Chapter – 4
Sale of Iron Ore

This chapter deals with the issues relating to price fixation and sales.

NMDC exports iron ore by entering into long term agreements (LTA) with Japanese Steel Mills (JSM). The prices received by NMDC were in line with the prices paid to Australian and Brazilian exporters by Japanese Steel Mills.

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The LTA prices of exports formed the basis for determining the domestic prices for the LTA with domestic customers.

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95 *per cent* of NMDC's sales came from LTA and rest were spot sales during 2005-12. Sales to domestic customers through LTA accounted for 84 *per cent* of its sales.

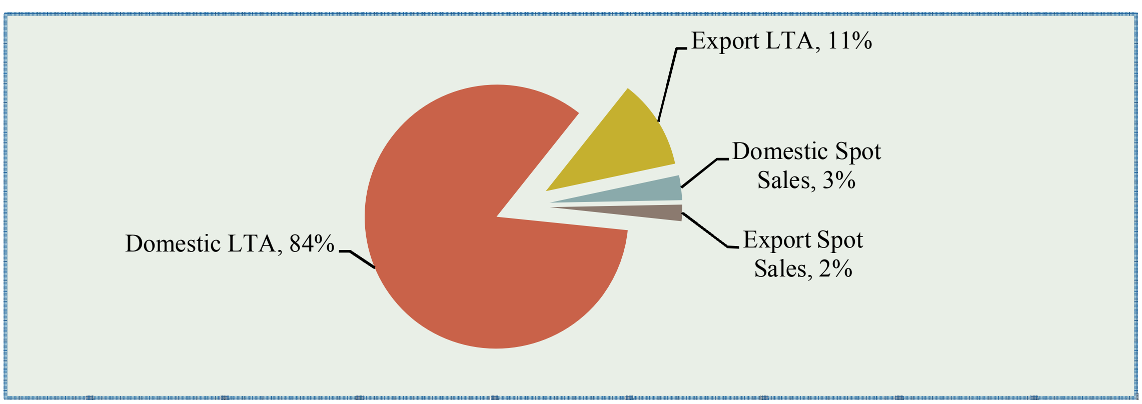
Overview

4.1 The Company enters into Long Term Agreements (LTA) for a period of five years with customers for sale of iron ore in the domestic as well as export market which, inter-alia, provide for minimum and maximum quantities to be supplied/ lifted by the Company/ customers. During 2005-12, NMDC contributed 13 *per cent* of the Country's iron ore production and met 26 *per cent* of the domestic iron ore demand in the Country. During FY 2011-12, it contributed 16 *per cent* of the Country's iron ore production and met 23 *per cent* of domestic demand. NMDC plays a vital role in the domestic iron ore market by catering mainly to the enterprises with non-captive mines such as Rashtriya Ispat Nigam Limited, JSW Steels Limited, JSW Ispat Limited, ESSAR Steels Limited etc. The Company had 27 iron ore customers apart from 65 sponge iron companies as of March 2012. In addition, the Company also sells iron ore in spot market. The table below indicates the sales volume and value during the last seven years ending March 2012.

Table 9: Table indicating Sales in MT and Value for seven years ended March 2012

Particulars	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Sales in million tonnes (MT)	24.80	25.59	28.18	26.47	24.09[11]	26.32	27.30
Sales (₹ in crore)	3669.47	4170.92	5705.32	7559.11	6222.60	11285.33	11167.56

Chart 2: Proportion of Domestic, Export and Spot Sales to Total Sales during 2005-12



[11] *The decrease in sales was mainly due to breakdown of slurry pipeline of ESSAR.*

Pricing mechanism

4.2 During 2005-12, the Company sold 95 *per cent* iron ore through LTA with the customers and the balance 5 *per cent* in the spot market. Japanese Steel Mills (JSM) negotiate iron ore prices with the major producers of Brazil and Australia. The Company's export prices were fixed in line with these benchmark prices.

4.3 So far as domestic LTA prices are concerned, the Company followed the Ganeshan Committee's[12] recommendations containing the methodology for fixation of domestic prices including mid-term revision for all the products, i.e., Lump, Calibrated Lump and Fines.

