

Legal and Economic Consequences of the Coal Scam Case, 2014

by

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Abstract

The paper analyzes the infamous 'coal scam' case, where the Supreme Court's verdict became a subject of heightened criticism and controversies. The article highlights the significance of the case on the legal and economic fronts and how the two of them are interlinked. The Supreme Court's decision of quashing the licenses was questioned on the grounds of the methodology applied for determining the losses incurred. The economic implications of the same have been far-reaching, leading to reduced efficiency and productivity in the entire industry. This was followed by a ripple effect in the banking industry, foreign investment, and ultimately the economic slowdown of the nation. The paper elucidates upon the incentives involved, the impact of this decision and proposes an alternate inference that could've potentially mitigated the damaged.

Keywords: Coal scam, Economic Efficiency, Licenses, Principal Secretary, Supreme Court

LEGAL AND ECONOMIC ANALYSIS OF THE COAL SCAM CASE- MANOHAR LAL SHARMA V THE PRINCIPAL SECRETARY (2014)¹

INTRODUCTION

This case refers to the infamous ‘coal scam’, or what is popularly known as ‘Coalgate’². This was brought to the nation’s attention, for the first time, when the Comptroller and Auditor General of India (‘CAG’) highlighted the fact that inadequacies in the coal blocks being allocated from 2004 onwards led to a huge loss to the exchequer. The contention made by the CAG stated that instead of allocating coal blocks in the country through a system of competitive bidding, the government’s methodology was very opaque and subjective. This loss was scaled up to 1.86 lakh crores, thereby, creating a huge political storm in the political, economic and legal aspects and drew a lot of public and media attention. A writ petition was filed with regard to this alleged scam at the Supreme Court by *Manohar Lal Sharma* against the *Principal Secretary*, and the verdict passed by the court, in this case, has had wide-ranging implications on the nation’s economy. It faced a lot of criticism on the legal and political fronts too.

DESCRIPTION OF THE CASE

The petitioners, in this case, are *Manohar Lal Sharma* and *Common Cause*, which is an NGO; and they challenged the coal block licenses that the Screening Committee, appointed by the Central Government, had granted to about 216 companies across seven states for carrying out coal mining activities. *Manohar Lal Sharma* had filed three writ petitions in 2012, and *Common Cause* had filed a writ petition in the same year; with additional matters and additional issues, ultimately, the two prayers were submitted together in the case. The case was defended by the *Principal Secretary* on behalf of the Union Government.

Contentions made by the petitioners state that the mandatory procedures prescribed under the *Mines and Minerals (Development and Regulation) Act, 1957*³ (‘Mines and Minerals Act, 1957’), were not followed by the Central Government when they allocated the coal blocks.

¹ *Manohar Lal Sharma v The Principal Secretary And Ors*, (2014) 9 SCC 516

² Lahiri-Dutt, K., 2016. *The coal nation: histories, ecologies and politics of coal in India*. Routledge.

³ Mines and Minerals (Development and Regulation) Act, 1957

They argued that under *the Coal Mines (Nationalization) Act, 1973* ('Coal Mines Act, 1973'), Section 3 (3) (a) (iii)⁴ was breached. They further stated in the court that the *Principal Secretary's* actions, in lieu of the government's directions, were arbitrary and lacked an application of mind; that they had no traces of objectivity or transparency. The *Doctrine of Public Trust*⁵ in India states that the State is the trustee of all the natural resources in the country, and the government was claimed to violate the *principle of trusteeship of natural resources* since it gave away precious resources which belong to the public at large. The petitioners also claimed that the allotments made by the government were manipulated by *mala fide* intentions and corruption in order to favour certain ineligible companies. The petitioners fundamentally presented two prayers in front of the court;

- To quash all of the allocations of coal blocks that were made to certain private companies by the Central Government between the years of 1993 and 2012.
- To begin an investigation monitored by the court, by the *Central Bureau of Investigation and Enforcement Directorate* or by a Special Investigation Team to investigate into all of the allocations of coal blocks made by the central government in the mentioned time period.

