CIRC RegTracker

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Enhancing Knowledge,
Strengthening Capacity

RT.018, January-March, 2015

CIRC RegTracker is an attempt to track the creation of regulatory institutions, their capabilities, performances and the way they interact with other institutions in shaping patterns of economic governance. It is being published regularly by the CUTS Institute for Regulation & Competition, a body devoted to enhance knowledge and strengthen capacity on the interstice between law and economics.

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.018, January-March 2015). 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 sectors: a) Coal; b) Petroleum and Natural Gas; c) Electricity; d) Telecom; and e) Transport.

HIGHLIGHTS

In this quarter, there are significant advances in the regulatory sphere which is in line with the current government's endeavours. While some are continuation and intensification of the past developments, there are few innovative proposals. The developments in this quarter include:

- The Coal Mines (Special Provision) Bill, and Mines and Minerals (Development and Regulation) Amendment Bill passed by the Parliament;
- Government suggests 'Price Pooling' for all gas based power plants;
- Government intends to put a cap on costs of coal fired power plants;
- TRAI seeks to regulate over the top players;
- Ministry of Railways creates a directorate to implement plans for environmental management;
- Airlines need to gain Domestic Flying Credits before they fly abroad.

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1. COAL

1.1 Mining Bills get a clear nod: no more Coalgate?

The parliament passed the Coal Mines (Special Provision) Bill, and Mines and Minerals (Development and Regulation) Amendment Bill on March 20th 2015 after prolonged wrangling and a race against time. This bill is set to kick-start the investment in a sector plagued by regulatory and political issues.

Consultants feel it will align industry with rest of the economy and clarity on licensing terms, auctions, transfer of concessions will enable the sector to attract investments, without having to depend on end-use plants but higher royalty may add to freight and enhance coal charges.

[HINDU 21.03.15; ET 21.03.15; MINT 20.03.15]

Points to Ponder

The Mines and Minerals Development and Regulation Amendment Bill 2015 crossed the legislative twilight zone of ordinances to become legislation. It is welcome as the coal bill will loosen the mining monopoly of the state owned Coal India, while bringing in greater transparency in the sector (See our earlier discussions on the topic ***RT.014, sec 1.2; RT.016, sec 1.1****). As the Bills turn into Acts with President's consent, the current process of auctioning will be replaced by requisite legislation, and probably resulting in some game changing commercial mining by the private sector. It provides a hope for aligning the mining industry with the rest of the economy and securing much needed investment, without having to depend on the end use plants.*

Few creases have to be ironed out. Especially, if the royalties increase, they will be passed onto consumers and how state electricity units will respond to this. It must be ensured that the MMRD Bill does not take the sector back to the exploitative practices of the past. It's a fact that India's most mineral rich districts are the poorest too. Recognising this, the Bill has introduced setting up of a District Mineral Foundation (DMF), whom the existing miners will have to pay an additional royalty of 100 percent and new miners will pay additional 33 percent, over and above the royalty paid to the state governments. As a part of the government's philosophy of cooperative federalism, the centre will no longer need to grant prior approval to the states before mines are auctioned. After this, there is no reason why this shouldn't trigger off a mining boom and India might just be on the cusp of a mining revolution.

1.2 The Coal Block Auction Conundrum

The government initiated e-auctions within 4 months of Supreme Court's decision to cancel the allocations of 204 coal mines in the last week of September 2014 [See **RT.016, sec1.1**]. The central government put 36 blocks for the allotment process, under which it allotted mines to states and PSUs. The application process for which started in February and a total of 69 applications were received, NTPC putting in the most number of applications, at eight. The coal ministry took all the cautious measures and said that electronic bids were decrypted and opened electronically in the presence of bidders. 101 coal mines were up for grabs.

A Delhi HC ruling on February 11 threatened to jeopardize the government's auction of coal blocks as it could potentially create a crisis in the power business. The Delhi High Court quashed the so-called end- use norms for coal mines for two blocks previously allotted to Jindal Steel and Power Ltd. Which eventually lead to cancellation of these blocks. Meanwhile, on the 19th of February, the Delhi High Court dismissed a case filed by Sarda Energy challenging the two-phased auction process saying it was not arbitrary. [**MINT 11.02.15**]

The first phase of the first five blocks that were put on auction saw aggressive bidding, bolstering the national auditor's claims that allocation of mines over the years had caused substantial losses to the national exchequer. In the first round, the government received aggressive bids of 14 coal blocks. [**MINT 17.02.15**]

On the 4th of March, government re-examined winning bids for four of the 18 mines put up for auction in February among discrepancy reports and selected bidders being inactive during the e-auction. These included Jindal Steel, BS Ispat and Balco. [**FE 17.03.15**]

Beginning on 4th March, in the second leg of the coal block auction, government put up 15 blocks for sale, with which, it stands to garner over Rs. 2 lakh crore in the entire auction process.