4.4 The salient features of the recommendations of the Committee are:

- There would be two categories of customers: (a) long term customers and (b) spot customers.
- The prices for the first year in the domestic market be fixed based on Net Sales Realization (NSR) from exports and thereafter, the base prices of iron ore for the domestic market be fixed effective from 1 April of every year based upon the percentage of increase / decrease accepted over the previous year's price by Japanese Steel Mills (JSM) for the ore supplied by the Company (suitably adjusted to dollar – rupee parity).
- The seller would reserve the right to review the prices on mid-term basis in unprecedented upward price (25 *per cent* and above) in the market scenario.
- For spot market and other customers, the Company may adopt competitive bidding/ e-auction.

Audit findings

Domestic LTA sales

4.5 Audit analyzed the following issues relating to domestic LTA sales:

- Price fixation during five years from 2005-06 to 2009-10 following Ganeshan Committee report;
- Price fixation during 2010-11; and
- Price fixation during 2011-12.

Price fixation in domestic market during 2005-10

4.6 The Company entered into long term contracts in August 2005 based on the recommendations of Ganeshan Committee for supplies to customers effective for a period of

[12] Ganeshan Committee was formed in March 2005 by Ministry of Steel to recommend a practicable formula to link price of domestic iron ore with prevailing international prices. The Committee gave its recommendations in April 2005 which were accepted by the Ministry in July 2005.

five years from 2005-06 and valid up to 2009-10 except in respect of one contract for supply of fines to ESSAR which is valid up to 2015.

4.7 The prices fixed for 2005-06 and subsequent years were based on the principle recommended by the Committee that net sales realization from exports to Japan be adopted as the basic price in the first instance, i.e., year 2005-06. The table below shows how the domestic prices were fixed on the basis of the prices offered by Japanese Steel Mills.

Table 10: Table indicating the basis for arriving at price as of 1 April 2005

Sr.	Particulars	BL*	BF*	DR CLO*	DL*	DF*
1	Price in US$/DLT[13] for Fe 65% as given by JSMs	50.44	39.13	50.44	48.74	39.13
2	Price in US$/ WMT[14] for Fe 65%	48.25	36.64	48.25	46.79	35.84
3	Bonus/ Penalty[15]	1.19	-0.56	4.76	0	-0.55
4	Price in US$/WMT including Sl. No. 3	49.44	36.08	53.01	46.79	35.29
5	Net FOB per WMT in ₹ (1 US$= ₹ 44.16)	2183	1593	2341	2066	1558
6	Less: Expenses (Freight, Port Charges, Royalty and Export Duty) in ₹	674	666	674	643	635
7	Net Sales Realization (₹ per WMT)	1509	927	1667	1423	923
8	Domestic Price (₹ per WMT)	1510	925	2000[16]	1450	925

* - BL: Baila Lump; BF: Baila Fines; DR CLO: Direct Reduction Calibrated Lump Ore; DL: Doni Lump; DF: Doni Fines.

4.8 The prices for the subsequent years were fixed considering the percentage increase negotiated with JSM on the initial price as above. The prices were also suitably adjusted for dollar-rupee parity.

Infirmities in the contracts pertaining to domestic LTA

4.9 In the international LTA, the prices were determined once a year and remained firm for the year. The Ganeshan Committee however recommended that for domestic LTA sales, the seller (the Company) should reserve the right to review the prices on mid-term basis in unprecedented upward price (25 *per cent* and above) in the market scenario. Accordingly, the Company in its domestic LTA provided, vide clause 4(B)(e), that seller reserved the right to review the prices on **mid-term basis** in an unprecedented variation in price of 25 *per cent* and above in the market scenario. The clause led to ambiguity as:

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[13] *DLT refers to Dry Long Ton. All export agreements are entered into in terms of DLT only. One DLT is 1.016 Dry Metric Ton.*

[14] *WMT refers to Wet Metric Ton. Price per WMT = {Price per DLT * (100 - moisture percent) /100}. All domestic supplies are made in WMT.*

[15] *For Baila Fines and Doni Fines, the bonus was shown as negative as the domestic supply of Fines contains only 64.5 Fe whereas the international contracts provide the minimum Fe content of 65 percent.*

[16] *DR CLO contains higher Fe of 67 percent. Therefore, it commands premium. Hence, higher price was fixed.*

- **The term 'mid-term' was not defined in the contract and thus, the issue as to when the price revision would be effected lacked clarity. The Company revised the prices only once during each year ; and**
- **The LTA also did not specify as to by what percentage the price should be increased in the event of unprecedented upward variation of 25 *per cent* and above in price.**

4.10 Due to lack of clarity in the contract, the Company revised the prices by less percentage than the actual percentage increase in the spot market. The Company also did not revise the prices as and when the prices went up in the market. As a result of this the Company suffered a loss of revenue of ₹ 1,173.68 crore in 2007-08 and 2009-10 offset by a modest gain of ₹ 427.74 crore in 2008-09.

