India gas-price move may spur upstream sector

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INDIA is poised to implement long-awaited gas price reforms in an effort to increase investment in upstream production. But the Reliance-BP joint venture developing the potentially prolific and contentious Krishna-Godavari D6 (KG-D6) deep-water block will not benefit just yet.

As a result, billions of dollars of investment remains up in the air.

As part of a major reform push, Narendra Modi's newly elected government, will increase domestically produced gas prices by 47% to $6.17 per million British thermal units (Btu) from 1 November.

The rise is slightly lower than the $8/million Btu number proposed by the previous government, mainly due to the removal of the liquefied natural gas (LNG) import price component from the original formula.

Ironically, it ties prices in India, a gas importer, to levels in exporting countries such as Russia and North America, where prices tend to be lower than in gas-hungry Asia. But half-yearly reviews are a positive sign.

There are further twists to the revised formula, including a deep-water gas price premium for new finds, yet to be announced.It is not clear if premium applies to all discoveries, only to undeveloped ones or to those developed after the announcement.

Yet analysts at Wall Street research firm Bernstein say the premium is one of the biggest positives stemming from the reforms. But they add that deep-water gas needs to be priced at least at $8/million Btu or more to be economic.

Coupled with changes to extend timelines and relax conditions in India's production sharing contracts, the reform allows the government to launch its long-delayed exploration offering early next year. Between 50 and 60 blocks will be included in the round. Still, the outlook remains uncertain for the BP-Reliance joint venture, which has long demanded pricing reform to spur development of the KG-D6 Block, offshore India.

The joint venture partners have lobbied for a price increase ever since BP invested $7.2 billion in 2011 to take a 30% stake in the Krishna-Godavari basin block, once flagged as India's biggest-ever discovery, to spur investment and raise waning production.

Output at KG-D6 has declined more than 80% since mid-2010 to around 12.5 million cubic metres per day (cm/d) from a peak of about 65 million cm/d. It was expected to hit 79 million cm/d by 2013, which would have nearly doubled India's total gas output.

Rising tensions

The disappointing performance triggered a tense stand-off between the joint venture and the government, which accused Reliance of deliberately slowing production to force gas price reform.

Under the latest reform, Reliance and its partners, which include Canadian independent Niko Resources, will continue to receive $4.2/million Btu from the block's two producing fields, D1 and D3, until they make up a shortfall between targeted production and actual output.

However this would not apply if a court rules that the production shortfall was unintentional and due to geological complexities.

Bernstein believes the drop in production was due to issues with the field's reservoirs and expects the partners will get the revised rate back-dated in full.

In May, the joint venture warned that reversing the move towards gas price levels above $8/million Btu would threaten $4 billion worth of investments planned for this year, and at least delay up to $10 billion of capital spending over the next four years.

Bernstein calculates that Reliance could potentially boost upstream production nearly fourfold from 13 million cm/d to between 40 million and 50 million cm/d with its D6 satellite fields and new D55 development, if gas prices climb above $8/ million Btu. On top of that, the MJ-1 discovery, also in the play, holds a further 84 billion cm of gas which could be developed.

Still, without certainty on pricing, it's not clear if Reliance-BP can stomach the billions of dollars in capital spending needed to develop its fields.

Reliance has said that it will cost more than $113 million to drill one deep-water exploration well, and $200 million to drill a development well.

Apart from gas price reform, India freed diesel prices from government control. The timing seems strategic, given the sudden drop in global crude prices, which will ease the burden on consumers.

And deregulation is expected to pave the way for private refiners to ramp up their retail businesses, which have been out-muscled by state-backed firms selling diesel at subsidised prices.

Fuel retail is lucrative as domestic diesel returns are $1-2/barrel better than exports due to tariff protection and lower freight cost, Macquarie Group's Abhishek Agarwal wrote in a note.

The move should also bolster the Indian economy and encourage more efficient consumption, as well as the development of cleaner energy sources.

Almost half of the $23 billion India spent on fuel subsidies last year went on diesel. And the nation's dependence on petroleum-based fuels pushed its trade deficit up to $14.3 billion in September.

Diesel fuels about 50% of all vehicles in India as well as the generators that are commonplace in retail and industry, a result of frequent power cuts. Modi has urged entrepreneurs to move into power generation, particularly from alternative energy sources, such as solar, hydroelectric dams, nuclear and wind farms. The National Action Plan on Climate Change calls for 15% of India's energy to be supplied from renewable sources by 2020.

"People have understood that India's lack of energy was the biggest impediment to growth, and Modi is translating this into action" Abheek Barua, an economist at the New Delhi-based think-tank Indian Council for Research on International Economic Relations, told the *International New York Times*. ●