Downstream Sector and Transport Fuel Market in India

12 March 2020 | by Sushmita Halder, Halder & Associates

Halder & Associates
Advocates

Tags: Halder & Associates India Financial and corporate

The downstream oil and gas (O&G) sector, refining, pipelines and marketing, in India since its nationalization in 1980's has been dominated by Government controlled Public Sector Undertakings (PSUs). In 1977, the Government of India (GOI) introduced Administrative Pricing Mechanism (APM), i.e., prices for petroleum products such as petrol and diesel (Transport Fuel) were directly administered by GOI, based on an opaque and complex "cost of operating capital plus" formula. However, with the growth of the country, the demand for petroleum products increased but investments in the industry failed to keep pace resulting in increased import of O&G, affecting the foreign exchange reserve.

With the liberalization of the Indian economy in 1990's, GOI opened up the O&G sector to private players, allowing 100% FDI in the downstream O&G sector under the automatic route. In 1998, Reliance Industries Limited opened the largest refinery in India. GOI removed APM in 2002 and allowed private players to enter the marketing sector. The oil marketing companies were allowed to set prices for Transport Fuel based on an import parity pricing formula instead of APM.

Post APM: Many private players such as Reliance, Essar and Shell were authorized by GOI to market Transport Fuels. However, with the increase in the crude prices beginning 2004, under the instruction of GOI, the PSUs, were restricted from increasing the retail prices of the Transport Fuel to protect the Indian consumers. The downstream Transport Fuel market was now indirectly regulated by the GOI. The PSUs were gives subsidies by the GOI to sustain their losses for selling Transport Fuel below the market price. No such subsidies were given to private players. The private players claimed such behavior of the PSUs as anti-competitive as they were selling Transport Fuel below the import parity pricing formula, and complained before the downstream regulator, Petroleum and Natural Gas Regulatory Board (PNGRB). The case was finally decided in 2012, where PNGRB found that the PSUs were not undertaking any monopolistic, unfair or restrictive trade practices, and were following the instruction of GOI to sell Transport Fuel at a GOI determined price. Further, GOI can: (a) issue price control order in its capacity as sovereign by creating a special class of companies, in this case PSUs, and (b) as a shareholder can direct PSUs to sell at a lower price with the intention to maximize consumer welfare.

Removal of Subsidies: Subsidies were removed by GOI on petrol in June 2010 and diesel in October 2014, and PSUs were allowed to sell Transport Fuel at the prevailing market price. Since then, many private players have been actively investing in the marketing sector and have made substantial profit from the retail sale of Transport Fuel. India currently has 66,817 petrol pumps of which, PSUs has 59,716, Reliance 1,394, Nayara Energy, formerly Essar Oil, 5,525 and Royal Dutch Shell 169 outlets. All these players propose to increase their outlet numbers over the next few years. Many other international players such as Saudi Aramco, Total and BP have shown interest in marketing of Transport Fuel.

However, Transport Fuel price is a sensitive issue, and in the past many political parties have used it to gain public support, resulting in GOI regulated prices until few years back.

November 2019 Guidelines for Transport Fuel (new guidelines): GOI to further encourage the Transport Fuel sector, in November 2019, approved the Guidelines for Granting Authorization to market Transport Fuel. The new guidelines revised the earlier norm for marketing Transport Fuel, which required an entity to make ₹2,000 crore (USD 290 million approx.) prior investments in the O&G sector. Under the new guidelines, an entity is only required to have a minimum net worth of ₹250 crore (USD 35 million approx.). Thus, allowing small and even non-oil companies to make investment in the marketing of Transport Fuel.

The new entities will however be required to install facilities for marketing of at least one new generation alternate fuel, like CNG, LNG, biofuels, electric charging, etc. at their proposed retail outlets within 3 years of operationalization of the said outlet. The new entities will also be required to set up minimum of 100 retail outlets with at least 5% of them in the notified remote areas within 5 years of grant of authorization.

However, for the above guidelines to work there needs to be adequate downstream infrastructure facilities, especially pipelines for transportation of Transport Fuel available on an open access basis to the new entrants.

Downstream Infrastructure: PNGRB has played an active role in the development of the downstream infrastructure. In 2018-2019 alone, PNGRB has authorized laying of 3437 km of LPG pipelines, 355 Km of petroleum product pipelines and 6 dedicated petroleum product pipelines. At present, India has 6883 kms operational, and 4845 kms under-construction petroleum product pipelines. IOCL operates a network of 14,189 km long crude oil, petroleum product and gas pipelines. These pipelines are available on common carrier and open access basis. PNGRB has also invited bids for development of petroleum products pipelines.

Open Access: Pipeline entities are given authorization to build pipeline only upon such entities keeping extra capacity available in the pipelines for common carriers. This capacity in the pipelines can be booked by any third party for transportation on open access and non-discriminatory basis.

To discourage any anti-competitive behavior, the network tariff for infrastructure available on open access basis is determined by PNGRB. Further, entities which are operating both in the transportation and marketing of natural gas are required to follow certain code of conduct to maintain fairness in the market. There has been violation of this code of conduct but PNGRB has passed many orders preventing anti-competitive practices.

Conclusion: With the development of the economy, the Transport Fuel market in India is only to grow. GOI has brought in all the right policies, and now should let the market competition cater to the consumer and not temper with the retail price in case of a high oil price scenario.

About the Author

Sushmita Halder, Halder & Associates, Advocates, India; Email; Website

Sushmita has over 14 years of experience of advising on oil & gas projects and has worked with leading law firms and multinational oil & gas companies in India. She has extensively advised on upstream and downstream oil & gas sector. On the upstream sector, she has advised, amongst others, on Production Sharing Contract, Joint Operating Agreement, Joint Bidding Agreement and Area of Mutual Interest Agreement. On the downstream sector, she has advised, amongst others, on Gas Sale Agreement, Gas Transmission Agreement, LNG terminal and on regulatory issues.

Related articles

- Offshore Wind Power in India: Where do we stand!!!
- Overview of Existing Data Protection Laws in India, and the Proposed Data Privacy Bill
- India's policy on FDI in multi-brand retail trade
- India - 2013 Overview
- Clasis Law hires new Mumbai head from Juris Corp