

# INTERNATIONAL INVESTMENT IN THE ENERGY SECTOR IN INDIA

## A BRIEF OVERVIEW

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*Energy is one of the most valuable resources in the world. With the large scale industrialization and development of the countries, demand for energy has increased manifold. Consequent to this ever increasing demand, the supply being limited by natural constraints, there has been an evident shortage in supply of energy resources, especially to the nations having limited energy resources (as these are largely reliant on import of the same).*

*International Investment can be primarily divided into four categories; namely, Commercial loans, Official flows, Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII). **For the purpose of this paper, we shall focus on Foreign Direct Investment in the Energy Sector in India.***

*With globalization occupying the centre stage of International agenda, sharing and exchange of technology and capital flows have become inseparable. Off late, there has been large scale capital investment in developing states in the form of 'Foreign Direct Investment (FDI)'. Governments of various developing countries are thus exploring the option of agreements, whereby the international investors agree to enter into what can be termed as 'International Investment Agreements' and the government can obtain capital and technological expertise which is not found in their own country. On the other hand, for investors who plan to expand their arena as well as seek to enhance their profits, growth in International Investment in the Energy Sector seems to be a very landmark development. However, this setup is not as easy as it prima facie seems like. India has allowed huge influx of foreign direct investment in various sectors, renewable energy being one of them, while on the other hand, India has refrained from bringing any foreign influx in the Nuclear Energy Sector.*

*In this paper, I shall be focusing my research on the FDI regime in the Energy Sector in India and its avenues. I shall also be shedding some light on exploring the need of FDI in energy sector and policy and legislation that needs to be worked upon before bringing such influx of 'outside-money' to the country. The subject of energy law involves consideration of various other technical aspects so as to work out a proper legislative draft. Thus, this paper will not just limit itself to legal aspect of the paper but also concentrates on the technicalities involved in the particular sector.*

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*For the research, my sources will be books on International Energy Investment Law, scholarly articles on the websites and primary sources of information like the policy circulars and analytical reports by industry chambers.*

## I. INTRODUCTION

The election manifesto of the newly elected government, BJP clearly evidences the fact that the party has been very keen on bringing reforms in the Energy Sector so as to ensure energy security and access of energy to all. In the manifesto, it clearly states that it seeks to “ensure supplier diversity and to avoid reliance on one single supplier for its energy needs.”<sup>2</sup> Its stand on FDI policy of the country is also fairly clear with the allowance of Foreign Direct Investment in all sectors that “require creation of job and asset, infrastructure and acquisition of latest technology and specialized expertise.”<sup>3</sup>

As the fourth largest consumer of energy and India being considered as FDI hub lately, International Investment in the form of FDI in Energy Sector in India has become a very lucrative area of investment for international investors. However, India has to rely majorly on imports to meet the basic, domestic needs of the consumers here. Most of the energy needs are fulfilled by thermal power which involves the use of coal. However, with an increase in the population, the present available resources might not be able to sustain and cater to the demands of the huge population burden.<sup>4</sup> On the top of it is the mounting burden of years of underinvestment in the energy sector which has left the country with poorly functioning systems due to lack of funds. Even if most of the energy sectors allow private participation in the market, many a times, the Indian players lack the requisite funds, and more importantly; the technology that is required for the execution of such technology-intensive plans typically involving high amounts of expenditure and capital investment. In such a regime the need of international investments, especially in the form of FDI has been time and again reemphasized. This is crucial as this allows the developing countries to enter into various agreements with other nations and obtain capital and technological expertise which might not be found in the host country.<sup>5</sup>

Typically, most of the capital flows in a country are governed by the standard laws and policies governing Foreign Direct Investment. However, energy sector is a different regime altogether. Although every country has its own policies that regulate foreign investment in this sector, there are many internationally binding treaties that give effect to the regulatory regime concerning FDI in the energy sector. UNCTAD defines Foreign Direct

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<sup>2</sup> 'BJP Election Manifesto 2014' (BJP website 2014) <[http://www.bjp.org/images/pdf\\_2014/full\\_manifesto\\_english\\_07.04.2014.pdf](http://www.bjp.org/images/pdf_2014/full_manifesto_english_07.04.2014.pdf)> accessed 30 August 2014

<sup>3</sup> Id.

