

# Regulatory Hotline

October 16, 2014

## COAL ALLOCATIONS CANCELLED!

- Supreme Court held that Central Government did not have power to allocate coal blocks in favor private companies. Even assuming the Central Government did, the allocation by Screening Committee was arbitrary and the improper allocation caused unfair distribution of national wealth. Hence, allocations were to be cancelled.
- Supreme Court holds that power exercised by Central Government left State Governments to only complete formalities on of allocation of mines. Further, the interpretation placed on the provisions of the relevant provisions would have to be in a manner that reconciled powers of Central and State Government.
- Supreme Court held that coal blocks allocated to certain Ultra Mega Power Projects in respect of which competitive bidding was carried out may be saved; however, in respect of all other allocations, unless specifically exempted, the allocations were to be cancelled irrespective of the stage of mining activity carried out.
- Allottees of the coal blocks must pay compensatory levy of Rs. 295/- metric ton of coal extracted as additional levy as per a report of the Comptroller and Auditor General of India.
- Companies participating in government contracts will have to ensure that the process of securing the contract strictly complies with the procedure established by law. Reports of independent agencies such as the Comptroller Auditor General should be considered before participating or concluding contracts with Central or State Government.
- This was an unprecedented case of executive actions being quashed on the ground that the same lacked no enabling provision in the relevant law.
- Aggrieved companies may have limited recourse in such circumstances.

In a landmark ruling<sup>1</sup> on the interpretation of the powers of the Central Government under the Mines and Minerals (Development and Regulation) Act, 1957 (**'Mines & Minerals Act'**) and Coal Mines (Nationalization) Act, 1973 (**'Coal Mines Act'**), the Supreme Court of India (**'Supreme Court'**) held that Central Government did not have power to allocate coal blocks under these Acts (**'SC Order'**). The Supreme Court further held that allocation by the Screening Committee was arbitrary, contrary to the procedure established by law and consequently had to be set aside. In a separate and subsequent order (**'Operative Order'**), the Supreme Court held that cancellations shall take effect after 6 months from the date of the Operative Order, i.e., September 24, 2014. Apart from the commercial impact of the cancellation, the allottees are likely to be put to financial prejudice as a result of the Operative Order.

The Operative Order is unprecedented in that companies have been penalized in an exemplary manner for omissions of the Central Government. Although while passing the final order in similar cases courts consider equity (principles of fairness), in the present case, the Supreme Court has not taken any extenuating factors in favor of the allottees into consideration and all allotments, irrespective of level of mining activities and conduct of the allottees, have been cancelled. This too, is unprecedented. Against such an order, affected parties may only file review petition. Theoretically, an affected company may sue Government of India, however, chances of success would appear extremely remote.

## BRIEF FACTS

Manohar Lal Sharma and Common Cause, an NGO, (**'Petitioners'**) challenged licenses that the Central Government appointed Screening Committee had granted to private companies and certain public sector undertakings (**'PSUs'**). The Screening Committee over a period of time had allocated 216 coal blocks to companies for carrying out coal mining in seven states. The grants were challenged, principally on the following grounds:

- Central Government did not follow mandatory procedure under the Mines & Minerals Act;
- Section 3(3)(a)(iii) of the Coal Mines Act, which provides for parties entitled to carry on mining operations, was violated by Central Government by making allocations in favor of ineligible companies;
- Screening Committee granted licenses to ineligible applicant companies over a course of 36 meetings based on subjective and arbitrary criteria.

## Legislative background

The Supreme Court first examined the scheme of the regulatory and legislative framework in respect of coal mining operations. Entry 23 of List II in Schedule 7 of the Constitution of India, 1950 (**'Constitution'**), empowers States in the Union to enact laws in respect of mines and mineral development. However, Entry 23 is subject to Entry 54 of List 1 in terms of which Central Government is empowered to legislate in respect of mines and minerals. Generally, legislative powers of States defer to those of Central Government in the event of a conflict.

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Section 4 of Mines & Minerals Act provides that all mining operations shall be under a licence. Under the Mineral Concession Rules of 1960, ('**Rules**'), framed in exercise of powers under Section 13 of the Mines & Minerals Act, an applicant would first make an application to the relevant State Government. Thereafter, the applicant is required to submit the plan to the Central Government and once approved by Central Government, the applicant was entitled to licence from the State Government. The Mines & Minerals Act and the Rules provide for the grant of licence for operating in respect of mines and minerals stated under the Mines & Minerals Act.

