

The Children's  
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Shri S. Kumar  
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Dr. R. Trivedi  
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Smt. S. Bhide  
Shri K. Gupta  
Shri D. Garg  
Shri A. Singh  
Shri P. Bhatnagar

Coal India Limited  
10 Netaji Subhas Road, Kolkata  
West Bengal 700001, India

March 12<sup>th</sup>, 2012

Dear Board Members,

As you are aware, the Children's Investment Fund (TCI) is the largest shareholder in Coal India Limited (CIL) after the Government of India. We have owned shares in CIL since the IPO. We have already written numerous letters and made several presentations to the relevant ministries and to the Board of CIL, which you can find on the website [www.coal4india.com](http://www.coal4india.com).

We again write this letter to you to address several of our concerns emanating from the way in which the affairs of CIL are being conducted, in detriment to public interest as well as interest of its stakeholders and shareholders.

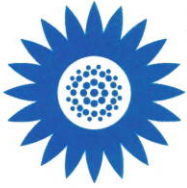
### **Government's interference on pricing**

There is sufficient evidence to show that the Board of Directors of CIL are not acting independently of the Indian Government on several matters including coal pricing. We have

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obtained a letter under the Right to Information Act, 2005 (RTI) addressed by Mr. Alok Perti, Secretary, Ministry of Coal, to Mr. N.C. Jha, former Chairman, CIL.

In his letter, Mr. Perti directed CIL to revise down the then effective price notification dated 31.12.2011 for various calorific bands and also set a deadline for the revision of 31.01.2012 (*see letter attached*). It is clear that the subsequent notification issued by CIL on 31.01.2012, revising the coal price was an immediate result of the directions of the Central Government (contained in Mr. Perti's letter and other similar such instructions that CIL may have received from the Government formally or informally).

As a result, the prices charged by CIL were not raised and remain 70% below landed international levels for FSA contracts. It need not be stated that under the Colliery Control Order, 2000 - coal pricing have been deregulated - and the power of the Central Government is merely to regulate supply and not to regulate coal price. We invite your attention to the judgment of the Indian Supreme Court in the matter of Ashoka Smokeless Coal India (P) Ltd. v. Union of India reported at (2007) 2 SCC 640 where the Supreme Court has taken strong exception to the Central Governments' interference in coal pricing. The court noted:

The coal companies evolve price fixation but admittedly, they have been doing so at the instance of the Central Government. The Central Government seeks to exercise its statutory power. Such a power, however, is confined to four corners of the 2000 Order. When there is no control over the price, the Central Government is forbidden to issue any direction that will have an impact thereover.

The Indian Government is one amongst several shareholders and has no legal right to directly instruct the Board in this manner. There was no push back at all from CIL's Board to the instructions from the MoC. In fact, they simply implemented the Government's instructions without any debate, question or challenge, in breach of their fiduciary duty. It is unacceptable that the Board is acting in this manner and not protecting minority shareholders who have invested in good faith in the company and who expect the Board to abide by the law.

#### **Acquiescence to interference by the Prime Minister's Office (PMO)**

We also refer to the recent action of the PMO to direct CIL to sign Fuel Supply Agreements (FSAs) with power projects with the condition that CIL would have to supply at least 80% of the contracted quantity (even if CIL has to import coal) failing which, it would be penalised. It appears that whilst earlier CIL had refused to sign contracts with more than a 50% trigger level, such decision was taken at the February 1<sup>st</sup> meeting of the PM's panel of Secretaries set up to address power sector woes. Clearly, this has been done at the behest of power companies—at the sole cost of CIL. At the time of the IPO, we met with Mr. P. Bhattacharyya, the then CMD. He stated that CIL would not sign any additional FSA's because there was such excessive

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demand for its coal that there was no commercial advantage for CIL to sign FSA's. Moreover, the Coal Ministry, has effectively directed the company to cap the quantity of e-auction coal they sell – again penalising the commercial interests of CIL illegally.

### **Breach of fiduciary duty - pricing**

It cannot be doubted that the Board of CIL has an independent fiduciary duty and have to observe utmost good faith towards CIL and its stakeholders. But it is increasingly clear that the Board of CIL is acting against the interests of the company and all its stakeholders. The Board appears to believe that its only duty lies in accepting the instructions of the Government at the detriment of its stakeholders' and shareholders' interests.

We need to point out that these instructions are not in the public interest because CIL earns less profit for the Government of India and hence the value of its stake in CIL declines as well.

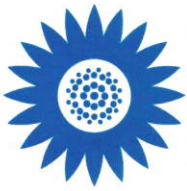
Private power producers generate greater profits at the expense of the people of India. Instead, CIL should be making these profits and the Government of India would receive these dividends to use as it sees fit for the benefit of the country. Coal is sold to power companies at a 70% discount to international market prices despite the fact that coal prices have been deregulated since 2000.

In May 2011, Deputy Chairman of the Planning Commission, Mr. Montek Ahluwalia wrote, "Coal is not under price control, but the nationalised coal companies have set domestic coal prices well below world prices, even after adjusting for the lower quality of Indian coal. The discrepancy between domestic coal prices and much higher import prices leads to an unwillingness on the part of power producers to import coal and keep lobbying for domestic coal linkages. This problem would not arise if domestic coal prices are equated with import prices."

