

## Comments On The Proposed Petroleum and Natural Gas Regulatory Board (Gas Exchange) Regulations, 2020 (“Draft Gas Exchange Regs.”)

### Executive Summary

- Present draft regulations contemplate a Gas Exchange that is a commodity exchange and would therefore fall under the exclusive jurisdiction of SEBI and will be regulated by the Securities Contracts (Stock Exchanges and Clearing Corporations) Regulations, 2012 and related regulations under applicable legal framework and not under the PNGRB Act.
- In order to formulate a gas exchange within the framework of the PNGRB Act and one that falls under the jurisdiction of PNGRB Act, the gas exchange has to be an enabling structure recognising or providing for creation of “gas hub” by enabling contractual arrangements between participating pipelines and market stakeholders.
- The present proposed regulations are based on the regulations of a commodity exchange and: (i) are creating an exchange that fall under the SEBI regulations, (ii) is seeking to regulate derivative contracts are under the exclusive jurisdiction of SEBI and (iii) are not reflective of the present regulatory framework governing gas transportation both via common carrier and last mile delivery via CGD networks.
- An enabling regulation recognising a contractually created gas hub and contractual arrangements between authorised entities and participating entities would be exclusively within the jurisdiction of PNGRB under the PNGRB Act.
- Since domestic gas price, with very few exceptions and that too because of specific contractual frameworks (and not because they are unregulated), are regulated by the The New Domestic Natural Gas Pricing Guidelines, 2014, the domestic gas will need to be excluded from being traded on the gas exchange and gas exchange will need to be limited to LNG and R-LNG.

### Overview

1. A Natural Gas Exchange enables price discovery and promotes rapid growth of the natural gas market. A Natural Gas Exchange enables price formulation rather than only managing the price level. However, under the Indian regulatory framework: (i) gas pricing is outside the scope of PNGRB Act, 2006 , (ii) domestic gas is governed by *The New Domestic Natural Gas Pricing Guidelines, 2014* , and (iii) only RLNG pricing is not regulated.
2. The entire natural gas price regime in India underwent significant reform on 18<sup>th</sup> October 2014 when. Based on the *Rangarajan Committee On Pricing of Natural Gas*; the Government of India notified *The New Domestic Natural Gas Pricing Guidelines, 2014* which provided a pricing formula for “well head gas price” applicable for all natural gas produced domestically, irrespective of the source, whether conventional, shale, CBM etc. and stipulated that the Director General of Petroleum Planning and Analysis Cell (DG PPAC) under the Ministry of Petroleum and Natural Gas shall notify the periodic revision of prices under the guidelines. This was made effective from 1<sup>st</sup> November 2014.
3. The Domestic Natural Gas Pricing Guidelines are made applicable to: (i) all gas produced by ONGC and OIL from the “nomination fields” vested with them, (ii) NELP Blocks, (iii) such

# CLARUS LAW ASSOCIATES

3<sup>rd</sup> Floor, Vijaya Building, 17 Barakhamba Road, New Delhi 110001, India. Telephone:+91-11-45469100. Fax:+91-11-45469111

of the Pre-NELP blocks where PSC provides for GOI approval of gas prices and (iv) Coal Bed Methane (CBM). *The exceptions to the pricing formula* were limited to situations where: (a) prices have been fixed contractually for a certain period of time, till the end of such period; (b) where the PSC itself is providing for a specific formula for natural gas price indexation/fixation, (c) where the gas is produced under Pre-NELP PSCs that do not provide for GOI approval of formula/basis for gas prices, (d) pricing of natural gas from small/isolated fields in nomination blocks of NOCs which is governed by the guidelines in respect of small/isolated fields issued on 08.07.2013; and (e) the D1, D2 discoveries of Block KG-DWN-98/3 which was at that time under arbitration, in respect of which special provisions were built in till the arbitration was settled. A special premium was also provided for gas from ultra-deep water wells.