In 1973, the Central Government nationalized mining activities through the Coal Mines Act to reorganize and reconstruct coal mines and ensure coordinated and scientific development and utilization of coal. The objective was to distribute coal resources as best to subserve the common good. Section 5(1) of the Coal Mines Act empowers Central Government, through an order in writing, to vest the right, title and interest of an owner in relation to a coal mine a Government company. Section 1A, inserted by way of an amendment, empowered the Central Government to 'take under its control the regulation and development of coal mines'. Section 1A (3) of the Coal Mines Act restricted the right to carry on coal mining operations exclusively in favor of<sup>2</sup>:

- The Central Government or a Government company, or a corporation owned, managed or controlled by the Central Government,
- A person to whom a sub-lease had been granted by such Government, company or corporation, or,
- A company engaged in the production of iron and steel.

In 1991, Section 3 (3) of Coal Mines Act was amended to allow private sector participation in coal mining operations for captive consumption towards generation of power and other end use. Due to various factors including the dismal power situation, shortage in coal production and inability of Coal India Limited ('**CIL**'), the approval of Cabinet was sought by Cabinet Note dated 30.01.1992 for 'allowing private sector participation in coal mining operations for captive consumption towards generation of power and other end use, which may be notified by Government from time to time.' Although projects were to be approved on a case-to-case basis, Section 3 (3) of the Coal Mines Act was amended to enable companies engaged in generation of power, washing of coal obtained from a mine or such other end use as the Central Government may specify. In this background rival submissions were urged on the power of Central Government to allocate coal blocks in favor of private companies.

### CONTENTIONS OF ATTORNEY GENERAL FOR UNION OF INDIA AND VARIOUS COAL PRODUCERS

- Central Governments legislative and executive power took precedence over that of States under the Constitution. Consequently, once the Central Government exercised powers, State Government would have to follow consequences from exercise of such powers.
- The power to allocate coal blocks can be traced to Section 1A and Section 3 (3) of the Coal Mines Act. These powers were in addition to those set out in Mines & Minerals Act.
- The allocation letter issued by Central Government under Rules, was part of the procedure for allocation of coal blocks. The procedure set out under the Rules, provided for detailed examination of the applicant and its documents. The Screening Committee considered the eligibility of the applicant based on the suitability of the coal block and end-use of the applicant.
- Since Union Parliament had the legislative competence in respect of mines and minerals, Article 73 of the Constitution extended executive power in respect of legislative matters as well.

Petitioners refuted these contentions and submitted that it was exclusively only companies set out in Section 3 (3) (iii) which could carry on coal mining operations. Further, neither the Coal Mines Act nor the Mines & Minerals Act empowered the Central Government to make allocations as made by the Screening Committee. Neither legislation provided for the procedure by which allocation could have been made as was done by the Screening Committee.

Interestingly State Governments objected to the role ascribed to them by the Central Government and submitted to the Supreme Court that they had no powers once Central Government approved an application under the Rules.

### SC ORDER

The Supreme Court held that the power of allocating coal blocks could not be traced to the Mines & Minerals Act or the Coal Mines Act. The Supreme Court also rejected the contention that executive power would extend to all matters in respect of which Central Government had legislative competence. The Supreme Court noted, based on submissions of various States of the Union, that their role was completely denuded and consequently, their powers under the two laws was completely whittled down. The Supreme Court held that the amended provisions of both laws did not restrict the role of State Government but the system of the Screening Committee, effectively denuded the powers of the State Government.

The Supreme Court held that if the two laws required an act to be done in a particular way, such act could be done only in that way or not at all.<sup>3</sup> The Supreme Court rejected the interpretation that Central Government was exercising powers under Section 1A of the Coal Mines Act since the manner of exercise by the Central Government reduced the statutory role of State Governments to only complete formalities. Even the amended Section 3 of Coal Mines Act did not empower Central Government to make allocation of coal blocks. Central Government did not frame rules nor issue notifications regarding the process to be followed for allocation of coal blocks. The Supreme Court held that the amended provision of Section 3 of Coal Mines Act would determine the application of the Mines & Minerals Act and that Mines & Minerals Act would not determine the manner of operation of the Coal Mines Act.

The SC Order then examined the system adopted by the Screening Committee and whether it was the most appropriate process for allocation coal blocks since allocation of coal blocks conferred largesse on the companies. The Attorney General contended that auctioning of coal blocks would have led to an artificial increase in the price and this would in turn have affected cost of power. Given the sensitivity of price of coal and its application auctioning of coal would not have been viable and State Governments supported this statement. The Supreme Court, reiterating its ruling in the 2G Scam case<sup>4</sup>, held that auctions did not have to be carried out in each and every case and that courts were not equipped to formulate a policy on allocation of public resources, however, where such allocation was arbitrary and violated principles of reasonableness under Article 14 of the Constitution, the same would be struck down.

