Chapter 6

Experience of pooled pricing of coal and oil

India has traditionally been importing fuel in the form of crude oil, uranium and natural gas to meet its huge energy demand. At present, nearly 80% of the total requirement of crude oil is met through imports and the balance amount is contributed by ONGC Ltd. and Oil India Ltd. (OIL). Import of coal has been rather limited so far, with most of the requirement being met by Coal India Ltd. (CIL). 20 – 25% of our consumption of natural gas is being imported as of now and additional facilities are being set up for regasification of LNG. There has been some measure of blending of domestic and imported supplies in all these three commodities. On the other hand, majority of our uranium requirement is met by imports and there is not much information readily available about the mix of domestic and imported uranium being used.

6.1: Pooling of Crude oil

ONGC and OIL transfer the crude oil produced by them to the oil marketing companies (OMCs), namely Indian Oil Corporation (IOCL), Bharat Petroleum Corporation Ltd. (BPCL) and Hindustan Petroleum Corporation Ltd. (HPCL) for refining. Petrol prices have now been deregulated by government, but OMCs are forced to sell diesel, kerosene oil and LPG at regulated prices, leading to huge under-recoveries. There is some movement to deregulate

them, particularly diesel. These under-recoveries are shared by upstream companies (ONGC, OIL, GAIL), Government of India and the OMCs themselves.

ONGC's annual report for 2011-12 states that during 2011-12, OMCs reported total under-recoveries of Rs. 1,38,541 crores. Out of this amount, 60.27% was provided by GoI, 39.70% by upstream companies and 0.03% was borne by OMCs themselves. The total share of upstream companies amounted to Rs. 55,000 crores. ONGC contributed Rs. 44,466 crores and OIL contributed Rs. 7,350 crores (as per OIL's annual report for 2011-12).

Average gross price for ONGC's crude oil during 2011-12 stood at US$ 117.40 per barrel. However, as per instructions of GoI, ONGC provided an effective discount of US$ 62.69 per barrel, resulting in a net price of US$ 54.72 per barrel. Similarly, OIL provided a discount of US$ 56 per barrel to OMCs. Although the term of price pooling is not specifically used for this mechanism, in effect it amounts to pooling of domestically produced 23.08 MT crude oil at US$ 54.72 per barrel and 3.80 MT of crude oil at US$ 59.82 with 172.11 MT imported crude oil at US$ 114.65 to be refined by OMCs.

Such pooling of domestic crude oil at discounted rates and imported crude oil has been going on for many years. Since only central public sector enterprises and government of India are involved in the process, there have been no legal or administrative complications. Private refiners source crude oil on their own and do not form a part of this pooling mechanism.

6.2: Blending of Coal

The Power and Steel sectors in India have been facing problems in supply of coal for a long time now. A new company called the International Coal Ventures Private Ltd. (ICVL) has been set up in the steel sector to outsource coal from abroad. In the power sector too, the Central Electricity Authority (CEA) has studied the technical feasibility of blending imported coal with domestic coal in Indian power plants. In its report[57], CEA has noted that "A large number of Indian power utilities are already using imported coal for blending. Generally, stations have been blending 10-15% of imported coal by weight. The fact that utilities have been using imported coal for blending for several years gives a comfort that these utilities have experience of using blended coal and also of handling imported coal." After studying technical aspects, the report recommends that 10 -15% blending of imported coal (15 – 22% on heat value basis) can generally be carried out in typical existing Indian power boilers designed for low quality Indian coals without envisaging any major problems.

The New Coal Distribution Policy, 2007 mentioned that in order to meet the domestic requirement of coal, CIL may have to import coal as may be required from time to time, if feasible. It allowed CIL to adjust the overall price of coal accordingly. CIL was given the responsibility to meet the full requirement of coal under Fuel Supply Agreements (FSAs) even by resorting to imports, if necessary.