The defendants, on behalf of the Union of India and multiple coal producers, argued that the Central Government is empowered to allocate coal blocks by way of Section 1A and Section 3 (3) of the *Coal Mines Act, 1973* and the same powers can be traced back in the *Mines and Minerals Act, 1957*. As part of the following established procedure, the Central Government issued an allocation letter under the *Mineral Concession Rules of 1960* ('1960 Rules') and Section 10 (3) of the *Mines and Minerals Act, 1957*. The 1960 Rules set out a procedure that ensures detailed examination of all of the applicants for allotments and their documents. The Screening Committee passed its decisions based on the eligibility of the applicants and their suitability with the use of coal blocks. The defendants stated that not only did the Central Government have legislative competence by way of the *Mines and Minerals Act, 1957*, but, Article 73 of the *Constitution of India*⁶ further extended their executive power relating to

⁴ Section 3 (3) (a) (iii) of the Coal Mines (Nationalization) Act, 1973 states that: "on the commencement of section 3 of the coal mines amendment act, 1976, no person other than, a company engaged in the production of iron and steel, generation of power, washing of coal obtained from a mine, or such other end use as the Central Government may, by notification, shall carry on coal mining operation, in India, in any form."

⁵ The Doctrine of Public Trust has grown from Article 21 of the Constitution of India and Article 48A provides the state with a duty as a trustee to protect the environment.

⁶ Article 73 of the Indian Constitution specifies the extent of the executive power of the Union

legislative decisions as well. They also mentioned that exercises powers, the state governments were bound to follow consequences of the same.

JUDGEMENT PASSED

This case is considered a landmark judgement since the Supreme Court, in a unanimous three-judge bench, gave an unequivocal interpretation of the powers of the Union Government as given under the *Mines and Minerals Act, 1957* and *Coal Mines Act, 1973*. The verdict stated that the Central Government was not empowered to allocate the coal blocks under these mentioned legislations. It was further declared that the Screening Committee made the allocations to companies on an arbitrary basis, which was contradictory to the procedure established by law and thereby, it was held invalid. Subsequently, the Supreme Court passed an *Operative Order*. This order declared that the licenses would be cancelled, which would take effect six months from the passing of the *Operative Order* in September 2014. The court was of the view that the cancellation would have its own commercial impact, and at the same time, the allottees would be subject to financial prejudice due to the passing of the *Operative Order*.

LEGAL AND ECONOMIC ISSUES INVOLVED

The legal issues that this case dealt with are:

- “Whether the guidelines framed by the Central Government for allocation of subject coal blocks were followed.”
- “Whether the process adopted for allocation of subject coal blocks was according to the procedure established by law.”
- “Whether the guidelines contain an inbuilt mechanism to ensure that allocation does not lead to the distribution of largesse unfairly in the hands of few private companies.”
- “Whether the guidelines were strictly followed and whether by allocation of the subject coal blocks, the objectives of the policy have been realized.”
- “Whether the reasons for not following the policy of competitive bidding adopted by the Government of India way back in 2004 for allocation of coal blocks was justified.”

- *“Whether any steps have been taken or are proposed to be taken against the allottees who have not adhered to the terms of allotment or breached the terms thereof.”*

The economic issues that this case dealt with essentially included problems such as- the coal blocks were being allocated and cancelled and ultimately were just left unproductive without being efficiently reallocated. The efficiency of the coal industry was significantly dropping. As a ripple effect, in the power industry, the employment sector and many other sectors were also suffering. Foreign investments in the country began drastically dropping, and the investment environment was tainted. The auctions of the coal blocks also didn't give high results. Most of the coal blocks were not even examined properly, and all of them were condemned to the same decision. The economic crisis that the country was facing was not taken into consideration.

ANALYSIS OF INCENTIVES INVOLVED

In 1991, when the country was facing a financial crisis due to imbalance in payments, economic slowdown, shortage in coal production, shortage of resources, etc., it was State electricity boards that were able to meet the power requirements. With the passing of the *Coal Mines Amendment Act, 1976*, the Central Government was allowed to mine coal as well. As per the 8th Five Year Plan⁷, after liberalization, it was decided that the participation of the private sector in coal mining operations for captive consumption was allowed. In this case, The Union Government did not put forward any defence other than minutes of meetings of the Screening Committee.

Even though the government was legally ineligible to allocate the coal blocks, since the laws they claimed as a defence was previously amended, the court did not acknowledge the same and only held it accountable for favouring certain specific entities.

The evident and condoning factors in the case in favour of the allottees were not even considered by the court, and all of them were cancelled and uniformly penalized without any wrong on their part. This sets an example to the private sector that when such companies enter into contracts with the government, they can be challenged in courts at

⁷ Planning Commission, 1992. Eighth Five Year Plan 1992-97 Volume 1 Objectives, Perspective, Macro-Dimensions, Policy Framework and Resources

any time and; even with the benefits of doing business with the government, the risks happen to outweigh them.

LONG TERM IMPACT OF THE JUDGMENT: WILL IT LEAD TO EFFICIENCY?

