IMPACT OF GOVERNMENT POLICIES ON COMPETITION IN INDIAN PETROLEUM INDUSTRY

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LIST OF ABBREVIATIONS

APM...............................................................Administered Price Mechanism
PSU..............................................................Public Sector Undertaking
BPCL..........................................................Bharat Petroleum Corporation Ltd
IOCL..........................................................Indian Oil Corporation Ltd
HPCL..........................................................Hindustan Petroleum Corporation Ltd
RPL.............................................................Reliance Petroleum Ltd
IBP.............................................................Indo-Burma Petroleum Company
MRPL..........................................................Mangalore Refinery and Petrochemical Ltd
HSD............................................................High Speed Diesel
OPC............................................................Oil Pricing Committee
LPG............................................................Liquefied Petroleum Gas
OMC............................................................Oil Marketing Companies
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CHAPTER I: INTRODUCTION

RESEARCH QUESTION

This paper aims at discussing the impact of government policies on Competition in the Indian Petroleum Industry. From the Administered Price Mechanism to its dismantling and bringing in the private players in the field, this paper shall deal with the current scenario of the petroleum industry and the appulse of policies on Competition in the country.

It is imperative to analyse whether these policies of government affect competition in the petroleum sector and also, whether the PSUs with the backing of the government are abusing their dominant market position.

BRIEF OVERVIEW

In any economy the energy sector plays an important role, the growth of the economy largely depends on the energy sector. In India, the history indicates that this sector was largely regulated by the government only. To a great extent this can be determined to be the cause of India’s poor share in the world’s oil and gas production and petroleum product consumption. Some of the biggest problems associated with the sector include excessive dependence on import of energy products and very little participation of private players in the sector.

Realising these issues, the government has taken steps to improve the status of the country in this field. Policies like Administered Price Mechanism have been dismantled\(^1\). Moreover, the government has facilitated the entry of private players in the industry, in both upstream and downstream activities. Thus, deregulation of energy sector was supposedly a step forward to improve the Indian Petroleum Industry.

To go into brief history of the Indian Petroleum Industry, it is significant to note that until independence of the country, the petroleum industry was largely dominated by private entities. It was only after independence that the government took control of the sector. Moreover in 1970s

when oil crisis hit the country, nationalisation of international oil majors took place in the country. It was, after this that the Administered Price Mechanism was suggested by the Oil Coordination Committee. This mechanism was aimed to assure stabilisation of petroleum prices across the country. Moreover, through APM producers, refiners and marketers were compensated for operating costs and also procured a fair return on their assets.

What the researcher aims at discussing through this report is not merely the APM and its dismantling, but the role that the government is playing thereafter. The dismantling of APM brought with it the freedom of private players to market the transportation of High Speed Diesel (HSD). Thus, private players assuming that they could fix the prices of HSD made large scale investments. However, the government intervention in the area continues as the government is still regulating the HSD price and is issuing oil bonds to the Public Sector Undertakings.

Therefore, the aim of the project of is to examine the current policy of the government regulating Indian Petroleum Industry on the touchstone of Competition Laws and suggest changes in the policy, if required.

**THE ADMINISTERED PRICE MECHANISM AND ITS DEFICIENCIES.**

The concept of Administered Price Mechanism (APM) came into existence in the year 1977 after the recommendations of the Oil Pricing Committee (OPC). The APM was a success in that era owing to the fact that all foreign oil companies were acquired by the government of India. The recommendation of the committee was that the domestic cost of production should be the determining factor for pricing of petroleum products. Moreover, the prices of raw materials as well as finished products were to be pre-determined on a continuous basis.

After its initial success, the APM had to depart due to the growing international market and the slow growth of Indian economy. The oil industry is said to be the wheel of an economy and its strategic linkage with almost all other sectors cannot be overlooked. The APM was scrapped off due to the changing oil policies of the gulf countries. On all occasions when the oil prices escalated, the world economy went into a zoom. In the deregulated system, the price rate is the one that floats with changes in global crude rates with producers’ and retailers’ margins added on

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2Ibid
and the government taxes added over it. Thus, administering oil prices on continuous basis was totally un-viable.

POST APM PETROLEUM INDUSTRY: INTERFERENCE BY THE GOVERNMENT

The need for dismantling of APM was a necessity owing to the changing world economy. However, the Government of India in a way or the other is still manipulating the prices through changes in duties and taxes. The state government also has the authority to scale up the sales tax whenever retail prices come down. For instance, the state policies of the Government of Maharashtra, the state government increased the sales tax in Mumbai to a whopping 40 percent which is the highest levy in the country.

