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March 6, 2013 New Delhi, India

Competition Law Issues in India's Oil & Gas Sector – Part 2

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COMPETITION LAW ISSUES IN INDIA'S OIL & GAS SECTOR – PART 2

Absence of an Independent Regulator in the Upstream Segment

While the downstream and midstream segments are regulated by the Petroleum and Natural Gas Regulatory Board ("PNGRB"), the upstream segment is directly regulated by the Ministry of Petroleum and Natural Gas ("MOPNG") with the technical support of the Directorate General of Hydrocarbons ("DGH"), under the administrative control of the MOPNG. Neither the MOPNG nor the DGH is an independent regulator.

To avoid conflict of interest situations and promote healthy competition with private sector companies in the oil and gas sectors, it has been argued that regulatory functions should not be discharged by the Government when it exercises substantial ownership control over PSUs and NOCs that dominate the upstream landscape (discussed in Part I of this report). In addition, the Expert Committee on Integrated Energy Policy had in their 2006 report recommended that the regulatory functions of the State should be separated from the Ministries that control the PSUs dominating the upstream segment.

The role of the DGH as an independent regulator is also questionable in view of the "revolving door" practice that allowed upstream PSU/NOC executives to work at the DGH on deputation/tenure basis and go back to the NOCs once their assignments are completed[1]. This practice has been frowned upon by the Chawla committee[2] who stated that "such a revolving door policy is not congruent with neutral regulation", and called for a more explicit separation between the roles of the policymaker (the MOPNG) and the regulator (DGH). The Expert Committee on Integrated Energy Policy (2006) had also noted that the present upstream regulation provided by the DGH was "neither independent nor comprehensive in a technical sense". It is, in fact, argued that the DGH is not even a regulator but predominantly an advisory agent of the MOPNG in view of its functions and responsibilities (as outlined in the resolution creating it).

The issue whether or not the DGH is independent is contentious and calls made by several committees over the years for an independent regulator for the upstream segment have gone unheeded by the Government. In a 2011 report, the Government had firmly rejected the suggestion to transfer the DGH's regulatory powers to an independent body. Recently, there have been reports that a committee of secretaries has, in principle, agreed to reconstitute the DGH as an independent technical office of the MOPNG. The talking points largely remain the same as the recommendations of the Chawla committee.

There is a glaring need for an independent regulator in the upstream segment which is characterized by dominant PSUs and NOCs, with natural monopolistic tendencies. Independent regulation is essential for a transparent and competitive market that offers a level playing field to all entrants, as India looks at more private sector participation in the oil and gas industry. The liberalization and deregulation process is not complete when Government owned companies still dominate the landscape. As stated in the Integrated Energy Policy report, "the regulatory responsibility/functions of the State must be separated from the Ministries that control the PSUs that dominate the energy sector, and are the principal owners of over 75% of India's energy assets and related infrastructure".

Lack of Level Playing Field

It is also argued that the Government's policies in the oil and gas sectors continue to favour NOCs and other oil PSUs, thereby leading to an effective denial of market access.

For example, despite the dismantling of the administered price mechanism ("APM") for determining and controlling prices in the hydrocarbon sector, the Government still controls prices of domestic LPG, public distribution system ("PDS") kerosene, and high speed diesel ("HSD"). This is done with the objective of protecting consumers from international price volatility and providing energy access for citizens, particularly the economically weaker section of society. With increasing international crude oil prices and the Government controlling domestic prices of these economically sensitive petroleum products, oil marketing PSUs have had to sell their products well below cost price[3]. The consequent losses are termed "under-recoveries", which are calculated as the difference between the cost price and the regulated price at which petroleum products are finally sold to the retailers (after accounting for subsidy, if any, paid by the Government). Under-recoveries are offset by way of additional cash assistance allocated from the fiscal budget from the Government (over and above fiscal subsidy, if any), and financial assistance by way of discounts from upstream NOCs[4]. There is on-going significant debate on how under-recoveries are calculated and how trade parity prices are actually notional in nature – this is outside the scope of the present discussions and will be addressed in the future.

Oil marketing PSUs are currently (effective February 16, 2013) incurring daily under-recovery of Rs. 4.54 billion (approximately US$ 84 million) on the sale of diesel, PDS kerosene and domestic LPG[5]. The bailout package by the Government every year – going out of taxes paid by the public – have actually been saving oil companies from posting losses in all these years.

Private oil marketing companies, however, do not have the luxury of being compensated for under-recoveries. Consequently, this has affected the entry/growth plans of private oil marketing companies as competing with oil marketing PSUs is not viable under the circumstances[6]. Clearly, this has a direct impact on the incidence of investment by private oil marketing companies, and throughout the entire oil value chain, and ultimately on greater market competition. The Competition Commission of India ("CCI") has stated that is it is taking the route of advocacy with the Government with respect to the practice of under recoveries by oil marketing PSUs[7].

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