The Supreme Court's decision of declaring 218 coal block allocations from the year 1993 to 2011 to be illegal and arbitrary, in an allegedly "*unprecedented*" judgement⁸, came right after the 2G verdict⁹ that the Supreme Court passed in 2012, and subsequently, the coal industry was said to face the casualty. The companies are being penalized exemplarily for the deeds of the government. Many Indian economists, such as *Professor Ashish Bhardwaj* from *Jindal Global University*, linked the Supreme Court's verdict with the economic slowdown that the country was facing at the time. During that time, the *State Electricity Boards* went bankrupt and under painfully higher debts because when the government made promises of providing electricity to all the households, the burden fell on the electricity boards. As a result of this, the private sector started facing high pressure, and subsequently, the private power players had to borrow more resources to cover the capital expenditure as well as the losses; thereby it became a never-ending cycle. The primary reason for this crisis to take place was because the most important raw material in our nation, being coal, was cut off from its supply.

A similar devastating impact was witnessed in many other industries in the country. Soon after the judgement was delivered, it was predicted that public sector banks would take huge hits because they extended credit to certain power plants whose coal supply was now cut off because the mines were cancelled by the Supreme Court. Most banks in India had exposure of taking a hit of up to 96,000 crores¹⁰. Very quickly, the banking sector fell into a massive loan

⁸ "Coalgate report rocks Parliament" Deccan Herald 2014

⁹ *Centre for Public Interest Litigation & Ors. V. Union of India & Ors.* [(2012) 3 SCC 1]

¹⁰ Kaur, S., 2014. FINANCIAL FORENSICS: WAY TO ABATE CORRUPTION. *Journal of Commerce and Management a Peer Reviewed International Journal*, 1(5)

problem, and the *Chairman of SBI, Rajnish Kumar*, cited that coal block cancellations were one of the fundamental reasons for the crisis is that the industry was facing.

Many economists were of the opinion that this judgement passed by the court did not in any way penalize the government; however, it did put the industries, the companies and other sectors in the economy into huge problems. This judgement essentially created a ripple effect, where when one sector took a hit, such as the power sector, another interlinked sector would also be paying for it, like the banking sector.

As a by-product of this economic slowdown, there were certain smaller players in the economy who would even be eliminated. In the thermal power sector, the big or international players stopped coming in, and those who were in the industry made their exit very soon. When the *Economic Survey 2016-17*¹¹ was released, it highlighted that the non-performing assets in the coal industry had significantly risen, which showed how devastating the effect was. It was claimed that one of the fundamental reasons for this result was that “*the judgement passed by the court had put approximately 24,000 MW of captive coal-based thermal capacity under stress*”¹². In the subsequent years, the country faced lower coal imports, increasing pre-cancellation levels of the coal auctions, lower production from the reallocated coal blocks, etc.

In this way, it can be seen that the long-term effect of the judgement was very evident on the economy. Foreign investment in the coal industry dropped, million people, were left in the country without employment, coal mines were lying closed and not being utilized, world coal prices were soft enough, and imports became cheaper. This significantly contributed to the economic slowdown that the country faced.

CONCLUSION:

¹¹ *Economic Survey 2016-17*, Union Budget, Ministry of Defence, Government of India, <https://www.indiabudget.gov.in/budget2017-2018/survey.asp>

¹² Mate, M., 2015. The Rise of Judicial Governance in the Supreme Court of India. *BU Int'l LJ*, 33, p.169.

AN ALTERNATE RULING THAT COULD HAVE BEEN PASSED

The present case at hand should have been dealt with by the Supreme Court with more consistency, and they should have kept in mind the concerns of all the stakeholders involved. The court should have examined the merits of the case with much detail and predicted the implications of its decisions. The court must have considered the economic situation of the nation at the time when the decision was being passed. The country was on the brink of getting into an economic slowdown, and the coal industry was one of the highest revenue-generating industries in our nation.

The Supreme Court did a good job in identifying that the *procedure established by law* was not followed by the Screening Committee and the Central Government in the process of allocation of the coal blocks. However, the right way to solve this would have been solving the loopholes in the legislation, making the law and its implementation much stricter, penalizing the government and the Screening Committee for violating the law, and acting in equity, justice and a good conscience and as per the *Principle of Laches*. Instead of making the corporate industries, companies and other interlinked sectors suffer the damage, the penalty and its effect should have been limited up to the government only. Even if the government had to necessarily cancel the allocation of the coal blocks, then it had to set up a new committee or a system whereby the coal blocks would be reallocated efficiently, based on thorough examination and analysis, and in a fair way; and further ensure that the productive capacity of these coal blocks wasn't deterred. This way, the economic crisis that the judgement brought about could have been avoided; and the importance of following the procedure established by law could be illustrated.

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