Another very important aspect that needs a mention here is the policy of government to cut down on the subsidy provided on petroleum products like LPG and Kerosene. The government of India is not ready yet to scrap off the subsidy provided on these products completely. Even the Ministry has admitted that direct transfer of price burden on household sector by scrapping off the subsidy is unjust and unreasonable. Moreover, the general implication of this policy would be that the market prices shall be controlled by the government itself, despite the dismantling of APM and the oil pool account of these products will continue to be maintained as a part of the general budget.

Also, due to the absence of any proper regulatory authority, the price disparity in various states will be huge, thus leading to stress on the consumers and affecting competition in the sector.

In a nutshell, it would not be incorrect to state that the role of government is still existent in the pricing of petroleum products. Despite, dismantling of APM in the country, there is still control of government over the activities in the sector. To what extent are these policies affecting competition in the country is matter of deliberation and debate, which shall be further discussed in the next chapters.

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CHAPTER II: COMPETITION ISSUES INVOLVED

REAL BENEFICIARY

It was till very recently that the monopolies owned by the government regulated various sectors. With the onset of liberalisation in India, private participation was allowed even in the Petroleum Industry.

As has been discussed earlier, initially the Government of India had the Administered Pricing Mechanism (APM) which was a complex system of cross subsidization wherein prices of some petroleum products were kept much higher than what market determined prices would have been. This policy was dismantled on the recommendations of Expert Technical Group, enabling private players to market transportation fuel including High Speed Diesel (HSD).

Thereafter, to promote competition in the Indian Oil Industry, this HSD was marketed by Public Sector Oil Companies like Indian Oil Corporation Ltd., Bharat Petroleum Corporation Ltd., Hindustan Petroleum Corporation Ltd., as well as private companies like Reliance Petroleum Ltd., Essar and Shell. RPL and other private players invested heavily and set up several outlets for retail sale of HSD across the country under the legitimate expectation that the prices of HSD would be fixed by the marketing companies themselves in consonance with the market determined price and, in consequence, it would be able to make profit from retail sales. ‘Table A’ shows the number of Retail Outlets.6

‘TABLE A’

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>No. of RETAIL OUTLETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>IOCL</td>
<td>8,100</td>
</tr>
<tr>
<td>HPCL</td>
<td>4,899</td>
</tr>
<tr>
<td>BPCL</td>
<td>4,861</td>
</tr>
<tr>
<td>IBP</td>
<td>1,649</td>
</tr>
</tbody>
</table>

6Y Chandra Sekhar, Indian Oil Industry: Transition to Deregulation, ICFAI University Press.
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MRPL</td>
<td>500</td>
</tr>
<tr>
<td>Reliance</td>
<td>5,849</td>
</tr>
<tr>
<td>Essar Oil</td>
<td>1,700</td>
</tr>
<tr>
<td>ONGC</td>
<td>600</td>
</tr>
<tr>
<td>Numaligarch Refinery</td>
<td>510</td>
</tr>
<tr>
<td>Shell</td>
<td>2,000</td>
</tr>
</tbody>
</table>

Despite dismantling the APM, the government continued to regulate the retail price of HSD.\(^7\) This led to huge losses to all the companies\(^8\). Wherein the Public Sector Oil Companies were issued Oil Bonds, the private players were left with only losses. The government issued oil bonds to the PSUs as a compensation for selling petroleum products at a lower price.\(^9\) This compensation has certainly helped these PSUs to resuscitate the enormous losses suffered. However, no such compensation was provided to the private players, which led to huge losses\(^10\).

As is known that the Petroleum Sector is a matured industry and it is pertinent to mention here that any such big industry keeps within itself only the fittest market players. For the kind of circumstances that have been created by the government of India under the veil of ‘under-recovery’\(^11\), is posing a looming threat to the private market players.

**CREATION OF DOMINANT POSITION AND ITS ABUSE**

In every economy competition has always been a boon to the consumers. Competition Act, 2002 envisages that anti-competitive agreements as well as abuse of dominant position shall be prohibited. Indian economy, on dismantling of the APM, hoped for a more consumer friendly and pro-competition market in the petroleum industry. This is possible only on the entry and sustained functioning of private players. However, the conditions discussed above and the losses suffered by the private market players are not too conducive for their existence in the market.

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\(^9\) Ibid.