Price revision during FY 2007-08

4.11 The average monthly price in the spot market in August 2007 increased by 33 *per cent* over the base price of April 2007. The spot prices further increased by 62 *per cent* over the base price in September 2007. By December 2007, the prices were 95 *per cent* higher than the base price. However, the Company revised the prices only from October 2007 and that too by 47.5[17] *per cent* only. Though the Management approached (February 2008) the Board for increase in prices, the Board did not agree for the price increase on the ground that frequent revision of prices may not be compatible with the concept of LTA.

4.12 **The total loss of revenue suffered by the company during 2007-08 amounted to ₹ 976.17 crore.**

Price revision during FY 2008-09

4.13 Contrasting the position in 2007-08, in 2008-09 the international prices had decreased by 32 *per cent* in October 2008 and 43 *per cent* in November 2008 over the base price of April 2008. The Company reduced (December 2008) its domestic LTA price by a flat 25 *per cent* (over April 2008 rate) with effect from 1 December 2008. Even after a reduction in prices by 25 *per cent*, the domestic price[18] of ore (BF: ₹ 1519/ tonne) still remained substantially lower than the price[19] (BF: ₹ 3413/ tonne) charged to overseas LTA customers.

[17] *Average price increase for the months August 2007 (33 per cent) and September 2007 (62 per cent) came to 47.50%. This 47.50% was applied to the long term base price of BF/ DF to arrive at the quantum of increase (₹ 574/ tonne). This increase (₹ 574/ tonne) was added to the long term base price of all products to arrive at the revised price.*

[18] *Price includes Royalty charged at the rate of ₹ 19 per tonne.*

[19] *Net FOB price in ₹/ WMT considering 1 US$ = ₹ 40.08.*

Price revision during FY 2009-10

As per LTA, NMDC reserved the right to review the prices on mid-term basis in an unprecedented variation in price of 25 *per cent* and above in the market scenario. The LTA were silent about the specific methodology for revision in prices relating to when to effect the price revision and by how much. We noticed revision of prices on the lower side by NMDC leading to a loss of revenue of ₹ 1173.68 crore during 2007-08 & 2009-10 and gain of ₹ 427.74 crore during 2008-09.

4.14 During the year 2009-10, the prices of iron ore fines in the spot market increased by 28 *per cent* by December 2009 over the base price of April 2009. Despite this, the Company revised the prices by 16 *per cent* only with effect from 1 January 2010. Consequently, the Company suffered a loss of revenue including bonus of ₹ 197.51 crore[20] on the total quantity of 6.11 MT of iron ore sold from January 2010 to March 2010. The Management approached (January 2010) the Board for increase in prices by ₹ 270 per tonne (16 *per cent* only) on the plea that the market may not be able to absorb the full increase and the Board agreed for the same.

4.15 Though NMDC has not increased its prices fully on the ground that the market may not be able to absorb full increase, the fact is that, the Company has no control over prices charged by the steel producers to the end users as indicated below.

Table 11: Table indicating the prices charged for steel (Delhi market) during 2009-10

(₹ per tonne)

Sr.	Item	April 2009	January 2010	March 2010
1.	TMT 12 mm	33,041	33,620	34,200
2.	HR Coils 2.50 mm	33,608	34,270	34,660
3.	GP Sheets 0.63 mm	39,328	44,480	44,270

Source: Joint Plant Committee, Ministry of Steel

4.16 The Ministry's reply to the above observations of Audit on pricing during 2005-10 and Audit contentions are given below:

[20] *The loss has been worked out considering the increase in spot prices by 26% (average of percentage variation in spot prices from July 2009 to December 2009).*

