INDIA AND AFRICA : FORGING CRUDE OIL TRADING RELATIONS

AS Ujwal

Introduction

Energy is one of the main drivers of India's policy towards Africa. In the Indian energy basket, the dependence on oil is only next to coal, based on consumption. Taking into account the domestic crude oil production, imports play an important role in meeting the processing requirements of Indian refineries. With the projected growth trajectory of the Indian economy, the need for oil and its share in the imports is likely to rise from the current level of about 80% to 90% by 2025, unless the indigenous crude oil production shows a steady increase in coming years. The Middle-East, South America and Africa are some of the other sources of crude oil that give regular inputs to Indian refineries. This short brief lays down the scope for India-Africa trade in crude oil, identifies the inherent issues and suggests some recommendations to resolve these issues.

Africa

From the hydrocarbon angle, Africa is an oil and gas exporting continent where crude oil production far exceeds the total demand within Africa. Important oil producing countries include Nigeria, Angola, Algeria, Libya, South Sudan, Egypt, Equatorial Guinea, Congo, Gabon, Cameroon etc. With on-going exploration activities, more countries are likely to be added to this list in future.

Majors like Royal Dutch Shell, ExxonMobil, Chevron, BP, TOTAL, Eni, Statoil, and others have been active for over six decades in exploration and production of crude oil and gas. These companies entered into Production Sharing Contracts (PSC) with the national oil companies such as the Nigerian National Petroleum Corporation (NNPC). They brought in technology and made large investments in setting up related infrastructure, enabling crude oil and gas exports. The oil handling terminals, pipelines, offshore platforms/storage vessels etc. are thus owned and operated by these companies. Based on the terms of the PSC, part of the production is allocated to and uplifted by NNPC as its share. However, major share of oil production continues to be monopolized by these companies. These majors finalise the sale contracts for their volumes and are operationally in an advantageous position, being the terminal operators.

While oil exports from Africa were supplied to locations around the world, a significant volume went to the United States (U.S.). In 2008, the estimated U.S.-Africa oil trade was worth $ 100 billion. However, the traded volumes started falling with increase in the domestic 'shale oil' production from North Dakota, Texas and other regions in the U.S. Therefore the U.S.-Africa oil trade has fallen below the $ 20 billion level and still falling. The reduction in the U.S. demand for oil has been partially offset by increasing volumes demanded and absorbed by China, Japan, India and Europe.

India Africa Crude Oil Trade:

The India-Africa crude oil trade has been in existence for about three decades now. The light and low-Sulphur based African crude oil, particularly Western and North African, is suitable for processing in the older refineries that are used in India for producing environment friendly middle distillate products. These products constitute a large chunk of the petroleum demand in the country. Marketing of the transportation fuels in India presently is largely in the hands of the state-owned public sector undertakings (PSUs) which carry out purchase of required crude oil grades from Africa. However, private refiners are expected to enhance their market participation in domestic market in near future. Their current production is either exported or supplied to the PSUs.

The major crude oil exporting countries to India include Nigeria, Angola, Algeria, Libya, Egypt, Equatorial Guinea. Congo, Gabon, Cameroon etc. However among these, the largest exporters are Nigeria, Angola and Algeria. Until before the recent political disruptions in Libya, Libyan crude oil flows were also regular.

Trading Mechanism:

Security of supply is one of the major considerations for oil consumers and particularly the refiners, just as security of demand is important for the producers. For effectively meeting both requirements, most of the National Oil Companies (NOCs) in Asia and Middle East enter into 'Term Contracts' with their consumers. Typically, such contracts have standard terms and conditions for a pre-agreed contract period including renewal options or even 'ever green' contracts. The pricing is formula based with variable elements and the grade-wise crude oil price is declared by the producer. Equality is maintained with uniform applicability of contractual conditions to term holders.

In Indo-Africa trade very few NOCs have term contract mechanism. While standard terms and conditions apply, the pricing is generally negotiated or is decided on a multiple price option basis. Majority of Indian companies do not have term contracts with the African NOCs. Bulk of the trade deals are finalized through tenders issued by the Indian buyers. The tendering mechanism provides a uniform competitive platform to all prospective bidders with tender conditions applicable to all sellers. Tenders are awarded as per procedure to the most competitive bid. Bidders mostly include oil majors and international oil trading companies – with traders getting tender awards regularly.

Issues:

Deteriorating law and order situation in Africa, mainly in the oil exporting countries, has been a matter of concern for oil industry. Despite government assurances, continued patrolling and direct interventions by the security forces, the international oil companies face huge difficulties in transporting, storing and operating their assets as well as safeguarding their human assets against incidents of kidnappings etc. These challenges ultimately hamper the implementation of contracts. This also affects the buyer confidence and brings in uncertainty. Some of the issues related to the crude oil loadings are identified below:

- Non-availability of crude oil in storage tanks in the terminal due to blowing up/rupture of incoming pipeline.
- Law and order situations at inland terminals and at offshore loading platforms, leading to closure of the terminal and offshore facilities
- Quantity variations in oil receivedas per ship's measurements as against shore tanks measurements which are important for preparing Bills of Lading,resulting in losses for receivers.
- Disruptions in contractual loadings on due dates on account of force majeure conditions at the loading terminal. Thisleads to detention of vessels apart from severely affecting receiving refinery pro-cessing schedule.
- Several cargos are loaded in VeryLarge Crude Carriers (VLCCs). Detention charges for VLCCs, even asa result of the seller's error, are not reim-bursed to the buyer.
- A term contract holder is normally entitled for the contractual volume and grade as per

the terms and conditions enumerated in the contract. Some African NOCs do not allocate the full term contract crude oil volumes over the entire period.

- The term allocations are about 50% of the contracted volume. Such low allo-cations against the entitlement defeat the very essence of a term contract incontext of security of supply.

- Non-allocation of any one of the preferred grade of crude oil to the term contract holder by one of the AfricanNOCs leads the buyer to opt for purchases through tenders, though the same is as per the conditions incorporated in the term contract.

Recommendations

- There is a need to bring in a stable, reliable, cost efficient and mutually beneficial trading mechanism for crude oil between Africa and India keeping long term interests of both countries in perspective.

- African companies further need to examine the feasibility of storing their crude oil in storage locations on Indian soil for ready availability for Indian buyers, thereby cutting the long lead time and enhancing their competitive edge.

- Support and facilitation between the producers (African companies) and the consumers (Indian companies) at the government level from both sides can provide a suitable platform for:

• Enabling deals between buyer and seller for entering into long term contracts for supply of crude oil. Emphasis should be on 'end-user' as a criterion for awarding the contract;

• Framing a mechanism for market-linked commercial arrangements including pricing, with appropriate financial safeguards for both parties. Trust and transparency is a necessary condition in this process;

• Providing security of supply for consumer and security of demand for producer over longer time horizons thereby ensuring energy security, as against spot deals.

• Establishing an appropriate review mechanism, including dispute resolution, without causing supply disruptions.