\(^11\) The term ‘Under Recovery’ is used to denote the ‘losses’ that the Public Sector companies have suffered in the Petroleum Sector. The term is used by the Government of India and justification of issuing oil bonds lies in these ‘under recoveries’.
The major marketing network in the country is controlled by the PSUs like IOC, HPCL and BPCL. The private players are still dependant on these PSUs for marketing\(^\text{12}\). Setting up their own marketing network is a costly affair\(^\text{13}\) and it is not easy for these private players to take on the state owned marketing giants and carve out a share for themselves. The already burdened private sector is trying to put some impression in the marketing field of oil sector. For example, Reliance, a market leader in petrochemicals, has acquired 26% stake in IPCL. However, none of government’s policies in the oil sector has helped private parties to sustain in the market\(^\text{14}\). This, in short, has led to the creation of dominant position of the PSUs in the energy sector. The Competition Act specifies, in its Chapter II, that “No enterprise shall abuse its dominant position”\(^\text{15}\). Dominant position refers to a ‘position of strength, enjoyed by an enterprise, in the relevant market which enables it to operate independently of the prevailing competitive forces or affect its competitors or consumers or the relevant market in its favour’\(^\text{16}\). This implies that having a dominant position or monopoly may not be a crime, but only the abuse of such position may be.

To quote a famous case to support the point, a reading of the *Brussels National Airport* case clarifies that the Belgian legislation provided for a system of stepped discounts on landing fees, which favoured airlines that had a large volume of traffic at Brussels airport over airlines having a lower traffic\(^\text{17}\). The thresholds established by the Belgian legislation were such that only a carrier based at the airport could benefit from the discounts to the detriment of other Community carriers. This had the effect of favouring the Belgian public carrier over its competitors. The Competition Commission of India considered that Article 82(c) of the treaty\(^\text{18}\) could be applied to cases where: "an undertaking in a dominant position gives preference to another undertaking from the State or another undertaking which is pursuing the same general policy"\(^\text{19}\). In this case,

\(^{12}\)Supra Note. 3.  
\(^{13}\)Ministry of Petroleum & Natural Gases Resolution Dated March 8th, 2002.  
\(^{15}\)Section 4, Competition Act, 2002.  
\(^{18}\)Treaty on the Functioning of the European Union.  
\(^{19}\)CCI v. SAIL, (2010) 10 SCC 744.
the State, acting through its intermediary, i.e. the Belgian Airways authority enjoying an exclusive right on the market for aircraft landing and takeoff services, was giving "preferential treatment" to a specific undertaking, i.e. the national public airline Sabena. The Competition Commission of India hence applied Article 86 in combination with Article 82(c). Thus, it can be interpreted from the plain reading of the section that what these government policies in the Indian Petroleum Industry are doing is basically resulting in denial of market access to the private players. Thus, it is important to determine that whether the government policies are adversely affecting competition in the country, thereby defeating the provisions of the Act or are they merely aiding the already suffering PSUs to recoup from the losses witnessed due to the, now unviable, APM.

**Lack of Proper Regulations Affecting Competition in the Market.**

The legislative delays in India are not something new or alien. Legislative ambiguities also have great impact on the competition in an economy. A survey conducted by The Energy and Resources Institution reveals that investors need satisfaction that their investment will at least make neutral returns before they look at opportunities. To this end, they must be assured of the continuity of existing policy regime, or the gradual move to a more favourable policy regime in the future. Given the lacunae in the government policies relating the determination of prices of petroleum products, the private investors who made huge investments in the sector have suffered huge losses and this has adversely affected competition.

Pricing is one of the most critical elements of energy regulation. This is because cost-reflective tariffs enable the utilities/operators to maintain, modernize and expand their facilities and services. Therefore, to create a competitive environment and reduce impediments to financial viability of energy provision, the regulatory framework should allow utilities to charge tariffs that cover underlying costs.

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20 Section 4(1)(c), Competition Act, 2002.
21 Section 19(3), Competition Act, 2002. This section provides that the ‘agreement’ either creates barriers to new entrants in the market, drives out existing competition, or forecloses the competition by hindering entry into the market in order to prove the agreement was anti-competitive.
23 Ibid.
administrative control in pricing of oil & gas and coal. It is worth noting that controls on pricing of fuel inputs have a direct bearing on competition in the electricity sector. In recent years, there has been an increased recognition on the need for introducing cost reflective pricing across the energy sector.
CHAPTER III: THE KIRIT PARikh COMMITTEE REPORT.

