



## Cheap Coal Does Not Benefit The Indian People

April 2012

# Summary

- The Fuel Supply Agreement (FSA) coal system should be abolished or FSA coal prices should be moved to market levels as soon as possible
- The FSA coal price discounts primarily benefit profits of private companies
- If FSA coal were priced at market levels, all Indian households currently receiving electricity could receive electricity for free
- Alternatively, 30% of Indian people currently without electricity could receive it for free
- The FSA coal system encourages corruption
- All coal should be washed as soon as possible

# Indian Supreme Court Supports Our Case

## Supreme Court Ruled Against Governments' Interference In Coal Pricing

The **Indian Supreme Court** in the matter of Ashoka Smokeless Coal India (P) Ltd. v. Union of India reported at (2007) 2 SCC 640 **has taken strong exception to the Central Governments' interference in coal pricing.** The court noted:

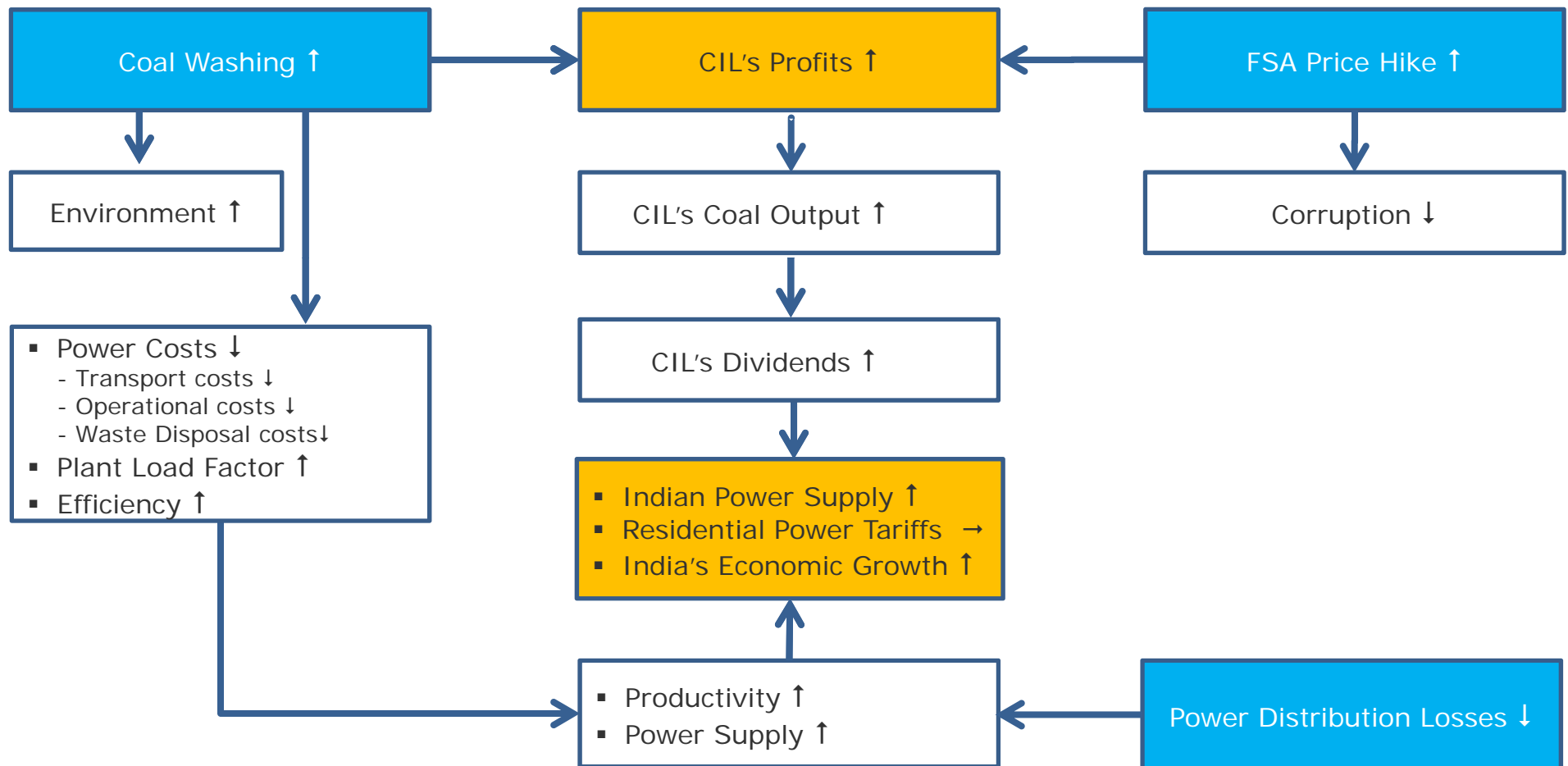
The coal companies evolve price fixation but admittedly, they have been doing so at the instance of the Central Government. The Central Government seeks to exercise its statutory power. Such a power, however, is confined to four corners of the 2000 Order. When there is no control over the price, the **Central Government is forbidden to issue any direction that will have an impact thereover.**

## Supreme Court Supports Sale Of Natural Resources By Public Auction

In the 2G Judgment, the **Indian Supreme Court** has emphasised that, "**natural resources are vested with the Government as a matter of trust in the name of the people of India, thus it is the solemn duty of the State to protect the national interest and natural resources must always be used in the interests of the country and not private interests**". Indeed, this also applies to CIL but we believe that it has been violated by the Board of CIL.