Table 12: Table indicating the Ministry reply and remarks of Audit

Gist of Ministry reply	**Remarks of Audit**
Ganeshan Committee mentioned about 'mutual discussion' to arrive at price in falling market and had left applicability of this clause on the wisdom of NMDC Board to take care of cyclical nature of iron and steel industry and totality of circumstances. The Board was consciously and specifically vested with the power to judiciously invoke and implement the 'mid-term review' provision as warranted by the prevailing market condition in totality. The quantum and periodicity of applicability of 'mid-term' price revision was left to the wisdom of NMDC Board by the Ganeshan Committee.	Ganeshan Committee regarded that the phenomenon of 25 *per cent* upward variation above the base price at the beginning of the year unprecedented and stated that this may happen due to volatility in spot market and/ or abnormal fluctuation in dollar rupee conversion rate. The intention of the Committee behind 'mid-term' revision was to ensure revision in prices in the event of unprecedented increase. It was up to the Company and its Board to ensure that there was no ambiguity in the terms and conditions of the contract and the terms should be so clear as to enable the Board to revise the prices immediately and by the percentage by which the spot prices have increased. But no such clarity was ensured. The issue here is about the clarity of terms and conditions in the contract.
Incorporating sacrosanct and rigid provisions with respect to frequent periodical revision in prices to long term customers based on spot market vacillations would have deterred the customers from entering into long term agreement with NMDC as the advantage of predictability in prices would have been lost.	The Ganeshan Committee wanted to ensure revision in prices only in the event of unprecedented increase of 25 *per cent* and above. This provision cannot be termed as sacrosanct or rigid as it provides enormous protection to the buyers. Rather this provision, in a good measure, acts in favor of customers who are not required to pay higher price up to 24.99 *per cent* increase in spot price.
'Mid-term review' as the phrase connotes, would ordinarily mean in commercial parlance to review after six months after commencement of the financial year in a yearly calendar and could be invoked only once thereafter.	The contention of the Ministry should be considered in the light of the fact that the term 'mid-term' in the broader sense means between the two points and allows price revision during the currency of LTA for the year, should there be an unprecedented increase or decrease in price in the market. Even this provision allows price stability up to a change of 24.99 *per cent*. Interpreting "mid term" as once a year has deprived the Company of substantial revenue in these years.
The customers could have resorted to legal recourse as there were differing legal opinions by advocates of repute on this provision.	The reply supports the audit contention that the terms and conditions were ambiguous (and hence the differing legal opinions).
As ordinarily meant and also concurred by Additional Solicitor General of India, 'mid-term' price revision necessitated revision of long term domestic prices after 30 September 2007, i.e., from 1 October 2007.	It is not that the Company has consistently revised the prices on 01 October every year. Prices have been revised on different dates in different years. Further, the Solicitor General had further stated that he was "of the opinion that the LTA does not restrict the number of times a mid term review can be carried out."

<table>
<tr>
<td>Based on the spot price variation witnessed in iron ore fines prices till September 2007 on umetal website, NMDC effected mid-term price revision by an absolute amount of ₹ 574/ tonne with effect from 1 October 2007 for fines ore as well as lump ore even though there was no transparent and reliable indicator to indicate whether there was any variation in iron ore lump prices.</td>
<td>The contention of the Ministry that the price revision was by an absolute amount of ₹ 574/ tonne and not 47.5 per cent is incorrect. As per the recommendations of Committee of Directors (CoD) comprising Director (Production), Director (Finance) and Director (Commercial), price revision with effect from 1 October 2007 would be based on average variation of August (33%) and September 2007 (62%). This average price variation (47.50%) was applied to the long term base price of BF/ DF (₹ 1209/ tonne) and rounded off to the nearest rupee to arrive at ₹ 574/ tonne. This quantum of increase in Rupee (₹ 574/ tonne) was added to the long term base price as on 1 April 2007 of all the products to arrive at revised long term base price.

Further, the Ministry's contention that there was no transparent indicator to know whether there was any variation in iron ore lump prices is not convincing. The Company is in the business of selling iron ore for decades and it knows that if the prices of fines go up, the prices of lump ore (which generally have higher Fe content) would also go up.</td>
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<td>Besides, NMDC's action of mid-term revision with effect from 1 October 2007 was highlighted as the cause for increasing of the steel prices by major steel producers during a meeting with Secretary (Steel) in February 2008. Any further increase of iron ore prices with effect from 1 January 2008 might have had an inflationary effect on steel prices besides defeating the essence of LTA and likely legal complication.</td>
<td>The Company increased the iron ore prices by 47.50 per cent with effect from October 2007 and declined to increase the prices with effect from January 2008 on the pretext that the increase will have an inflationary effect on steel prices. However, it can be seen from below that the increase in iron ore prices in October 2007 had an impact of increasing input cost by only ₹ 1,062 per tonne of steel produced in March 2008, whereas, the prices of steel increased by ₹ 10,350 per tonne of steel in March 2008 when compared to October 2007 prices.