<sup>4</sup> Dezan Shira & Associates, 'Key Sectors for FDI in India: Manufacturing and Energy' (India Briefing 2013) <<http://www.india-briefing.com/news/key-sectors-fdi-india-manufacturing-energy-6412.html>> accessed 22 August 2014

<sup>5</sup> Mustafa Erkan, *International Energy Investment Law- Stability through contractual clauses* (1st, Kluwer Law International, Great Britain 2011) 5

Investment as “an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor.”<sup>6</sup>

The most crucial thing that has to be noted about FDI is that it ensures that the company has a lasting interest, unlike portfolio investments that are highly volatile as the investors can always pull out their resources. Exiting the FDI market in India is not all that easy. Thus, when international investments are being talked about in any sector, especially capital intensive sectors like energy sector, FDI is the best possible option unlike other forms of international investment.<sup>7</sup>

## II. ENERGY CHARTER TREATY

In a highly globalized world with exchange of resources and technology being more like a norm than an exception, Energy Charter Treaty (ECT) facilitates the functioning of the regime as it lays down multi lateral rules which provide a more efficient and effective framework that ensures optimum balance for international cooperation. In this manner, Energy Charter Treaty is perhaps more effective than the cooperation that is ensured by bilateral agreements and non binding instruments. Based on principles of competitive market and sustainable development, it as well ensures that the international energy market is effectively capitalized by the investors and adds to the advantage of the host country. This treaty was signed in 1994 and came into force in the year 1998.<sup>8</sup>

The Charter has, over the years that it has been enforced, has protected FDI as the central issue under legally binding and non-binding provisions that developed during the Energy Charter Process. This charter, in addition seeks to provide conducive climate for the smooth functioning of the government and industry.<sup>9</sup> The Charter has come to become the main document in the energy sector which is legally binding in nature, since

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<sup>6</sup> 'Foreign Direct Investment (FDI)' (UNCTAD 2013) <[http://unctad.org/en/Pages/DIAE/Foreign-Direct-Investment-\(FDI\).aspx](http://unctad.org/en/Pages/DIAE/Foreign-Direct-Investment-(FDI).aspx)> accessed 30 August 2014

<sup>7</sup> Swarnima Bhardwaj, 'Foreign Direct Investment in Power Sector' (Maheshwari and Co. Legal Consultants 2011) <[https://www.google.co.in/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0CEwQFjAE&url=http%3A%2F%2Fwww.maheshwariandco.com%2Frepository%2Fpresentation%2Fdownload%2FFDI\\_in\\_Power\\_Sector.ppt&ei=pfAYVOLcGdSGuAS-14DoDA&usg=AFQjCNHYI3xH\\_1Awme7nerpZS86837KNhA&sig2=YVMxoc0Eilno49x0iOotyA&bvm=bv.75558745,d.c2E](https://www.google.co.in/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0CEwQFjAE&url=http%3A%2F%2Fwww.maheshwariandco.com%2Frepository%2Fpresentation%2Fdownload%2FFDI_in_Power_Sector.ppt&ei=pfAYVOLcGdSGuAS-14DoDA&usg=AFQjCNHYI3xH_1Awme7nerpZS86837KNhA&sig2=YVMxoc0Eilno49x0iOotyA&bvm=bv.75558745,d.c2E)> accessed 14 September 2014

<sup>8</sup> 'Strengthening India's Energy Security: a Role for the Energy Charter' (Energy Charter 2008) <[http://www.encharter.org/index.php?id=21&id\\_article=141&L=0](http://www.encharter.org/index.php?id=21&id_article=141&L=0)> accessed 23 August 2014

<sup>9</sup> T. Bak, 'Potential Impact of the Energy Charter Treaty on FDI Promotion and Protection in view of Global Trends, Energy Governance and Possible Actions towards ECT Non-Members' [2013] Energy Charter Secretariat Knowledge Centre 2013, 5-6

its coming into existence in 1991 in Eurasia.<sup>10</sup> Nearly every provision of the Charter seeks to facilitate the inflow of Foreign Direct Investment (FDI) in the country.<sup>11</sup>

Thus, apart from the host countries' policies, the popularity of FDI in energy sector can very well be attributed to the ECT.