The court has also emphasised that, "State owned or public-owned property is not to be dealt with at the absolute discretion of the executive. Certain precepts and principles have to be observed. Public interest is the paramount consideration. **One of the methods of securing the public interest... is to sell the property by public auction** or buy inviting tenders... there may be situations where there are compelling reasons necessitating departure from the rule but then the reasons for the departure must be rational and should not be suggestive of discrimination".

# Increase FSA Coal Prices Without Higher Electricity Prices



# FSA Coal - Encouraging Corruption

- 80% of CIL's coal is sold under FSAs at discounts up to 70% to landed cost of comparative imported coal
- Government of India (GOI) forces this system on CIL by arguing that it keeps steel, cement and power prices low for the benefit of all Indian people. However, generally the benefits of artificially low coal prices are not passed on to end consumers
- Some power companies keep the FSA benefits to themselves as they sell power under merchant power tariffs
- Non-power companies which receive FSA coal at a discount to market prices either resell coal to third parties at higher prices, or make higher profits
- There is significant excess demand for FSAs coal because huge profits are available for companies buying discounted coal, and coal available under FSAs are limited

# FSA Coal - Encouraging Corruption

- FSAs are not justifiable for non-power companies as they sell their products at non-regulated prices
- Because huge free profits are available for the privileged firms awarded with FSAs, we believe this process is susceptible to corruption
- For unregulated industries such as cement and steel companies, a large proportion of these companies have to buy coal at market prices. This means that firms which receive FSAs coal keep the whole benefit to themselves instead of passing it on for the end customers' benefit
- FSA coal provided to the regulated power sector primarily benefits industrial companies (50% of power consumption) and to a lesser extent middle class consumers (25% of power consumption)
- There is no guarantee that these massive subsidies do not simply result in higher profits for the industry while 30% of India's population do not have access to electricity at all
- This is why, we believe, large industrial companies pushed the PMO to impose new FSAs on CIL and why corruption is encouraged by the FSA system

# Increase FSA Coal Prices Without Higher Electricity Prices

- Indian households consume close to 200bn units of power annually, which can ENTIRELY be paid for by dividends from Coal India Ltd (CIL) if FSA coal prices were raised to market levels
- 30% of the Indian population has no access to electricity. Higher dividends from CIL could be used to provide these people with access to electricity
- Higher coal prices will accelerate investments in additional coal mines which will subsequently reduce Indian coal and power shortages
- Artificially low FSA prices encourage corruption and theft
- Coal washing only marginally increases the cost of electricity while the benefits to the environment and to the power companies are substantial
- India's Aggregate Technical and Commercial losses (AT&C losses) exceed 28% of total power produced\*. As a result State Electricity Boards are heavily loss-making

\* Source of 2010 data: PFC report on 'Performance of State Distribution Utilities'

# Additional Profits Of CIL Would Cover All Indian Households' Electricity Bills

<b>IFRS profits CIL year ending March 2013 *</b>	<b>4</b>	<b>\$ bn</b>
Estimated FSA sales for CIL by in FY13 *	375	bn tons
Delta between FSA prices and coal prices at market *	<u>50</u>	\$ per ton
<b>Incremental profits CIL</b>	<b>19</b>	<b>\$ bn</b>
<b>Total profits CIL</b>	<b>23</b>	<b>\$ bn</b>
Shares owned by the Government of India (GOI)	90	% of TSO
<b>GOI's share of CIL's profits</b>	<b>20</b>	<b>\$ bn</b>

Units of electricity consumed by Indian households	195	bn
Average price per unit assuming FSA coal prices at market *	<u>4.6</u>	Rs
Electricity bill for Indian households	890	Rs bn
<b>Electricity bill for Indian households</b>	<b>18</b>	<b>\$ bn</b>

\* Based on TCI's estimates, this excludes grade A&B FSA coal and market prices are based landed prices in India

FSA coal is a direct transfer of a \$19bn subsidy to increase profits for the private sector instead of providing cheap electricity to Indian households



