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The Secretary
Petroleum and Natural Gas Regulatory Board
1st Floor, World Trade Centre
Babar Road
New Delhi – 110001

26.08.2019

Subject: Comments on the Proposed PNGRB (Determination of Natural Gas Pipeline Tariff) Amendment Regulations, 2019

Dear Madam,

Please find enclosed our comments to the draft PNGRB (Determination of Natural Gas Pipeline Tariff) Amendment Regulations, 2019 pursuant to the Public Notice dated 02.08.2019 read with Public Notice dated 26.08.2019.

We are a leading law firm advising on various matters in oil and gas sector in India and internationally. We are submitting these comments in our independent capacity out of our interest in the field.

Warm regards



Enclosed: Annexure A (Comments On Proposed PNGRB (Determination Of Natural Gas Pipeline Tariff) Amendment Regulations, 2019

ANNEXURE A

**COMMENTS ON PROPOSED PNGRB (DETERMINATION OF NATURAL GAS PIPELINE TARIFF)
AMENDMENT REGULATIONS, 2019**

1. The proposed amendment is seeking to provide a regulatory basis for determining natural gas transportation tariff on a combined basis for two or more "interconnected" natural gas pipelines by introducing a new Regulation 4A into the PNGRB (Determination of Natural Gas Pipeline Tariff) Regulations, 2008.
2. The proposed regulation would need an amendment in the PNGRB Act in order to be within the framework of the PNGRB Act. Without amendment to the PNGRB Act the present proposed amendments would be liable to be challenged as being *ultra vires* PNGRB Act.
3. The specific function vested with the Hon'ble Board under s. 11(a) PNGRB Act is to "*protect the interest of consumers by fostering fair trade and competition amongst the entities*". The Hon'ble Supreme Court of India, in the case of *PNGRB v. IGL* ((2015)9SCC209) in Para 27 thereof, upheld the decision of the Hon'ble High Court of Delhi in the case of *IGL v. PNGRB* and quoted with approval the decision of the High Court of Delhi in para 11 of its judgement in which it was laid down that "*Clause (a) of section 11 while prescribing protection of interest of consumers limits the same to, by fostering fair trade and competition amongst entities engaged in distributing, dealing, transporting, marketing gas. The function of the Board thereunder is of regulating the inter se relationship between the entities under the Act and the consumers.*" Thus, there is no broad power or function vested with the Hon'ble Board to undertake actions such as providing for integrated tariff purportedly for interests of consumers. The interests of consumers can be protected specifically by fostering fair trade and competition amongst the entities.

The Hon'ble Supreme Court of India in the case of *PNGRB v. IGL* has specifically held that the tariff determination power vested under s. 22 PNGRB Act is "*subject to the provisions of the Act*" and therefore has to be read together with and being limited by the other provisions of the PNGRB Act.

Thus, the tariff determination function under s. 22 PNGRB Act is to be read together with and be limited by s. 11 PNGRB Act as well as other provisions of PNGRB Act. Under s. 11(e)(ii) PNGRB Act the tariff can be determined only for common carrier or contract carrier. Thus, the Hon'ble Board cannot determine an "integrated tariff" unless the specific

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"integrated pipeline network" is authorised as a common carrier or contract carrier. The proposed draft regulations, by seeking to allow a "combined tariff" to be determined for "interconnected pipelines" is therefore ultra vires PNGRB Act and is also in violation of the specific judgement of the Hon'ble Supreme Court in PNGRB v. IGL.

4. The present draft regulations in fact violate the specific direction provided in s. 20(5) PNGRB Act in respect of common carrier pipelines which is that "*the Board shall be guided by the objectives of promoting competition among entities, avoiding infructuous investment, maintaining or increasing supplies or for securing equitable distribution or ensuring adequate availability of petroleum, petroleum products and natural gas throughout the country.*" This is because allowing interconnected pipelines to have a combined tariff can result in infructuous investments in pipelines that are not interconnected to larger networks or result in consolidation instead of competition.

