

# Legislative Brief

## The Petroleum and Natural Gas Regulatory Board Bill, 2005

Introduced on Dec 21, 2005 in the Rajya Sabha

Passed by Parliament on March 21, 2006

Awaiting Presidential Assent

### Highlights of the Bill

- ◆ The Petroleum and Natural Gas Regulatory Board Bill, 2005 establishes the Petroleum and Natural Gas Regulatory Board (PNGRB) to regulate downstream activities in the petroleum and natural gas sector.
- ◆ The PNGRB shall regulate the laying and expanding of (a) transmission pipelines for gas and petroleum and (b) city/ local gas distribution networks.
- ◆ The entity that lays the pipeline will have the right of first use and any other entity will have to pay it a transportation charge for use of the pipeline.
- ◆ Entities will have to register with the PNGRB to market petroleum products and natural gas, operate LNG terminals and establish storage facilities beyond specified capacity.
- ◆ The PNGRB will have the same powers as a civil court to settle disputes. The Appellate Tribunal under the Electricity Act will serve as the Appellate Tribunal for this Act.

### Key Issues and Analysis

- ◆ The Bill proposes a separate regulator for the petroleum and natural gas sector independent of the electricity regulator. Several countries have a common energy regulator for both gas and electricity.
- ◆ The Bill does not elaborate on whether the setting up of refineries will continue to be monitored by the Petroleum Ministry or whether the PNGRB will oversee this activity.
- ◆ Transportation tariffs for pipelines will be regulated by the PNGRB and determined on a cost of service basis. This does not incentivise cost-efficiency.
- ◆ The Bill does not provide sufficient clarity on how the PNGRB will enforce retail service obligations.
- ◆ There appears to be an overlap in the jurisdiction of the PNGRB and the Competition Commission of India.

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February 13, 2005

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## PART A: HIGHLIGHTS OF THE BILL

### Context

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The government announced the phased dismantling of the Administered Pricing Mechanism for certain petroleum products in 1997. In March 2002, it notified that the marketing and pricing of all petroleum products except kerosene and LPG was to be deregulated with effect from April 2002. The Petroleum and Natural Gas Bill, 2005 seeks to establish the Petroleum and Natural Gas Regulatory Board (PNGRB) to protect the interests of consumers in the deregulated scenario by promoting fair trade and competition among entities and ensuring adequate availability and equitable distribution of petroleum, petroleum products and natural gas.

### Key Features

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The Petroleum and Natural Gas Regulatory Board will regulate downstream activities in the petroleum and natural gas sector i.e. the refining, processing, storage, transportation, distribution, marketing and sale of petroleum, petroleum products and natural gas.

#### Framework for Transportation and Marketing

- Entities engaged in both marketing and transportation of petroleum, petroleum products and natural gas will have to separate the two activities within a specified period and comply with the affiliate code of conduct (which addresses issues like transparency, conflict of interest etc.).
- Pipelines for transportation of petroleum products and natural gas will be common or contract carriers. A common carrier is a pipeline for transportation of petroleum, petroleum products or natural gas by more than one entity on a non discriminatory open access basis.\* It does not include pipelines to transport petroleum products to a particular consumer and pipelines to transport crude oil. A contract carrier is a pipeline for transportation of petroleum, petroleum products and natural gas by two or more entities that have entered into a contract for at least one year. A contract carrier can be treated as a common carrier if it has surplus capacity or if the contract period has expired.
- An entity will have to obtain authorization from the PNGRB to lay or expand a pipeline or gas distribution network. Either on the basis of an application or if it deems it necessary, the PNGRB will invite applications from entities interested in laying the pipelines. Selection of entities will be done in a transparent manner. The PNGRB can give an entity the exclusive right to lay, expand or operate a gas distribution network for a specified period. It can also declare an existing pipeline or local natural gas distribution network as a common or contract carrier.
- The entity that lays, operates or expands the pipeline or gas distribution network will have the right of first use. Any other entity will have to pay a transportation charge to the authorized entity for use of the pipeline. This charge will be determined by the PNGRB.
- An entity will need to register with the PNGRB to (a) market petroleum, petroleum products and natural gas (b) establish and operate LNG terminals and (c) establish storage facilities for petroleum, petroleum products and natural gas exceeding capacity specified by regulations.
- Entities involved in marketing of petroleum products and natural gas will have to fulfill certain obligations specified by the PNGRB such as setting up marketing infrastructure and retail outlets in remote areas, maintaining minimum stock of petroleum and petroleum products etc.
- Dealers and distributors of petroleum products and natural gas will have to maintain supplies of specified quality and quantity to consumers throughout working hours, display maximum retail prices and fulfill any other obligation specified by the PNGRB.