4. It should be noted that as per PPAC communication dated 31.03.2020, the price of domestic natural gas for the period from 1<sup>st</sup> April 2020 to 30<sup>th</sup> September 2020 is US\$ 2.39/MMBTU on GCV basis<sup>1</sup>.
5. Thus, domestic gas would necessarily have to be excluded from being traded on any gas exchange.
6. It should be noted that the price of LNG and Regasified LNG (“**RLNG**”) remain unregulated and are presently not regulated by the Government of India. The price for RLNG is established by the entities that import LNG and market RLNG to customers.
7. As per the Oil & Gas data released by the Petroleum Planning & Analysis Cell (PPAC) for June 2020, LNG/R-LNG met about 54% of the total annual natural gas demand as of June 2020, and for the year 2018-19, LNG had met about 47% of the total natural gas consumption. Even adjusting the LNG/R-LNG consumption data for June 2020 for COVID-19 contraction in overall demand and reduction in domestic production (PPAC Data shows 13.2% fall in domestic production in June 2020 as compared with June 2019 and a reduction of 6.9% in import of LNG in June 2020 as compared with June 2019), it is clear that on an annual consumption basis LNG will be meeting almost 50% of annual gas demand.
8. Since domestic gas cannot be subject to any price discovery in light of the Domestic Natural Gas Pricing Guidelines, a primary challenge to be resolved by any regulations of gas exchanges will be to ensure that domestic gas is not traded or does not become subject matter of trading in the gas exchanges, unless a specific clarification in this regard is issued by MOPNG, Government of India.
9. Although it is well recognized that a Natural Gas Exchange can play a significant role in developing a robust market for trading in natural gas<sup>2</sup>, the *sui-generis* legal framework governing gas production, gas transportation and distribution prevailing in India presents a unique set of challenges for structuring, implementation and regulation of natural gas exchange in India.

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<sup>1</sup> See: PPAC Letter Ref NO. PPAC/Gas Pricing/April-September 2020 dated 31.03.2020  
<https://www.ppac.gov.in/WriteReadData/CMS/202003310535049612411DomesticNaturalGasPricefortheperiodApril-September2020.pdf>

<sup>2</sup> A Natural Gas Exchange provides a regulated and anonymous market place and significantly contributes towards the development of gas trading hubs. Gas Exchanges have helped create new business. The National Balancing Point (NBP) of Great Britain and the Title Transfer Facility (TTF) Virtual Trading Point operated by Gasunie Transport Services in the Netherlands and NGX, headquartered in Calgary, Alberta, Canada are leading examples of natural gas exchanges. These exchanges have enabled the growth of the natural gas market in their countries considerably. Development of exchanges is important not only in the light of the investments, innovations and trading activities that it will generate, but also from the perspective of the long-term impact it will have on the country's energy security strategy.

# CLARUS LAW ASSOCIATES

3<sup>rd</sup> Floor, Vijaya Building, 17 Barakhamba Road, New Delhi 110001, India. Telephone:+91-11-45469100. Fax:+91-11-45469111

10. However, the present proposed draft Regulations, would require further review before they are notified and made effective.

11. ***Present Draft Exchange Regulations Are Adapted From The Securities Contracts (Stock Exchanges and Clearing Corporations) Regulations, 2012. The Gas Exchanges of the structure presently contemplated Under Draft Exchange Regulations would fall exclusively under SEBI Jurisdiction and be outside the scope of PNGRB Act.***

The present Draft Exchange Rules are adapted from the Securities Contracts (Stock Exchanges and Clearing Corporations) Regulations, 2012 (“**SEBI Exchange Regulations**”). The present Draft Exchange Regulations contemplate a gas exchange that would make the gas exchanges of a nature that would be exclusively subject to SEBI’s jurisdiction and also have to comply with SEBI Exchange Regulations and result in a jurisdictional conflict. “Natural Gas” has been notified as a “commodity” by the Government of India under the SCRA vide notification dated 27.09.2016. Thus, unless the proposed gas exchanges are of a nature and structure that are outside the scope of SEBI Exchange Regulations and SCRA and SEBI Act, they would fall exclusively under the jurisdiction of SEBI.

The policy direction given by the Government of India under the PNGRB Act, would not be able to negate the jurisdiction of SEBI or exclude the gas exchanges from being governed by the SEBI Exchange Regulations.

The present Draft Exchange Rules should therefore be reconsidered.

12. ***Draft Exchange Regulations should be restructured to provide a framework for enabling and recognizing contractual arrangements and capacity trading***

Since the requirement under law presently is only for entities to obtain authorization for individual common carrier or contract carrier, the duly authorized common carrier entities can undertake the creation of gas trading hubs, including widening participation to all stakeholder entities through contractual arrangements. An enabling regulation recognising a contractually created gas hub and contractual arrangements between authorised entities and participating entities would be exclusively within the jurisdiction of PNGRB under the PNGRB Act and enable the same. Such an enabling framework should recognize the ability of participating entities to create the structures as they may determine and allow for transfer of pipeline holdings to a suitable legal structure as participating entities may envisage such as LLP, JVC, Joint Operator Arrangements etc., through contractual arrangements.

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