CIRC RegTracker

Enhancing Knowledge, Strengthening Capacity

RT.016, July-September 2014

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.016, July-September 2014). 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 endeavour to raise production. While some are continuation and intensification of the past developments, there are few innovative proposals.

Supreme Court's decision on coal block allocations further emphasises the need for market reforms in the coal sector in order to achieve better competition, regulatory governance and consumer welfare. Simultaneously, the government has decided to allow foreign companies to operate selected CIL coal mines to improve production. The Kelkar Committee has recommended market-linked gas pricing, which may attract grater private participation in the sector. In the electricity sector, CERC's position on new tariff norms seems to emphasise efficiency in plant operation to better achieve consumer welfare. Across the energy subsectors, the developments are oriented towards improving production and energy availability in a cost effective manner. While the goals are justified, what India needs is a coherent approach and clear road map of reforms.

The new government at centre has proposed a cognate regulator for the communications sector, which would be a useful step towards better regulation. Keeping with its private sector focus, the government has allowed FDI in railway projects and proposed modifications in method of allocation for highway projects. We hope that these regulatory developments will ease the private sector's participation in India's key infrastructure sectors. Following sections discuss the developments in greater detail, though not in depth.

CONTENTS

LATEST PUBLICATIONS

- Competition and Regulation in India 2013: Leveraging Economic Growth through Better Regulation
- Modi's Maiden Motion: What's New for Renewables?
- Setting Competition Jurisprudence: Deductions from COMPAT's Orders
- Trailing Five Trends in Five Years of Competition Law Regime in India: Need to Gear up for Competition Law Compliance
- Regulating the Race to Renewables
- India's Green Industrial Policy: Pursuing Clean energy for Green Growth

1. COAL

1.1 214 Illegal Coal Blocks Cancelled by Supreme Court

The Supreme Court on September 24 cancelled all but four of the 218 coal block allocations it had declared illegal and arbitrary in its August 25, 2014 verdict. Most power, steel and cement companies that were allocated coal blocks between 1993 and 2011 will have to return them. The government is now free to auction or allot the blocks to central firms.

On the Centre's request to save 40 functional coal blocks and six ready-to-function ones, the court said 42 of them would continue to function for the next 6 months, these would have to pay an additional levy of Rs. 295 per metric tonne of coal extracted, (which some estimates say, could amount to a total of Rs 8,000 to 10,000 crores) to make up for the loss highlighted in the CAG report on the coal scam.

The four functional coal blocks exempted from cancellation are two ultra-mega power projects, one operated by NTPC and another by SAIL.

[FE 25.09.2014; HT 24.09.2014]

Amidst this, the Power and Coal Minister Piyush Goyal has set up an Inter-Ministerial Committee to further explore possible options in order to finalise the way forward after the SC decision. The committee is expected to handover the report to the government with the way forward by the end of October. **[FE 27.09.2014]**

Points to Ponder

India's energy sector received a body blow on August 24 when the court had ruled that said coal blocks were allotted through an "ad-hoc and casual" approach "without application of mind". It said, "Common good and public interest suffered heavily in the unfair distribution of the national wealth – coal". It stemmed from the allegations by the national auditor that the government under-priced coal mines and gave away as much as $33 billion in windfall gains to companies, in the scandal that has come to be known as "coal-gate".

The SC decision will raise questions on sanctity of government contracts and thus, impact on investment climate. This will in turn affect the economy in long run, which was quite evident with a sudden fall of metal stocks and Sensex over 200 points (but recovered later). Blanket cancellations, in a country with critically low coal supplies and frequent blackouts, will cripple the coal output growth, which fuels more than two- thirds of the power generated in India.

Moreover, both the government and the court seemed to be aware of the economic ramifications of handling this quandary. In this regard, India Ratings & Research (Ind-Ra) has suggested that the Government could look at providing coal linkages to end-use plants and reallocating the captive coal blocks on priority. The SC decision would call into question viability of some of India's biggest companies and simultaneously, put enormous pressures on Indian investors and financing agencies as they fear that the cancellation of blocks could lead to cost overruns, hurting the borrower's ability to repay loans and raise bad debt burden.

