Petroleum price fixation

Three and a half years after the government set up a regulator for the downstream petroleum and natural gas sector, it still insists on fixing product prices, violating the statute, says Mukesh Kacker

MUCH has already been written about how competition and regulation of competition, or more correctly, regulation of anti-competitive behaviour, leads to increased allocative efficiencies and consumer welfare. Less, however, seems to have been written on whether the structures of regulation put in place secure these desirable ends. This is particularly true in case of India where independent regulation is of relatively recent origin and is still evolving. It is, therefore, of immense importance that the structures of regulation put in place in different sectors be put under both intellectual as well as public scrutiny to see whether they are truly independent and empowered to regulate anti-competitive behaviour. It will be worthwhile to take a close look at the state of regulation in the petroleum and natural gas (PNG) sector, which has been consistently in the news of late.

The PNG sector consists of four sub-sectors: exploration and production of PNG, oil refining and marketing, natural gas transportation and marketing, and crude oil and petroleum products pipelines. Of these four, the first, referred to as upstream, is supposed to be regulated by the directorate general of hydrocarbons (DGH) while the remaining three downstream sectors fall under the domain of the Petroleum and Natural Gas Regulatory Board of India (PNGRB).

The DGH was created by a government resolution in 1993 and was posited as the regulator of the upstream sector. Nothing could be farther from truth. It is neither independent nor a regulator. When the instrument of creation, an order of the ministry of petroleum and natural gas (MoPNG), derives its genesis from a mere resolution rather than a statute, then independence would remain an illusory concept. The DGH operates under direct and complete administrative control of the ministry. It functions with the assistance of an advisory council and members of the council and staff of the DGH are appointed on deputation/tenure basis by the ministry in consultation with the DGH. In terms of its mandate, the DGH is predominantly an advisory, rather than a regulatory body.

As per the MoPNG order, the DGH has been mandated to regulate only one area —the preservation, upkeep and storage of data and samples pertaining to petroleum exploration, drilling, production of reservoirs etc — and to cause the preparation of data packages for acreages on offer to companies. In all other areas relating to various aspects of exploration and production, it is only supposed to advise the MoPNG. In reality, therefore, it is the ministry that regulates the upstream sector, with the DGH virtually functioning as an advisory wing of the ministry.

Competition in the market place is strengthened when firms derive psychological comfort from the twin securities of clear policies (on pricing, sale etc) and independent regulation. Unfortunately, in the upstream sector, there is complete void on these two fronts. Amidst the claims and counter-claims of failure and success of the Nelp-VIII, the fact remains that the void referred to above will be considered by firms as a major deterrent both to placing of bids as well as to post-bid dispute resolutions. The RIL-RNRL and RILNTPC dispute is merely a manifestation of this void.

THE scenario in the downstream sector is vastly different from that in the upstream sector —

at least in respect of the structure of regulation. But is the end result any different? Here we have a genuine regulator, owing its existence to a statute and not to a mere resolution. In 2006, the Petroleum and Natural Gas Regulatory Board Act, 2006, was passed and the PNGRB was notified on October 1, 2006. The PNGRB has been invested with tangible regulatory powers and the statutory nature of its genesis gives it its independence. But despite its powers and independence, it is the MoPNG that seems to call the shots in the regulatory space. Nothing illustrates this better than the strange situation in the fixation of prices of transportation fuels.

Before March 28, 2002, the marketing and pricing of petroleum products including transportation fuels, namely, motor spirit (MS) and high-speed diesel (HSD), were controlled by the government under a mechanism known as administered price mechanism (APM). The APM was dismantled by a notification dated March 28, 2002, under Section 3 of the Essential Commodities Act, 1955. Then, in 2006, the PNGRB came into existence. As a result of these two events, the theoretical position obtaining since October 1, 2006, is that all entities are free to price their products and the PNGRB is to regulate anti-competitive behaviour like predatory pricing. However, strangely, the government (read: MoPNG) still fixes the prices of MS and HSD and the PNGRB appears to be either powerless or disinterested in doing anything about it. How can the government fix these prices now? What is the role of PNGRB?

The above issues have been examined brilliantly in a landmark judgment, dated October 5, 2009, by the Appellate Tribunal for Electricity, in Appeal No. 50 of 2009. The judgment, either directly or indirectly, establishes the following positions:

Sections 11(a), 12 and 25 of the PNGRB Act, 2006, together give a wide amplitude to its duties and powers to foster fair trade and fair competition among the entities.

The dismantling of the APM by the notification dated March 28, 2002, was a policy decision that has not been reversed by another policy decision. The government, therefore, cannot fix prices under the garb of policy.

Section 2(x) of the Act specifically provides that it is only the entities that can fix the price and not the government.

The above power given to the entities to fix the price cannot be usurped by the government.

If the prices are to be fixed by the government as a sovereign, then it has to be declared as a public policy after observing formalities as provided under the Constitution.

The PNGRB has so far been a mute spectator and has hardly lived up to the expectations of the firms and the nation at large. And this brings into focus another important observation: that independence may be a necessary condition but is certainly not a sufficient condition for a regulator to be effective.

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