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[57] Central Electricity Authority (April 2012), *Report of The Group for Studying Range of Blending of Imported Coal with Domestic Coal*

CIL did not import coal as per requirement, nor was it able to boost domestic production to be able to meet the requirement of power plants. In view of a large number of new power projects getting stuck due to uncertainty of coal supply, CIL was asked by GoI to sign FSAs by 31st March, 2012. When the independent Directors on the Board of CIL did not agree to face the risk of penalties being invoked under FSAs in the event of shortfall in supply by CIL, a Presidential Directive was issued to CIL on 3rd April, 2012 directing it to sign FSAs with power producers assuring them of at least 80% of the committed coal delivery.

Taking note of the problems being faced in increasing domestic production of coal, the 12th five year plan Working Group on the Power Sector set up by the Planning Commission has recommended import of coal and price pooling of domestic and imported coal. Relevant extracts from this report are reproduced below:

> *The concept of pooling of price of domestic and imported coal is necessitated due to the fact that the production of domestic coal is not increasing commensurate with the requirement of coal for power stations which are existing and are being planned, based on domestic coal. Most of the new Power Utilities would be required to import coal to bridge the gap between their requirement and availability of domestic coal.*
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> *A solution to this problem could be the allocation of coal to Power Utilities from the nearby coal source to the extent possible to minimize transportation cost. Power Utilities located in coastal areas may be asked to use larger chunk of imported coal being nearest to the port subject to design limitations. Most of the coal mines of Coal India Ltd. are located in Central India; giving almost an equal distance of coal transportation from coal mine to a majority of Power Stations. Therefore, the Power Utilities which are at a larger distance from ports may be allocated coal from the mines of Coal India only and be asked to use imported coal only in the case of shortfall to avoid unnecessary double movement of coal rakes.*

It is accepted fact that the cost of imported coal is higher than domestic coal even after accounting for its higher GCV, at present rate it is almost two and half times costlier than domestic coal on heat value basis. This could be a deterrent to the Power Utilities at coastal areas which would be asked to use a higher chunk of imported coal as it will increase their cost of generation.

A case, therefore, exists for importing coal to bridge the gap between requirement and availability of domestic coal and the cost of the same to be equitably borne by all the power utilities. It may however be mentioned that the concept of pooling cost is to be applicable to power stations designed for domestic coal only. Imported coal based stations and stations linked to dedicated coal blocks are not to be considered in this pooling mechanism.

Pooled price is to be evaluated based on the heat value (Rs/Kcal) of the coal. CIL shall be responsible for importing coal and levying the pooled price on the various power utilities. This is reasonable in view of the fact that the New Coal Distribution Policy stipulates that CIL is responsible for meeting 100% of the normative requirement of coal of the power utilities, and import of coal may be resorted to the extent required.

Looking at the apprehensions of CIL regarding getting the right price for imported coal, the Prime Minister's office asked CEA to build a consensus and make sure that CIL does not get a raw deal. Once pool pricing is implemented and CIL gets the right remuneration, it can start imports to meet 80% coal supply to power plants. Pricing of imported coal would be based on gross calorific value system, which is already implemented by Coal India.

Pool pricing mechanism for coal based on cost plus prices has not yet taken off smoothly. Cost plus price is based on the additional expense CIL or its subsidiaries would have to incur in supplying imported coal to fulfil FSA commitments. Cost plus price is higher than the government's notified price and envisages a 12% return on investments by coal companies. Coal companies like Western Coalfields Ltd., a subsidiary of CIL, are finding customers unwilling to pay the full price of coal and are unable to clear fresh

investments or projects that would keep production going after existing mines are exhausted.

6.3: Pooling of Natural Gas Prices:

Efforts made in pooling of natural gas have been discussed in Chapter 5 already. In addition, pooling of natural gas has been practiced in fertilizer plants of the country for a long time now without any problems. There seems to be a case for extending such efforts on a much larger scale.