CIRC RegTracker

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Enhancing Knowledge, Strengthening Capacity

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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. It 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 the latest Issue of RegTracker (RT.014, January-March 2014). As always, we have captured several interesting developments around economic regulation, a mixed bag of both good and bad.

This Issue includes the developments around de-allocation of captive coal block, Competition Commission's investigation against Coal India Limited and proposed coal regulator, and their implications for India's energy scenario. In case of petroleum, the government seems to be in favour of new revenue sharing formula suggested by Rangarajan Committee, while the Rangarajan formula for gas pricing was notified recently. While CERC's compensatory tariff for import coal based power plants has attracted criticism, more private players have approached the regulator for similar relief. Seeking to promote healthy competition, telecom authorities have finalised spectrum user charges, released M&A guidelines and clarified spectrum trading rules. The transport sector seems to be undergoing major transformations with a proposed highway regulator, a new model concession agreement, entry of FDI in railways and a proposal for Civil Aviation Authority.

While some of these developments are much needed and will have positive outcomes, some are inappropriate and could produce damaging implications. We have presented our observations and recommendations on individual development. Detailed discussion of sectoral issues and developments follows.

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- Manoeuvres for a Low-Carbon State in India: Identifying Agency, Authority and Accountability in Governance of Clean Energy Development

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1. COAL

1.1 Coal Min to de-allocate captive coal blocks

During the hearing of coal allocation scam case, the Supreme Court directed the Ministry of Coal to take appropriate actions against the coal blocks that have delays in commencing production. Pursuant to this an Inter-Ministerial Group (IMG) recommended that out of 61 such coal blocks, 31 must be de-allocated.

The companies that are under scrutiny include Hindalco, Tata Steel, Adani Power, Jindal Steel and Power, JK Cement, Bhushan Ltd and JSW Steel. The coal ministry has cancelled 51 blocks in the past on the grounds of delay. IMG has also recommended imposing tax/ special cess on cement and steel companies having captive mines. [**BS 29.01.2014**; **MINT 16.01.2014**; **TOI 16.02.2014**; **FE 20.02.2014** **FE 22.03.2014**; **ET 19.03.2014**]

Points to ponder:

The good news is that the Cabinet Committee on Investment (CCI) is looking into fast tracking the blocks that have been allocated but production for which seems 'mines-ahead.' The scam hit sector, seems to be derailed lately and production prospects are bleak.

Only 35 of the 218 captive blocks allocated since 1993 have started production. But is this step of biting a bullet by government actually reformative? Does it stand the test of pragmatism? Before mass cancelling of blocks, the coal ministry must ensure that the 'best' must not be the enemy of the 'good'.

Few private companies which were allocated blocks in the past slammed this decision of the government saying that they are being punished for no fault of theirs; a minor delay has been reported owing to factors such as delay on part of government clearances, Naxal activities, delayed environmental screening and land acquisition bottlenecks. In this light, it is to be ensured that this de-allocation should not provide a setback to non-controversial blocks.

A solution to this may be the liberal approach of the ministry towards power generation companies that have made substantial investment in their end-use projects but have lost allocation of captive coal blocks without any major fault of the promoters. However, this does not apply in favour of all the coal blocks. The law must follow its course and the faulty blocks must be put up for auction in a time bound manner. But, to cancel those blocks, which are above board, could be damaging.

In light of the fact that we, as a country, are largely suffering in terms of deficit domestic supply of coal, this decision is certain to further stymie power and energy sector and decelerate the growth. Therefore, the need of the hour is to overhaul the market design for coal, by transparent auctioning of mining rights in a hope that pragmatism won't be sacrificed at the hands of perfection. With reference to imposing special cess on cement and steel industries (FE 22.03.2014)*, it seems that this decision of the government comes in the wake of the controversial CAG report on coalgate that accused the government of providing undue benefits to the private companies. However, the additional impost may pressurise already ailing steel manufactures and in turn affect the consumers on whom such costs will be trickled down.*

1.2 Competition Commission of India orders to inquest Coal India

Competition Commission of India (CCI), acting on a complaint filed by Wardha Power Company, sets Coal India Ltd. (CIL) on fire again on abuse of dominance. Following the hefty penalty of Rs. 1,773 crore that was imposed on CIL two months ago (see **RegTracker** **RT.013, sec 1.2**), a fresh investigation has been ordered against Coal India and its subsidiaries. Wardha Power also alleged that the state run entity, from which it procures its coal, increased the price of coal from Rs 1613 per metric tonne to Rs 2177 per metric tonne, without giving any justification for this price hike. The order passed by the Commission has asked the Director General to report within 60 days. The DG has been entrusted to find out the involvement and role of the persons in charge at the time of contravention. [**IE 31.01.2014**; **ET 31.01.2014**]

Points to ponder:

Such repeated complaints are as old as the Coal India itself. Many of its clients, including the largest power generator, the National Thermal Power Corporation (NTPC) have been complaining in the past about imposing fuel supply agreements (FSAs) and the substandard coal CIL has been supplying.