INTRODUCTION

An expert committee with the aim of providing an outline for pricing of petroleum products including petrol, diesel, LPG and kerosene was set up by the Ministry of Petroleum and Natural Gases. These prices were expected to be feasible over a wide range of international prices. This committee, further, analysed the consequences of government policies on the petroleum industry.

According to the report of this committee, the whole policy of the government to provide subsidies on major oil products consequently led to stressed government finance and also reduced the cash surplus of upstream public sector oil companies restricting their ability for exploration of domestic fields and acquisitions overseas.\(^{24}\)

This report also clarified that the price control, subsidies and taxes can introduce distortions which may not be desirable. For example: The higher excise duty on petrol compared to diesel encourages use of diesel cars. Also, lower diesel prices lessen the incentive to shift freight movement from trucks to railways, which consume 4 times less diesel for every tonne km of freight.

Moreover, control on pricing also restricts competition. Several oil marketing companies, viz. Reliance Industries, Essar Oil and Shell India, that were not part of the subsidy sharing arrangement, closed down their retail marketing businesses across the country.

This report also dealt with the questions as to the level of government intervention in the petroleum market. Thus, the report very categorically and in an unbiased manner deals with and tries to find a viable policy that not only benefits the consumers to the greatest extent possible, but to also reduce the fiscal burden on the government.

RECOMMENDATIONS

The Kirit Committee Report has suggested a few recommendations to improve the condition of petroleum market in India. This committee has done a detailed analysis of the policies of the

government in this sector. What is primarily suggested is that there should be a long term pricing strategy that should be workable over international oil prices. Moreover, the strategy so formed should limit the fiscal burden on the government. This committee has also recommended that the policy should be able to promote healthy competition in the domestic oil sector.

The major recommendation of this committee is that the prices of both petrol and diesel should be market determined, both at refinery gate and at retail level. Moreover, the consumption trends clarifies that diesel need not be subsidized. The report also suggests a higher excise duty on diesel vehicle owners.

Further, the report suggests that to allow the private players to sustain in the market, it is necessary that ‘under-recoveries’ be dealt with by a proper mechanism and losses in the sector be reduced both for private players as well as PSUs. It is recommended that there should be a periodic reduction in kerosene allocation and an increase in the prices of kerosene and domestic LPG. Thus, the subsidy be curtailed and losses recovered.

Also, the committee has deliberated over the issue of competition in the petroleum sector. According to this committee report, market determined price for petro-chemical products would be the most viable option, thereby providing a level playing field to both public and private participants and promoting competition in the country.

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Ibid.
CHAPTER IV: STEEP RISE IN OIL PRICES- POLICIES OF GOVERNMENT AND PUBLIC OUTCRY.

Having explained the transition from APM to its dismantling and the role that the government is playing in the oil and petroleum sector, it is essential to discuss the present scenario in the field. The government of India despite dismantling the APM regulated the retail price of HSD. This step was taken to avoid burdening the common masses by scrapping off the subsidies on LPG and Kerosene. However, now the government has declared that the Oil Marketing Companies (OMC) that have already suffered huge losses due to this policy, shall not be allowed to bleed more. This signifies that the end users, i.e., the common people will have to share the burden.

The government policies post-APM did not favour the OMCs in any sense. These policies rather posed huge burden on these companies. A developing country like India where import of Oil products is so large, tandem with international market becomes a necessity. Despite Oil Bonds being issued to PSUs, the losses are of such magnitude that these companies are forced to suspend their projects due to financial crunch.

The question that arises now is that who shall compensate for these losses. The condition of Indian economy per se is not such that the burden is put entirely on the common people. Moreover, no government would want to take the crucial step of increasing the prices of oil products to an extent that the public is discontented as it would definitely affect the government. Also, experts believe that the current hike in prices is not driven entirely by high demand. However, there seems no situation that domestic prices of oil products get reduced. The reason behind this is the aim to generate surplus funds for the oil companies to withstand future price hikes.

The current steep rise in petrol prices has led to a public outcry. The opposition and allies likewise have detested the steep hike. But, the response of the government to this fuming attitude is that global uncertainty and the rising oil imports bill and the battering of the Indian currency

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has led to this increase. Table ‘B’\textsuperscript{27} shows the fuel price changes in India over the years and how the change in prices of subsidised petroleum products is minimal as compared to HSD.

