.12.2013). Engaging with domestic private players will help to boost domestic investment as well as on the other hand will help in build of better connection between government and private players. Therefore, in order to reap benefits of allowing FDI in railways, the government must at first try to work on its domestic loopholes, and must aim to complete projects on time for the economy to get rolling.

5.4 Single bidder for Railways Coach Project

Indian Railway's capacity for meeting the increasing demand for passenger traffic is severely constrained on account of shortage of rolling stock besides bottlenecks in infrastructure.

The Ministry of Railways has, therefore identified augmentation of coach manufacturing capacity as a pressing priority and has decided to set up a new Rail Coach Factory at Palakkad, Kerala to manufacture passenger coaches, through a Joint Venture Company to be formed with a private sector partner selected through international competitive bidding.

The project, being developed on PPP basis, has received only one bid from CSR China. The rail coach factory, estimated to cost Rs. 600 crore, will produce 400 stainless steel and aluminium coaches in a year. The railways has taken over 230.10 acre of land for the project. It will hold 26 per cent equity in the project, subject to a cap of Rs 60 crore.

Given this situation of only one bidder, the hurdle in front of railways is to decide on whether to go ahead with just one player or to relax certain conditions in order to attract new bidders. (**FE 20.12.2013**)

Points to Ponder:

Although, Ministry of Railways has been taking steps to meet the pressing demand of railways, but taking steps in haphazard manner without analysing pros and cons leads to delays in projects, like this case; which in turn can lead to a failure.

As in this case, ministry should speak to other capable parties about their objections and relax conditions in order to allow other bidders to participate in the bidding process by reinviting tenders. Otherwise going with single bidder will be questioned. Government Financial Rules also do not permit procurement unless there are at least three bids. Even, when there is competition, it has been seen in many cases that the winning bidders seek renegotiation of the contract which the government is then coerced into accepting due to the fact that it has no option but to see the premature closure of the project.

5.5 New Tariff Plan: Operators vs. Passengers

These months also saw another interesting change. In contrast to earlier model of single till, Ministry of Civil Aviation (MoCA) has proposed the hybrid model (combination of both single till and dual till model) for determining air tariff, which is cheaper than dual-till model but expensive than single-till. This move of government is expected to offer a new edge to the operator of Bangalore International Airport, as valuation of airport is likely to increase under new valuation model, but on the other hand it will disregard the interest of passengers. (**MINT 14.11.2013**)

Points to Ponder:

Undoubtedly, the move will definitely increase the valuation of airport projects and would make the business more attractive for private investors. But if one looks at the impact of revised tariff plans on passengers it is not wanting. As compared to single-till model, passengers will have to pay higher fares. Higher airfares or levies on airfares would impact demand negatively, as with rise in prices passengers will be less willing to take flights, which could be a sign of wary for airline operators.

Complying with interest of both the operators and passengers, there is a need for a strategic reconciliation of interests, because if fares kept on rising even after public private partnerships then there would be no incentive for private operators' participation. The current situation demands a strong intervention from Airports Economic Regulatory Authority to balance passenger and operator interests.

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