CHAPTER III: MINISTRY OF COAL

Central Coalfields Limited

3.1 Loss of revenue due to road sale of coal instead of sale as washed coal

Despite price advantage of washed coal over raw coal, Pundi Mines of Kuju Area resorted to road sale instead of sending raw coal to Rajrappa Washery for washing and sale thereafter, resulting in a net loss of revenue of ₹ 19.34 crore to the Company during the period from 2006-07 to 2009-10.

The Rajrappa Washery of Central Coalfields Limited (Company), with installed capacity of 30 lakh tonne, was commissioned in June 1987 with a capital investment of ₹ 76.41 crore for beneficiation of raw coal i.e. washing of raw coal for production of washed coal. The Washery was designed for raw coal feed with ash content of 26 *per cent*. Washed coal fetches higher price than raw coal. Since inception, the Rajrappa Washery suffered shortage of raw coal due to poor production performance of the linked Rajrappa Coal Project. To meet the shortage, other coal producing projects[1] (OCPs) were linked to the Washery since May 2002 and from 2006-07 onwards. The entire production of the Pundi Mines of Kuju Area was linked to the Rajrappa Washery.

It was revealed in audit (December 2007 and October 2010) that despite sufficient availability of raw coal, Pundi Project[2] supplied a total of 14.29 lakh tonne of raw coal to the Rajrappa Washery during the period 2006-07 to 2009-10. This included 9.38 lakh tonne of better washery grade coal and 4.91 lakh tonne of inferior E grade coal having high ash percentage and thus unsuitable for the Washery. However, during the same period, it sold 5.69 lakh tonne of washery grade coal by way of road sale to private parties instead of transferring the same to the Washery which was suffering from acute non-availability of better washery grade coal. During the period, the Rajrappa Washery was left with a shortfall of 12.82 lakh tonne of washery grade coal as its requirement was 22.20 lakh tonne. As the price advantage for washed coal over raw coal varied between ₹ 230.95 and ₹ 730.00 per tonne for the period from 2006-07 to 2009-10 even after considering better price fetched by the Company on road sale of coal at the price above one grade higher than the notified price, the Company suffered a net loss of revenue of ₹ 19.34 crore for diversion of 5.68 lakh tonne of washery grade coal for road sales instead of feeding the same to the Rajrappa Washery for producing washed coal.

While admitting the facts, the Management stated (December 2010) that road sale of raw coal had to be resorted to for the following reasons:

- The supply of raw coal from Pundi was restricted as the stock of raw coal was building up at Rajrappa Washery since 2006-07 which was exposed to spontaneous heating and fire. Further, the decision of road sale was justified as

[1] ***Jharkhand, Pundi, Pindra, Topa projects of CCL***
[2] ***The production as well as road sale of other linked OCPs was less***

otherwise it would add to the cost of transportation and stocking at Rajrappa Washery.

- The designed parameter of the Washery (for feeding raw coal with ash content of 26 *per cent*) was not sufficient to handle the poor quality of raw coal which restricted the transfer and feeding of raw coal from Pundi mines having ash content of more than 30 *per cent*.
- By selling coal at the price above one grade higher than the notified price the Company had not only earned the maximum possible revenue by way of an additional profit of ₹ 45.73 crore but at the same time saved the Company from the impending loss due to occurrence of spontaneous fire.

The Management's contention is not tenable for the following reasons:

- As stated by the Management, the designed parameter of the Washery was not capable of handling poor quality of raw coal received from Pundi. In such a situation, the decision of the Management to sell better washery grade coal to private parties and to supply inferior grade coal to Rajrappa Washery was injudicious.
- Instead of resorting to road sales, transferring of washery grade coal to the Rajrappa Washery was better option to tackle the space problem in stocking of coal and avoiding the possibility of spontaneous fire as it would reduce the building up of unsuitable quality of coal stock at Rajrappa Washery.
- Transferring of washery grade coal to the Rajrappa Washery would have ensured proper utilization of installed washing capacity of Rajrappa Washery and would have generated more revenue.
- Although the Company got the price of coal one grade higher than the notified price and earned an additional profit of ₹ 45.73 crore on road sales, even considering the same the net loss of revenue remained substantial i.e. ₹ 19.34 crore due to non-beneficiation of washery grade coal.
- The decision to go for road sales by local Management was unilateral which was against the plan of the Company to supply the same to the washery for its optimum capacity utilisation.