With no option of purchasing Indian coal otherwise, CIL and its subsidiaries have long held the monopolised position in the market of coal mining and supply, which serves as a root cause to such issues that are arising.

Due to this course of CIL, many private sector fuel demanding companies have no other option than to import coal from the foreign market, burdening the exchequer and the current account balance. The government, on realising the need of the hour, has lately been advocating setting up a regulator for coal sector, but does it not make more sense to have a uniform regulator for the entire energy sector rather than coal alone in order to ensure no serious disruptions during the transition (inter-linkages)?

The question is that will the repeated actions of CCI against CIL prove fruitful in the due course? It seems that to expect CIL to ameliorate itself is to ask for the moon, the only solution is to curb its monopoly power. As an urgent remedy, participation of private sector in mining may provide some relief. This can be done if mining rights are transparently auctioned through public bidding.

1.3 Green Norms Eased for Coal Mines

On the background of mismatch in the domestic demand and supply of coal in the country, where an annual deficit of 204 million tonnes was to be met from costly imports, the government towards the end of last year invited bids from private sector to give a push to coal mining in a Public Private Partnership (PPP) mode (see **RegTracker RT.013, sec 1.3**).

The Ministry of Coal has announced that the developers that have bagged green clearance for their existing coal mining projects under the Environment Impact Assessment (EIA) notification of 2006 would be eligible for the exemption of expanding without any public hearing. However, the projects cleared under the 1994 version of the Environment Impact Assessment notification would have to conduct fresh public hearings for each of their expansion projects. [**ET 11.01.2014**; **ET 27.12.13**]

Points to ponder:

It has been evident that lower coal production has adversely affected power, steel and other industry projects. The coal ministry has always alleged that such delays have been primarily responsible for lower coal production, against the counter acquisitions of inability of Coal India to meet its own annual production targets.

This announcement came as a blessing to Coal India during the time when it has petitioned the average pendency at state level for Stage-I clearance to be more than four years and that for Stage-II clearance more than 2.5 years and thus has been constantly arguing its case for accelerating environment and forest clearances.

In light of this, the move of the ministry on green clearance norms would certainly ease the production conditions for coal mines. In a situation that the country has been largely suffering from derailed growth owing to lag in coal production, this step would certainly furnish a pro-growth and more liberal environmental regulatory framework.

1.4 Cabinet's 'non- statutory' consent

The Cabinet Committee on Economic Affairs on Thursday (20.02.2014) approved setting up of an independent coal regulatory body through an executive order as there was little chance of the Coal Regulatory Authority Bill 2013 getting approved by the Parliament.

Under this arrangement, the regulator will be empowered to specify the principles and methodology for determination of price of raw coal and washed coal and any other by-product generated during washing. The regulator will advise the government on the principles and methodologies for price determination; however the state owned CIL will continue to fix prices.

Apart from regulating methods for testing for declaration of grades or quality of coal, specifying procedure for automatic coal sampling and adjudicating upon disputes between the parties, the major function that the regulator would be undertaking is promoting competition and economic efficiency. [**FE 22.02.2014**; **BS 21.02.2014**; **BS 26.02.2014**; **BS 27.03.14**; **ET 31.03.2014**]

Points to ponder:

The Regulator as conceived by the Cabinet has only advisory/recommendatory powers, powers to frame principles and methodology. If there is any violation of the same, the regulator has powers to

impose penalty or take up any other corrective measures to remedy such violations. However, it will have no decisive role in the cancellation or suspension of mining licences.

It is unclear how a non-statutory body can effectively adjudicate disputes between PSUs and buyers. The scant regard given to the best practices model in government procurement by the Union Government certainly raises doubts about the efficacy of interventions from a mere advisory body such as the conceived regulator.

If the government has serious thoughts about the coal regulator then it must first break the monopoly nature of CIL by bringing in private players and accentuating the level playing field. Unless a legislative mandate is there, the regulator being merely a non-statutory body would only raise red flags without any tangible effect on arbitrary or corrupt practices.

2. PETROLEUM AND NATURAL GAS SECTOR

2.1 *Centre dumps NELP and proposes new model*

The New Exploration Licensing Policy (NELP) was a major initiative launched by the government in 1998 to accelerate the speed of hydrocarbons exploration and production in India by opening up the upstream sector to private participation. And since then attempts have been made to offer level playing field to private players alongside national oil companies.

