Opinion on Discriminatory Application of IFEM

The Competition Commission of Pakistan (hereinafter the "Commission") took notice of concerns raised by an oil refinery (hereinafter "the Refinery") in respect of benefits of Inland Freight Equalization Margin (IFEM) denied to it by the Oil and Gas Regulatory Authority (OGRA) and Ministry of Petroleum and Natural Resources (MPNR), which discriminates against the Refinery and results into competitive disadvantage to it vis-à-vis refineries who are receiving IFEM from OGRA. The Commission held a public hearing in the matter at the Commission's headquarters on 25 February, 2014 and issues this Opinion under Section 29(c) of the Competition Act, 2010.

I. Background

IFEM is the cost of inland movement incurred by (i) a refinery for transportation of crude oil from source to refinery; and (ii) by an oil marketing company for transportation of finished fproduct from supply point to depots in the country. IFEM is included in the consumer price and the purpose of IFEM is to maintain the same prices of Motor Gasoline (Petrol), High Speed Diesel Oil (Diesel), Light Diesel Oil (LDO) and Kerosene Oil across the country by reimbursing transportation costs to refineries and oil marketing companies.

There are five oil refineries in Pakistan; two upcountry refineries, two coastal refineries located near Karachi Port Trust (KPT) and one refinery located in Hub, Balochistan. Upcountry refineries are primary beneficiary of IFEM whereas coastal refineries are in proximity of KPT and therefore, do not incur transportation cost requiring reimbursement from IFEM.

The Refinery is situated in Hub, Balochistan and refines crude oil imported from abroad. The crude oil is picked from Port Qasim Authority (PQA) and is transported to Hub, Balochistan and therefore, incurs transportation cost from PQA to Hub. The Refinery became operational in 2004 with a capacity of 35,000 Barrels Per Day (BPD). Later on, capacity was enhanced by setting up another unit which was designed to cater for 120,000 BPD. Further, the Refinery has also installed its own deep sea floating jetty, Single Mooring Point (SPM), which is connected to Refinery via undersea pipeline (12 Km) to transport crude oil to Refinery and saves road transportation cost.

The Economic Coordination Committee (ECC) in its decisions dated 16 August 2011 and 22 February 2013 has allowed the Refinery to recover its transportation cost and also operational cost in respect of SPM from the pool of IFEM but these decisions have not been implemented till date. Further, the Refinery has not yet been given the status of 'supply source' which restricts the oil marketing companies to recover their cost of road transportation for distribution of refined oil produced by the Refinery, from the IFEM pool.

The Commission held a public hearing on 25 February, 2014 relating to the matter, which was attended by the representatives of MPNR, OGRA, refineries and oil marketing companies.

II. ISSUE

Whether barring the Refinery from claiming IFEM distorts market conditions, which results in lessening of competition in crude and refined oil markets.

III. Concerns and Discussion

1. Transportation Cost of Crude Oil

OGRA has denied the transportation cost of crude oil to the Refinery on the following two major grounds:

i. *"two ECC decisions coexist wherein one decision has disallowed crude transportation to [the Refinery] whereas the other has allowed the same"* and MPNR did not seek approval of ECC regarding rescinding latter's earlier decision; and

ii. the Refinery has availed certain investment incentives, therefore, it cannot be given the benefit of IFEM pool.

A. ECC Decisions

i. ECC in its decision dated 19 March 2009, on the summary of MPNR dated 17 March 2009 allowed tax holidays to the Refinery, but did not allow the reimbursement of transportation cost of crude oil.

ii. ECC in its decision dated 16 August 2011 on the summary of MPNR dated 09 August 2011, allowed the Refinery to recover its crude oil transportation costs from IFEM pool, till 30 June, 2012; thereafter, the Refinery was to start importing crude oil through it SPM.

iii. ECC in its decision dated 22 February 2013 on the summary of MPNR dated 21 February 2013 allowed the Refinery operational cost of SPM through IFEM.

Which decision should prevail in the case of two conflicting decisions of a higher forum is a proposition of law that is too well settled to admit any debate. The courts have held that judgment later in date and time shall prevail.[1] From the documents available to the Commission, it stands clarified that the abovementioned summary submitted by the MPNR to ECC on 21 February 2013 clearly mentioned the earlier decision of ECC dated 19 March 2009 whereby the Refinery was not allowed inland transportation cost of crude oil and also its later decision dated 16 August 2011 to approve crude oil transportation cost for the Refinery. Therefore, it cannot be doubted that an informed decision was not made at the forum of ECC.