Table ‘B’

\begin{center}
\begin{figure}
\centering
\includegraphics[width=\textwidth]{india_fuel_price_changes.png}
\end{figure}
\end{center}

It is of utmost importance for the experts in the field to analyse the situation and come up with a solution for managing the oil and petroleum industry and suggesting the most viable and competent policy so that the losses suffered by OMCs be reduced and the burden on common man be the minimum. Also, the policy should make sure that it promotes healthy competition in the market and there is no anti-competitive activity undertaken by any of the market players, whether private players or any Public Sector Undertaking.

\textsuperscript{27} http://in.reuters.com/article/2010/06/07/idINIndia-49104120100607, Last accessed on June 27\textsuperscript{th}, 2012.
CHAPTER V: CONCLUSION AND RESEARCHER’S OPINION

The Indian Petroleum Industry has undergone a wide variety of changes over the years. From a deregulated sector before independence, to regulation by the advent of APM, back to being deregulated, this sector has transversed a full circle.

This paper has discussed in detail the causes for dismantling of the APM and the extent of government control on the sector post dismantling. The present situation has also been dealt with including the furore amongst common masses due to the soaring price hikes in the petroleum products.

The basic aim of this report is to bring to the notice of the Competition Commission of India the anomalies and a fallacy that exists in respect of the policies that government has in the petroleum sector. The researcher would also like to bring to the notice of the Competition Commission of India that the policy of subsidising a few of the petroleum products might ultimately result in anti-competitive practice of predatory pricing as this policy is resulting in huge losses to private players and resulting in their being swiped away from the market. This is evident from the fact that majority retail outlets of private companies like RPL, etc have been shut down.

Moreover, such a policy by the government will be detrimental to chances of entry of foreign players in the petroleum industry, which is set to become a necessity in the near future owing to growing demands of petroleum products in the burgeoning Indian economy. Thus, it is pertinent for the Competition Commission of India to look into the matter and analyse the position of both private as well as PSUs.

Another very important factor that needs to be noted is that whether mechanism of Administered Pricing needs to be brought back to regulate the pricing of petroleum products that are sky-rocketing. Moreover, the burden being imposed on the general masses is too much for them to handle. The government besides recouping the losses needs to make policies that put minimum burden on the citizens who are already suffering due to hike of prices of all commodities of general usage.

Predatory Pricing is an exclusionary practice. It is not only when it has actually produced exclusionary effect, but even when it is likely to cause these exclusionary effects. The definition is cited in United States v. U.S. Machinery Corp. 110 F. Supp. 295 (D. Mass 1953)
Further, to improve competition in the petroleum market, the suggestion of government to merge the national OMCs into two major oil companies\(^{29}\) is much debatable. The Competition Commission of India is of utmost importance in deciding whether this merger would be beneficial in the long run or not. Also, the requirement of a regulatory body is in deliberation. Whether this body which will act as a holding company for the entire sector would serve the purpose of healthy competition and to recoup the losses, is also a matter to be considered in great detail.

Further, it is imperative to ascertain whether the Competition Commission of India has the jurisdiction to deal with the above stated situations. Regulations can be defined as ‘restraints on market behaviour or structure’.\(^{30}\) Regulations have been categorized under four broad categories: economic (concerning pricing, entry/exit, registration, prior approvals), technical (relating to technical aspects distinct and unique to the sector), social (regarding public interest issues such health, safety and environment) and administrative.\(^{31}\) It was held in *CCI v. SAIL*\(^{32}\) by the Supreme Court of India that the Competition Commission was vested with powers of wide magnitude to enforce competition law, which is not the case with sector regulators. Admittedly, while competition authorities cannot be assumed to possess the technical know-how unique to a particular sector, S. 21A of the Competition Act, 2002 empowers the Commission to make a reference to any statutory authority in order to obtain sector specific information.\(^{33}\) Thus, the Competition Commission can deal with the issues related to petroleum industry despite the existence of the Ministry of Petroleum and Natural Gases, if there is any anti-competitive arrangement in the field.

To sum up, what is the need of the hour is a clear framework for the functioning of the petro-chemical sector. The government needs to intervene, but to what extent should be decided. Further, keeping in view the provisions of Competition Act, 2002, the policies should encourage

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\(^{29}\) The proposal is to merge HPCL and BPCL with ONGC. GAIL is proposed to be merged back to ONGC. And the second company would comprise of Indian Oil Corporation and Oil India Limited. Anupama Chowdary and DG prasuna, *Oil PSUs- Should they be merged?*, Chartered Financial Analyst, October 2004.


\(^{32}\) (2010) 10 SCC 744.

healthy competition and should give variety of choices at variable rates to the general public, rather than leading to formation of dominant position and thereafter its abuse.
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