

How Reliance's Options on Natural Gas Price Hike Narrowed

PARANJOY GUHA THAKURTA, JYOTIRMOY CHAUDHURI

A clutch of public interest petitions and legal entanglements between Reliance Industries and the Ministry of Petroleum and Natural Gas on the pricing of natural gas and other issues are now before the Supreme Court. A record and discussion of the many legal cases in a battle that is going to be a protracted one.

Paranjoy Guha Thakurta (*paranjoy@gmail.com*) and Jyotirmoy Chaudhuri are among the co-authors of *Gas Wars: Crony Capitalism and the Ambanis*.

Why did Reliance Industries Limited (RIL) issue a notice of arbitration to the government seeking an early decision to increase the administered price of natural gas? The company, India's largest in the private sector, claimed on 10 May that it had "no other option but to pursue this course of action" since RIL – together with its partners, British Petroleum and Niko Resources of Canada – was "unable to sanction planned investments of close to \$4 billion" during this year. It can, however, be argued that RIL chose this option because it did not foresee an early resolution to a set of legal disputes pending before the Supreme Court. Nor did it foresee an expeditious conclusion to the arbitration proceedings on the imposition of penalties of \$1.8 billion on the company by the Ministry of Petroleum and Natural Gas two years ago.

Whereas RIL and the former petroleum minister M Veerappa Moily did try very hard to push for the implementation of the June 2013 decision of the cabinet that would have almost doubled the price of gas from 1 April 2014 for a period of five years – a decision that was stayed by the Election Commission of India on 24 March – the company's actions on the eve of the results being declared were clearly influenced and determined by the realisation that the new government (and not the outgoing one) would have to take a call on the contentious issue of hiking the officially administered price of natural gas extracted from the Krishna-Godavari (KG) basin.

Public Interest Litigation

It is evident that the legal entanglements involving RIL and the petroleum ministry over various issues, including the price of gas, may take a while to get resolved since a new bench of the Supreme Court will have to be constituted – in the first week of July this year, at the earliest – to hear two public interest litigation (PIL) petitions which were heard only partially. The PIL petitions allege, among other things, that the government and

RIL conspired to lower gas production from the KG basin and increase its prices in contravention of particular provisions of a production sharing contract signed between the government and a contracting firm led by RIL more than 14 years ago in April 2000.

RIL stated that the government was arbitrarily forcing it to sell gas at \$4.20 per million British thermal units (mBtu) even after 31 March 2014 following the expiry of contracts that the company had entered into with various users, notably fertiliser companies. It added that this was in “contravention of the production sharing contract” and hurting the business interests of the contractor group as well as the government. RIL stated that it continued to supply gas at \$4.20 per unit to consumers “under protest but in good faith”. As if to back up its claim, the company sent a terse one-page letter on 14 May 2014 to urea manufacturing companies informing them that once a higher rate was approved, they would be charged the difference in prices for the supply of around 12.5 million standard cubic metres per day (mscmd) of gas from 1 April this year onwards at the “provisional” price of \$4.20 per unit.

The price of \$4.20 per unit had been fixed by the government in September 2007 for a period of five years and gas production from the particular block (D6) in the KG basin operated by the RIL-led consortium started in April 2009. RIL stated that on its request for clarity on the price of gas after 31 March 2014, the government had in May 2012 appointed a committee headed by C Rangarajan (who was then also the chairman of the Prime Minister’s Economic Advisory Council) to review the production sharing mechanism in the oil and gas sector. The committee proposed a new formula for pricing of gas, based on market prices of gas across the world that would be applicable for five years before making a transition to a “gas-on-gas” arms-length price that would be determined by market competition. The formula was based on a 12-month average of prices prevailing at particular international hubs as well as the landed prices of liquefied natural gas (LNG) imported into India.

The formula of the Rangarajan committee would have effectively almost doubled the price of gas to \$8.30 per unit. On 17 January this year, the petroleum ministry published in the Gazette of India the new guidelines for pricing of gas. However, before the Domestic Natural Gas Pricing Guidelines 2014 could be notified, on 5 March this year, elections were announced and the model code of conduct of the Election Commission came into force.

Gas Price Hike

RIL claimed that even after a request was made to the government that the new price of gas be notified and made applicable with effect from the conclusion of the ninth and last phase of the elections on 12 March, the petroleum ministry acted in an “arbitrary” manner by “completely ignoring” the decision of the cabinet and “indicated” that new prices would be announced only in the second quarter of 2014. The ministry also returned a bank guarantee of Rs 509.55 crore deposited by RIL since the new rate has not been announced. The bank guarantee, which was meant to cover the incremental revenue that RIL would have earned in the April-June quarter if the price of gas were nearly doubled to \$8.30 per unit, had been devised to cover the company’s liability if allegations of gas-hoarding from 2010 to 2011 in the Dhirubhai-1 and 3 (D1&D3) fields in the eastern offshore KG-D6 block were proved. The bank guarantee had been provided, even as the Election Commission ordered a stay on the hike in the price of gas on 24 March.