The Director General of Hydrocarbon (DGH) has offered 46 hydrocarbon blocks to investors under NELP 10 (MINT 12.01.2014). The Government of India has officially dumped the existing NELP regime and has planned to launch the 10th round with extended tax holidays, zero royalty payment and longer contract tenure to attract investors. According to a draft Cabinet note circulated by the oil ministry, the new regime proposes to discard the key features of the old system of allowing the explorer to first recover its entire expenditure in developing oil and gas fields before sharing profits with the government. [**ET 01.01.2014**; **ET 22.01.2014**]

Points to ponder:

The former Oil Minister, Jaipal Reddy appointed a Committee headed by Dr C. Rangarajan, whose recommendations for having a successful NELP round has been to move to the revenue sharing formula from the present production sharing contract (PSC) regime.

The Rangarajan Committee suggested a new system in which the government gets its share from day one and has no interest in the accounts and expenditure of the company. However the Planning Commission wants to stick to the existing rules, where operators are allowed to recover their cost before sharing their revenue with the government.

The existing regime requires a close scrutiny of costs and incentives claimed by the operators. The Plan panel was backed by a committee led by the 13th Finance Commission Chairman Vijay Kelkar. The present Oil Minister, M. Veerappa Moily appears to have decided in favour of moving to a new regime, though no official statement has been released.

Keeping aside the bureaucratic controversy over the two reports, logically the old PSC regime has been backed by the Kelkar Committee having the simple reason that with lower risk, more firms will be willing to bid for exploration, but no reference to previous experience has been given where under the same PSC regime attracting global players hasn't been encouraging.

On the other hand the new model would reduce the chances of corruption and gold plating of the cost, along with reducing the policing of the operators. This has been one of the contentious issues in the fight between Reliance Industries and the government on the falling gas production from the KG-D6 block.

Also, the new model proposes specific financial penalties for default by the contractors with eliminating the need to assess the costs incurred. It should also be noted that frequent policy changes have been causing investment reluctance by the foreign firms. Whether we have PSC or revenue sharing model in place, one need to create confidence that no retroactive change in policy is made.

2.2 *Govt. notifies gas price based on Rangarajan formula*

The Government has notified a new natural gas pricing formula based on the recommendations of

the Rangarajan Committee, according to which, starting April 2014 natural gas price will be priced at an average price of liquefied natural (LNG) imports into India and benchmark global gas rates, including Henry Hub prices. The formula will be applicable to all gas produced by both public sector firms like ONGC and private companies like Reliance Industries for five years till March 31, 2019. [BL 10.01.2014, FE 11.01.2014, BS 13.01.2014]

Points to ponder:

The new formula is calculated by taking an average of the US, Europe and Japanese hub prices and then averaging it out with the netback price of imported liquefied natural gas to give the sale price of domestically-produced gas and the major gain is said will be made by ONGC, OIL, RIL and Cairn India.

As per the new pricing mechanism, the new gas price is likely to be US$8.4/mmbtu for FY2015. Currently, gas prices are in the range of US$4.2-5.7/mmbtu for domestically produced gas. The new prices would be revised on a quarterly basis, taking into account the 12-month average of global rates and LNG import price with a lag of one quarter.

However, these guidelines will not be applicable where prices have been fixed contractually for a certain period of time, till the end of such a period. It is, however, bad news for power and fertiliser firms who lobbied aggressively against the move to raise domestic gas prices. This would raise fertiliser subsidy and raise costs enormously for gas-fired power plants.

Also, with reference to the existing coal bed methane (CBM) companies, there is no clarity on those charging a higher gas price. The uniform gas pricing formula will mean CBM players such as Great Eastern Energy Corporation Ltd (GEECL) and Essar Oil, which are drawing a higher price, will be paid a lower sum. The government's decision to accept the Rangarajan formula has been challenged in the Supreme Court.

2.3 DHG's financial oversight function to be vested with Income Tax Authorities.

The Kelkar Panel has recommended hiving off DGH financial oversight function and vesting it with the income tax authorities. It has been recommended that as the revenues are going to the Consolidated Fund of India the finance department should be involved to do financial oversight of the contractors. (MINT 13.01.2014)

Points to ponder:

These recommendations restrict DGH to technically overseet contractors and overhaul the energy sector regulations in the country if it is accepted by the government. The committee is of the view that the primary role of DGH will be to safeguard the owner's interest in the 'prudential and fiduciary' dimension, while the 'fiscal' dimension such as collection of royalty, cess, corporate tax and profit petroleum would be the responsibility of the revenue authorities according to the new recommendations.