B. Investment Incentives

An important fact that needs to be highlighted is that the Refinery was allowed to recover the cost of crude oil transportation in respect of its first unit; however when the Refinery decided to set up another unit, for which the investment incentives were given, where crude oil was transported by SPM, it was allowed to recover the operational cost of SPM.

Investment incentives are given to allow players to enter the market/or expand their business. Investment incentives cannot be offset by denying benefits normally given to existing market players.

[1] *See for example*, Muhammad Saleem v. Fazal Ahmad, 1997 SCMR 315 (2009); Muhammad Ramzan v. Rahim Shah 2009 CLC 866 (2009).

The IFEM pool is an indirect subsidy given to residents of Pakistan by covering the transportation costs of the refineries and oil marketing companies to ensure that their products are available to consumers at a uniform price across the country. Denying access to the Refinery to the IFEM pool on the basis that it has enjoyed investment incentives and is a private sector entity results in distorting competition in the relevant market.

2. Operational Cost of SPM

With respect to denying reimbursement of operational cost of SPM to the Refinery, OGRA has taken the stance that:

i. the Refinery is saving wharfage charges as it imports crude oil through its own SPM. Therefore, allowing the operational cost of SPM may lead to the double reimbursement to the Refinery; and

ii. the ECC has allowed operational cost to the Refinery at the rate of Pak Arab Refinery which amount does not represent the operational cost of the Refinery.

OGRA has stated in its letter dated 15-05-14 sent to the Commission that *"in case of local crude, the producers supply the crude to the local refineries at the refinery gate, therefore, no freight is incurred by the refineries, however, as per the pricing mechanism approved by the Federal Government the ex-refinery price allowed to refineries include the wharfage element."* This means a refinery situated in hydrocarbon rich area and using local crude oil, does not have to pay crude oil transportation, but it is still given ex-refinery price containing wharfage element. Inclusion of wharfage element in ex-refinery price and operational cost of SPM are two different matters. Hence, reimbursement of operational cost of SPM is justified on the same principle by which transportation cost is reimbursed to other refineries from the IFEM pool.

As far as the rate is concerned, this is a dispute regarding computation which can be resolved by independent fair determination; however, existence of a dispute relating to applicable rates cannot take away the right to access the IFEM pool.

3. Declaring the Refinery as "Supply Source"

Currently, the Refinery is not declared as "supply source" and therefore, transportation cost incurred by oil marketing companies is not reimbursed from IFEM. This makes oil marketing companies shy of transporting the oil from the Refinery, thereby reducing the supply of refined oil from the local source in the market.

During the course of the hearing the only reason to oppose declaring the Refinery as "supply source" given by the MPNR was that giving this status is subject to start of production of a refinery and the second unit of Refinery has not yet started production. This matter can be resolved on satisfactory inspection of the Refinery.

Discriminatory access to the IFEM pool and denying the status of "supply source" distorts the market conditions for the Refinery and puts it at a competitive disadvantage vis-à-vis its competitors, thereby making it difficult for it to compete in the market. Further, such unequal treatment given to an undertaking discourages new investment and creates barrier to entry in the oil market.

Regulated products covered under IFEM constitute approximately 50% of the total oil products produced in Pakistan by the refineries. Though the maximum prices are set by the OGRA, operational efficiency and synergy may allow the refineries to achieve economies of scale and may thereby reduce the price charged to end consumer. Therefore, it is essential to have a non-discriminatory regulatory environment that creates confidence and helps bring more investment, technology, capital and resources, thereby making the relevant market competitive.

IV. Recommendation

In view of the foregoing and in the interest of eliminating discrimination among refineries and creating a level playing field in crude and refined oil markets, it is recommended that the Refinery be given:

(i) the benefit of IFEM in terms of transportation cost of crude oil as allowed by ECC in its decision dated 16 August 2011;

(ii) the benefit of IFEM in terms of operational cost of SPM as allowed by ECC in its decision dated 22 February 2013; and

(iii) the status of “supply source” .

ISLAMABAD, THE 7TH DAY OF AUGUST, 2014.