The Supreme Court noted that the Screening Committee framed certain guidelines however rejected the same as the guidelines applied were ‘totally cryptic and hardly meet the requirement of constitutional norms to ensure fairness, transparency and non-discrimination.’ On an examination of the minutes of meetings of the Screening Committee, the Supreme Court observed that:

- The procedure followed was in contravention of Section 3(3)(a)(iii) of the Coal Mines Act;
- The procedure for comparison of competing companies was not as per constitutional norms;
- Consideration of ‘consortium of companies’ was impermissible under Coal Mines Act. The system of issuing allocation letters to one leader company and imposing obligations on an associate company was completely impermissible under the Coal Mines Act;
- The system of ‘consortium leader’ and ‘associate companies’ was completely violative of Section 3 of the Coal Mines Act, showed failure to consider *inter se* merits of applicants and showed failure of applying objective standards;
- Norms applied by the Screening Committee changed from meeting to meeting and were not consistent;
- Minutes of several meetings failed to disclose the rationale and reasons as to why certain companies were selected;
- Minutes even failed to disclose the particulars of the consideration of successful applicant;
- Several applicants did not have recommendation of the State Government

The Supreme Court also examined whether Central government could allocate coal blocks to PSUs. The Supreme Court held that allocation of coal blocks to PSUs through the government dispensation route was violative of Section 3 of the Coal Mines Act as the Coal Mines Act permitted coal mining operations only by specified companies stated in the Section.<sup>5</sup>

## OPERATIVE ORDER

On a preliminary point, certain parties sought to submit that they were not heard. However, the Supreme Court concluded that all parties likely to be adversely affected were heard and principles of natural justice were “realistically and pragmatically” applied. Although the Attorney General sought to distinguish 46 from the 216 allocations, the Supreme Court held that only 4 allocations could be “saved”.<sup>6</sup> As far as the others were concerned, they stood cancelled absolutely.

However, 6 months has been given to enable Central Government and CIL to adjust to the changed situation and to coal block allottees to manage their affairs. The Supreme Court observed that Union of India could not deal with natural resources that belong to the country as if they belonged to “few individuals” and that the cancellation was ordered to correct the wrong done by Union of India. Consequently, relying on a report of the Comptroller and Auditor General, the Supreme Court ordered that every allottee who’s allocation had been cancelled, would also have to pay an additional levy of Rs. 295/- per metric ton of coal mined. The Supreme Court applied this figure even though the cost of mining could not be ascertained with mathematical precision.

Supreme Court further directed that inquiry by Central Bureau of Investigation will continue into 12 coal blocks identified by the Attorney General (not disclosed in the Operative Order) and any other allottee.

## ANALYSIS

It is quite unusual that the SC Order does not record any submissions of individual allottees in respect of the Screening Committee minutes. There does not appear to be any defence put forth even by Union of India in respect of the minutes of meetings.

Unlike the 2G Scam Case<sup>7</sup>, this case is unprecedented for holding that Central Government fundamentally lacked power under the law to allocate coal blocks. The Supreme Court did not hold that Central Government did not have power to allocate *at all* but did not have power to allocate in favor of entities other than those mentioned in Section 3 (3) (iii) of the Coal Mines Act. The Supreme Court also concluded that there was no notification in terms of Section 3 (3) (iii) (4) – *such other end user the Central Government may, by notification, specify*. The lack of notifications has hurt private allottees. An argument that could have been raised but was not, is whether Central Government can save the allotments through retrospective notifications or any other form of retrospective amendment.

The ruling emphasizes the importance of adhering to procedural due process. However, the burden is clearly on companies that contract with government to satisfy themselves that government has the power to contract with companies. Companies contracting with government should also be prepared to defend these contracts in courts as they can be challenged by anybody and at any time. The principle of laches has been completely ignored and the Supreme Court has cancelled actions of the Central Government even though they relate to 1993. The additional levy of Rs. 295/- per metric ton imposed uniformly on every allocatee without any finding of wrong doing against them is a double whammy for the allocatees.

While the rewards from doing business with Government of India may be high, the risks appear to be even higher.

– M.S. Ananth & Pratibha Jain

You can direct your queries or comments to the authors

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<sup>1</sup> Manohar Lal Sharma v. The Principal Secretary & Ors. Writ Petition (Crl.) No. 120 of 2013.

<sup>2</sup> Section 1A (3) of the Coal Mines Act.

<sup>3</sup> Relying on Nazir Ahmed v. King Emperor [1935-36] 63 IA 372].

<sup>4</sup> Centre for Public Interest Litigation & Ors. V. Union of India & Ors. [(2012) 3 SCC 1] and also on In re Special Reference No.1 of 2012 [(2012) 10 SCC 1].

<sup>5</sup> Note 2 above.

<sup>6</sup> These are: 3 blocks allocated to Moher and Moher Amroli Extension allocated to Sasan Power Ltd. (UMPP) and Tasra (allotted to Steel Authority of India Limited. Pakri Barwadih coal block allotted to National Thermal Power Corporation (NTPC).

<sup>7</sup> Note 4 above.

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