Table indicating the prices charged for Rebars (12 mm) by RINL during 2007-08
<table>
<tr><th>Product (₹/ tonne)</th><th>April 2007</th><th>October 2007</th><th>March 2008</th></tr>
<tr><td>Iron ore price charged by NMDC (BF)</td><td>1,209</td><td>1,783</td><td>1,783</td></tr>
<tr><td>Cost of iron ore consumed per tonne of saleable steel produced (1.85 tonnes)</td><td>2,237</td><td>3,299</td><td>3,299</td></tr>
<tr><td>Increase over April prices</td><td></td><td>1,062</td><td>1,062</td></tr>
<tr><td>Rebars 12 mm</td><td rowspan="2"></td><td>30,900</td><td>41,250</td></tr>
<tr><td>Increase over October prices</td><td></td><td>10,350</td></tr>
</table>
Source: Price Circulars, RINL

Thus, the cost of iron ore as a percentage of sale price of steel was about 10 per cent or less and hence the increase in price of saleable steel attributed to increase in iron ore price is not fully justified.</td>
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By application of the power vested in the NMDC Board, the mid-term review provision could fetch an additional revenue of about ₹ 950 crore to the coffers of NMDC during the years 2007-08 & 2009-10.	Though the Board exercised its powers and the Company generated additional revenue, if it had exercised the revisions fully and timely, the Company could have generated further additional revenue of ₹ 745.94 crore during 2007-10.
Increasing the iron ore prices by a higher amount in FY 2009-10 would have adversely impacted the lifting of iron ore by customers and thereby NMDC's sales also would have reduced drastically.	NMDC had signed LTA with the domestic customers according to which, each customer was liable to take a minimum off-take of the product agreed as per the contract (Clause 2). As per Clause 20 of the contract, on failure of the customer to lift less than 90 *per cent* of the quantities agreed, the buyer ceases to be a long term customer. The buyers, thus, would have lifted the ore particularly when it still would have come very cheap even after 26 *per cent* increase (BF: ₹ 2130/ tonne including royalty) as compared to the price (BF: ₹ 2891/ tonne at exchange rate of ₹ 50.53 per US$) charged to overseas customers during 2009-10.
There were domestic indicators, viz., OMC lump prices, lump and fine price variation as reported by www.steelprices-india.com in the domestic market, which were showing less than 25 per cent variation in market scenario.	As per the domestic LTA, the price fixation for 2006-07 and beyond was based on base price *plus* increase/ decrease in export price and price adjustment for JSM on FOB basis for the relevant year. Hence, until the completion of domestic LTA, i.e., up to 2009-10, the price fixation was based on export LTA prices. As the initial prices were based on the net realization from JSM prices which resulted in keeping the prices for domestic buyers lower than that of the overseas buyers, the international spot prices should have been the basis.
Monthly variation in iron ore (Lump) prices in domestic market in case of Gandhamardan Lump of Orissa Mining Corporation showed reduction in prices by 2.3% in December 2009 when compared to April 2009 prices.	As per the recommendations of CoD of NMDC, the prices of lump ore in both Barbil and Gandhamardan Sector of Orissa Mining Corporation had increased by 10% in the month of December 2009 compared to their respective prices of April 2009 and that of fines increased by about 24-36%.

Price fixation during FY 2010-11

4.17 The currency of the domestic LTA ended on 31 March 2010 and hence was due for renewal by 1 April 2010. However, the overseas LTA were valid up to 2010-11. Therefore, for 2010-11, the Company fixed prices on the basis of increase/ decrease given by JSM. In the meantime, globally pricing structure for iron ore had undergone change to quarterly pricing from April 2010. The Company also decided (June 2010) to revise the pricing mechanism from annual pricing to quarterly pricing.