Thus, the Company suffered net loss of revenue of ₹ 19.34 crore on road sale of washery grade coal instead of transferring the same to the washery and sale as washed coal. This also led to under utilization of washing capacity of the Washery. The Company should ensure supply of washery grade raw coal from linked projects to its washeries instead of road sale of the same to private parties for optimal utilization of the installed washing capacity and for generating higher revenues.

Eastern Coalfields Limited

3.2 Avoidable expenditure due to failure to follow the procedure prescribed for obtaining direct power supply from generating company

Failure of the Company to complete formalities required for obtaining open access permission from Jharkhand State Electricity Regulatory Commission resulted in avoidable expenditure of ₹ 10.62 crore for drawing power at enhanced rate.

Eastern Coalfields Limited (Company) and National Thermal Power Corporation (NTPC) constructed (June 1990) 220 KVA Farakka Lalmatia Transmission Line at Rajmahal Project to receive electricity directly from NTPC. The drawing of electricity directly from NTPC at the rate of ₹ 3/- per KWH was more economical than the prevailing rate of ₹ 4 per KWH charged by the Jharkhand State Electricity Board (JSEB) (erstwhile Bihar State Electricity Board). However, the Company could not avail power at cheaper rate from NTPC as its transmission line was under the command area of JSEB and the Electricity Act in force did not permit such supply of power directly from NTPC. Subsequently, Electricity Act 2003 allowed consumers to draw power directly from NTPC for which open access permission was to be granted by the State Electricity Regulatory Commission.

As per Electricity Act 2003 and notification of Jharkhand State Electricity Regulatory Commission (JSERC) (Open Access in Intra State Transmission & Distribution) Regulations 2005 (June 2005), the Company was required to apply in the prescribed format containing requisite technical information along with non-refundable application fees to the State Transmission Utility (STU) being the nodal agency. Audit, however, observed (March 2008 and August 2010) that instead of applying to JSERC through STU, the Company applied directly to NTPC in January 2006 i. e. after a lapse of 6 months from the date of issue of notification by JSERC. In reply, NTPC advised the Company (March 2006) to apply to the JSERC. The Company applied to JSERC in June 2006 i.e. after a lapse of another three months. JSERC advised the Company (July 2006) to follow the JSERC Regulations 2005, as per which the Company was required to submit the application to STU, along with technical details and application fees for long term open access permission. The Company applied for a second time to JSERC in May 2009 i.e. after a lapse of two years and eleven months. In turn JSERC again drew attention (June 2009) to the JSERC Regulations 2005. But till date, the Company had not complied with the required formalities. As a result, the Company failed to obtain direct power supply from NTPC w.e.f. 1 April 2008 onwards. Consequently, the Company had to pay electricity charges at the higher rate of ₹ 4 per KWH instead ₹ 3 per KWH, resulting in avoidable expenditure of ₹ 10.62 crore for the period from April 2008 to March 2010.

The Management stated (February 2009 and August 2010) that after getting permission from JSERC, the Ministry of Power had to be approached for allocation of power directly from NTPC.

The reply of the Management was not convincing as the Company failed to follow the procedure prescribed in the Regulations of JSERC 2005.

As the formalities required for obtaining the necessary access were not completed, the Company incurred as of March 2010 avoidable expenditure of ₹ 10.62 crore for drawing power at enhanced rate.

The matter was reported to the Ministry in October 2010; reply was awaited (February 2011).

Recommendation

The Company should take immediate steps to obtain open access by following the prescribed procedure to save on electricity charges.

Neyveli Lignite Corporation Limited

3.3 Capital Financing

Introduction

Power generation projects are capital intensive and have long gestation periods. The power sector is also subject to regulatory control, with administered prices and therefore the methods of capital financing assume great significance. As per the extant Central Electricity Regulatory Commission (CERC) Regulations (Regulations), the capital cost of a power project, including the capitalised interest of the debt used to finance the project, is reimbursed over a period of time through a mechanism called capacity charge[1], a part of the new Availability Based Tariff (ABT) regime introduced since April 2003.