### III. OIL AND GAS SECTOR- FDI PROSPECTS IN INDIA

In India, Oil and Gas Sector has been of utmost significance as this sector is primarily and directly responsible for many other essentials in the country. The economy of the country is massively dependent on the proper regulation of this sector. Thanks to refining and exports, over the past few years, India has witnessed a record breaking increase in the gas sector. Domestic demand for the energy source is also expected to grow further. In India, ONGC (Oil and Natural Gas Corporation of India) and OIL (Oil India Limited) have come to dominate by and large the majority section of the sector. However, due to the ever increasing gap between the demand and supply of petroleum products, India imports 60% of the crude oil resulting in mounting expenditure. India does not exactly lack the resources but it lacks exploration of resources. As the data suggests, about 78% of the area of the country is yet to be explored and thus India has the potential to discover new potential sources and capitalize on the same.<sup>12</sup> As of now, this sector contributes almost 2.83% of India's total FDI Share.<sup>13</sup>

#### NEW EXPLORATION AND LICENSING POLICY, FDI AND ITS IMPACT ON THE COUNTRY

India came up with the New Exploration and Licensing Policy (NELP) in the year 1997-98 for the exploration and production of oil and natural gas so as to encourage equal participation from the private as well as the public sector enterprises.<sup>14</sup> It was principally the move that prompted the government to open up FDI in oil and gas sector and the government ultimately allowed 100% FDI with complete equity through automatic route in the sector<sup>15</sup>. Besides, this policy mandated the government to provide land to the companies to carry out the process of exploration through the process of international competitive bidding.<sup>16</sup>

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<sup>10</sup> Id.

<sup>11</sup> CPA Speed, TW Walde, 'Will the Energy Charter help international energy investors' [1996] UNCTAD, Volume 5, No. 3 1, 19

<sup>12</sup> 'Oil and Gas: Sector Overview' (Maheshwari and Co. Legal Consultants 2013) <<http://www.maheshwariandco.com/services/oilandgas.html>> accessed 2 September 2014

<sup>13</sup> See n 3

<sup>14</sup> 'Oil and Gas' (Invest India 2012) <<http://www.investindia.gov.in/oil-and-gas-sector/>> accessed 13 September 2014

<sup>15</sup> Sakshi Parashar, 'Legal Aspect Of Oil And Gas Sector' (Manupatra 2011) <<http://www.manupatrafast.com/articles/PopOpenArticle.aspx?ID=3b9928f3-1807-4916-b783-33b3c38992db&txtsearch=Subject:%20Oil%20And%20Gas>> accessed 8 September 2014

<sup>16</sup> Directorate General of Hydrocarbons, 'A Glimpse of NELP-X - Directorate General of Hydrocarbons India' (DGH India 2014) <<http://www.dghindia.org/admin/document/Topstory/13.pdf>> accessed 4 September 2014

With developments in legal field taking place consequently there have been corresponding advancements in the business sector with India witnessing one of the biggest FDI deals in the year 2011 between British Petroleum and Reliance Industries.<sup>17</sup> Again Malaysia's national oil company, Petronas has fixed a deal with Maharashtra Industrial Development Corporation for building a lubricant plant.<sup>18</sup>

The positive aspect of such deals and FDI influx is the increase in foreign exchange that benefits the government exchequer ultimately. Besides, since international giants like the British Petroleum and Cairn Energy<sup>19</sup> come in with huge amount of capital, upstream exploration which is highly capital intensive is benefitted by such ventures. Also, FDI ensures the influx of new technology and easier access to flow of large amounts of capital in the country which may ultimately help in exploring the upstream as well as the downstream, thereby giving utmost effect to the objectives as envisaged by NELP.<sup>20</sup>

Besides these, the government has adopted the following to increase and promote FDI in oil and gas sector:-