The company claimed that this “capricious” situation has put their “future investment plans in jeopardy” with proposed investments worth \$8-10 billion over the next few years being put on hold. RIL also claimed the government would be incurring a revenue loss of Rs 300 crore per month. The company, in its statement, made no bones about its displeasure given the uncertainty on the price of gas prevailing.

Delay in One Arbitration

The legal battle that will ensue could be protracted. It has taken over two years to finalise the presiding arbitrator of the

three-member arbitral panel in an earlier arbitration process initiated by RIL in November 2011. RIL had filed the arbitration petition on 16 April 2012 seeking the appointment of a third presiding arbitrator in its ongoing dispute with the government. Two former chief justices of India S P Bharucha and V N Khare had earlier been appointed by RIL and the government, respectively, to represent them in the arbitration proceedings.

The arbitration petition was argued at length in the Supreme Court before Justice Surinder Singh Nijjar. The Union of India, represented by senior counsels Anil Divan and Dushyant Dave, objected to a foreign national being appointed as the third arbitrator. The government argued that since the British Petroleum (BP) group was a major stakeholder together with RIL in the contract to extract gas from the KG basin and since BP had a presence the world over, the appointment of a foreigner as a third arbitrator could potentially compromise the independence of the panel as a whole.

On 31 March 2014 in a 70-page order, Justice Nijjar decided to appoint the third arbitrator himself. He explained that due to the sharp divergences in opinion between the parties, the court had asked the senior counsel from both sides to suggest names for the third arbitrator. The judge held:

Although two lists have been duly supplied by the learned counsel for the parties, I am of the opinion, in the peculiar facts and circumstances of this case, it would be appropriate if an individual not named by any of the parties is appointed as the third arbitrator.

Justice Nijjar rejected Anil Divan’s apprehensions as “imaginary and illusory” and added:

Whatever is being said about the influence/presence of British Petroleum in other jurisdictions would apply equally to the Union of India, if the third arbitrator is an Indian national, within the Indian jurisdiction.

The judge did not stop at that. He went on to state that he had “discretely (presumably meaning, discreetly) conducted a survey to find a suitable third arbitrator who is not a national of any of the parties involved in the dispute”. He then pronounced “upon due consideration” the

appointment of James Jacob Spigelman, former chief justice and lieutenant governor of New South Wales, Australia. As the third arbitrator and also provided his email address which the judge said had been “supplied to the court”.

Two days later, on 2 April 2014, the proceedings suddenly took a new turn. The government’s counsel Dave pointed out a “bona fide mistake” and urged the court to retract its directive. He said that the arbitrator appointed by the court was on top of the list of the preferred names provided by RIL. Senior counsel for RIL, Harish N Salve, did not oppose this and said that he was planning to point out the same fact to Justice Nijjar, who then recalled his own directions to appoint Spigelman as the third arbitrator.

On 29 April 2014, Justice Nijjar appointed another retired judge from Australia, Michael Hudson McHugh, to head the three-judge arbitration panel. McHugh has been a judge of the court of appeal of the Supreme Court of New South Wales and a judge of the High Court of Australia.

Combining Arbitration Cases

RIL has now sought to club the new arbitration with the earlier suit. According to RIL’s lawyer Harish Salve, who spoke to CNBC-TV18:

We invited the government to read the same tribunal, which is already in place here. So, we can get a quick resolution. It depends on what the government does. It’s a sensible course of action, if you have two tribunals you read the same thing over and over again for two sets of tribunal doesn’t make sense it’s a not cost efficient and it’s not time efficient (see http://www.moneycontrol.com/news/business/ril-serves-arbitration-notice-to-govt-gas-pricing-issue_1083279-1.html).

However, these arbitration proceedings may not commence immediately since the Supreme Court is hearing PIL proceedings in related matters seeking a stay in the arbitration till the court decides on the legality of the production sharing contract. The PILs filed by Gurudas Dasgupta, former Member of Parliament belonging to the Communist Party of India and a non-governmental organisation Common Cause – the lead author of this article is a member of its

governing council – continue to be heard by the Supreme Court.