The Regulations implemented after April 2004 inter alia impose restrictions on the means of financing the project by limiting the debt equity ratio[2] in determining the capital cost of the project. The Regulations further stipulate that the normative[3] Return on Equity (ROE) should be restricted to actual equity investment, subject to a ceiling of 30 *per cent* of the capital cost. It allowed recovery of entire cost of debt from the beneficiaries through tariff.

Neyveli Lignite Corporation Limited (Company) got the approval from Government of India for implementing four projects comprising a mine and a power project each at Neyveli and Barsingsar. The approved cost of the projects was ₹ 5540.30 crore (revised to ₹ 6630.19 crore in 2008-09) to be financed out of borrowings of ₹ 3878.21 crore (revised to ₹ 4641.13 crore) and internal resources of ₹ 1662.09 crore (revised to ₹ 1989.06 crore).

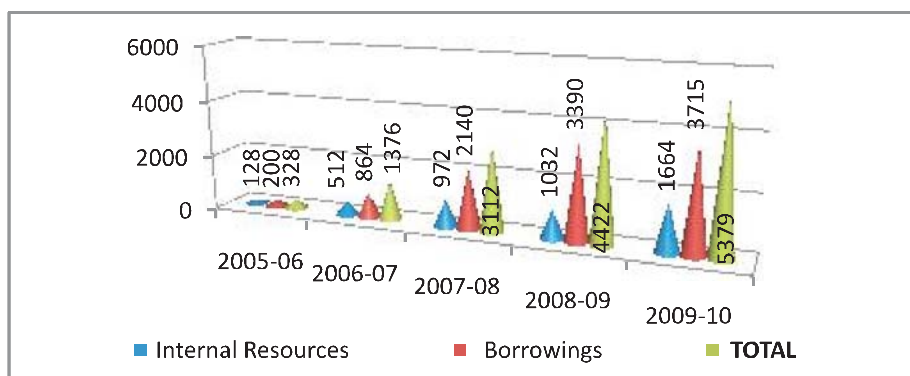
For timely implementation of projects, the Company considered the factors like magnitude/timing of requirement, mode and funding options in the borrowing programme/action plan (December 2004) and adopted CERC stipulated funding pattern of 70:30 for the entire project cost including interest during construction (IDC). The Company also decided to deploy internal resources judiciously to avoid excess deployment as it would lead to foregoing investment income (opportunity loss).

[1] Comprises depreciation of assets, interest on loan, return on equity, O&M expenses, insurance, taxes and interest on working capital
[2] Percentage of debt/equity to total capital cost, which is expressed in terms of ratio, limited to 70:30.
[3] Norm for return on equity specified in the tariff regulations from time to time.

Total expenses incurred on these projects cumulated at the end of financial year and means of their finance as at the end of March 2010 are depicted in the graph 1 below:

Graph:1 Expenses on a mine and power project each at Neyveli and Barsingsar

(₹ in crore)



Scope of Audit

Audit examined actual financing of all the four projects undertaken by the Company between 2005-06 and 2009-10. This examination is limited to assessing the methodology of financing the projects and consequent impact on capacity charges/opportunity loss and does not extend to utilisation of funds.

Audit objective

Thematic examination was conducted to ensure that the capital financing was done

- At optimum cost to the Company; and
- At optimum cost to the beneficiaries.

Audit methodology

Audit Methodology involved a review/examination of proposals and validation of calculations.

Audit criteria

The objectives of the framework is to keep the cost of power to the beneficiaries at the minimum possible level while compensating the power generating stations adequately for their capital investments. The criteria used as a benchmark for determining the optimum finance ratio is the maximum extent of capital, which could be recovered through capacity charges as per CERC regulations. The criterion for the interest rate paid is the minimum possible alternative that was available to the Company for financial debt compensation and earning capability of equity if alternatively invested in short term deposits.