4.18 The pricing mechanism followed for fixation of price as of 1 April 2010 is indicated below:

Table 13: Table indicating the price fixation as of 1 April 2010

Sr.	Item	BL[21]	BF/ DF[22]	DL[23]
1.	Price in US$/ DLT for Fe 65%	139.39	122.80	134.70
2.	Moisture content in % (Wt. avg. of 2009-10 for Export Dispatches)	2.82	4.55	3.21
3.	Price in US$/DMT for Fe 65% (Sr. 1/ 1.016)	137.19	120.86	132.57
4.	Price in US$/ WMT (Sr. 3 * (100-Sr. 2/ 100)	133.32	115.36	128.31
5.	Fe bonus rate (US$/ DLT) for additional Fe Fe bonus rate (US$/ WMT) for additional/ less Fe	6.88 6.58	1.8893 1.77	2.0723 1.97
6.	Additional/ less Fe%	0.50	-1.00	0
7.	Bonus/Penalty (US$/ WMT) (Sr. 5 * 6)	3.29	-1.77	0
8.	WMT Price (US$/ WMT) (Sr. 4 + 7)	136.61	113.59	128.31
9.	**Net FOB per WMT in ₹ (1US$= ₹ 45.22)**	**6177.50**	**5136.54**	**5802.18**
10.	Less: Expenses (export rail freight, port charges, royalty and export duty) in ₹	1988.50	1897.54	2012.18
11.	**Netback (₹ per WMT) – Reference Price**	**4189.00**	**3239.00**	**3790.00**
12.	Less: 5% loyalty bonus on Reference Price	209.00	162.00	189.00
13.	Base Price	3980.00	3077.00	3601.00
14.	Less: 5% Price Volatility Discount on Base Price in view of glut in steel market	199.00	153.00	180.00
15.	**Net Base Price charged for Q1 of 2010-11**	**3781.00**	**2924.00**	**3421.00**

NMDC passed on undue benefit to the customers by allowing loyalty bonus of 5 *per cent* and further reduction of 5 *per cent* from base price for market conditions. This unwarranted price reduction resulted in loss of revenue of ₹ 600.83 crore to the Company during 2010-11.

4.19 The Company after reducing the prices using net back method allowed further discount of 5 *per cent* by way of loyalty bonus to arrive at the base price. A further reduction in prices by way of 5 *per cent* incentive in view of the glut in the steel market was given to the customers during the first two quarters of 2010-11. The extension of loyalty bonus and incentive to LTA customers was unwarranted as the international prices are based on negotiations which inherently include all such factors as loyalty and incentives. As such there was no case for extending the same to domestic customers particularly, when the prices charged to them were much lower than that charged to overseas customers (Sr. 9 & 11 in Table 13). This reduction in reference price by 5 *per cent* throughout the year and further reduction in base price by another 5 per cent during the first two quarters resulted in passing on benefit to the customers amounting to ₹ 600.83 crore during 2010-11.

[21] BL: Bailadila Lump
[22] BF/DF: Bailadila Fine/ Doni Fine
[23] Doni Fine

NMDC has switched over to quarterly pricing with an option to increase price by two-thirds of the increase in the international price by more than 5 *per cent* but in case of decline exceeding 5 *per cent*, the price is reduced fully. This disparity in pricing has caused NMDC a further loss of ₹ 227.34 crore during 2010-11.

4.20 The price fixed in the first quarter of 2010-11 was the base price which was further adjusted in the subsequent quarters based on the percentage changes in the JSM prices. The Board decided (June 2010) to increase the price by two-thirds of the increase in the international price if the latter increases by more than five *per cent* in the current quarter over the price of previous quarter. However, in case of decline in the international price by more than five *per cent*, the Board decided to decrease the price fully, instead of two-thirds. **Therefore, the disparity remained in 2010-11 as the Company did not treat increase or decrease in prices on equal footing.**

4.21 The first quarter price fixation was based on the percentage of increase the Company obtained from JSM. During second and third quarters, the prices increased by 22.16 and 5.91 *per cent* respectively over Q1 prices and for fourth quarter, they increased by 7.67 *per cent* over the prices of previous quarter. However, the Company effected price increase by two thirds instead of full increase leading to loss of revenue of ₹ 227.34 crore on a quantity of 15.30 MT sold in the last three quarters of 2010-11.

4.22 The Ministry's reply (July 2012) on the above audit observations and the Audit contentions are mentioned below:

Table 14: Table indicating the Ministry reply and remarks of Audit

Gist of the Ministry reply	**Remarks of Audit**
Q1 FY 2010-11 net back prices were derived from JSM export prices of Q1. NMDC Board, with a philosophy of 100 per cent customer retention, decided to offer a discount of 5 per cent to all long term customers for the entire year.	The LTA price for export to JSMs is fixed after negotiations between officials of Ministry of Steel, NMDC, MMTC and JSMs/ POSCO. The negotiated price is based on the price increase offered to Australian suppliers of ore. The price in US$/ DLT for 65% Fe as on 1 April 2011 was already the negotiated price and can be said to have element of discount. **Hence, in a scenario of low base price and increased freight/ export duty, allowing a further discount was not in the financial interest of the Company.**
Besides, considering glut in steel market, prevailing at that point of time, NMDC Board decided to offer another tranche of 5 per cent discount (price volatility discount) on the base price for Q1 and Q2 only which enticed the long term customers to sign the long term agreement and ensured continuous revenue stream for the Company.	The net back prices were already substantially lower than the prices charged to overseas customers due to high export duty and export rail freight. Thus, price volatility discount was not justified.