Furthermore, the draft regulations presently do not protect the interests of the consumers as they do not stipulate that the integrated tariff will not be increased upon revision or stipulate a limit to any change in a review of tariff. The main risk for consumers in an integrated tariff will be that the first integrated tariff may show a reduction in overall tariff for consumers that are located at the end of the pipeline network due to combining of capital expenditure. However, in the subsequent revisions, due to additional capital expenditure due to renovation or expansion of the integrated network it will result in increase of the tariff. For example, if GAIL undertakes a renovation of any part of or a substantial portion of the HVJ pipeline (which is due for renovation as it was laid in the 1980s), the integrated tariff will have a massive increase. The present draft regulations do not limit in any manner the extent or prescribe a maximum percentage by which an integrated tariff could be increased. It is therefore placing the consumers at risk for unprecedented level of tariff increases as older pipelines comprising an integrated network are replaced or upgraded.

5. Presently, the framework of the PNGRB Act does not support the concept of "an integrated" or "combined" transportation rate for interconnected pipelines. The Hon'ble Supreme Court in the case of PNGRB v. IGL has clearly held that the provisions of s. 22 PNGRB Act have to be read as being "subject to the provisions of the Act" which include the provisions of s. 11 PNGRB Act. The function of the PNGRB under s. 11 PNGRB relating to transportation rate and authorisation of common carrier are as follows (i) s. 11(c) PNGRB Act specifically vests the PNGRB with the specific function to "authorise entities to...lay build, operate or expand a common carrier or contract carrier.."; (ii) s. 11(d) PNGRB Act specifically vests the PNGRB with the specific function to "declare pipelines as common carrier or contract carrier" and (iii) s. 11(e)(i) PNGRB Act specifically vests PNGRB with the function to "regulate by regulations...transportation rates for common carrier or contract carrier."

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6. The term "common carrier" is defined in s.2(j) to mean "*such pipelines for transportation of petroleum, petroleum products and natural gas by more than one entity as the Board may declare or authorise from time to time on a non-discriminatory open access basis under sub-section (3) of section 20, but does not include pipelines laid to supply- (i) petroleum products or natural gas to a specific consumer, or (ii) crude oil.* Explanation,- For the purposes of this clause, a contract carrier shall be treated as a common carrier, if – (a) such contract carrier has surplus capacity over and above the firm contracts entered into; or (b) the firm contract period has expired."
7. s. 16 PNGRB Act specifically stipulates that "No entity shall – (a) lay, build, operate or expand any pipeline as a common carrier or contract carrier, without obtaining authorisation under this Act...". Sections 17, 18 and 19 provide for the process for grant of authorisation of a common carrier pipeline.
8. If the pipelines are presently authorised as separate distinct pipelines an integrated tariff common to these multiple separate authorised would be ultra vires the overall framework for tariff determination that presently exists.
9. The PNGRB NGP Authorisation Regulations will need to be amended to specifically provide a framework to reflect the proposed Regulation 4A of the NGP Tariff Regulations, so as to recognise integrated system of two or more interconnected pipelines as an authorised common carrier.
10. The amendment proposed by the draft Regulation 4A of the PNGRB NGP Tariff Regulations, by itself will not result in the authorisation of the interconnected pipelines to become a "common carrier" as authorised by PNGRB. This is because the function to determine transportation rate is vested under a different statutory provision and the power to authorise common carrier pipelines is vested under different statutory provisions and the power to determine transportation rates is, under s.22 PNGRB Act, "subject to the provisions of the Act". It is therefore clear that in the exercise of the power to determine transportation rate, PNGRB cannot proceed to recognise a new common carrier.
11. It should be further noted that to enable a valid integrated natural gas pipeline tariff in addition to amending the PNGRB NGP Authorisation Regulations, the framework for determination of natural gas pipeline tariff under Schedule A of the PNGRB NGP Tariff Regulations will necessarily have to be amended to allow for "pooling" or "combining" of



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the capex and other data. By way of illustration the following provisions of Schedule A are not contemplating determination of an integrated tariff:

(a) First Para of Schedule A stipulates:

"The natural gas pipeline tariff shall be determined by considering a reasonable rate of return on normative level of capital employed plus a normative level of operating expenses in the natural gas pipeline."