[**MINT 15.03.15**]

Points to ponder

Coal block auctions have had a controversial history since the CAG said in a 2012 report that the allocation of mines over the years has caused losses of Rs 1.86 lakh crore to the exchequer. The economic survey this year underlined the importance of coal as a fuel to revive the growth of the country. Since India plans to reach a coal production target of 630.25 mt in the current *financial year, and a billion tonnes by 2019, the bid amount crossing Rs 2 trillion dovetails with the PM's plans to develop the coal rich eastern part of the country. The ministry mentioned that the bids were assessed by a technical evaluation committee to short-list bidders for participation in the electronic auction which was conducted from mid-February. Successful auction of the coal blocks post the introduction of the reforms could lead to an increase in the share of the captive coal blocks in financial year 2016.*

At the conclusion of first phase of coal block auctions, it emerged that thirteen companies that have invested hugely in end-use plants could not regain possession of the blocks previously held by them. Many of them opted out of the race; many had to settle for other blocks that could add to their costs. This shows that reallocation process, pursuant to the Supreme Court order cancelling 204 blocks could have a marginal to significant adverse impact on many existing ventures. Whereas, the companies that were buying coal from the open market and have secured coal blocks can be expected to benefit. But those who had blocks and are having to re-bid for them will see costs increase. Even then, if the final cost of coal is cheaper than imported coal, they may still retain a cost edge. But what is certain is that coal users are in uncharted waters. Analysts say that the price of cement, sponge iron and steel may rise because of the aggressive bidding by companies, but electricity tariffs are unlikely to increase as mines for the sector are being auctioned through reverse biding.

With the demand of coal consumption reaching 900 mt, India is only behind the China and US, but it is to deliberate upon that when such unexpectedly high prices are paid for natural resources, does it means that companies are flush with funds or are they overpaying out of desperation? The answer may be that the design of the auction is complex and even the coal mining law could have been more reformist and drafted without timidity.

2. PETROLEUM AND NATURAL GAS

2.1 Oil Ministry suggests Price Pooling for all Gas based power plants

In view of no additional gas output expected from fields auctioned under the New Exploration Licensing Policy (NELP) until March 2017, the Oil Ministry has proposed that all domestically produced gas should be included in the price pooling scheme for the power plants. This would have direct cost implication for state owned NTPC stations, as well as for plants operated by GVK Power and Torrent Power; gas is presently supplied to all these under the Administered Price Mechanism (APM).

The scheme was initially proposed for any additional gas produced in the country in the next four years, along with imported liquefied natural gas, to be sold at an average 'pooled price'. Since the move could push the tariffs from APM gas supplied NTPC stations and few others, the oil ministry has suggested lowering the fixed cost realisation of power developers from Rs.1.31 per unit and reducing re-gasification charges by 50%.

The power ministry is redrafting the price pooling scheme based on availability of domestic gas and may implement it in phases. Another important factor will be gas allocation policy which the Oil Ministry plans to change, dropping power plants to fifth in the gas allocation priority. City gas distribution supplying CNG as auto fuel and piped cooking gas is to be accorded top priority, as per a Supreme Court order. **[ET 02.02.2015]**

Govt. wants to rationalize gas utilisation policy

The Domestic gas is allocated to various sectors based on guidelines set by the govt. from time to time. The government wants to rationalise the gas utilisation policy and remove any anomalies/ambiguities that may exist in the current policy framework. Currently, top priority in gas allocation is afforded to fertiliser, followed by power sector. The revised gas policy will have gas for transport (CNG) and domestic cooking gas (PNG) as the top priority, followed by plants providing inputs to strategic sectors of atomic energy and space research, urea plants, power and domestic LPG. **[FE 18.02.2015]**

Subsidy for imported gas-based power units

In an attempt to boost power generation through gas-based power plants, the government has approved a mechanism to import gas for the purpose and to subsidise supply of such power. Re-gasified liquid natural gas will be imported for supply to the plants to generate power.