The devil is in details: The prevailing legislation governing the coal sector, India's Coal Nationalisation Act 1972, needs to be reformed on priority, which cannot be addressed by any court ruling. The inability of India to meet the coal shortage of about 100 million tonnes, despite being a coal abundant country calls for a clamour for the sector to be denationalised. Competitive bidding makes sense only in the absence of any monopoly player in the market. The larger questions are yet to be answered. In the current energy scarcity scenario, what will happen to the hopes of raising the growth rate from below 5% to above 6%? What would be a reform pathway for addressing the market grid-lock and thus, come out of the energy scarcity scenario?

1.2 Few of the CIL mines set to be run by Foreign Firms

In a move to be aimed at increasing supply from the monopoly CIL that has failed to achieve its targets for several years, the Minister of Coal and Power of the Government of India came out with a decision early this August to allow some selected mining projects of Coal India Ltd (CIL) to be operated by foreign companies.

Despite having the fifth largest reserves, India is third largest coal importer in the world. Coal and power Minister Piyush Goel told the parliament that a few projects of Coal India were identified to be developed under the mine developer cum operator route. **[FE 10.10.14; REUTERS 31.07.14]**

Points to Ponder

To realise Modi's promise of Power for All, Goyal has been pushing CIL to quickly raise its output. Coal India produced 462 million tonnes in the last fiscal year, against a target of 482 million. Although the operation under the mine developer cum operator route seems a good take as it allows international and domestic operators to take part in coal extraction, the road is still troublesome to tread given the issues such as the difficulties in acquiring land in India. This may be a stumble for even the international firms in order to bring mines into operation.

While India is desperate to increase its coal production to meet the growing demand, the paths taken are sporadic and falling short of necessary attention. As an immediate priority, drawing on the past experiences, the Government need to prepare a comprehensive roadmap for market reforms in the energy sector to achieve better consumer welfare while powering the growth strategies.

2. PETROLEUM AND NATURAL GAS

2.1 Kelkar Panel Suggests Market Linked Gas Pricing

To make new exploration and production activities viable, a committee under former finance secretary Vijay Kelkar has recommended market-linked pricing for domestic natural gas. The suggestion comes amid ongoing consultations by a committee of secretaries on a new gas-pricing formula. The committee, set up in 2013 to "prepare a road map for enhancing domestic production and sustainable reduction in import dependence by 2030", had brought out its first report in January. According to it, market-driven prices for gas will create a gas market in the country by increasing supply. **[BS 29.08.2014]**

Points to Ponder

According to the Committee, natural gas should be free from government intervention. The market driven prices for gas will create a gas market within the country by increasing supply. The prices should apply to all forms of gas, irrespective of the source.

As India is likely to be a net importer of hydrocarbons, market governed pricing for gas can be implemented under the new pricing policy which is under review and deliberation. The Panel has identified the unsuitability of RSC model for India's geology. According to the Panel either PSC with cost recovery on a self-certification or planned government take (tax and royalties) imposed with super normal profit tax should replace RSC. Continuing with PSC along with cost recovery on a self-certification basis and shifting the review of cots to the revenue authorities, will keep the government's and the contractor's objectives in sync at all times.

However, this model can adopted if caution is exercised to ensure that all checks by the revenue authorities, in matters of profit, are not misused to participate in any decision making process or become any sort of performance audit, beyond due financial audit process. Such model shall not only attract more participants in the sector but will consequently help in increasing domestic production.

2.2 Decision on gas price rise deferred

Domestic gas producers will have to wait for 45 days more to get some clarity on the new gas price, with the government saying on Wednesday that it had deferred the much-awaited decision on new pricing guidelines till November 15. The deferment dashed the hopes of private-sector player Reliance Industries, which has even gone for arbitration on the issue. Besides RIL, the other beneficiaries of an increase in gas price would be Cairn India, Oil and Natural Gas Corporation and Oil India. **[BS 25.09.2014]**

Points to Ponder

The new price was to come into effect beginning April. However, general elections were announced and the Election Commission asked the government to delay the pricing decision till the completion of polls. The new government deferred the decision once again, after the committee of secretaries on gas price has asked for some more time to submit the report. Some members of the committee want to link the price of gas with the cost of production while others don't want to raise prices for gas produced from oil fields that have recovered their costs.