This makes it clear that tariff is determined based on the normative capex and opex of a particular natural gas pipeline

(b) Para 1 of Schedule A stipulates:

"The entity to which these regulations apply shall submit all technical, operating, financial and cost data of the natural gas pipeline project that may be required by the board in determination of the natural gas pipeline tariff."

This makes it clear that the data to be submitted for determination of natural gas pipeline tariff is that relating to the specific natural gas pipeline project and does not provide for combining multiple projects together

(c) Para 2 of Schedule A stipulates:

"The unit rate of natural gas pipeline tariff to be charged for a period shall be the calculated based on the "Discounted Cash flow" (DCF) methodology considering the reasonable rate of return as specified in clause 3 to be the project's internal rate of return. The parameters relevant to the applicability of the DCF methodology considering the reasonable rate of return as specified in clause 3 to be the project's internal rate of return."

This makes it clear that under the present framework a project specific internal rate of return is determined and there cannot be scope for combining projects.

(d) Para 3 of Schedule A stipulates:

"The rate of return on capital employed once applied to a natural gas pipeline project shall remain fixed for the entire economic life of the project."

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This makes it further clear that the rate of return to capital employed is specific to a natural gas pipeline and therefore a combined tariff for interconnected pipelines is presently not contemplated.

(e) Para 4 of Schedule A stipulates:

"(1) The reasonable rate of return shall be applied on the total capital employed to determine the return on capital employed in the project over its economic life and the authorized entity is free to leverage the financing of the project in any suitable manner.

(2) The total employed shall be equal to the gross fixed assets in the project less accumulated depreciation plus normative working capital (equal to thirty days of operating costs excluding depreciation and eighteen days natural gas pipeline tariff receivables).

(3) The gross fixed assets shall be equal to their actual historical cost of acquisition (including the cost of an subsequent replacement or improvement or modification) or that normatively assessed by the Board, whichever is lesser and required in the natural gas pipeline project over its economic life based on the principles³ to create and sustain an efficient infrastructure. "

This again reinforces the fact that what is contemplated under the regulatory framework is a pipeline specific tariff

(f) Para 5 of Schedule A stipulates:

"Operating costs required in the operation and maintenance of the natural gas pipeline over its economic life shall be computed,..."

This again reinforces the fact that what is contemplated under the regulatory framework is a pipeline specific tariff.

(g) Para 6 of Schedule A stipulates:

"The volumes of natural gas to be considered as divisor in the determination of the unit



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natural gas pipeline tariff over the economic life of the project shall be computed on a normative or actual basis, whichever is higher. Volume on normative basis shall be calculated as indicated below:

(a) The divisor for each of the first five years of operations of the natural gas pipeline shall be arrived by multiplying the applicable percentage utilization for the year, as per the basis indicated below, with seventy five per cent of the capacity of natural gas pipeline as declared under the Petroleum and Natural Gas Regulatory Board (Determining Capacity of Petroleum, Petroleum Products and Natural Gas Pipeline) Regulations, 2010 .."