Project financing - background

The Company submitted two proposals (December 2004 and January 2005) at initiation of the process of project financing viz. (a) a proposal seeking sanction of ₹ 1200 crore for funding the identified requirements of foreign exchange for the project and (b) a proposal

to raise ₹ 2000 crore as Rupee Term Loan (RTL). In the course of these two proposals, the Management stated to the Board that:

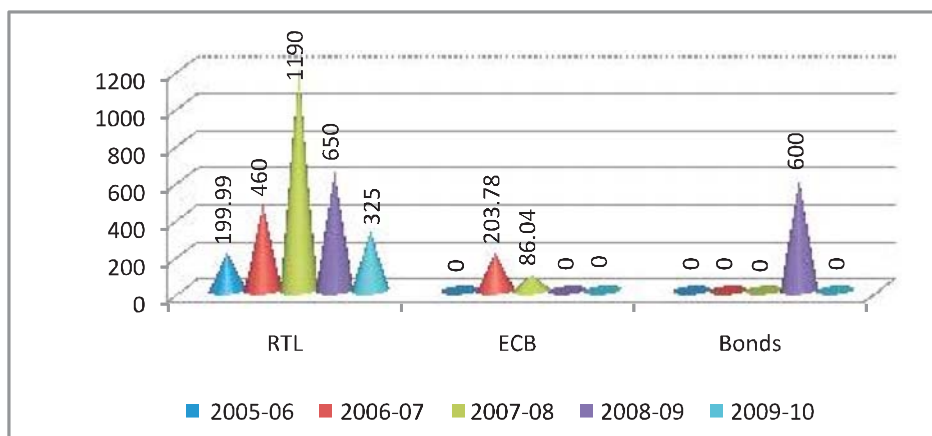
- the foreign exchange component would be funded through External Commercial Borrowings (ECB) or foreign currency loan from Export Credit Agencies (ECA) and the Rupee component funded through Bonds/RTL;
- to follow judiciously the CERC-stipulated funding pattern to derive maximum return;
- though foreign exchange component identified to be Euro 68 million and USD 177.916 million (equivalent to ₹ 1201.84 crore) forming the basis for seeking sanction of ₹ 1200 crore for ECB, there was no certainty that the equipment would have to be imported because of the possibility of selection of indigenous vendors; and
- as and when the requirements were clearly identified for procurement, it would choose to fund it through the lowest cost option.

The Board approved (January 2005) both the proposals. Audit, however, observed that in the above proposals, the Board was not appraised of relative cost of each option in detail.

The Company also sought approval (December 2008) from the Board for issuing Neyveli Bonds with a face value of ₹ 10 lakh each for ₹ 600 crore with coupon rate ranging from 8.5 to 9 *per cent* per annum payable annually and a tenure of ten years with put/call option after seven years. This was approved in January 2009. Accordingly, the Company executed agreements with banks/financial institutions for RTL (November 2005), ECB (March 2006) and also raised bonds (January 2009) with due approval. The graph below summarises the funds raised through these sources during the five years ended 2009-10:

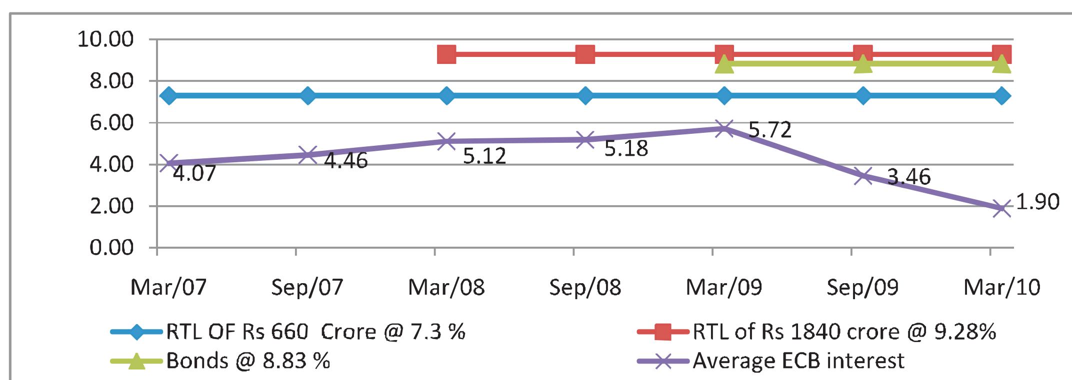
Graph 2: Funds raised during past five years ending March 2010

(₹ in crore)



The rates of interest paid by the Company on the above sources of borrowings are indicated in the Graph 3 given below:

Graph 3: Rates of interest paid on the borrowings



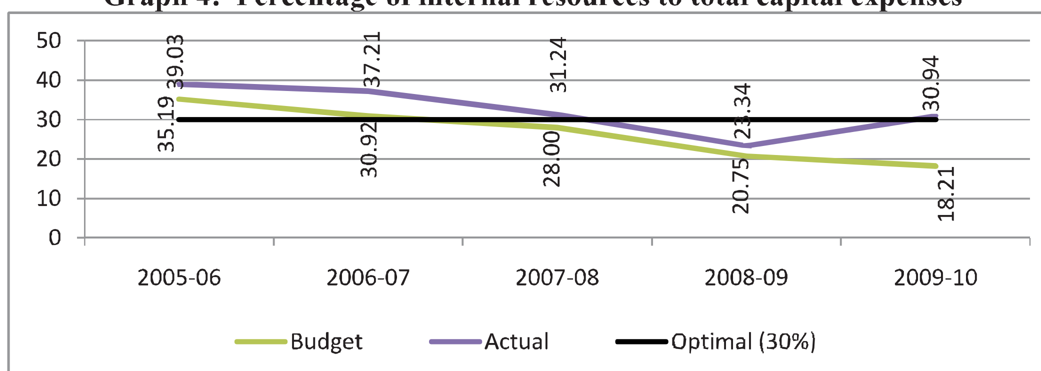
Audit findings

The major audit findings are discussed in detail in the succeeding Paragraphs.

3.3.1 Non-maintenance of stipulated Debt-Equity ratio

The Company prepares annual financial budget for both capital works and revenue items. The graph 4 below represents the budgeted and actual percentage of internal resources deployed to cumulative capital expenses during the five years ended 31 March 2010.

Graph 4: Percentage of internal resources to total capital expenses



Audit observed that even in the annual financial budget estimates, debt equity ratio of 70:30 was not maintained by the Company in meeting the budgeted capital expenditure.

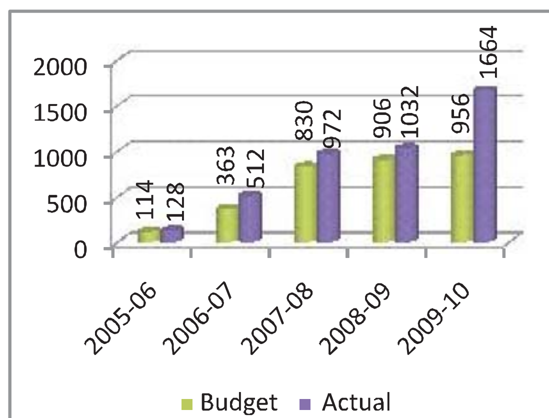
3.3.2 Cash budget:

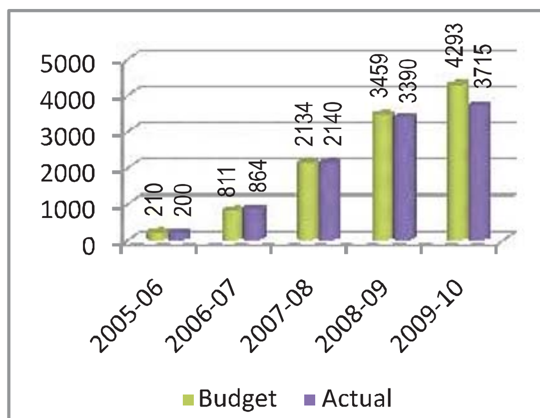
Cash budget is a tool for ensuring efficient cash Management both for Revenue and Capital expenditure. Though the Company obtained the detailed schedules for supplies and payments in advance from the contractors/suppliers, it did not prepare/review Cash Flow Statement for the entire project period to assess the quantum of funds required and to plan the timing of finance requirements. Consequently, the Company met the capital expenses out of its internal resources in excess of 30 *per cent* as depicted in graph 4. The graph 5 below indicates the budgeted and actual capital expenditure met out of internal resources and borrowings:

Graph: 5

Capital Expenses met out of Internal Resources (Cumulative)

Capital Expenses met out of Borrowings (Cumulative)
(₹ in crore)





Audit observed that on account of deployment of its internal resources in excess of 30 *per cent* of capital cost, the Company incurred opportunity loss as discussed in Para.7.4.