- The refining sector has been de-licensed and is open to the joint venture of public private partnership. In case of a private Indian company, FDI is permitted upto 100%
- For petroleum products and pipeline sector, FDI through automatic route is permitted upto 100%. Same follows for natural gas/ LNG pipeline through FIPB route, with government approval.
- 100% FDI for the purpose of market study and policy formulation in the sector.<sup>21</sup>
- FDI up to 100 percent is permitted via the automatic route on petroleum product marketing. FDI in this sector is subject to the existing sectoral policy and regulatory framework in the oil marketing sector<sup>22</sup>
- FDI up to 100 percent is allowed on the automatic route in oil exploration in both small and medium-sized fields, subject to and under the policy of the government on private participation in: (1) exploration of oil and (2) the discovered fields of national oil companies
- FDI up to 100 percent is permitted via the automatic route for petroleum product pipelines<sup>23</sup>

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<sup>17</sup> 'Oil and gas Sector in India' (info@energytoday.co.in 2013) <<http://www.energytoday.co.in/subscribe.php?id=193>> accessed 9 September 2014

<sup>18</sup> Id.

<sup>19</sup> 'FDI inflows Petroleum and Natural Gas' (Business Maps of India 2011) <<http://business.mapsofindia.com/fdi-india/sectors/petroleum-natural-gas.html>> accessed 6 September 2014

<sup>20</sup> 'India has Huge Growth Prospects in Oil and Gas Space' (Step Ahead 2013) <<http://www.moneycontrol.com/gestepahead/article.php?id=945481&cid=9>> accessed 14 September 2014

<sup>21</sup> 'India's Energy Sector: Key Regulatory Policies' (D&B 2009) <<https://www.dnb.co.in/IndiasEnergySector/KeyRegu.asp>> accessed 13 September 2014

<sup>22</sup> FDI Policy for Petroleum and Natural Gas Sector, <http://petroleum.nic.in/fdi.pdf> accessed 14 September 2014

<sup>23</sup> See n 3

However, unlike what has been envisaged, the response trend in the sector due to FDI represents a very different story.

Till 2010, there was hardly any impact caused by FDI that was witnessed in the petroleum sector unlike the positive response in the refining sector. This major loss has been caused due to the absence of adequate legal infrastructure in this regard relating to pricing and monopoly in the sector. Thus, to make the FDI policy a success, it is imperative that the country has a strong legal infrastructure to support the reforms which are being brought about in the sector.<sup>24</sup>

#### IV. FDI AND INDIAN COAL SECTOR

The importance of coal in economy, particularly, the energy sector cannot be emphasized more. It forms the very basis of the Energy Sector in India. The coal production unit accounts for 58% of electricity generated in India. As of now, India is the third largest producer of coal.<sup>25</sup> Its importance is furthered by the fact that not just for thermal energy purposes, coal is crucial for steel, cement and many other small industries that depend on it for its energy requirements.

#### PERMISSIBLE FDI LIMIT

The policy as it stands allows for 100% FDI in the coal sector for private, Indian companies that are desirous of setting up or operating power projects and coal or lignite mines for captive power consumption. Similarly, 100% FDI is allowed for setting up coal processing plants on the pre condition that that company shall not, itself engage in coal mining and not sell washed or sized coal from coal processing plants. For captive consumption, FDI upto 74% is allowed for exploration or mining of coal or lignite.<sup>26</sup> However, all the influx of foreign investment in this sector is carried out in accordance with the provisions of Coal Mines (Nationalization) Act, 1973.<sup>27</sup>

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<sup>24</sup> Sanjay Kaul, 'Change in Petroleum FDI policy : Impact assessment ' [2013] Centre of Policy Initiatives & Energy Studies (CPIES) , 42

<sup>25</sup> 'FDI inflows to Coal production' (Business Maps of India 2011) <<http://business.mapsofindia.com/fdi-india/sectors/coal-production.html>> accessed 13 September 2014

<sup>26</sup> Press Information Bureau, Government of India: FDI in Coal Sector <http://pib.nic.in/newsite/erelease.aspx?relid=9157> accessed 18 August 2014

<sup>27</sup> Sanjay Jog, 'Centre allows 100% FDI in Coal Sector' *The Economic Times* (Mumbai 2007) <http://www.financialexpress.com/news/Centre-allows-100-FDI-in-coal-sector/211544> accessed 13 September 2014