Simply put, if these recommendations are accepted, we are unnecessarily inviting government participation in otherwise independent regulatory body and attempt which is impending disaster towards the autonomous functioning of independent sector regulators unbridled with bureaucratic inefficiencies and scrutiny.

3. TELECOM

i. *Spectrum Usage Charge*

Currently, mobile operators pay anything between 3% and 8% of their annual gross revenue to the government as SUC based on the total airwaves but the wireless broadband and 4G spectrum holders' license terms means they pay merely 1% of their annual revenue. TRAI had proposed imposition of a flat 3% as SUC for all airwaves obtained in auctions and 5% for radio waves granted under earlier rules of subscriber-linked allocation.

Yet when asked to reconsider this position, TRAI reiterated their earlier stand to make all SUC uniform for all players, but instead clarified that it would be OK with the overall SUC being reduced to 1% to match other players (BWA) to reduce the discrepancy. The government was caught between the devil and the deep sea since a reduction would mean significant revenue loss while an increase would be legally and contractually untenable.

Prophetically, in mid-January the Attorney General Goolam E Vahanvati, upon a reference by the Telecom Commission, opined that the government could not raise the spectrum usage charge on BWA

spectrum holders from 1% of their adjusted gross revenue to 3%. The Telecom Commission (TC) had considered and presented 3 options for reference but could not reach a consensus on a new system of calculating the SUC that would ensure revenue neutrality for the government as well as be legally tenable. Notwithstanding the same, it reiterated that the SUC slab system needed to be changed. [**BS 08.01.14; FE 08.01.14; BS 25.01.14; FE 26.01.14; BS 28.01.14; FE 28.01.14**]

Points to Ponder:

Apart from saving cost for some operators a uniform SUC would boost the possibilities of consolidation in the industry through mergers and acquisition as well as bandwidth sharing and trading.

But the Empowered Group of Ministers has rejected economic reasoning and revenue projections in lieu of the Government not being dragged to court. This move benefits the Reliance-Jio combine primarily, which holds pan-India wireless broadband (data) licenses which were recently modified to include voice as well. It is pertinent to note that the expert body TRAI had opined that any challenge to the BWA/4G contract would survive on the grounds of the government exercising its sovereign power by changing the SUC rate.

It had further supported uniform SUC saying that the differential SUC "acts as a disincentive for any merger or acquisition, spectrum sharing and trading as well as in acquiring additional spectrum. It also creates unwanted opportunities for arbitrage between bands and technologies likely to operate under a common unified licence, etc."

The issue of arbitrage in spectrum revenue reporting is also a significant concern that remains unresolved. Indian Telcos have a history of under-reporting revenues with the issue landing up in court in 2010 and prompting TRAI to take a view on a uniform SUC. Now that differential SUCs have been mandated the government should lay down strict islanding provisions between BWA services and voice services through separate phones and SIM cards for the services provided by 2.3 GHz and 900/1,800 MHz spectrum bands.

In the absence of any such provision, there would be huge opportunity of arbitrage available to operators with both set of spectrum bands, as they can shift revenues accruing from 900/1,800 bands to 2.3Ghz band to pay lower charges to the government.

Mobile operators had told the DoT that in the absence of a flat SUC, the industry did not have any incentive to buy additional radio waves either through auction or sharing process. It shall have to be seen now as to how the GSM, CDMA and 4G/BWA license holders behave in the spectrum options to ensure rational prices are charged and healthy competition is ensured, in an environment that clearly doesn't offer a level playing field.

3.2 Government to release telecom M&A guidelines

The Empowered Group of Ministers (EGoM) on telecom has approved M&A guidelines for telecom Sector. These guidelines may need a Cabinet approval if legal opinion finds that the consolidation activity amounts to sale of equity. As per the guidelines market share of a merged entity should not exceed 50% of the subscriber base. Telecom companies which procured spectrum through auction would not have to pay additional money to government for airwaves. However, if a company acquires a telecom operator that was allocated spectrum at old rate then it will need to pay the difference between market rate and old rate to the government. [**FE 28.01.2014**, **BS 27.01.2014**]

Points to ponder:

As discussed in our previous edition (see **Regtracker, RT.013, Sec 4.4**), *this move has been taken to encourage spectrum consolidation in the telecom sector. The much awaited guidelines are well appreciated in time where the sector is suffering from price war and cut throat competition. The EGoM approved the cap on market share (in revenue as well as user base) of the merged entities in a circle from 35% to 50%. This would give an additional flexibility of 15 per cent to acquire other tele-companies.*

Without a doubt consolidation among the top telecom operators can be weeded out in those circles where the cap of 50% will be breached upon merger unless the operators are willing to bring the post-merger combined share within the permitted cap in a year. Though, there will be ample leeway for bigger operators to merge the smaller

(regional) operators or even smaller operators merging their operations.

