

The Goa Foundation

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To:
The Chief Secretary,
Secretariat,
Porvorim, Goa

Sub: Recoveries of amounts from sale of iron ore from mining leases found operating without a valid lease from November 2007 till September 2012

Dear Sir,

In its judgement dated 21.4.2014 in Writ Petition No.435/2012, the Supreme Court has held that mining lessees in Goa illegally operated their mines from the period November 21,2007 till September 10, 2012.

Mining cannot be carried out in the absence of a valid mining lease. Under the provisions of the MMDR Act and MCR rules, Government must commence the process of recovery of the amounts that have accrued to the mining lease holders through illegal mining operations during the period specified above.

I am including a note which indicates that the amount due for recovery is in the region of approximately Rs.25,149 crores. With 12% interest burden, this amounts to Rs.35,780 crores.

We are ready to assist with any further action needed in this context, including providing any additional clarifications your office may require.

Yours sincerely,



Dr. Claude Alvares
Director

Encl: Note on recovery (with table)

Note submitted by the Goa Foundation to the Chief Secretary, Goa Government, on 28.4.2014.

How much is recoverable from miners ?

Who owns the iron ore which is found in Goa?

Mineral resources are the property of the people of the State. Under Article 294 of the Constitution, mineral resources are owned by the States. This position is consistent with The Goa, Daman and Diu Land Revenue Code, 1968 as well as the Portuguese Colonial Mining Laws, 1906. In simple language, the people of Goa own the mineral resources, including iron ore, manganese ore and bauxite. The Government is only the public trustee over these resources on behalf of the people. As Public Trustee of the ore, the Government needs to ensure that the *maximum amount of the value of the mineral should be captured by the State* through whatever legal and contractual structures it may choose.

Overview of the illegalities

There are a number of illegalities that have been found which the State and others need to investigate and prosecute. Here's a couple of important ones:

Leases being illegal

1. The Supreme Court has found that deemed extension of leases for mining post 21-Nov-2007 is illegal. This applies to almost all mines in Goa. This implies that around 5 years of mining activity and ore extraction was illegal – as no mining can be carried out without a valid lease.
2. There are some 42 condonation cases that the Shah Commission and PAC pointed out as illegal. The Goa Government has already declared that it is prosecuting these cases. To the extent that these are found illegal, the mining activity and extraction will be illegal from the day of condonation. Newspaper reports of Oct 5, 2013 reported that a lease of Ajit Kadnekar was cancelled on such grounds and that Rs. 180 crores was being raised as a demand by the government against the lease holder. The basis of the claim needs to be determined.

Compensation to the value of the property taken is required. There is also criminal liability. The miners want to convert “illegal to proper” by paying a penalty. The penalty would ideally be the royalty value, on the basis that this is

what the state would have earned from legal mining.¹ However, the mood in the State among the general public is different: there is large-scale demand for recovery of illegally earned money and for punitive action to be taken under the criminal laws against the persons responsible for this state of affairs. The people of Goa want rich thieves to be treated like any other thief – full compensation, jail term. Parrikar is proposing a penalty to legalize or regularize the illegal.

Valuing the Mineral Resource Extracted Illegally

Technically, the value of the mineral resource (or “rent”) is the difference between the price paid in the market for the ore versus the total cost of producing it (including a proper return on capital). Let’s think about gold for a minute. Say that we can sell 24-carat gold for Rs. 33,000 per 10 grams. Now, it would be foolish to suggest that gold ore underground is also worth Rs. 33,000 per equivalent 10 grams because it costs a lot of money to transform gold ore into gold. The owner of the gold ore can use competitive bidding to hire a contractor to extract the ore, refine it into gold, deal with the waste and sell the gold in the market. Assume that the winning contractor charges Rs. 2,000 per 10 grams of gold for all these services. The value of the gold ore underground is therefore Rs. 31,000 per 10 grams (that can be extracted at Rs. 2,000 per 10 grams). This value of the ore is essentially the international market price of the gold minus the fair cost of extracting and process the ore to make the gold. In economic terms, this is called the “Economic Rent” or “Depletion Cost” or “Mineral Depletion.”² The Economic Rent changes as the mineral price fluctuates on global markets and as mining technology improves.

How could we calculate the value?

If we are trying to calculate the value of the iron ore in an illegal mining scenario, we need to subtract the costs of the contractor from the international price to arrive at the value of the iron ore. A mining company essentially performs the same tasks as a raising contractor. Therefore, it should earn enough to cover all its costs & taxes, plus a reasonable return on the capital it has invested. This ensures that all costs are covered. Any profit over and

¹ This argument is incorrect as the state had to follow the public trusteeship principle at the time of renewal also. Therefore, it should have auctioned off the lease, instead of renewing it.

² The CAG (The Comptroller and Auditor General of India) used a similar methodology in its calculation of “windfall gain” in the ongoing coal block allocation investigation. See https://en.wikipedia.org/wiki/Indian_coal_mining_controversy#Second_CAG_charge:_22windfall_gain_s.22_to_the_allocatees_were_1067303_crore_.28US.24160.C2.A0billion.29

above the reasonable return on capital would be “unearned profit” and represents the value of the iron ore.