## COAL SECTOR AND FOREIGN INVESTMENT-A BRIEF OVER VIEW

The basic problem relating to coal sector is due to the fact that coal is a non-renewable, exhaustible resource.<sup>28</sup> This makes it a very sensitive sector in the sense that the use of coal must be carried out in a judicious manner as well as in an efficient manner to ensure that there is minimal wastage and maximum, optimal output. With the depleting resources, it is important that higher levels of capital is invested into the sector so as to ensure that the feasibility of extraction of new resources can be assessed as well as exploited.<sup>29</sup>

### V. INDIAN POWER SECTOR AND FDI

India's power sector happens to be the fifth largest in the world. The huge size of the market of power sector and the high levels of investment return are crucial factors for the flow of FDI in the country.<sup>30</sup> In India, 100% FDI is permissible through the automatic route in all power sectors, barring the atomic energy channel. Due to high return on investment, India has been regarded as an investment hub.<sup>31 32</sup>

No project relating to investment can be a huge success without legal framework and policy regime guiding it through. Thus the government has initiated several projects which have reinforced the faith of the investors in the power sector, thereby playing a catalyst to accelerate capacity building and exploration and exploitation of new and potential sources. National Electricity Policy, Mega Power Policy, Tariff Policy, have been a few of the many policies that have been crucial in encouraging investments in the power sector. This is where the relevance of a legal regime comes into picture as its relevance is evident from the way investment and energy policies are structured in the country.

This sector essentially encompasses all the other sectors that involve/result in power generation. Yet the regulations governing FDI rules in this sector are slightly different in this section. The arenas for investment in Indian power sector pertain to the following sectors:-

- Hydro Projects
- Captive Power
- Ultra Mega Power Projects
- Nuclear Power
- National Grid Program

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<sup>28</sup> 'Coal' (Clean Energy 2013) <<http://www.epa.gov/cleanenergy/energy-and-you/affect/coal.html>> accessed 12 September 2014

<sup>29</sup> 'Report of the Working Group on Coal and Lignite for Formulation of eleventh five year plan (2012-17)', Government of India, Ministry of Coal (Delhi, 2006) [http://planningcommission.nic.in/aboutus/committee/wrkgrp11/wg11\\_coal.pdf](http://planningcommission.nic.in/aboutus/committee/wrkgrp11/wg11_coal.pdf) accessed 12 September 2014

<sup>30</sup> 'FDI inflows to power sector' (business.mapsofindia.com 2011) <<http://business.mapsofindia.com/fdi-india/sectors/power.html>> accessed 8 September 2014

<sup>31</sup> 'A Brief Overview on Power and Energy Sector in India' [2013] Corporate Catalyst India 1, 2

<sup>32</sup> 'Power' (InvestIndia 2012) <http://www.investindia.gov.in/power-sector/> accessed 13 September 2014

- Rural Electrification
- Trading
- Renewable Energy

#### FDI PERTAINING TO INDIAN POWER SECTOR

In the power sector, FDI up to 100% is permitted through automatic route. Generation as well as transmission of electric energy produced through thermal plants, both coal based and non coal based, non conventional energy sources as well as generation and distribution of electricity to households, industrial houses and other users has the provision of 100% FDI through automatic route.<sup>33</sup> In part III of the Electricity Act, 2003, Section 61 specifies that the tariff policy shall be guided by factors that encourage competition as well as optimum investments.<sup>34</sup> Similarly, the act empowers the Central Commission<sup>35</sup> as well as the State Commission<sup>36</sup> to promote investment in electricity industry. Besides this, the Act also provides for trading in power. The most crucial incentive provided by the government in this sector is the five year tax holiday granted for more than five years that shall have a deduction of 30% taxable profits.<sup>37</sup>

In India, participation of private entities in the electricity sector has always been encouraged. Post the implementation of the Electricity Act, 2003, power exchanges have been very common and have promoted captive power generation. This was furthered by the initiatives taken by the central commission to set up power exchanges. All such moves by the government ultimately led to the creation of a conducive environment for investments in the sector. Besides, this also led to the creation of a fixed and clear FDI policy of the government in the power sector.<sup>38</sup>

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<sup>33</sup> Id.