Thus, the relaxed rules may pave way for consolidation which was being prevented owing to the existing rules. However, the 'lock-in-condition' which bars telecom companies from transferring equities within three years after buying spectrum from auction, may cause problem in possible mergers.

Interestingly, it should be noted that when a merger takes place it does not lead to outright sale of equity in the company; it rather results in consolidation and equity dilution. If an operator were to acquire another operator, the acquirer will not have to pay for the spectrum as it had got in its licence agreement and will only have to shell out the market price for the spectrum being acquired. However, if a new operator which bought spectrum through auction decides to acquire an incumbent operator, the acquirer will have to pay market determined price for the spectrum held by the target operator. The Indian telecom industry which is reeling under intense competition may welcome these rules but it is unlikely to immediately catalyse consolidation though it could be a reality in the near future.

3.3 *TRAI Clarifies spectrum trading rules- Bar on spectrum leasing*

The Telecom Regulatory Authority of India (TRAI) has cleared the working guidelines for spectrum trading, allowing cellular operators to buy and sell spectrum. However, it has recommended leasing of airwaves be barred, for now. Mobile operators can trade spectrum they had bought through auction or by paying a market price. But administratively allocated spectrum couldn't be traded. Companies trading spectrum would have to notify the Department of Telecommunication (DoT) about the quantity of spectrum being sold, as well as the price. [**FE 04.01.2014**, **BL 28.01.2014**, **BS 29.01.2014**, **ET 29.01.2014**]

Points to ponder:

In India the issue of spectrum trading has been under continuous debate since 2010 when TRAI recommended reforming 'Spectrum Management and Licensing Framework' in its annual performance report followed by its Recommendations on 'Auction of Spectrum' dated 23rd April, 2012.

In these Recommendations, TRAI noted that in countries where spectrum trading was permitted, the spectrum is normally assigned through a market mechanism. However, in India except for 3G/BWA spectrum, all other spectrum available with the Telecom Service Providers (TSPs) had been obtained through an administrative process without paying its market price. But as it was apprehended that permitting such TSPs to trade in such administratively allocated spectrum would result in unearned windfall gains to such TSPs resulting in anti-competitive conduct, trading of spectrum was not allowed then.

Considering that the average spectrum holdings of TSPs in India are low in comparison with international standards, an urgent need was felt to allow spectrum trading and hence the said notification by TRAI. It should be noted that spectrum consolidation desired to be achieved through bringing in M&A norms in telecom sector can also be achieved through spectrum trading. A TSP holding spectrum that is paid for but in excess of its current requirements would then be able to directly trade these holdings with another TSP which requires additional spectrum for its operations. This would help to ensure optimal allocative efficiency of this limited natural resource, making the sector as a whole better off in the bargain.

3.4 *Spectrum Auctions Successfully Completed*

Eight mobile phone companies participated in the much awaited bidding for 385 MHz of airwaves in the 1800 MHz band, the largest amount ever to be put on the block, and 46 MHz in 900 MHz band. 16 blocks each in Mumbai and Delhi and 14 blocks in Kolkata were auctioned from licensees whose permits expire November 2014. At the end of auctions, the government was richer by approximately Rs. 61,000 crores. [**FE 07.02.14**; **ET 07.02.14**; **BS 07.02.14**; **ET 10.02.14**; **BS 15.02.14**]

Points to ponder

The recent spectrum auctions were finally complete amidst much policy wrangling, time extensions, a business enabling tweaking of the entire regulatory framework and tense bidding over almost a month that resulted in significant revenue gains for the government.

On the one hand companies bid to preserve their turf while on the other, those who feared uncertainty from expiry in other circles or hope to get stronger in areas that are doing well, competed for airwaves.

The auctions have demonstrated that companies bid to secure, protect and prioritise their consumers by building capabilities through additional spectrum to offer enhanced services, as well as by deploying competition efficiencies to keep the auction price rational and tailored per the different telecom circles. Nevertheless, technically the auction allowed for a player to secure just enough spectrum to crowd out the other players in a circle, have a greater say in pricing and, at a later stage, even monetise via spectrum trading.

For telcos it might just turn out to be a 'winner's curse' given the aggressive bidding. Given that the telecom industry's total adjusted AGR is Rs 140,000 crore, an outflow of approximately Rs 61,000 crore will surely dent the bottom lines industry-wise.

