Coal block auction sees aggressive bidding

Aditya Birla Group’s Hindalco bids successfully for the 29.2 MT Kathautia mine in Jharkhand

After the Supreme Court cancelled allocation of 204 mines in September, the government decided to auction the blocks. Photo: AFP

New Delhi: The first round of auctions for five coal blocks that were offered over the weekend in the first phase saw aggressive bids from project developers, bolstering the national auditor’s claims that allocation of mines over the years had caused substantial losses to the national exchequer.

The winning bid of `2,860 per tonne for the 29.2 million tonne (mt) Kathautia mine in Jharkhand, reserved for the so-called unregulated sector which includes cement, aluminium, steel and iron was placed by Hindalco Industries Ltd on Sunday. A day earlier, the winning bid of `1,402 per tonne for 6 mt Sial Ghogri block in Madhya Pradesh, which was also reserved for the unregulated sector, was won by Reliance Cements Co. Pvt. Ltd. The Belgaon block in Maharashtra was won by Sunflag Iron and Steel Co. Ltd by placing a winning bid of `1,785 per tonne.

The government expects the auctions to end the uncertainty that unfolded in August when the Supreme Court cancelled 204 coal mining permits awarded to companies, including Hindalco, terming their allotment as arbitrary and illegal. The court cancelled the licences after the Comptroller and Auditor General (CAG) in 2012 found that awarding the mines without an auction may have cost the exchequer `1.86 trillion. Subsequently, the government decided to auction mining permits.

Analysts say the prices for cement, steel and sponge iron 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 so-called reverse bidding, where the lowest bidder wins the auction.

The price discovered in the auction is more a reflection of the existing fuel scarcity in India, said Sambitosh Mohapatra, partner-power and utilities at consulting firm PricewaterhouseCoopers in India.

“For the state governments, it means a windfall in royalties and taxes; for power distribution companies, it means reduction in power purchase costs in existing PPAs (power purchase agreements),” said Mohapatra. “The only fear is that these prices discovered are more a reflection of existing deficit situation and should not be assumed as business as usual—it might impact the cost structure and competitiveness of several sectors—impacting the Make in India growth story.”

Two models have been adopted for auctioning coal mines—one meant for regulated and the other for unregulated sectors. Accordingly, coal mines for power, a regulated sector, are being auctioned through the reverse bidding process. For unregulated sectors such as steel, iron, cement and captive power, a regular bidding process called forward bidding has been adopted, in which the highest bidder will be successful. The auctions started on Saturday for the so-called Schedule II list (mines that were operational when the allocations were cancelled).

“These auctions will change the economies of the coal-bearing states. It will revitalize the state finances,” said a top government official, requesting anonymity.

States such as Jharkhand and West Bengal stand to gain as much as `2.5 trillion and `1.5 trillion, respectively, over a period of 30 years. Power minister **Piyush Goyal** has maintained that India’s power generation capacity will grow by 50% because of the reforms process initiated in the sector and the coal block auction proceeds would help to develop eastern parts of the country.

The aggressive bids, apart from benefiting the states, will add to the costs of companies, according to analysts.

“The efficiency which was envisaged in private sector mining which could have passed to the consumer will be sucked out due to the premiums to be paid," said Shubhranshu Patnaik, senior director, Deloitte Touche Tohmatsu India Pvt. Ltd, a consulting firm.

The winning bid for the Talabira-I block reserved for the power sector was placed by GMR Chhattisgarh for `478 per tonne which will be paid to the Odisha government, meaning the consumer for the electricity produced from the coal from this block will not be levied a fuel charge. Also, the bids for the Sarisatolli block in West Bengal was still on at `436 per tonne at the time of going to press.

While a Reliance Cements spokesperson declined to comment, queries emailed to the GMR group remained unanswered till press time.

Low electricity tariffs would benefit the state government-owned distribution companies, which have been hobbled by low tariffs, slow progress inparing losses, higher electricity purchase costs and crippling debt. State electricity boards are burdened by debt of `3.04 trillion and losses of `2.52 trillion.

"There's almost an artificial shortage that has got created as there are many power and steel assets already in the operating stage, which are performing sub-optimally due to lack of thermal coal. This is forcing many players to go aggressive in terms of bids put out for coal blocks as players want to secure the supplies as soon as possible," said Abhishek Poddar, a partner at consulting firm AT Kearney Ltd.

It's crucial for the government to get production up and running in the cancelled coal mines. **Coal India Ltd**, the world's largest coal producer, is struggling to meet rising demand for the fuel. While India's power generation capacity grew 60% over the last five years, coal production expanded by about 6%. Of India's installed power generation capacity of 255,681.46 megawatt (MW), around 60%, or 154,170.89 MW, is coal-based.

"Commercial justification of these bids would depend of the current fuel economics of the end-use plant and its distance from the mine," added Debasish Mishra, senior director, consulting at Deloitte Touche Tohmatsu India Pvt. Ltd.

The government aims to auction or allot 110 coal mines. Of these, 65 will be auctioned and 45 allotted to state-owned firms in a process to be completed before the end of the current fiscal year. The 110 mines up for grabs have around 350 million tonnes (mt) of reserves. Of these, 42 blocks with a production capacity of 90 mt are operational.

In a related development, the government has received 130 bids for 20 Schedule III mines that will be offered in the next phase starting 25 February. Schedule III mines are those that were nearly operational when the allocations were cancelled.

"These bids will be evaluated by a multi-disciplinary Technical Evaluation Committee to shortlist bidders for participation in the electronic auction to be conducted on MSTC portal from February 25, 2015," the coal ministry said in a statement.

"While different players will ascribe different values to a coal block depending on their business realities, there is no need for a runway bidding as the pricing outlook in the global thermal coal market is quite muted in medium to long term. We may have scenarios where coal imports may actually become cheaper than landed domestic coal," said Poddar.