The Ministry stated (January 2011) that the Company prepared its monthly cash budget duly considering every aspect of project funding through online system being monitored on daily basis and monthly forecasts for managing and drawing high value payments.

The cash budget prepared by the Company was not, however, found to consider the detailed schedules of supplies and payments, obtained from the contractors/suppliers under the agreement, for the entire project funding plan. Even though at the end of each year of the project period, the optimum debt equity ratio was more or less maintained, the deployment of equity in excess of the stipulated 30 *per cent* in the interim quarters led to an opportunity loss that need to be avoided.

3.3.3 External Commercial Borrowings

3.3.3.1 Low cost ECB contracted insufficiently

As against the sanction for ₹ 1200 crore, referred to in Para 6, the Company contracted (March 2006) an ECB of only Euro 50 million (₹ 286.60 crore) for imported components worth Euro 50.51 million (₹ 289.48 crore) to fund foreign exchange requirements (identified up to June 2005) of Mine II expansion and Barsingsar Mine**.** The procurement process for TPS II Expansion and Power Project at Barsingsar was thereafter completed in June 2006. The total imported component of the procurement worked out to Euro 75.21 million and US$ 21.02 million (expenditure in foreign currency was ₹ 683.49 crore up to 31 March 2010). In the meantime an unsolicited offer from the existing ECB lender for Euro 50 million was received (May 2007) offering similar terms. Despite assertion in the earlier proposal to the Board that foreign exchange was to be funded through ECB/ECA, action for further ECB was only taken belatedly in July/August 2008 that did not fructify. The Management finally submitted (December 2008) a note to the Board for funding it through bonds instead of ECB without inviting a reference to the earlier note which stated that imported components would normally be funded through ECB or ECA loans. There was no justification in the note for delay in seeking or considering ECB.

The interest rate on ECB was the cheapest among the three sources as shown in graph 3. Thus, raising funds through Bonds at higher rates resulted in additional interest burden of ₹ 17.66[1] crore for 2009-10 alone. This indicated that the Company did not implement its own stated intent of seeking lower cost ECB for the project.

The Company stated (July 2010) that the foreign exchange requirement of other equipment/ services spread over a long period were not so significant as to go in for additional ECB. Further the LIBOR interest rates and Euro currency were fluctuating frequently during the review period. The limited average maturity, stringent financial covenants and market disruption clause of ECB would have exposed it to the risk of early repayment of entire loan before the project attaining the rated capacity. There was more possibility of ending with higher interest and FERV, had it signed the ECB in 2007. The Ministry stated (January 2011) that the Company's decision to have a mix of RTL with flexible drawdown, longer and divided maturity, a dose of inflexible ECB at low cost and Bond at moderate and fixed terms was the best choice and was a necessity to fund the normative equity at 30 *per cent*.

It is pertinent to note that the actual expenditure in foreign currency was Euro 120.91 million and US$ 5.77 million (₹ 683.49 crore) as against the actual ECB of Euro 50 million (₹ 286.60 crore) up to 31 March 2010. Since, the Company's belated attempt in July/August 2008 to avail additional ECB did not fructify, it was forced to resort to raise bonds and, therefore, the issues stated were not considered then. As regards the Ministry's reply on best financial mix it should be noted that at the end of 31 March 2010, the actual interest during construction (₹ 612.38 crore[2]) had exceeded the approved estimate (₹ 464.32 crore) indicating the Company's ineffective pursuance of its own policy decision.

3.3.3.2 Non-consideration of minimum drawdown variable during evaluation of ECB offer

The agreement executed for ECB of Euro 50 million in March 2006 had important conditions that the loan amount should be drawn in instalment (known as drawdown) of minimum five million Euro each on or before 31 December 2006 (Tranche A)/31 December 2007 (Tranche B) and payment of commitment charges, calculated at 0.20 *per cent* per annum on the aggregate daily undrawn amount from 1 October 2006 (Tranche A) and 1 April 2006 (Tranche B), on the last day of each successive quarter period.