In a very volatile market of rising price trend, it is a general commercial practice not to pass on entire increase to the customers as it may impact the sales volume severely. Whereas in a falling market, if the prices do not go down with the prevailing market condition, then there may be hardly any buyer. With this philosophy, NMDC decided to increase its domestic prices by only 2/3rd of JSM export price increase and to pass on the entire benefit in case of reduction in prices. *Audit suggestion to remove the disparity between upward and downward price revisions has been noted by the Company and the Company has already implemented a new pricing policy from the year 2011-12, which does not have any such provision.*	The prices of domestic LTAs during 2005-09 were based on the percentage increase effected by the JSMs. Similarly, even during 2010-11, when the export prices offered to JSMs were increased by a certain percentage, the same percentage increase should have been effected on the price charged to the domestic LTA.

Price fixation during 2011-12

4.23 The overseas LTA expired on 31 March 2011. These were not renewed as of March 2012. Therefore, there was no JSM reference price to form base for determining the domestic price. The Board decided (May 2011) to fix prices on a quarterly basis on a net-back method (i.e., notional net realization from export after deducting expenses) taking into account the international prices as per Platts Index (65% Fe content) as benchmark prices and suitably adjusting them for dollar-rupee parity. The domestic prices for the first quarter of 2011-12 were arrived at after deducting the export railway freight, port charges, export duty and royalty as shown in the table below.

Table 15: Table indicating the basis for arriving at price as of 1 April 2011

Sr.	Particulars	BL	BF/ DF	DL
1.	Price in US$/DLT[24] for Fe 65%	201.32	177.37	195.45
2.	Moisture content in % (Wt. avg. Q1 of 2010-11 for Export Dispatches)	1.56	3.12	3.19
3.	Price in US$/DMT for Fe 65% (Sr. 1/ 1.016)	198.14	174.57	192.36
4.	Price in US$/ WMT (Sr. 3 * (100-Sr. 2/ 100)	195.05	169.12	186.22
5.	Fe bonus rate (US$/ DLT) for additional Fe Fe bonus rate (US$/ WMT) for additional/ less Fe	9.93 9.62	2.7288 2.60	3.0069 2.87
6.	Additional/ less Fe%	0.5	-1.0	0

[24] *DLT price is arrived at by taking the average FOB price in the preceding quarter using Platts Index (65% Fe).*

7.	Bonus/Penalty (US$/ WMT) (Sr. 5 * 6)	4.81	-2.60	0
8.	WMT Price (US$/ WMT) (Sr. 4 + 7)	199.86	166.52	186.22
9.	Net FOB per WMT in ₹ (1US$= ₹ 44.45*)	8883.78	7401.81	8277.48
10.	Less: Expenses (export rail freight, port charges, royalty and export duty) in ₹	4942.12	4537.94	4842.42
11.	Netback (₹ per WMT)	3941.66	2863.87	3435.06
12.	Domestic price to be fixed based on net back	3942	2864	3436
13.	Domestic Price (₹ per WMT) fixed for 1st quarter of 2011-12	4540 [after 15% premium]	2870	3960 [after 15% premium]

** INR 44.45/ US$ - 60 days forward cover as on 5 April 2011*

4.24 The above mentioned price fixation methodology was followed to fix the prices for the second quarter of 2011-12. In the 3rd quarter, the prices of fines were fixed based on the similar method followed for 1st and 2nd quarter. However, in case of Lump ore, the premium was decreased from 15 *per cent* to 10 *per cent* citing the prevailing economy and the market conditions.

4.25 During the fourth quarter, the Company followed the same methodology for fixation of price of fines based on netback method as was done during the first three quarters of 2011-12. However, in respect of Lump, the Board approved for finalization of price based on weighted average prices obtained by Orissa Mining Corporation (OMC) from its four operating mines.

Issues in price fixation

4.26 The foregoing discussion indicates that the Company's pricing policies did not adequately reflect the movement in international prices. The Company followed different methods for price fixation during this period (2005-2012). The larger issue is how the Company should fix the price so that its financial interests get protected. There are no issues so far as export LTA prices are concerned as those prices are based on the international benchmark prices offered by JSM to suppliers from Brazil and Australia. However, there are issues in the fixation of domestic prices as discussed below.