With more licences expiring in 2016-17, the government will be reluctant to reduce the reserve price which may result in certain smaller players being driven out or consolidating. But bankers don't expect all telecom companies to approach them as the government has eased the payment process for the current round of spectrum sale. Companies can borrow up to $750 million (about Rs 4,650 crore) from abroad and are allowed to pay in instalments. Because of the deferred payment system introduced for the current round of auction, companies may end up paying only Rs 15,000 crore ($2.5 billion) upfront. Some have raised cash independently recently, like Airtel while others like dual tech-operators were spending less to acquire only the bare minimum spectrum to pare up existing spectrum to offer enhanced data services.

3.5 A New Penalty System Governs Telecom Operators

The rationalization of penalties for the Telecom Sector, albeit a couple of years after the then Minister Kapil Sibal promised them, were finally approved by The Telecom Commission. The penalty system is a slab-based penalty structure with fines ranging from Rs 1 lakh to Rs 50 crore depending on the nature and severity of the violation or offence by an operator.

The new norms are a consequence of the Telecom Commission's decision on 29 April 2011, on the recommendations of a April 2008 committee headed by the then DoT additional secretary, who had also suggested a number of major changes including a uniform licence fee, but they do not mirror the subsequent TRAI recommendations in 2012, on the same issue. This changes the earlier system which allowed the maximum fine to range up to Rs. 50 crore but at the same time laid down no clarifying factors or parameters of differentiation for the severity and type of offence. This lead to an anomalous situation wherein due to the lack of guiding factors, bureaucratic discretion was being exercised to levy the maximum penalty even for minor offences such as late submission of papers and absence of placards on mobile towers.

Industry estimates that the DoT had imposed total penalties of Rs. 6,850 crore based on the flat rate of Rs. 50 crore per violation but has not been able to collect the entire amount as most penalties have been legally contested by operators. [**MINT 05.03.14**; **FE 06.03.14**; **FE 28.03.14**]

Points to Ponder:

The penalty based system comes at an opportune time and though late from its original roll-out schedule, coincides with an exciting phase in the telecom sector. The latest rounds of GSM spectrum auctions have just concluded allowing a fresh infusion of expertise and capital into the system with the issue of new licenses. Additionally, incumbent operators are in the process of renewing their existing licenses or shall be required to do so shortly since their license terms expire.

Coupled with the structured approach by the DoT to reform the entire legal and regulatory framework for telecom, with policy reformulation ranging from changes in the M&A guidelines to this change in penalties, the telecom sector is poised at massive consolidation. This post reformatory environment shall also allow incumbent and new operators to operate at a level playing field to explore business opportunity. A rational and gradationally culpable penalty system shall provide the correct incentive for enterprises to ensure maximum consumer and operational efficiencies. Nevertheless, for an industry that is already burdened with debt of Rs 2.5 lakh crore in 2012-13, severe penalties could become the game changer.

4 TRANSPORT

4.1 *Highway Regulator- A long road to go*

Ministry of Road Transports and Highways (MoRTH) has proposed the Regulatory Authority for Highways in India Bill, 2013, which grants adjudicatory powers to the proposed regulator in areas such as contract dispute resolution, renegotiation of future contracts ensuring contractual provisions, fixing tariffs and deciding on terms and conditions for companies to exit road projects. [**BS 08.01.2014**]

Due to declining role and lack of private sector participation, financial stresses, enhanced risks and issues in management of contracts, setting up of independent regulator for highways was addressed as the need of hour by the Finance Minister in the budget speech for 2013-14. But, in spite of addressed need, the draft has till now only received comments from various ministries including recent comments from Finance minister P. Chidambaram. In his comments, he has questioned the development of single tier tribunal mechanism and pointed out various other issues. As per words of Roads Minister Oscar Fernandes, an independent road regulator is expected to be set up by end of this year or next year. [**BS 27.01.2014**; **ET 03.03.2014**]

Points to Ponder:

At present, NHAI is the sole organisation for management of highways in India. Though the name is bit misleading with 'Authority', NHAI is a mere agency, responsible for the development, maintenance and management of National Highways entrusted to it and for matters connected or incidental thereto. (Another misleading name in India is that of the Steel Authority of India which has no regulatory function but operates steel mills like Tata Steel and so on).

An independent regulator for the sector is being planned to restrict procedural delays, and find expected solutions to road projects which have been on hold due to litigation and arbitration. Thus, setting up an independent regulator will certainly cut down the powers and role of NHAI; but, it would ensure steady and efficient completion of road and highway projects. In addition, a highway regulator would regulate projects in such a way that the need for renegotiation does not arise and public interest is firmly protected.