While some of the competitive bidders had not specified any drawdown in their quotes, others quoted different minimum drawdown. The Company had not, however, factored this in its commercial bid evaluation though this condition involved opportunity loss and it was also aware of the break up of payables against import commitments. Thus, the Company's failure in factoring the minimum drawdown in the bid evaluation process led to opportunity loss of ₹ 4.93 crore. It also resulted in avoidable payment of commitment charges of ₹ 10.11 lakh out of ₹ 43.52 lakh actually paid.

The Ministry stated (January 2011) that in the bids, only major points like loan amount, interest rates and other fees were quoted but other procedural aspects on drawdown,

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[1] ***Interest on Bonds for 2009-10 ₹ 25.50 crore; Interest paid for ECB loan in 2009-10 ₹ 7.84 crore; Difference ₹ 17.66 crore***

[2] ***Comprising Interest on Bonds ₹ 62.85 crore; ECB ₹ 40.65 crore and RTL ₹ 508.88 crore***

representation and warranties, covenants etc. were discussed and finalised after identifying the lender.

The fact remained that the bid evaluation note (July 2005) submitted to the Board considered uniform drawal schedule in evaluating the offers. As the bidders stipulated different minimum drawdown schedule in their offers, this should have been factored in.

3.3.3.3 Deficient execution of ECB Contract

In view of contractual terms for drawal of minimum amount and owing to constraints in following RBI stipulations for parking surplus ECB funds abroad till maturity of payment, the Company decided (June 2006) first to incur the expenditure out of internal resources and to draw the ECB as recoupment of such expenses. The Company got recouped an amount of Euro 50 million (₹ 286.60 crore[♣]) on six occasions between August 2006 and August 2007 after due approval.

A scrutiny of the recoupment revealed omission of some expenses that were claimed in the subsequent occasion. Further, the time taken for recoupment ranged between 26 and 105 days after accumulation of expenses up to Euro 5 million. These omissions/delays resulted in opportunity loss of ₹ 1.61 crore.

The Company stated (July 2010) that procedural requirements involved collection of supporting documents and lead time to accumulate enough claims to match minimum drawdown. The Ministry endorsed (January 2011) the views of the Management.

In regard to time delays and omissions, it is pertinent to note that in one instance alone, the proposal (4 June 2007) for recoupment of Euro 5 million (expenses incurred up to 4 April 2007) was deferred and resubmitted (16 July 2007) without considering the additional expenditure of Euro 8.021 million (equal to ₹ 44.16 crore) incurred between 3 May 2007 and 13 July 2007. The loss involved in this specific instance was ₹ 1.15 crore (opportunity loss ₹ 1.07 crore and commitment charges ₹ 7.50 lakh). Had the Company put in place a system for recoupment of all expenses at the earliest available opportunity, it could have avoided loss of ₹ 1.61 crore out of ₹ 6.54 crore.

Recommendation

The Company may critically analyze and factor each condition of foreign currency loan in the evaluation process for selection of most favourable source.

3.3.4 Rupee term loan – Premature revision of interest rate

The Company executed (November 2005) an agreement with consortium of seven banks (Consortium Members) led by Canara Bank for availing of term loan of ₹ 2500 crore. The loan was repayable in 20 half yearly instalments starting on completion of four years from the date of first disbursement. The agreement further enabled the consortium members to revoke in part or full or withdraw or stop financial assistance at any stage by giving reasonable notice.

The agreement stipulated a fixed interest rate of 7.35 *per cent* per annum (compounded quarterly i.e., 7.30 *per cent* per annum payable monthly), to be reset at Benchmark Prime Lending Rate (BPLR) of Canara Bank minus 3.40 *per cent* per annum after five years