This makes it clear that the volumes have to be determined for specific pipeline and cannot be used to make a combined tariff

(h) Para 7 of Schedule A stipulates:

"The economic life of the natural gas pipeline shall be as specified in the Petroleum and Natural Gas Regulatory Board (Authorizing Entities to Lay, Build, Operate or Expand Natural Gas Pipeline) Regulations, 2008"

This makes it clear that the economic life is specific to the relevant pipeline as authorised under the PNGRB NGP Authorisation Regulations:

(i) Para 8 of Schedule A stipulates:

"The entity shall submit for the Board's approval, the calculations in respect of apportioning of the unit natural gas pipeline tariff over all the tariff zones during the economic life of the project in the form specified under regulation 5, by following the methodology as specified under sub-regulations (a), (b) and (c), regulation 7 of the Petroleum and Natural Gas Regulatory Board (Authorizing Entities to Laying, Building, Operating or Expanding Natural Gas Pipeline) Regulations, 2008"

This makes the zonal apportionment specific to each specific authorised pipeline and does not presently enable a combined tariff to be apportioned in tariff zone of an "integrated pipeline".

(j) Para 9 (1) of Schedule A stipulates:

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"The unit natural gas pipeline tariff shall be determined for the natural gas pipeline over its economic life and levelized during-

This mandates that the natural gas pipeline tariff is to be determined for a specific natural gas pipeline over its economic life. This does not provide for the determination of "combined" or "integrated" pipelines.

Thus, the framework of the PNGRB Act is clear that the transportation tariff under s. 22 PNGRB Act can be determined only the specific authorised common carrier or contract carrier.

Thus, until such time as the authorisation for the relevant pipelines is provided as an integrated network or the pipelines are duly authorised under s.16 PNGRB Act as an integrated pipeline, merely amending the tariff regulations will not be sufficient.

12. Regulation 4A into the PNGRB Tariff Regulations will not provide a suitable regulatory framework for enabling the determination of integrated pipeline tariffs. Instead an additional Schedule B will need to be added to specifically provide a framework for determination of integrated tariffs for interconnected pipelines or, in the alternate, suitable modifications carried out to Schedule A of the present PNGRB Tariff Regulations.
13. The draft regulations presently do not provide for any check or balance to ensure that only authorised common carrier pipelines are considered for the purposes of determining combined tariff. The draft regulations are only providing the condition that the combined tariff can be determined for "two or more inter-connected natural gas pipelines". This will not ensure that only authorised common carrier pipelines are considered as being eligible for consideration under the regulations. The pipelines whose authorisations are being challenged or disputed by the entity to whom they are granted should also not be eligible for being considered. For example GAIL in the pending writ petition before the Hon'ble High Court of Delhi namely *GAIL v. PNGRB (WP(C) 1189/2016)* (which writ petition although dismissed once has been reinstated upon review and is therefore a pending writ petition) has challenged all the authorisations granted to it under the PNGRB Act and hence those pipelines whose very authorisation as common carrier pipelines are being challenged by GAIL before the High Court of Delhi cannot be considered as being eligible for being considered for a combined tariff, as GAIL itself is disputing the very authorisation granted to its pipelines under the PNGRB Act. Therefore, it would seem that such pipelines cannot



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be considered for determination of any "combined" tariff framework created under the PNGRB Act.

Similarly, the authorisation dated 15.02.2011 issued to GAIL for Dadri Bawana Nangal Pipeline has been set aside by the Hon'ble APTEL in the case of *GSPL India Gasnet Limited v. PNGRB and GAIL (Appeal No 254/2014)* vide Judgement dated 22.09.2017. GAIL has not appealed from the said decision and the same has become final and binding. Therefore, it is clear that such pipelines cannot be considered for determination of any "combined" tariff framework created under the PNGRB Act.

Thus, the draft Regulation 4A instead of using the term "two or more interconnected natural gas pipeline" should be made more specific to limit the same to "*two or more authorised common carrier pipelines*".

14. The proposed draft Regulation 4A can be also discriminatory as inherent in the concept of "combined tariff" is a favourable regime for longer interconnected pipelines and not for stand-alone pipelines originating from a source till a point. It also does not favour regional pipelines.
15. It is submitted that presently the proposed draft Regulation 4A do not assist in the development of a "national grid" declared by the Government of India, unless all pipelines identified as part of the national grid are considered as one "interconnected network" and a combined tariff is determined for the same.