An important point has been brought about by Pradeep S. Mehta in his article, "Going down the wrong road" (12.06.2013), wherein he dismisses the need for a highway regulator by arguing that regulators are needed only in sectors where there are market failures; he further goes on to say that in the case of highway sector, there are government failures, but not market failures.

Furthermore, the Planning Commission of India has raised objections to the perceived need for a regulator. The MoRTH has asked the Commission to clarify its contradictory position and also said that it will respond to Regulatory Reform Bill only after the contradiction is resolved. The objection is rooted in the fact that the proposed regulator, the way it is being designed, will be a mere dispute resolution body. Calling it a regulator would be wrong. Moreover, dispute resolution in infrastructure sector PPP projects can be handled by a single body, which is already proposed in a new draft bill by the Planning Commission. This will cover dispute resolution in all PPP projects, and will include road and highways. Do we need a separate dispute resolution body for each and every sector?

The draft bill suffers from conceptual and drafting errors but we cannot throw the baby out with the bathwater.

As an aside, the NHAI should renamed as the National Highway Agency of India and not an authority, and indeed SAIL should renamed as Steel Agency of India Ltd., if we wish to retain the abbreviation. Our babus latch on to the word 'authority' to create a commanding name, but without understanding that it only creates confusion among the laypersons.

New model for road projects

After consulting with NHAI, state governments and the private sector, Planning Commission has reached to final stage of developing the new model concession agreement (MCA). In the new proposed model, government will pay 50 per cent of project cost to developer during construction period when financial burden and rest will be paid as annuity plus interest (at bank rate plus 2 per cent) during operation period. [**ET 24.03.2014**]

Points to Ponder

National highways in India have a total length of 70,934 km and serve as the main road network of the country. Even though expressways and national highways constitute only about 2 per cent of the length of all roads, they carry about 40 per cent of the road traffic. Over the last five years the number of vehicles has been growing at an average of 10.16 per cent per annum. This strains the road infrastructure. This demands significant improvement in highways in India.

With emergence of new model, the grieving highways zone could get a boost with a direction to hurl out a new construction and growth indication that will make it cheaper to build and work projects and enhance project viability in cases that are otherwise not viable on toll. As per claims made by proponents of this move, it will benefit developers because under the new scheme the developers have to bring lesser amount of money and also have to borrow less, leading to reduction of financial stress on PPP projects of development.

Given the current situation and a dire need to revive the road infrastructure sector to attract more private investors, whether this new model will be a game-changer or not, will attract more private investors; can only be determined only after its implementation.

4.2 Committee recommends new norms for premium payments

Another announcement was pertaining to payment of premium to NHAI. The C. Rangarajan Committee, formed by the Union Cabinet to suggest ways to revive stuck roads projects has submitted its recommendations for all widening projects to finance ministry. As per recommendations, premium rescheduling for projects will happen only if the toll revenues collected at a particular project is not enough to meet the annual cost. In addition it also states that in case of deferred amount the developer will have to pay an interest equal to bank rate plus 2 per cent on the premium, amounting to 10.75 per cent and clear the due premium collected due to years of deferment a year before completion of its concession period. But NHAI seems to be disappointed with these recommendations as suggestions given by authority were not given due consideration. These recommendations were approved by highway ministry on April, 1 2014; as informed by finance minister. [**BS 04.01.2014**; **BS 27.01.2014**; **ET 05.03.2014**]

Points to Ponder:

Given the dramatic slowdown in numbers of road projects being awarded and existing projects turning into non-performing assets (NPA), in January this year several infrastructure majors like GVR, GMR, L&T threatened to walk out of projects due to downturn in the economy. In this light recommendations by the committee may offer some respite to struggling infrastructure companies that had been requesting for easier payments terms in the face of the economic slowdown and high interest rates.

Moreover, on-going projects would benefit from this and several leftover projects may also now get started. But given the levels of penalties and interest rates it remains to be seen if stressed highway developers subscribe to this scheme or not, because many of them consider rates to be too high. The proposed draft bill to resolve disputes in all PPP projects through dedicated tribunals is perhaps the way out as it will be administered by judicial persons as heads and thus its decisions will stand scrutiny in courts.

