India-Iran oil trade continues within sanctions regime

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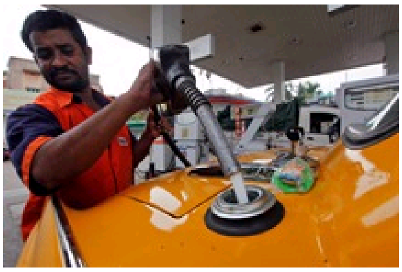
Delhi is currently drawing up a policy to response to the July round of EU sanctions that banned the London-based, 13-member Protection and Indemnity Association (P&I) from providing insurance and reinsurance to tankers carrying Iranian oil. Since the P&I group covers around 95% of the world's tanker fleets, including India's, the move poses serious problems for the oil import-dependent country. Meanwhile, to avoid supply interruptions, Delhi reportedly has allowed domestic refineries to buy oil from Iran on a cost, insurance, freight (CIF) basis, which obliges the latter to bear the cost of insurance and freight. This reaffirms India's unwillingness to terminate energy ties with Iran.



An employee fills a taxi at a fuel station in Kolkata (REUTERS/Rupak De Chowdhuri)

What next

India will decrease but not stop Iranian oil purchases and create its own provisions for shipping. It will wait to see how the CIF unfolds before increasing insurance cover or granting sovereign guarantees to shipments. Given India's growing energy demands, public sector explorers will continue to make investments in Iran's energy sector, albeit within the sanctions regime.

Impact

- Middle Eastern and West African oil producers will increasingly cut into Iran's share of India's oil basket.
- India's imports are likely to fluctuate on a monthly basis depending on Iran's ability to serve all of its major Asian buyers.
- The resumption of Iranian oil exports to South Korea in September after a two month gap is likely to precipitate such fluctuations.

Analysis

India remains unwilling to stop importing oil from Iran: it sees no viable alternative to the volume of Iranian supplies and is also wary about damaging relations with a long-standing cultural and economic ally (see INDIA/IRAN: Delhi to tread a delicate path on oil - March 28, 2012). However, to secure a waiver from new US sanctions, it has reduced the volume of imports. India imported about 11% of its crude oil from Iran in 2010, but has now cut this down to below 9%. In June alone, oil imports fell 18.2% year-on-year, which led to Iran slipping to fourth position from second among oil suppliers to India.

To make up for the shortfall, India is replacing Iranian oil with barrels from Nigeria and Angola. This uptake has increased particularly since July, and August has seen strong imports, with Indian refiners taking around 21 cargoes, second only to China, which has bought 28.

Nigeria and Angola are benefiting from the reduction in Iranian oil supplies to India

Delhi's insurance offer

Delhi is considering various means to overcome the logistical constraints in handling these supplies:

- In early August, state-run insurer United India Insurance Company (UIIC) agreed to provide protection and indemnity cover (pollution and personal injury claims) of 50 million dollars to Indian tankers carrying Iranian oil, with General Insurance Corporation-Reinsurance offering reinsurance on a per-voyage basis. This cover is half the 1 billion dollar liability on personal injury and environmental clean-up claims provided by the P&I group.
- The UIIC has separately offered hull and machinery cover of 50 million dollars to Indian ships.

Insurance difficulties

However, despite these offers, government efforts to insure Iranian shipments face serious constraints. India's two largest shipping companies -- state-run Shipping Corporation of India and privately-owned Great Eastern Shipping Company -- have rejected the government's offer, saying that the insurance is inadequate:

- They say that the cover limit of 50 million dollars is insufficient for large tankers. In case of a collision, spills and injury to seafarers, the total exposure of claims would far exceed this amount. Even the Civil Liability Convention requires 140 million dollars of cover for large tankers.

- According to them, the 50 million dollar hull and machinery cover is inadequate for physical damage to large tankers, which are typically used to carry cargoes of 2 million barrels of crude or more. They demand a higher cover up to 100 million dollars. However, the UIIC has said it is unable to offer higher cover because sanctions have blocked their access to reinsurance facilities from European insurers.

- In the government's offer there is no coverage for ports on the India-Iran route, such as Fujairah (UAE). This is in contrast to the P&I group, which has ties with various ports.

- Furthermore, Indian ship owners do not want to upset their Western clients by trading with Iran.

Amid these concerns, only Mercator Limited (a private shipper) has agreed to ship Iranian oil and offered its 1994-built, medium-sized aframax vessel in an enquiry submitted by the Mangalore Refinery and Petrochemicals Limited (MRPL).

Iranian option

To maintain its trade relations with Asia and in order to help Delhi overcome insurance difficulties, Iran has announced that it would deliver crude in Iranian tankers and provide a 1 billion dollar cover on vessels delivering to its Asian clients (see IRAN: Sanctions raise pressure on troubled oil sector - July 2, 2012).

Since the failure to resolve the insurance issue has impeded the oil trade, Delhi has agreed to Iran's offer on request from Indian refiners:

- The MRPL was able to import only 90,000 tonnes of crude in July against a contracted volume of four cargoes of 90,000 tonnes each. The refinery is increasing spot cargo purchases to make up for the shortfall in Iranian imports and is managing with inventories. It has a 5 million-tonne contract with Iran for the 2012-13 fiscal year (April-March), which it does not plan to revise. Having received government clearance, it will now begin importing from Iran on a CIF basis.

- Indian Oil Corporation, another state-run refiner, which stopped lifting Iranian crude in May to avoid US sanctions, has stated that it will start lifting oil cargo in September.

- State-run refiner Hindustan Petroleum Corporation Limited plans to lift about 99,300 barrels per day of oil from Iran in August. It imported only one cargo in July of the two planned of around 1 million barrels of oil each.

Energy investments

With India meeting 80% of its oil needs with imports, state-owned oil and gas companies have been scouting overseas for energy assets. Since Iran has the world's second largest oil and natural gas reserves, several Indian firms are invested in the country's energy assets:

Besides harming the oil trade, international sanctions are impeding India's investments in Iran's energy assets

- In 2009, the overseas arm of the public sector Oil and Natural Gas Corporation (ONGC-Videsh), Indian Oil Corporation and Oil India Limited explored for oil and gas in the Farsi block in the Persian Gulf. They proposed investing 5.5 billion dollars in the development of the Farzad-B asset, which holds an estimated 21.68 trillion cubic feet of gas.
- The same year, ONGC-Videsh, India-based Petronet LNG Limited and UK-based Ashok Leyland Projects Services signed agreements with Iran to develop one of the 28 phases of the South Pars field by taking up a 40% stake. They also agreed to invest 10 billion dollars in sourcing 6 million tonnes of gas from the field and converting it into liquefied natural gas.

Sanctions are harming these investments:

- ONGC-Videsh, for example, is experiencing funding hurdles for the South Pars gas field project since banks are unwilling to fund the purchases.
- Foreign firms are barred from investing over 20 million dollars per year in Iran's energy sector, slowing the pace of Indian investment (see PROSPECTS 2012 Q3: Iran - June 11, 2012).