[♣] ***Excluding foreign exchange gain of ₹3.20 crore.***

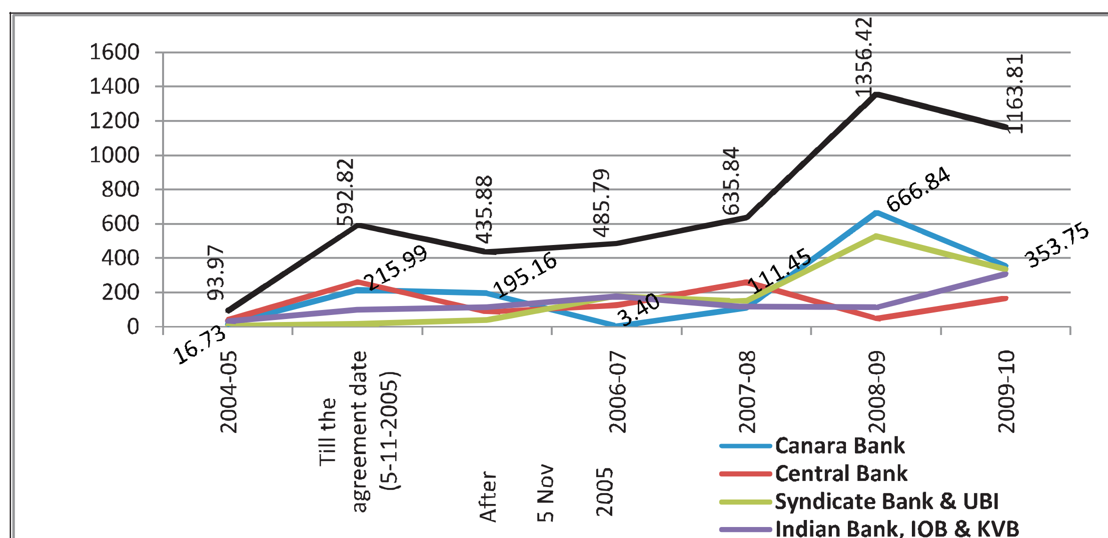
from the date of first drawal and at the end of every five years thereafter. There was also a mutual understanding (June/July 2005) that the Company would place its surplus funds with Canara Bank based on their competitiveness to justify their terms of interest for RTL.

The first loan instalment of ₹ 62.42 crore was drawn in February 2006 and hence, the interest was to be reset from 23 February 2011 as per the agreement. The Company had drawn an aggregate amount of ₹ 660 crore up to March 2007. Canara Bank, however, demanded (March 2007) premature revision in the interest rate from 7.35 to 9.85 *per cent* (BPLR of 13.25 less 3.40 *per cent*) for the remaining ₹ 1840 crore presumably because of non-placement of deposits with them. The consortium members declined to release further funds without consent for enhanced rate.

Regarding short term deposits, the daily average amount placed with consortium members, in particular with the consortium leader Canara Bank, reduced drastically after executing the agreement and up to March 2007 as shown in graph 6 below:

Graph 6: Daily average short term deposits placed with consortium members

(₹ in crore)



The Company had to agree (January 2008) for the enhanced rate of 9.35 *per cent* (BPLR net of 3.40 *per cent*) and drew the balance ₹ 1840 crore between January and December 2008. Thus, failure to factor in the contractual obligations in the investment decisions, resulted in an increase in the project cost by ₹ 64.94 crore being the differential interest on ₹ 1840 crore reckoned from their dates of disbursement to 31 March 2010. Further, deployment of internal resources, in excess of 30 *per cent* of project cost, during the intervening period of nine months led to an opportunity loss of ₹ 32.02 crore (at the quarterly average rate of interest earned on deposits).

The Company contended (July 2010) that it could not place the deposits with Canara Bank as it had to adhere to DPE[♣] guidelines on obtaining the best possible rate. The

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♣ ***Department of Public Enterprises***

Ministry stated (January 2011) that there was no direct link between preferential placement of deposit with banks and their upward revision of interest. In order to avoid cost and time over run, the expenses were met out of internal resources, as project funding strategy.

The Company's claim of adherence to the DPE guidelines should be viewed in the light of the fact that deposits were placed with various banks at different rates during the same time. While it is a moot point as to what role the lack of business played in premature increase of a fixed interest rate by the Canara Bank, it is clear that there is no incentive to economise on the cost of debt as it is fully pass-through and thereby exposes the ultimate consumer to higher costs.

Recommendation

The Ministry may provide suitable incentive to the Companies to ensure that the cost to the ultimate customer is as least as possible.

Conclusion

- The Company planned Debt Equity ratio of 70:30 and would probably maintain 70:30 at conclusion, which is appreciated.
- The Company did not prepare a detailed cash budget covering the entire project period and had to lose out by deploying internal funds in the interim periods.
- The Ministry did not consider the reduction of the overall cost to the customer. The policy framework did not provide the right incentive for ensuring this.