<sup>34</sup> Electricity Act 2003, s. 61

<sup>35</sup> Electricity Act 2003, s. 79

<sup>36</sup> Electricity Act 2003, s. 85

<sup>37</sup> See n 28

<sup>38</sup> Pramod Deo, 'Radical Implications of FDI up to 49% in power exchanges' *The Financial Express* (2012) <http://www.financialexpress.com/news/radical-implications-of-fdi-up-to-49-in-power-exchanges/1010973/0>

accessed 12 September 2014

## VI. FDI AND INDIAN NUCLEAR ENERGY SECTOR

After thermal, hydroelectric and renewable sources of energy like wind and solar energy, nuclear energy is the fourth largest source of electricity. Due to global warming and other environment related concerns, the reliance on nuclear power has been increasing due to the shift to non-polluting sources of energy. Till 2010, India had 20 nuclear power plants.<sup>39</sup>

### INDIAN FDI POLICY AND NUCLEAR SECTOR

As per the FDI policy of India and Foreign Exchange Regulations, foreign investment in Nuclear Sector is prohibited. However, the government too has off late, realized the importance of international investment in this sector. Nuclear Energy Sector is a capital intensive sector requiring huge amounts of capital investment as well as inclusion of latest technological equipments something which may not be available currently in India and the domestic investment in the country might currently not be able to afford this. Again, exploration as well as exploitation of the inputs like uranium involves huge amount of expenditure. Thus the government plans to import nuclear equipment from various other countries like France, Britain, Russia and the US, by way of bipartite contracts. Eventually the government has started looking for avenues for the inflow of FDI in the country. The Department of Atomic Energy, Government of India has started organizing India Nuclear Energy which is an International Exhibition and Conference to bring together the nuclear agencies from all over the world, together. This enables the buyers and sellers arrive at the best possible price for their equipments.

The economic survey 2008-09 had suggested allowing FDI in nuclear power generation sector with a cap of 49%. The Consolidated FDI policy of 2014 puts nuclear sector in a list of prohibited sectors.<sup>40</sup> “However, there is no restriction on FDI in the nuclear industries for manufacturing of equipment and providing other supplies for nuclear power plants and related other facilities.”<sup>41</sup>

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<sup>39</sup> Aakash Chauhan, ‘Nuclear Energy in India’ (helpline.com 2011) <http://www.helpline.com/business-law/NCLR/nuclear-energy-in-india.html> accessed 23 August 2014

<sup>40</sup> DIPP

<sup>41</sup> ‘Foreign Investment in Nuclear Power Sector’, Government of India, Department of Atomic Energy [http://dae.nic.in/writereaddata/parl/budget2014\\_2/lssq55.pdf](http://dae.nic.in/writereaddata/parl/budget2014_2/lssq55.pdf) accessed 13 September 2014

## CONCLUSION

The energy sector in India comprises of various components, the constituent units of which are vastly different. This difference calls for a different policy for each sector. The nuclear sector for instance has been kept closed to FDI due to security reasons. For other renewable sources of energy like wind and solar energy, private and international investment has been very lucrative. The investment in oil and natural gas sector depends on international prices and international geo-politics and thus the FDI policy and consequent legal framework has to depend on a lot of other circumstances. Thus it is not possible to have a straight jacket policy for the entire energy sector. However, on the brighter side, each constituent sector has a well defined committee or a central commission that researches as well as tackles the entire policy regime. Thus bringing about a lot of laws and rules is not very difficult. Hence, if policy formulation for different sectors might not be easy, application and procedural formulation would be a relatively easy task.

India is a party to the Energy Charter, the international convention on energy law and enforcement. This also ensures that the countries that are a party to this create a favourable atmosphere for FDI in the country, besides ensuring that such legislations and policy formulations are undertaken by the government that can help in achieving the aims and objectives of the Charter.

Indian FDI policy even if well formulated still has a long way to go due to the procedural and enforcement inadequacies that the sector still faces. If that is achieved, the benefits of FDI in the energy sector shall be realized very soon.