Consumers are facing a severe shortage of natural gas. Oil and gas firms say that the shortage will *increase unless the gas price gives companies the incentives to increase exploration. In such an event consumers will be forced to import more LNG, which costs more than the domestic gas. Giving producers a free hand to price gas may prove unviable for fertilizers and power plants.*

Delay in the gas price increases and uncertainty over the new prices would discourage upstream producers from further investments in exploration and production (E&P) in India and will curb the expected increase in revenue for the current fiscal year for the oil companies. In light of next round of NELP being proposed to be announced, it is expected that the government would not delay further and shall bring the pricing mechanism soon.

For another view, please see: 'Gas & Hot Air' [AA 13.10.2014]

2.3 Oil Ministry revives debate on hydrocarbon incentives

Petroleum and natural gas minister Dharmendra Pradhan has signalled the government's desire to debate the incentive regime governing hydrocarbon exploration. Pradhan indicated that the oil ministry was actively considering the issue and was willing to explore the middle ground between two contentious options: the existing cost-recovery model and the alternative revenue-sharing model. [**MINT 29.09.2014**]

Points to Ponder

The production-sharing contract framework for the oil and gas sector currently allows for cost recovery by oil and gas explorers before they pay the government a share of revenue. There has been a debate on whether to retain the existing production-sharing agreement or shift to a new revenue-sharing one, with support emerging for both proposals. Explorers want the existing contract to continue. There has been waning investor interest in the Indian hydrocarbon sector, with around 70% of Indian basins remaining largely under-explored. The response to the NELP has been tepid. Thus adopting recommendations as proposed by the Kelkar Committee would explore the middle ground between the two contentious options: the existing cost recovery model and the alternative revenue sharing model.

3. ELECTRICITY

3.1 CERC rejects NTPC plea to revisit tariff norms

In a setback to NTPC, the Central Electricity Regulatory Commission (CERC) has refused to make any changes in the tariff regulations that it has put in place for FY15-FY19. In March this year, the state-owned power generating company had approached the Delhi High Court asking for the rules to be altered since it believed they would hurt its financials and the HC had, in turn, asked CERC to re-examine the tariff norms.

CERC believes that since NTPC got an additional 'reasonable rate of return on investment' through the life of its generating stations in the 2014 tariff regulations, funding and financing of its projects and its revenue and cash flows, are not likely to be hit. [**Mint 15.07.2014**; **FE 15.07.2014**]

Points to Ponder

The position taken by CERC is a welcome step and it shows maturity of the independent regulatory mechanisms in the sector. According to CERC, as an outcome of the new tariff norms, NTPC's profit margin may be reduced compared to previous tariff norms, but the loss of profit could be made up by improving plant operation efficiency. The reasoning here shows the increased emphasis on operational efficiency along with financial viability of the sector.

The new tariff norms prescribed by CERC has retained the base return on equity (RoE) at 15.5% (and additional RoE of 0.5% to incentivise timely completion of projects) to ensure financial viability of the public utility. At the same time the new norms propose a shift in the basis of incentives from plant availability factor to the plant load factor (PLF).

It appears that the apex electricity regulator is finally wearing its 'consumer protection' hat. If implemented, the new tariff norms will be a step to rationalise power RoEs without cutting core RoE. At the same time, emphasis on PLF improvement will result in avoidance of some capacity addition needs and also bring down the cost for end consumers. The real consumer welfare outcomes will be evident if and only the norms are implemented. However, NTPC has maintained its *stand against the new norm and are seeking legal course for remedy.*

4. TELECOM

4.1 Communications Bill proposes to overhaul telecom sector

The Modi government is planning a new "super regulator" for the communications sector. To be called Communications Commission, the new body could replace TRAI.
The new Bill aims to repeal the laws that govern the telecom sector currently. As part of the proposals, DoT has suggested a new Communications Bill that will replace the Indian Telegraph Act 1885, the Indian Wireless Telegraphy Act 1933, the Telegraph Wires (unlawful possession) Act, 1950, the Telecom Regulatory Authority of India Act 1997, and partially the Cable Television Networks (Regulation) Act 1995, and the Information Technology Act 2000. As far the constitution of the new body is concerned, the Bill proposes a 6-member regulator with one Chairman, who will have 5-year tenure. The member will include one each from sectors like telecom, broadcasting, finance, management, accountancy and either law or consumer affairs. The Telecom Disputes Settlement and Appellate Tribunal (TDSAT) may also get replaced by Communications Appellate Tribunal.