#### Establishment, Powers and Duties of the PNGRB

- The PNGRB comprising a Chairperson, a member (legal) and three other members shall be appointed by the central government for a five year term, and may be removed from office only under specified conditions.
- The PNGRB will register entities to market petroleum products and natural gas, operate LNG terminals and establish storage facilities. It will authorize entities to build common/ contract carrier pipelines and local gas distribution networks and regulate transportation rates and access to these pipelines. The PNGRB will monitor prices and take corrective measures to prevent restricted trade practices, lay down technical standards and specifications for construction and operation of pipelines and infrastructure

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\* This means that the pipeline owner cannot discriminate between entities with respect to tariff rates and terms of access. Any entity can access the transmission pipeline subject to availability of capacity.

projects and maintain a data bank of information on activities relating to the petroleum and natural gas sector.

### Settlement of Disputes

- A Bench comprising of the Member (Legal) and one or more members nominated by the chairperson of the PNGRB will settle disputes between entities on matters relating to refining, transportation, marketing and distribution of petroleum products and natural gas and registration/ authorization issued by the PNGRB. The Bench will have the same powers as a civil court. Disputes under the purview of the Consumer Protection Act, 1986 will not be taken up.
- The Appellate Tribunal under the Electricity Act, 2003 will serve as the Appellate Tribunal for this Act. The central government will appoint one or more Technical Members (Petroleum and Natural Gas) on the Tribunal.

### Powers of the Central Government

- The central government can issue directions to the PNGRB in the interest of sovereignty and integrity of nation, national security, friendly relations with foreign countries or public order. It can also issue policy directives to the PNGRB in public interest, for maintaining supplies and ensuring equitable distribution. While the government will give the PNGRB an opportunity to be heard, the decision of the government will be final.
- To ensure continuous supply of petroleum, petroleum products and natural gas in the event of war, natural calamity or other such circumstances, the central government can take over the management of the facilities of any entity or retail outlet. The affected entities will have an opportunity to be heard if possible and the collector of the district shall determine the compensation payable.

### Other Provisions

- The Petroleum and Natural Gas Regulatory Board Fund shall be constituted. Grants, fees, penalties and charges received by the PNGRB will be credited to the fund. The Fund will be used towards expenses incurred in carrying out the provisions of the Act, including payment of salaries, allowance and pension.
- The PNGRB shall maintain a Petroleum and Natural Gas Register which will contain details of registered/ authorised entities. The register will be open to public viewing and any person can obtain a certified copy of any entry on payment of a fee.
- During an initial period of three years, the PNGRB shall monitor (1) agreements entered into and approved by the government before commencement of the act between oil companies for sharing petroleum, petroleum products or infrastructure facilities (2) setting up of dealerships and distributorships of motor spirit, superior kerosene, high speed diesel and LPG and CNG stations.

## PART B: KEY ISSUES AND ANALYSIS

### Common Energy Regulator versus separate Oil and Gas Regulator

The Bill envisages that the PNGRB will be a regulatory body independent of the regulator for the electricity sector. However, both electricity as well as the downstream petroleum and natural gas sector will have a common appellate tribunal. There could be an argument in favour of a common energy regulator as gas is an important input for power generation as well a competitor of electricity in several uses. Several countries such as U.K, Ireland and France have a common regulator for gas and electricity. In India, there may be some practical difficulties in having a common regulator. While electricity is on the concurrent list of the Constitution with both the state and the centre having jurisdiction, petroleum and natural gas are on the union list. Also, electricity and petroleum and natural gas come under two separate ministries. The Expert Committee on Integrated Energy Policy recommended separate independent regulators for all energy sub sectors as domain knowledge of the sub sector is important but recommended a common appellate tribunal.<sup>1</sup>

### Powers of the PNGRB

While the Electricity Act, 2003 clearly specifies that the electricity regulator shall be guided by the National Electricity Plan, National Electricity Policy and the Tariff Policy of the government, there is no analogous provision for the oil and gas sector in the proposed Bill. The PNGRB appears to have independent powers to

determine tariffs, the basis on which pipelines will be common or contract carriers etc. The regulations governing these issues will be made by the PNGRB and laid down in Parliament.