Through reverse bidding, power plants will quote a tariff, the subsidy for which will be released through the Power System Development Fund (PSDF), as this fund is meant for grid stability and gas based plants best handle peak loads. The mechanism requires the stakeholders such as govt., gas transporters and power producers etc. to forego or accept much lower revenue realisation. The subsidy will be available to distribution companies. Unlike a proposal for gas pooling, there will be no change in domestic gas allocation to existing users. Through this, the govt. is expecting an increased power generation of about 79 billion units. **[BS 26.03.2015]**

Points to Ponder

The proposal is expected to have positive effects on the economy, despite the pooled average price of gas being higher than the domestic price. For one, it will help utilise about 16,000 MW of stuck, gas-based power plants from current zero per cent of plant load factor (PLF) to about 30-40 per cent. According to a study by NCAER, this will also have multiplier effects with increase in employment. Since the selling price of electricity has been administratively capped at Rs.5.5 per kilowatt, the expected revenue shortfall for power plants is proposed to be partially borne by government as subsidies and tax concessions, and partially borne by inter-linked sectors taking cuts in their revenues.

The revision in priority order under the gas utilisation policy appears to be a rational choice. CNG and PNG need to be promoted because they are cleaner fuels. PNG through the city gas route should replace LPG and reduce the burden of subsidy.

3. ELECTRICTY

3.1 Government may put a Cap on Costs of Coal-Fired Power Plants

The government plans to cap costs of power plants that can be passed on to electricity consumers, to prevent rise in tariffs as all power firms have agreed to forego mining costs for winning the blocks. The move will hit power firms as they will have to absorb the mining costs throughout the life of the block and will not be able to pass on the high coal costs under different heads. Companies said the move was unfair and the government should have indicated such plans before coal block auctions. [**ET, 11.03.15**]

Points to Ponder

*Compensatory package for power generators, to pay off increased cost of imported coal, has been an issue of contention for more than a year, since the Deepak Parekh-led committee and Central Electricity Regulatory Commission allowed a compensatory package for Tata Power's Mundra Ultra Power Project (See **RT.013, Sec 3.2** for further discussion and our take). This move was not accepted by all, especially by many of the power procurers.*

A similar situation has arisen recently, where the power generators are at a discomfort. The government had earlier expressed intent to revise existing power purchase agreements (PPAs) between generators and distributors to lower electricity tariffs from plants that will run on coal from auctioned captive blocks. All generators who have successfully bided for coal blocks have agreed to forego mining costs for winning the blocks. Suspecting that they may smuggle the mining costs to tariff, the government now plans to cap the costs of the plants to prevent higher tariff in new PPAs. However, the power generators are unhappy with the move and branded it as unfair. They argue that the government should have indicated such plans before coal auctions.

The government is soon expected to release advisories to electricity regulators and amend the National Tariff Policy to enable the regulators to reopen the legally binding PPAs to revise the fuel costs. This is a complex situation. While generators' demand for fairness and transparency is valid, government's intent to pass on the low coal costs to end consumers is also justified. Keeping electricity cost affordable for end consumers is as important as ensuring a reasonable return on investment of private players in electricity generation. India needs to ensure universal access to electricity to meet its developmental agenda, and private sector participation in the sector (both generation and distribution) will be crucial for achieving this goal. We have to wait and see how the regulators handle this emergent complex issues and balance between economic and political considerations.

4. TELECOM

4.1 Spectrum Auctions

The e-auction of radio frequency spectrum, or airwaves, for telecom operators concluded after 19 days and 115 rounds of rigorous bidding with officials placing the initial estimate of total commitments at over Rs.109,000 crore.

Officials said the names of the successful bidders will not be divulged since the Supreme Court, while allowing the e-auction to proceed, had directed that its consent be taken before awarding spectrum, due to litigations filed by interested parties. Eight companies participated in the auction.

The government said that about 89% of the spectrum put on sale was provisionally allocated to bidders. The aggressive bidding could force operators to raise call rates by four to six paise a minute in the future as they face spiralling costs to service the rising debt burden. Some phone companies such as Vodafone are clearly unhappy with the limited spectrum that was put up for sale and the expense incurred.

This was the first time that telecom firms have been allowed to use their eligibility points for bidding across spectrum bands — 800-, 900-, 1,800-, and 2,100-MHz — shuffling from one to another. They earlier had to stick to one band and bid within it. [**BS 25.03.2015; ET 26.03.2015**]

Points to Ponder

Spectrum is a scarce natural resource, whose use should maximise economic returns to society at large. The objectives of such spectrum auctions are to obtain a market determined price of spectrum in the bands through a transparent process and ensure efficient use of spectrum. This will further stimulate competition in the sector and promote rollout of the new services in the sector. This is set to redefine the telecom sector in India.