The new Bill is also being drafted keeping in mind global regulations, including those of Ofcom (the UK) and China among many others. The new Bill will take into account the changing trends of the communication sector, globally and include new areas like information management, authentication and even financial management.

[**Mint 08.09.2014**]

Points to Ponder

In this information driven era based on communication networks, robust legal framework governing communication systems is pivotal. The communications convergence will include the convergence of services, networks and devices. This bill will seek to change legislative framework in India including some legislation which dates back about 200 years. Such reforms aimed at convergence require institutional framework for ensuring convergence of telecommunications, broadcasting, data-communication, multi-media and other related technologies and services. It is apparently not clear what can be achieved by combining carriage and content regulation.

Interestingly, a similar Bill called Communications Convergence Bill was mooted earlier and then lost steam because of seemingly turf issues between information and broadcasting, and telecom ministries. The Communications Convergence Bill was introduced in Parliament in 2001, but lapsed with the dissolution of Parliament in 2004.

Since the bill is drawing inspiration from the UK laws, it might be good to not have an Appellate Tribunal and, as in UK, empower the Competition Appellate Tribunal to deal with appeals from the new regulator. Otherwise this will mean creating more parking lots for retired babus and judges.

The National Telecom Policy, 2012 also exhorts that a move towards convergence between telecom, broadcast and IT services, networks, platforms, and technologies is imperative. This will overcome the existing segregation of licensing, registration and regulatory mechanisms in these areas to enhance affordability, increase access, delivery of multiple services and reduce cost. With successive incremental moves, the Indian telecom sector has evolved from a government monopoly to a reasonably competitive structure. It seems that for greater policy coherence and clarity for all the stakeholders, it is important that all communication industry participants are governed by a single regulator. Though, formulating such a regulatory structure will be an uphill task.

However, if this effort succeeds, it will show the path to create similar cognate regulators for other sectors such as transport, finance and energy. In the area of financial sector there is already a proposal to merge four regulators into one.

4.2 TRAI recommends telcos be allowed to share airwaves

In a move that could help companies significantly reduce cost of mobile services, TRAI has recommended allowing sharing of all categories of airwaves held by operators including spectrum allocated at old price. All access spectrums in the bands of 800/900/1800/2100/ 2300/2500 MHz will be sharable provided that both the licensees are having spectrum in the same band. Earlier in

February 2012, the government in-principle approved sharing of only that spectrum under new licencing regime which has been purchased through spectrum auction to increase interest of bidders and enhance revenue generation in the auction.

As per recommendations, TRAI will try to ensure that the administrative processes for spectrum sharing remains hassle free.

After the Supreme Court verdict that cancelled 122 2G licences, government has been allocating spectrum through auction only. TRAI has also earlier given its recommendation on spectrum trading. These two proposals are aimed at facilitating telecom operators to get spectrum through a business deal from other telecom operator without having to wait for allocation from the government. A meeting of the Telecom Commission is expected to be held in mid-October 2014 to discuss issues including the spectrum sharing and trading.

[**BS 21.07.2014; FE 22.07.2014; ET 25.09.2014**]

Points to Ponder

Spectrum sharing has been recommended both in spectrum won through auctions and the ones which are with the operators through the earlier allocation process. These recommendations of TRAI allowing operators to share 3G spectrum need to be approved by DoT. The move to allow sharing of all kind of airwaves if approved by the government will benefit incumbent players to bring down cost of spectrum ownership and might percolate as benefit for consumers. To bring down the cost of spectrum, GOI's Economic Survey 2014 recommended the government to come out with better spectrum management through measures like trading and sharing of spectrum.

According to some news reports the recommendations of the TRAI on spectrum sharing, based on which the government will issue the final guidelines, are unlikely to offer much relief to the Telcos. The guidelines, though movement in the right direction will not address all concerns of the telecom sector. The concept of intra-circle sharing of 3G spectrum has not been allowed by TRAI. Lack of 3G spectrum on a pan-India basis with any operator is the biggest problem in the telecom sector, which the guidelines do not seem to address.

Concerns like bar on spectrum sharing beyond two operators in a circle and inter-band sharing can be addressed if spectrum trading is allowed along with sharing of the spectrum. Earlier this year, TRAI had recommended liberal trading guidelines but DoT is yet to approve them. Due to the scarcity of spectrum, it is better to go for efficient spectrum management market mechanisms like sharing and trading. Spectrum sharing and trading will facilitate competition, which is seen as essential to driving down prices and stimulating improvements in quality and innovation.