After Dasgupta’s PIL petition was filed in the Supreme Court on 30 July 2013, a bench headed by the then Chief Justice of India P Sathasivam and comprising Justices Ranjan Gogoi and Ranjana Desai, issued notices to the Union of India, the minister of petroleum and natural gas Veerappa Moily and others seeking their responses to the government’s decision to nearly double the officially administered price of natural gas from \$4.20 per unit to \$8.40 per unit from 1 April 2014 onwards. Thereafter, a similar set of petitions were filed by Common Cause and former bureaucrats, such as former Cabinet Secretary T S R Subramanian, former secretary, economic affairs, Ministry of Finance, E A S Sarma, former secretary, Water Resources, Ramaswamy R Iyer and former chief of the Indian Navy Admiral L Ramdas.

Call for Independent Investigation

In September 2013, the same bench of the Supreme Court issued notices to the union government and RIL seeking their responses to the allegations levelled by the petitioners who are seeking an independent investigation into alleged acts of collusion between RIL and the Government of India, specifically the Ministry of Petroleum and Natural Gas. The petitioners claimed that the government had not acted against RIL which allegedly reduced output deliberately and sought to “hoard” gas in anticipation of higher prices. They had also opposed the government’s decisions to first increase the price of gas from \$2.3 per unit to \$4.2 per unit in September 2007 and, again, to \$8.4 per unit in June 2013.

Even before the bench headed by Chief Justice Sathasivam heard arguments on the petitions on gas pricing, Colin Gonsalves, counsel for Dasgupta, supported by Prashant Bhushan, counsel for Common Cause and others, urged the court of Justice Nijjar to stay proceedings in the arbitration petition relating to penalties imposed on RIL by the petroleum ministry for alleged suppression of gas output because of its failure to drill the requisite number of wells in the contracted area in the KG basin.

Justice Nijjar, however, refused to stay the hearing of the arbitration petition and held that the two pleas were different. Thereafter, the lawyers for both sets of petitioners mentioned that the dispute was pending before the court of the Chief Justice of India, repeating their earlier prayer for a stay on the arbitration proceedings. The bench posted the case to be heard along with the main PILs.

On 6 January 2014 when this case came up before the Chief Justice, hearings were adjourned since the union government had failed to file its reply. On 4 March, when the case came up again, the PILs were listed before a completely new bench comprising Justices Balbir Singh Chauhan, Jasti Chelameswar and Kurian Joseph. This bench eventually started hearing the arguments in the PILs on 11 March.

RIL had completed its arguments as the Supreme Court went into recess on 12 May. When it reconvenes on 30 June, the bench will have to be reconstituted again since Justice Chauhan will retire on 1 July. (Justice Nijjar retires on 6 June.) This will mean that the petitions will have to be heard again.

On the arbitration notice, Bhushan has claimed that RIL and the government were acting in collusion all along. He alleged that RIL was hoping that the incoming government will be “even more pliable” in allowing for a higher gas price. He contended that the government had first colluded with the company by allowing them to retain fields which ought to have been relinquished and thereafter, re-auctioned. Bhushan pointed out that the Comptroller and Auditor General of India (CAG) had found RIL guilty of grossly inflating capital costs by over-invoicing and “gold-plating”. Further, the CAG’s report presented in Parliament in September 2011 had claimed that RIL was “squatting” over an area of more than 7,000 square kilometres in the KG basin though the company was obliged to have surrendered more than 90% of this area by 2007.

RIL was also allowed to increase its capital expenditure from \$2.4 billion to \$8.8 billion after it claimed that gas production would be increased from 6 trillion cubic feet (tcf) at an average extraction rate of 40 mscmd till 2022 (part of the Initial

Development Plan submitted by the company in 2006) to a level of 11 tcf extracted at an average rate of 80 mscmd. However, gas production from KG-D6 kept dropping and over the last two years, output has come down to 8 mscmd.

The petitioners have claimed that RIL “hoarded” gas but the government did not penalise the company. In May 2012, the petroleum ministry, then headed by S Jaipal Reddy, decided to impose a

penalty on the company disallowing cost recovery. The initial penalty amount was \$1.4 billion which later went up to \$1.8 billion. In October 2012, Jaipal Reddy’s ministerial portfolio was changed by the then Prime Minister Manmohan Singh and Veerappa Moily was made minister of petroleum and natural gas.

Bhushan has also alleged that RIL laundered money earned by selling gas through a “shell” company or a

“nameplate” company called BioMatrix, which is registered in Singapore. The Indian High Commission in Singapore had reported that this company, with negligible equity capital and assets, had invested a large amount of Rs 6,500 crore in four Indian companies that are controlled and owned by Mukesh Ambani, chairman and managing director of RIL. These allegations have to be adjudicated upon by the Supreme Court.