The auction has opened a number of new opportunities for subscribers in new circles for 3G services in 2100 Mhz band and LTE in the 850Mhz band. This will help operators strengthen mobile broadband connectivity through expansion of 3G services. The key reason for aggressive bidding by incumbents was the looming expiry of 900MHz spectrum rights for incumbent operators such as Bharti Airtel and Vodafone in key metros. Such pricier licence renewals might lead to a situation where the smaller operators, will choose to exit the sector. This will lead to decrowding[1] and consolidation in the sector and will favour the bigger players. This spectrum auction will exert pressure on telcos' balance sheets and cash flow, and keeping in view price competition will limit their ability to invest in upgrading quality of services.

Expansion of mobile and broad band network will help in realising the country's "Digital India" vision, powering Smart Cities and building nationwide mobile broadband network.

4.2 TRAI seeks to regulate over the top players

The country's telecom regulator has started preparing a regulatory framework for over-the-top (OTT) communication services. TRAI published a consultation paper on this and raised twenty questions for discussion and sought views from the public on various issues related to OTT. These broad questions include intricate issues like Net Neutrality, whether time has come to regulate OTTs and possible ways to regulate OTTs.

At present, consumers get to make phone calls and send messages using Internet connection through mobile applications and their computers. They are required to pay only Internet bandwidth consumed but nothing on per call or message basis. Telecom operators and VoIP service providers or OTT players have been at loggerheads over this issue.

OTT providers make use of the service providers' infrastructure to reach customers, which not only helps them make money but also allows them to compete with traditional services offered by telecom service providers. Telecom operators have said that OTT players are eating up their main revenue without investing in networks. On the other hand, OTT players defend themselves by demanding access to Internet or web-based services without hurdle for growth of communities and nations.
[**BS 27.03.2015**; **IE 27.03.2015**; **BL 29.03.2015**]

Points to Ponder

OTT refers to applications and services that are accessible on the Internet by using operator networks offering Internet access services, such as social networks, search engines and amateur video aggregation sites. Some such OTT players include Skype, Viber, WhatsApp, Chat On, Snapchat, Instagram, Google Talk, Hike, Line, WeChat, Tango, Facebook Messenger and eCommerce sites like Amazon, Flipkart and Snapdeal.

TRAI's consultation is aimed at policy and regulatory environment for regulating OTTs. The consultation paper discusses various important issues like current policy dispensation for OTT players vis-a-vis TSPs; security concerns of OTT players providing communication services; issues related to security, safety and privacy of the consumers; issues arising because of 'net-neutrality'; network discrimination and traffic management practices; non-price based discrimination of services and ensuring transparency to consumers; and pricing-related issues, including differential pricing for data access. Such a broad set of issues which can

[1]http://indianexpress.com/article/opinion/columns/network-congestion/

Although it has been seen that some countries have tried to regulate OTTs and have framed rules of net neutrality, there is no standard definition of net neutrality across the globe. In this era of disruptive innovation, internet acts as a neutral platform and its regulation should be with great caution and debate. Net neutrality proponents argue that everyone should get the same service quality, regardless of the quantity and characteristics of their transmissions. Although underlying principles to regulate internet and OTTs can be same, yet each country has to devise its own tailored regulation keeping in mind its own constraints and state of digital development.

5. TRANSPORT

5.1 Indian railways gets cracking on environment protection, fuel bill

The Ministry of Railways has created a new directorate in the Railway Board to implement the plans for environmental management. The plan includes the focus on pollution control, efficiency in energy consumption, conservation of resources like water, proper use of land and development, and use of renewable energy. The newly formed environmental directorate will monitor the implementation of the plans and function directly under the Board chairman. This environmental body has already ordered all zonal bodies and production units for an energy audit. It has also asked all the zonal bodies and production units to prepare reports on environmental issues.

[**BS 02.02.2015**]

Points to Ponder

The new environmental protection plan of the Ministry of Railways is a good initiative in the way of sectoral environmental reform. These initiatives have plans reduce the energy, water use and development of the renewable energy for railway operation. This new body and its environmental management initiatives could help to improve the financial health of the Indian Railways. It could also be helpful in the direction of the pollution control with minimising the diesel consumption and maximum use of green energy. Presently Railway locomotives consume 2.6 billion litres of diesel annually which accounts around 70 percent of the fuel bill. This effort of the Ministry could reduce fuel bill significantly with a proper implementation of this plan.