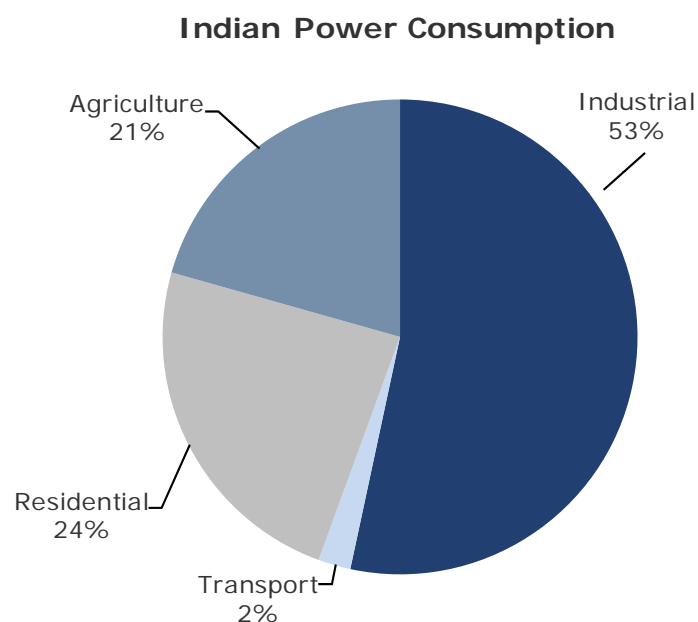
# The Case For Coal Washing

- Most of the Indian coal shipped to power stations is not washed and has a 30-50% ash content
- Coal washing removes most unwanted ash; today only 4% of the coal mined by CIL is washed and only 25% is planned
- Coal washing only marginally increases the cost of electricity while benefits to the environment and power companies are substantial; existing plant power generation increases by 10%\*
- Power companies benefit from better efficiency, lesser coal consumption, lower transportation costs, lower maintenance costs, better thermal efficiency, higher plant availability and lower waste disposal costs. With carbon credits, benefits include lower emissions and higher profits
- India benefits from greater electricity supply and economic growth
- Environmental benefits – reduces CO<sub>2</sub> emissions by 11%\*, ash and better air quality
- Reduced load on strained rail and road transportation systems means more coal supply to India

\* Source: case study presented on coal beneficiation and utilization of rejects by C. Zamuda Ph.D. and M. Sharpe, PE, Ranchi India August 2007

# Real Price Impact Of Washed Coal Is Minimal

**Only 24% Of Total Power Consumption Comes From Indian Households**



**A 100% Price Increase From Washing All Coal Will Increase The Cost Of Power By Only 9% \***

Price hike related to washed coal	100%
Reduction coal consumption	<u>25%</u>
Adjusted price hike	50%
Reduction in operating costs **	5%
Reduction in transportation costs	6%
Reduction in waste disposal costs	<u>1%</u>
Effective price hike	38%
Coal cost as % of delivered power	40%
Domestic coal as % of total power generation	<u>59%</u>
Impact on average price of power	9%
Number of years to adjust	3
<b>Electricity price hike per annum</b>	<b>3%</b>

Sources: \* TCI estimates and company input

\*\* Case study presented on coal beneficiation, reduction in auxiliary power consumption 1.5% and 3% improvement in boiler efficiency

# Current Plans To Wash Coal Are Insufficient

- Today only 4% of CIL's production is washed
- CIL's announced plans to increase washing capacity by 111mn tons which account only for 25% of CIL's current production
- Environmental approvals for coal washeries are direly needed
- CIL needs the support of its customers to fully implement 100% coal washing

# Disclaimer

This document is being issued by TCI Fund Services LLP and is for private circulation only. The information contained in this document is strictly confidential and is only for the use of the company, firm or individual to whom it is sent. The information contained herein may not be reproduced, distributed or published by any recipient for any purpose without the prior written consent of TCI Fund Services LLP.

No reliance may be placed for any purpose on the information and opinions contained in this document or their accuracy or completeness. No representation, warranty or undertaking, express or implied, is given as to the accuracy or completeness of the information or opinions contained in this document by any of TCI Fund Services LLP, its partners or employees and no liability is accepted by such persons for the accuracy or completeness of any such information or opinions.

The summary description of TCI Fund Services LLP included herein and other materials provided to you are intended only for discussion purposes. This information is not intended to provide, and should not be relied upon for, accounting, legal or tax advice or investment recommendations. You should consult your tax, legal, accounting or other advisors about the issues discussed herein.

Distribution of this information to any person other than the person to whom this information was originally delivered and to such person's advisors is unauthorised and any reproduction of these materials, in whole or in part, or the divulgence of any of their contents, without the prior consent of TCI Fund Services LLP in each such instance is prohibited. Notwithstanding anything to the contrary herein, each shareholder (and each employee, representative, or other agent of such shareholder) may disclose to any and all persons, without limitation of any kind, the structure of TCI Fund Services LLP, and all materials of any kind (including opinions) that are provided to the shareholder.

TCI Fund Services LLP, 7 Clifford Street, London, W1S 2FT, UK