India gas pricing reform stalls

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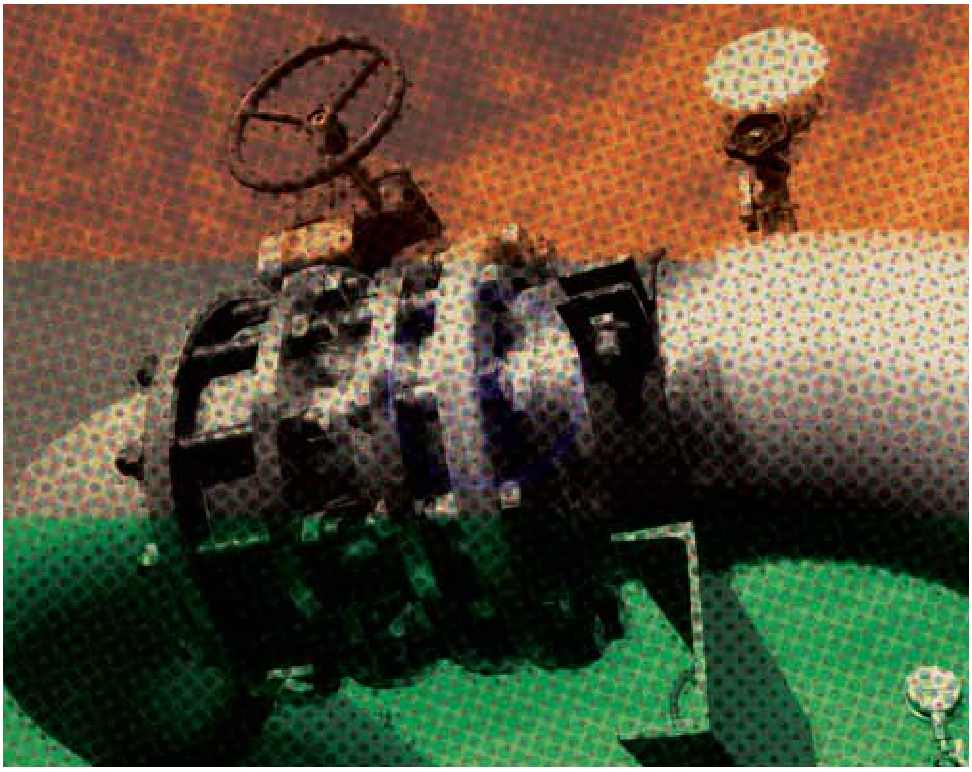

Delayed action: India will pay a steep price if reforms are not made

THE Indian government's surprise decision to delay the increase in natural gas prices until after the general elections in mid-May will not only cost upstream players billions of dollars in lost revenues, but it also highlights the political risks faced by investors.

The price increase, due to take effect from the start of April, was expected to spur exploration in India's oil and gas sector as demand for energy expands in Asia's third-largest economy.

Under the new formula, domestically produced gas prices would have jumped from between $4.20 and $5.70 per million British thermal units (Btu) to $8.40. The higher prices would have helped Reliance Industries and UK supermajor BP develop the KG-D6 Block, a deep-water gas block. Boosting production in the area, which holds India's biggest gas discovery, is difficult at low prices.

Furthermore, it's uncertain whether gas prices will ultimately be revised upwards. If market reformers take power, they could restore the price formula.

Moody's had projected combined revenues of the upstream companies to rise by up to $2.8 billion had the price rise been implemented in April as scheduled. The ratings agency estimates the companies will lose about $10 million to $12 million of revenue for every billion cubic metres of gas produced each month the reform is delayed.

Reliance Industries, run by Indian billionaire Mukesh Ambani, claims India will lose around $20 billion per year if gas price reforms are not implemented, as rising energy demand will be met using costly fuel imports.

The government estimates total demand for natural gas at about 100 million tonnes in the 2014 fiscal year starting April, and expects domestic production and imports of liquefied natural gas (LNG) to be around 25 million to 30 million tonnes and 10 million to 15 million tonnes, respectively. This would leave an unmet demand of between 55 million and 65 million tonnes for the year.

The delay also highlights the regulatory risk faced by investors in India. Even though the politically sensitive gas price reform was announced in June 2013, well before the elections, the decision to postpone the increase was taken only a week before its planned implementation.

Incumbent politicians, fearing for their seats, were forced to react to the anti-establishment threat of the fledgling Aam Aadmi, or Common Man, party, which has promised to lower prices.

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The Common Man party says the gas price reform is solely aimed at providing huge undue benefits to Reliance.

Reliance's earnings would fall less than 2% if the deferral lasted for a quarter, compared with a 7-8% hit at state-backed Oil & Natural Gas Corporation, say analysts at Nomura.

As the elections near, Reliance is locked in legal dispute against the authors of a book accusing the company of "crony capitalism" in relation to the KG-D6 field it operates with BP. Reliance sent a notice to the authors and distributors, which include Amazon, of the book *Gas Wars – Crony Capitalism and the Ambanis*, which was released in late April, alleging defamation and demanding that all copies of the publication be destroyed.

The move marks the latest controversy faced by Reliance connected to its gasfields off India's east coast, including a dispute over gas production levels that has seen the firm accused of excessive political influence by campaigners during the national elections.

Gas Wars details a number of alleged irregularities relating to the regulation and pricing of gas from the KG-D6 Block, in which BP bought a 30% stake for $7.2 billion in 2011.

Reliance is engaged in an arbitration process with India's outgoing government over allegations that the company deliberately suppressed production at the fields in anticipation of a future higher price, a charge Ambani's firm denies.

The KG-D6 field was hailed as India's largest gas discovery when it was found in 2002, but has since been dogged by technical difficulties and waning production that have cut its estimated value. ●