Sesa Goa (now Sesa Sterlite) is the only public company engaged in mining in Goa. However, it is by far the largest producer and exporter of iron ore from Goa (30% by volume), so it is representative. We have used the official accounting data for the iron ore segment for Sesa Goa. An overwhelming majority (74% by volume) of Sesa’s mining operations were in Goa. Further, since it is well integrated, we can get an understanding of the complete cost structure right through exports. Taking the Sesa Goa figures as the base for our calculations, we have scaled up the data for Goan exports as a whole. Figures for Goan exports are taken from the Annual Selected Statistics of GMOEA. We were able to use GMOEA data only upto 2011-12.

As we are calculating this value in the context of illegal mining, we have set the reasonable rate of return to zero. Therefore, any profits after tax (as relates to Goan iron ore) are unearned income, and are the value that needs to be recovered. By simple extension, we can take the figure for segment earnings before Interest and Tax (EBIT) and multiply that by the Sesa effective tax rate to get the proportionate income tax. Finally, we can arrive at the segment PAT by subtracting the proportional income tax from EBIT.

The Results

The results that are laid out in the table annexed below (on separate page) do not consider (a) the values for 2012-13 (mining was banned in September 2012), (b) penalties that would be leviable, (c) compensation for the depletion in water filtration and storage or the damage to the environment, and (d) interest on the above. If we examine the position including these assets, the demand for recovery would increase.

NOTE: All the data is for the period 2004-05 till 2011-12. Only for the calculation of Recoverable Amount and interest have we taken figures from Dec-2007 onwards.

What should be done?

The State should focus some attention on quick recovery of this amount. The following steps should be considered :

1. In order to recover money arising on account of illegalities, a separate organization with an investigative & prosecution arm may be needed. Since

the amount recoverable is large, costs of setting up such a team would be more than adequately justified.

2. None of the parties involved in illegal mining should be allowed to dispose of their assets or create any further encumbrances on properties.
3. Consideration should be given to creation of an effective Whistleblower Protection Act and mechanism and to legally give rewards for information leading to recovery of money. This kind of scheme has been successfully used around the world. The reward is set at 10% for the US IRS.
4. Setting up a fast track or special court to speedily dispose of these cases.

Annex 1

	Units	2007-08	2008-09	2009-10	2010-11	2011-12	Total	Remarks / Sources
Sesa iron ore sales	Mn Tons	6.2	15.1	21.4	18.1	16.0	76.8	Sesa Goa annual accounts
Sesa iron ore sales	Rs. Cr	1,645	4,308	5,241	8,594	7,516	27,304	Sesa Goa annual accounts
Sesa iron ore EBIT	Rs. Cr	1,022	2,171	2,869	4,819	3,246	14,128	Sesa Goa annual accounts
Sesa effective tax rate	%	33%	26%	23%	24%	34%	25%	Sesa Goa annual accounts
Sesa iron ore income tax (est.)	Rs. Cr	341	573	671	1,159	1,105	3,849	Multiplying EBIT by the effective tax rate
Sesa iron ore Profit After Tax (PAT)	Rs. Cr	681	1,598	2,198	3,660	2,141	10,278	EBIT - income tax (est.)
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Sesa goan iron ore sales	Mn Tons	4.5	10.1	15.6	14.3	13.3	57.8	Sesa Goa annual accounts
Sesa goan iron ore to total iron ore	%	73%	67%	73%	79%	83%	75%	
Sesa goan iron ore PAT	Rs. Cr	494	1,069	1,598	2,892	1,780	7,833	PAT x (ratio of goan iron ore to total iron ore)
Earned profit (0% RoNA)	Rs. Cr	-	-	-	-	-	-	Illegal mining. No profit from illegalities
Sesa goan iron ore recoverable amt	Rs. Cr	494	1,069	1,598	2,892	1,780	7,833	After 20-Nov-2007 to be recovered from Sesa Goa
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Goan iron ore exports	Mn Tons	16.7	38.1	45.7	46.8	38.3	185.6	GMOEA Special Statistics
Sesa goan iron ore sales	Mn Tons	4.5	10.1	15.6	14.3	13.3	57.8	Sesa Goa annual accounts
Sesa as % of Goa	%	27%	27%	34%	31%	35%	31%	Sesa sales a significant part of Goa exports
Goa exports / Sesa sales		3.72	3.77	2.93	3.28	2.88	3.21	Scaling factor
Goan iron ore recoverable amount	Rs. Cr	1,838	4,029	4,690	9,473	5,120	25,149	After 20-Nov-2007 to be recovered
Recxoverable amount per ton	Rs. / MT	1,099	1,058	1,027	2,022	1,338	1,355	
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Goan iron ore recoverable amount	Rs. Cr	1,838	4,029	4,690	9,473	5,120	25,149	All of 2012-13 needs to be added. Penalties and interest needs to be added. Compensation for environmental damage needs to be added.
Years until 31-Mar-2014		6	5	4	3	2		
Interest @ 12% till Mar 31, 2014	Rs. Cr	1,323	2,417	2,251	3,410	1,229	10,631	Total interest due
Recoverable amount incl. Interest	Rs. Cr	3,161	6,446	6,941	12,883	6,349	35,780	Value of ore + interest
Recoverable amount per person	Rs.						245,450	

Note : Values for 2007-08 are for four months of illegal mining extraction out of an eight month season