## Refining

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The Statement of Objects and Reasons of the Bill states that refining and processing activities will also be regulated by the PNGRB. The Bill mentions refining only in relation to adjudication of disputes between entities by the PNGRB. It does not discuss registration/ authorization of refineries. Currently, licenses for refineries are issued by the Ministry of Petroleum and Natural Gas. There is no clarity on whether the status quo will continue or the PNGRB will regulate the setting up of refineries. This is unlike the electricity sector where the Electricity Act, 2003 specifies that any generating company can establish, operate and maintain a generating station without obtaining a license if it complies with certain specified technical standards relating to connectivity with the grid.

## Transportation through Pipelines

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### Access to Transmission Pipelines

Construction of pipelines is highly capital intensive. When one pipeline exists, it is not economically viable to set up another pipeline and this implies barriers to entry. Pipelines are thus natural monopolies. Therefore, any pipeline policy has to find the optimum balance between the need to provide access to the various users and at the same time ensure that there are enough economic incentives to attract investment in the sector.

Currently, an entity owning a transmission pipeline is under no obligation to provide access to its pipeline even if it has spare capacity. Under the PNGRB Bill, all transmission pipelines (except pipelines to a specific customer and upstream pipelines) will be either common or contract carriers. The details of the basis on which a pipeline will be declared a common or contract carrier have been left to the regulations. The Revised Policy for Development of Natural Gas transmission pipelines and City or Local Gas Distribution Networks pipelines suggests that authorization for laying a pipeline will be done through a competitive bidding process. Parties will be given three months to declare interest in laying the pipeline. The total capacity of the pipeline will be that of the proposer as well as contracts entered into. The proposer will have to satisfy the condition that in future, capacity can be increased by 25% within a 120 day notice period. This excess capacity will be available for use on a non discriminatory, open access, first come first serve basis.<sup>2</sup>

### Tariffs for Transmission

The tariffs for transmission of natural gas through common or contract carrier are to be determined by the Board. The details on how the tariffs shall be determined have been left to the regulations. The draft regulations indicate that initial tariffs for pipelines may be determined on a cost of service basis which will include components such as operating cost, depreciation, reasonable rate of return on capital employed etc. The PNGRB will prescribe the methodology for determining the various components by benchmarking costs against similar projects and considering efficiency norms.<sup>3</sup> The Revised Policy for Development of Natural Gas transmission pipelines and City or Local Gas Distribution Networks pipelines suggests that the transportation tariff will serve as a cap to enable lower negotiated rates between entities.

While the cost plus formula does not provide incentives to improve efficiency, this is an issue that many regulators around the world are grappling with. In the United States, tariffs cover operating costs and a reasonable rate of return on capital employed is assured. Tariff in some countries such as the United Kingdom, Argentina, Australia and Spain is regulated through price caps, with escalations linked to an index. These price caps are reviewed periodically and adjusted on the basis of actual costs.

## Regulatory Overlap

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### Competition Commission

The Bill empowers the PNGRB to undertake corrective measures to prevent restricted trade practices in the petroleum and natural downstream industry. The Competition Commission of India was established in 2003 under the Competition Act, 2002 to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade. There appears to be an overlap in the jurisdiction of the two bodies and some clarification is required on this issue. There may be a need to evolve a mechanism of consultation between the PNGRB and the Competition Commission.

The Telecom Regulatory Authority of India Act, 1997 clearly states that the Authority does not have jurisdiction on matters relating to monopolistic trade practice, restrictive trade practice and unfair trade practice which are subject to the jurisdiction of the Monopolies and Restrictive Trade Practices Commission (now replaced by the Competition Commission).

### **Weights and Measures Department and the Civil Supplies Department**

Currently, the Weights and Measures Department and the Civil Supplies Department enforce quantity and quality of petroleum products and natural gas at retail outlets. The Bill envisages that the PNGRB will regulate and enforce retail service obligations. The Bill does not elaborate on the mechanism the PNGRB will adopt to enforce retail service obligations by all dealers and distributors of petroleum products and natural gas. It is possible that a scenario of regulation by multiple agencies might arise.

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#### **Notes**

1. Draft Report of the Expert Committee on Integrated Energy Policy, Dec 2005 (Chairman Kirit Parikh)
2. Revised Policy for Development of Natural Gas transmission pipelines and City or Local Gas Distribution Networks Pipelines, October 2005, Ministry of Petroleum and Natural Gas, Government of India
3. Proposed Regulations Governing Natural Gas Pipelines, Related Facilities and Tariff, Petroleum Planning and Analysis Cell

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