4.27 The Company has mainly followed the 'Net back' method and 'Domestic price parity' method (based on the prices obtained by OMC) to fix the prices of domestic iron ore at different points of time. It has not explored the e-auction route on a large scale[25] to sell its ore.

4.28 Under the 'Net back' method, the domestic price is fixed after reducing expenses such as export railway freight, port charges, royalty and export duty from the international price (LTA or Spot). This price, however, suppresses the domestic price due to high export related expenses as shown below.

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[25] *Between October 2011 and March 2012, 20 e-auctions were conducted and 2.79 MT (1.84 MT from Donimalai mine and 0.95 MT from Kumaraswamy mine) was sold.*

Table 16: Table below indicates the percentage of domestic price vis-à-vis export price for Baila Fines

BF Prices (₹/ WMT)	April' 05	April' 06	April' 07	April' 08	April' 09	April' 10	April' 11
Export FOB price	1,593	1,908	2,070	3,413	2,891	5,137	7,402
Less: Expenses	666					1898	4538
Net Back Price	927	1,114*	1,209*	1,970*	1,666*	3,239	2,870
% of Export FOB price to Net Back price	58	58	58	58	58	63	39
Price charged to domestic buyers (incl. royalty)	946	1133	1228	1989	1833	3216	3157

* - The price indicated is actual price charged for the year.

4.29 It can be seen from above that the 'Net back' price as a percentage of Export FOB price has declined considerably in 2011-12 mainly due to deductions of increased export railway freight and export duty which are Country specific. As a result, the domestic buyers are paying much less for iron ore than that paid by overseas buyers as shown above.

4.30 While the domestic buyers pay less price for iron ore than the overseas buyers, this does not necessarily get translated into price advantage to the customers as shown below.

Table 17: Table below indicating the price difference between overseas prices and domestic prices of Hot Rolled Coils

(₹/ Tonne)	April – December 2005	April 2011	March 2012
Overseas price of HR Coils	20,351	38,046	35,348
Domestic price of HR Coils 2 mm	28,444	43,020	47,630

4.31 Thus, the 'net back' method does not protect the financial interests of the Company, mainly due to high export related expenses. This method, in a good measure, is akin to extending a concession (in the form of lower iron ore prices than the international prices) to the domestic buyers. *On being pointed out that NMDC could consider e-auction method for sale of iron ore, the Ministry narrated the following factors which would render e-auction method unsuitable.*

- *Iron ore, being a bulk commodity, cannot be stored in large quantities. E-auction results in delays in evacuation. This would reduce the output and the Company cannot have economies of scale.*
- *Steel companies need assured supply of ore.*
- *Risk of likely cartelization in the long run.*

4.32 Wherever the price of end-product gets regulated by a regulator on the basis of input costs, the fixation of a low price for inputs helps in keeping the price of end-product low for the consumers. As the steel prices are determined by the demand and supply forces of market and are not regulated by a regulator, keeping the prices of iron ore low only results in steel producers making additional profit at the cost of iron ore suppliers. In such a scenario, it is desirable that the market driven price is charged while ensuring assured supply to customers and predictability of price.

4.33 It is, therefore, recommended that, in view of the present scenario where the steel product prices are market determined, the iron ore domestic price fixation mechanism may be established which would address the following issues:

(i) Optimum price realization for NMDC's ore;

(ii) Assured supply to domestic steel producers; and

(iii) Predictability of price.

Spot sales

4.34 The spot sales accounted for 5 *per cent* of total sales of the Company during 2005-12. The Company laid down spot market sales policy in December 2007. Spot sales are carried out through e-auction. The salient features of spot sales policy of the Company are:

i. The Committee of Directors (CoD) would decide the quantities for spot sales.

ii. The Company would adopt e-auction / competitive bidding for disposal of quantities.

iii. Reserve price shall be fixed based on the prevailing market trends before commencement of e-auction.

iv. Spot sales should be resorted to periodically after ascertaining the quantity for spot sales. The quantity for spot sales is the surplus quantity after meeting the commitments made to long term customers.

4.35 We observed that the spot sales were being conducted as per the laid down procedures and there were no material issues.

Recommendation # 4

The domestic price fixation mechanism for iron ore may be established which would address the following issues:

- ***Optimum price realization for NMDC's ore;***
- ***Assured supply to domestic steel producers; and***
- ***Predictability of price.***