5. TRANSPORT

5.1 FDI in Railway Projects

Due to insufficiency of funds at domestic level to refurbish Indian Railways, the need for introducing Foreign Direct Investment (FDI) in Railways is being felt since mid of last year. (See **RegTracker RT.013, Sec. 5.3** and **RT.014, Sec. 4.3**). Now with efforts to attract more FDI to India, Cabinet has cleared the proposal to allow 100 per cent FDI in railways infrastructure, excluding operations via automatic route.

The cabinet has approved 100 per cent FDI in nine categories in the railways including high speed rail projects, port connectivity, dedicated freight corridor, electrification, manufacturing and maintenance of rolling stock etc.

[**BS 07.08.2014**; **MINT 07.08.2014**]

Points to Ponder

India has opened many sectors including civil aviation, pharmaceuticals and telecommunications to foreign investors in recent years, with the goal of improving the nation's finances, infrastructure development, and driving economic growth.

Given current scenario of insufficient revenue realisation and government funding, FDI liberalisation in railways sector would help in modernisation and expansion of the sector. Simultaneously, it will give boost to infrastructure development and generate jobs. It is to be noted that the growth of the sector relies heavily on capital investment. Opening gates to FDI will provide necessary impetus to the sector and encourage private participation. In addition, *foreign investment can surely help expedite the process for ongoing big ticket projects that have been pending for long. The development of dedicated freight corridors has a direct positive influence on the creation of more industrial corridors. Importantly, it will also help railways add capacity and help flourish business.*

The announcement will serve as a prompt resolution to investment-related concerns and help India take the next step in its economic growth. However, FDI is not yet allowed in train operations and safety. Considering that Indian Railways does not have a great track-record in terms of safety, there is an immediate need to address safety concerns. Once the issue of infrastructure is tackled, it immediately has a direct impact on operations and safety. Faster decisions on implementation of projects would also help in improving operations and safety standards.

However, 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, including land acquisition, delays in project clearance, business procedures, and poor domestic investment etc. Therefore, domestic reforms focusing establishing an enabling environment are a priority area for consideration.

5.2 Modification in method of allocation for Highway Projects

Due to lower responses to PPP projects, the government is planning to redesign the way the projects are allocated based on their viability assessment. Under the new design projects would be bid out in three ways: in case where no VGF is required, the BOT (toll) model will be adopted; in case of projects requiring VGF up to 20% of cost, the NHAI will formulate both BOT as well as EPC models and the final decision would lie on road ministry; and lastly projects that are not going to work on BOT (toll) model with VGF up to 20%, the EPC would be directly followed.

[**FE 19.08.2014** ; **FE 08.09.2014**; **FE 12.11.2014**]

Points to Ponder

With few takers for road projects, the National Highways Authority of India (NHAI) wants the government to stop bidding out road projects through the public-private-partnership (PPP) route.

Due to the economic slowdown and loopholes in the design and execution, awarding of contracts for national highways has slowed down in the past few years. Given the slowdown in awarding of road contracts, such a strategy would ensure wider participation by developers and on the other hand the strategy will also bring clarity for the government to assess the willingness of investors in the highway sector and launch bids in conformity with market realities so that the projects awarded don't fail at a later stage.

In addition it is important that road ministry should be cautious while exercising its power, as many projects have different circumstances and thus some level of flexibility must be built in. However, to reap maximum benefits from these changes, a continuous watch at operational level is necessary. In addition, for smooth awarding and proper implementation as well as effective functioning of projects greater transparency and timely working has to be ensured in order to avoid any delays.

Furthermore, the proposed changes do not address two of the major concerns raised by private partners, viz. contract re-negotiation and reversal of assets. Does the proposed change offer adequate incentive for private players in the sector? Given the current situation, whether the proposed modification will be a game changer or not can be determined only after its implementation.

News Sources

Asian Age (AA)	Economic Times (ET)	Hindustan Times (HT)	Reuters (Reuters)
Business Standard (BS)	Finacial Express (FE)	Mint (Mint)	

CUTS Institute for Regulation & Competition
R 75, 1st Floor, Greater Kailash I, New Delhi 110048
Ph: +91 11 26463021/22/23, Fax: +91 11 40535921
Web: www.circ.in, Email: circ@circ.in