4.3 Green signal for FDI in Railways with caution on Chinese firm

Meanwhile Ministry of Home Affairs (MHA) has given its green signal to DIPP proposal of allowing up to 100 per cent FDI in dedicated freight corridors and high speed railways network; and restricting it to 74 per cent in case of JVs in other areas of railways. [**BS 12.01.2014**]

But it seems that MHA had "strong objections over allowing the participation of Chinese and Pakistani companies in Indian railway network" and it might incorporate a clause cautioning against investment from Chinese companies. As regards this, MHA has told DIPP to view investments made by Chinese firms, especially in the core and sensitive areas with caution. MHA said Chinese investments should not be allowed in Jammu & Kashmir, Northeast and Sikkim. [**BS 30.01.2014**]

Points to Ponder:

Till now, FDI was banned in railways transport other than Mass Rapid Transport System and component manufacturing. With the FDI move, the government hopes to get investments from

German and US companies which have already shown a lot of interest in locomotive projects. Indian infrastructure sectors, including railways, are resource starved, hindering expansion and service quality improvement. Undoubtedly, the move is anticipated to give a boost to this sector in terms of infrastructure expansion and various other direct and tangible benefits, but allowing FDI to resolve prevailing problems and loopholes puts domestic players on their back foot. Moreover, foreign investors would need a reasonable return on their investment, which in turn will raise the passenger fare, which is at present subsidised. Though it may improve the railway service quality, can Indian passengers afford a higher cost for it?

As regards the concerns on involvement of Chinese firms, the MHA restricted entry of Chinese players due to security reasons. The proposed FDI policy is expected to bring in approximately Rs one lakh crore of investment in the form of public-private partnership projects. However, considering the intent of Home Ministry it might be difficult for Chinese companies to make their presence felt in Indian railways. Please see ***CUTS Competition Distortion Dossier*** *(***CDI-23: January-March, 2014***, Sec 7, p.8) for further discussion on its implications for market competition. Similar concerns of security were expressed in 2010 regarding China-made telecom equipment after which a telecom security policy was put together, stating that the telecom companies using the equipment are responsible for the security aspect as well and have to give an undertaking that there is no spyware installed in the equipment.*

Given the level of trust deficit and security dilemma between two countries, security concerns at present cannot be ignored and given the current scenario government's decision to put hold on movement of Chinese persons for working in India is significant. But, Indian government with help of various security forces (such as Railway Protection Force and the Government Railway Police) should try to overcome these issues with neighbouring countries, to realise complete benefits of opening up its sectors to foreign players.

Therefore, entry of foreign players in every sector (may it be railways, retail or any other) must be gradual and with safeguards so that India can realise full benefits of FDI. The government should try to ensure that foreign and domestic players are at equal footing. Further, to see the overall impact of FDI in railways, India has to wait for some times and have to follow the appropriate path and take necessary actions so that a mix of both foreign players as well as domestic can co-exist in India without harming each other.

4.5 Civil Aviation Authority to replace DGCA

Some time back the US aviation watchdog had pointed out 31 inadequacies in Indian air safety and maintenance standards. The government had gone for a year-long audit and had been taking hasty steps to overcome them, but it was clearly not enough. The US Federal Aviation Administration (FAA) has lowered India's aviation safety ranking, finding regulatory oversight to be inadequate. India's ranking has been downgraded to category II from category I, placing India into a safety category that includes Ghana, Indonesia, Uruguay and Zimbabwe. Degradation implies that Air India and Jet Airways—the two Indian airlines that fly to US destinations—wouldn't be allowed to expand flights and their existing flights would be subjected to additional checks. [**BS 11.02.2014**]

The downgrade means that Directorate General of Civil Aviation (DGCA) has not been able to meet the standards in areas such as technical expertise, air safety etc. In a move to regain its higher safety ranking from FAA, the bill for replacing DGCA with a financially autonomous Civil Aviation Authority (CAA) has been approved. [**BS 14.02.2014**]

Points to Ponder:

FAA audits are critical as it has international clout and civil aviation authorities in other countries might just follow its example and question safety standards in India. Such a rating for a country may lead to other troubles for its carriers as their flights may be subjected to closer scrutiny and checks, which could lead to difficulty in running their business. Lower rating also means high risk for investors and thus, higher cost of leasing and borrowing for the carriers, as the investors require a better return for faster payoff.

Besides, the civil aviation industry in India is in dire need for an overhaul and replacing the DGCA with CAA may be the first step. The reasons for replacement of DCGA are shortage of trained manpower; inability to retain manpower due to structural problems; and DGCA's limited financial

power and its inability to meet the demands of the civil aviation sector. With the establishment of the CAA, the ministry hopes it will be able to handle all such deficits.

In order to withstand FAA standards, sufficient number of Flight Operations Inspector (FOIs) should be employed and specialised training should be provided to them. In addition to this, market determined salaries should be paid to the new recruits as per industry standards.

If above issues will addressed by upcoming CAA, only then this replacement would be beneficial and would help India to regain its position in FAA audit report and allow continuous and enhanced number of flights to US.

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