A blind acceptance of the unreasonable and unlawful directions of the Government, and that too, within a period of one month of revision of coal prices in December 2012, is a clear instance of breach of fiduciary duties that the Board owes to CIL.

### **Other breaches of fiduciary duty**

There are multiple other examples in the past where the Board failed to protect minority shareholder interests. Last year, there was no opposition from the Board against the draft mining bill prior to the Cabinet approval. The draft mining bill is highly detrimental to coal mining companies as it proposes to increase coal mining taxes effectively by 39%, hence discriminating CIL against other Indian mining companies. Another example is the dramatic lack of progress in



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the implementation of coal washeries, which was acknowledged by the former CMD Mr. Jha after he retired.

Additionally, a large portion of output appears to disappear in the supply chain and system. Major theft of coal is especially acute at the Rajmahal project of ECL, CCL and some of the coking coal mines of BCCL.

By failing to raise coal prices as desired by the National Planning Commission, over 200,000 jobs in the underground coal mines are jeopardized because these mines are loss making due to high costs and they are forced to sell coal at significant discounts to international market prices.

Furthermore, the environment is being severely damaged by the misallocation of resources resulting from mispriced coal and the lack of systematic coal washing.

In addition, the company should be paying a significant dividend given that it continues to hold over \$10 bn of excess cash whilst generating a large amount of ongoing cash flow. In this case, we believe the Government of India is in alignment with shareholders in seeking a substantial dividend and or share buyback but there is still excess cash continuing to build in the company with no resolution of this point.

One final issue is that the company is being directed by the Government of India to make value destructive acquisitions overseas with no clear benefit to CIL. CIL has enormous domestic reserves and it makes no economic sense for it to be buying expensive overseas reserves.

### **The 2G Judgment: use of natural resources**

It is relevant to point out that various politicians, bureaucrats and corporate executives have been accused and taken into custody for their involvement in the 2G spectrum corruption scandal that deprived the Government of proceeds that would arise from a fair, transparent and competitive allocation of natural resources. There is a real danger for the Board of CIL that CIL's failure to raise coal prices to the power sector will be seen in the same light resulting in significant legal risk to the Board.

The Indian Supreme Court has emphasised that, "natural resources are vested with the Government as a matter of trust in the name of the people of India, thus it is the solemn duty of the State to protect the national interest and natural resources must always be used in the interests of the country and not private interests". Indeed, this also applies to CIL but we believe that it has been violated by the Board of CIL.

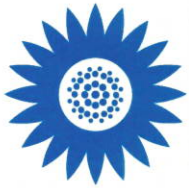
The court has also emphasised that, "State owned or public-owned property is not to be dealt with at the absolute discretion of the executive. Certain precepts and principles have to be observed. Public interest is the paramount consideration. One of the methods of securing the

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public interest... is to sell the property by public auction or buy inviting tenders... there may be situations where there are compelling reasons necessitating departure from the rule but then the reasons for the departure must be rational and should not be suggestive of discrimination". These are the principles that the Board ought to follow.

### **Fair and appropriate treatment of investments**

At all times leading up to and since the initial investment, TCI acted with care and scrutiny, and in full compliance with all regulatory requirements. TCI then made an investment in CIL for which it is entitled to receive full protection of India under the laws of India as well as the international investment agreements to which India is a party.

A foreign investor such as TCI who has invested substantial sums in accordance with the regulatory mechanisms is entitled to hold and retain that investment free from any damage that it might suffer on account of the CIL Board not acting in its fiduciary duty and acting purely at the behest of the State. TCI is entitled to fair treatment as a substantial foreign investor, and is entitled to the full protection of its rights under the Indian laws and is also likewise entitled to full protection, fair and equitable treatment in accordance with the international laws and international investment agreements that bind India.

By not taking into account its fiduciary duties, the CIL Board apart from harming public interest and the interests of the company, has treated, and continues to treat, the investments made by TCI in an unfair and an inappropriate manner resulting in tens of billions of rupees of value destruction for shareholders.

### **Legal action**

We are strongly considering taking legal action against CIL's individual Board Members for breach of fiduciary duties if no clear commitments are made public in the immediate future to provide parity of coal prices to import prices and rectifying the other breaches of fiduciary duties which we have outlined in this letter;

- underpricing of FSA coal to market levels
- acquiescence of the mining bill
- slow implementation of the washeries
- lack of action on prevalent theft of coal
- tolerance of inefficiencies in underground mines
- underdelivery of coal production targets despite abundant reserves

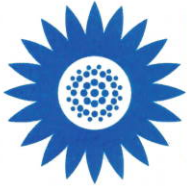
We urge you to address the above breaches and make a public commitment to align CIL's coal prices to market prices in a clear timetable and act immediately as an independent Board in all matters.

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Finally, we have been asking for over one year now to make a presentation to the full Board about the problems and opportunities in the operations and governance of the company. This has never been accepted and we would like to request this again with a urgency.

Contrary to the reputation India seeks to gain in the global marketplace as a fair ground for foreign investors, we find the actions of CIL and its individual Board Members to be reckless and lacking integrity; we will hold each Member personally liable. We will not be complacent in aligning our respective interests. We look forward to your prompt response on all of the points raised in this letter.

Yours sincerely,

Oscar Veldhuijzen  
Partner

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