Apart from these initiatives, the formation of the new environmental directorate to overlook these environmental protection plans is a significant development in the way of intra-sector environmental governance system. This new environmental body in the ministry could set technical standard and directly monitor and evaluate the environmental aspect of the all railway projects and recommend ways for the better uses and reuses of the environmental resources.

*However there are concerns over the overall health of the Railway. Some experts believe that a mere change in the Railway Board level and instituting new bodies might not lead to any basic change. Further Indian Railways need to improve its infrastructure and should implement several important recommendations of Bibek Debroy committee including focus on core areas of railway [**ET 02.04.2015**].*

5.2 NDA government hits reset on road projects

After the failure of getting any bid for at least 21 projects worth Rs. 27,000 crores in the year 2013-2014 the Ministry of Road Transport and Highways proposed a new model public private partnership to develop highways. This is called a hybrid annuity model which reallocates the risks in the road construction for private players. In this model investors require to contribute only 60 percent of the project cost and government will take care of all politically sensitive risks.

Under this model government will collect the toll and pay the developer biannually for recovering investment, interest cost and operation and maintenance free. Government hopes that this model of road development could be a game changer which could revive private investment in the road sector. [**MINT 19.02.2015; FE 20.02.2015**]

Points to Ponder

The new highway development model proposed by the ministry is a positive sign for the road sector development in the country looking at the previous trend. The new model minimises the financial and revenue risk which was there in the earlier model. In addition to that private players also get relieved from the political sensitive burdens.

Risking sharing under the hybrid annuity mode

Financial risk	*Shared between government and private company*
Revenue risk	*Government (collection and management of the toll)*
Operation and Management risk	*Private company*

*It seems that this model will attract more private investment to the road sector which will be beneficial for all the stakeholders in this process. However experts caution that further modification of the hybrid mode is required before fully adopting it. Therefore industry experts suggest that "the government should start with three or four projects first to test the model and then improve and refine it" [**BS 19.03.2015**].*

One of the criteria which could be consider as problematic is government paying a part of the capital cost at the commencement of the construction work which means private firms will get revenue even before the actual operation of the project. Apart from that government might face problem when it scraps road tolls due to political reasons. In that situation there will be more financial burden on the government. It seems that this is only a financing model and it could solve part of problem by de-risking the financial side of the private developers.

5.3 New airlines might find flying abroad tougher

The Union Civil Aviation Ministry had proposed a Domestic Flying Credit (DFC) based system for allowing new airlines to fly abroad replacing the current rules (five year old airline with 20 planes is allowed to fly abroad). Several industry experts views that this move would raise the barriers further for the new airlines wanting to fly abroad. According to the ministry the new airlines keen to fly abroad have to gain a minimum 300 DFC points before they start flying long haul routes (more than six hours long).

However, Indian carriers will need at least 600 DFCs to start flights on short haul routes including Persian Gulf countries and Southeast Asia. The DFC will be calculated on the basis of capacity deployment (using sector unit and available seat-km) and route served. In this system airline operating flights on the remote locations such as the Northeast will get more credits than others.
[**BS 19.03.2015**]

Points to Ponder

*This capacity deployment based credit system of the ministry might prove tough for the new airlines wanting to fly abroad. In addition to that this credit system is very confusing and DFC point calculation seems to be more complex in this system. Therefore it is making the regulation more complex which could work as a barrier to the market access for the newly launched airlines. Some of the industry experts are also in view that this could break the low cost model and the passengers will be the ultimate looser in this method [**BS 21.03.2015**].*

However the proposed DFC rule will help old domestic airlines like Indigo, SpiceJet and Jet Airways to expand their international operation. On the one hand the DFC point method is restrictive for new airlines wanting to fly abroad but on the other hand it is a system with easing of the earlier rule of five year and 20 aircraft guideline. In a rough estimate an airliner with five aircraft can accumulate 200 credits within two years and 600 credits in four years. So in this calculation different domestic carriers operating from last two to three years can also fly abroad, especially on the long haul routes and within four years they will be eligible for the short haul routes like Southeast Asia and Persian Gulf. This effort of easing business is also coupled with the strategy of increasing air connectivity in the remote areas or non-trunk routes like Northeast, Jammu and Kashmir etc.

Financial strength of several Indian airliners could be strengthened by allowing them to fly on the international routes rather than asking them to wait for five years and 20 aircrafts. Adoption of this method could also reduce excess capacity in the domestic market and improve aircraft utilisation. However the proposal of barring new carriers for short haul routes raises concern as it seems that government want to protect existing airliners.

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