

Airports Economic Regulatory Authority of India
Order No. 04/2010-11

AERA Building,
Administrative Complex,
Safdarjung Airport,
New Delhi 110003

Date of Order: 28th June 2010

Date of Issue: 30th June 2010

**In the matter of Economic Regulation of Air Navigation Services -
Regulatory Philosophy and Approach**

1. BACKGROUND

- 1.1 Pursuant to enactment of the "The Airports Economic Regulatory Authority of India Act, 2008" (hereinafter referred as the 'Act') and establishment of the Airports Economic Regulatory Authority (hereinafter referred as the 'Authority'), the Authority is to perform the following functions in respect of major airports:
- (a) to determine the tariff for the aeronautical services;
 - (b) to determine the amount of the development fees in respect of major airports;
 - (c) to determine the amount of the passengers service fee levied under rule 88 of the Aircraft Rules, 1937 made under the Aircraft Act, 1934; and
 - (d) to monitor the set performance standards relating to quality, continuity and reliability of service as may be specified by the Central Government or any authority authorised by it in this behalf.
- 1.2 As per Section 2 (a) of the Act, any service provided "for navigation, surveillance and supportive communication thereto for air traffic management" are aeronautical services. These services are commonly understood as "Air Navigation Services" (ANS).
- 1.3 Under the Chicago Convention, 1944, the management of airspace is a sovereign function. In terms of Section 12 (2) of the Airports Authority of India Act, 1994, this function is statutorily assigned to the Airports Authority of India (AAI). Thus, in India, the provision of ANS, in civil airspace, is solely the responsibility of AAI. AAI provides ANS at all civil airports, including major airports irrespective of the ownership of such airports.



2. PROCESS ON STAKEHOLDER CONSULTATION

- 2.1 As provided for in the Act and in order to ensure transparency in the process leading up to the framing of appropriate procedures/ systems for economic regulations, including the terms and conditions for determination of tariff, the Authority issued a White Paper on 'Regulatory Objectives and Philosophy in Economic Regulation of Airports and Air Navigation Services' ('White Paper') on 22nd December 2009. The White Paper provided stakeholders an opportunity to consider the issues highlighted therein and submit evidence-based feedback, comments and suggestions. The Authority received 28 submissions in response to the White Paper. The submissions were put up on the Authority's website for general information.
- 2.2 The Authority considered various views and opinions submitted in response to the White Paper and prepared a Consultation Paper listing out the major issues impacting formulation of its regulatory philosophy and approach and laying out its rationale for the positions / approach it was minded to take. The Consultation Paper (No. 3/2009-10) was issued on 26th February 2010 with the intention of providing a further opportunity to stakeholders to make relevant submissions to the Authority before it finalised its Regulatory Philosophy and Approach.
- 2.3 On 16th March 2010 the Authority convened a consultation meeting to elicit the views of the stakeholders in person.
- 2.4 The Authority received 21 written submissions containing suggestions and comments in respect of the Consultation Paper from the stakeholders. These suggestions and comments together with the minutes of the meeting held on 16th March 2010 may be accessed on the Authority's website (<http://aera.gov.in>).
- 2.5 The Authority has considered views and responses submitted by stakeholders on various aspects of the Consultation Paper. The issues relevant to Air Navigation Services are broadly discussed in the following paragraphs.

3. APPLICABILITY OF REGULATORY APPROACH

- 3.1 The Authority received several consultation responses on the applicability of the Authority's regulatory approach.
- 3.2 The Consultation Paper had also highlighted that the position discussed therein may not apply, ipso facto, to the two Civil Enclaves (at present, Goa and Pune) under the regulatory ambit of the Authority. Appropriate views in respect of the said Civil Enclaves would need to be taken by the Authority with



the representation of the Ministry of Defence in accordance with the provisions of sub-section (1) of Section 4 of the Act.

4. STAKEHOLDER RESPONSES TO REGULATORY APPROACH AND PHILOSOPHY

- 4.1 In general, stakeholders supported the ANS proposals highlighted by the Authority in the Consultation Paper.
- 4.2 However, IATA raised a substantive comment in relation to ICAO principles of non-discrimination and non-cross subsidization. IATA argued that there should be no discrimination between the different categories of users, and in particular revenues from international traffic should not be used to subsidise services to domestic traffic, and vice versa. It argued that such discrimination would contravene the spirit of Article 15 of the Chicago Convention.
- 4.3 Article 15 of the Chicago Convention, inter-alia, states that:

Every airport in a contracting State which is open to public use by its national aircraft shall likewise, subject to the provisions of Article 68, be open under uniform conditions to the aircraft of all the other contracting States. The like uniform conditions shall apply to the use, by aircraft of every contracting State, of all air navigation facilities, including radio and meteorological services, which may be provided for public use for the safety and expedition of air navigation.

Any charges that may be imposed or permitted to be imposed by a contracting State for the use of such airports and air navigation facilities by the aircraft of any other contracting State shall not be higher,

- a) *As to aircraft not engaged in scheduled international air services, than those that would be paid by national aircraft of the same class engaged in similar operations, and*
- b) *As to aircraft engaged in scheduled international air services, than those that would be paid by its national aircraft engaged in similar international air services*

All such charges shall be published and communicated to the International Civil Aviation Organization, provided that, upon representation by an interested contracting State, the charges imposed for the use of airports and other facilities shall be subject to review by the Council, which shall report and make recommendations thereon for the consideration of the State or States concerned. No fees, dues or other charges shall be imposed by any



contracting State in respect solely of the right of transit over or entry into or exit from its territory of any aircraft of a contracting State or persons or property thereon.

- 4.4 A plain reading of Article 15 makes it clear that it is specific to the question of equal treatment between national aircraft and aircraft from other contracting States and appears to be designed to secure that national aircraft do not obtain an unfair advantage in competition with aircraft from other contracting States.
- 4.5 It is apparent that the application of Article 15 of the Chicago Convention, 1944 requires that India, as a contracting State, establish non discriminatory tariff, *inter alia*, for ANS service provided to aircrafts of all contracting State, engaged in international civil aviation.
- 4.6 It is also clear that Article 15 does not extend its application to tariff for domestic civil aviation.
- 4.7 In substance, ICAO principle is that there is no discrimination between the aircrafts on account of their nationality. The Authority fully supports this principle of non-discrimination and is minded to have due regard to the same in respect of similarly placed aircraft.
- 4.8 However, the Authority believes that in some circumstances there may be sound economic rationales for an element of price discrimination between different categories of customers. For instance, the work of economist Frank Ramsey in the 1920s shows that social welfare could be maximised in a regulated revenue setting by setting prices for different categories of customers with reference to the price elasticity of demand of those customers. Such pricing may be rational, welfare maximising and not therefore unduly discriminating. Equally, there may be legitimate social or wider public policy objectives that some price discrimination would benefit.

5. CONSULTATION PAPER RESPONSES: AIR NAVIGATION SERVICES

- 5.1 The Authority received a limited number of responses relating to Air Navigation Services (ANS). The substantive issue raised by airlines was that ANS should be subject to price-cap regulation, rather than rate of return regulation as proposed in the Consultation Paper. Airlines also highlighted the importance of user consultation for ANS, especially in relation to major capital investments. Airlines further proposed that the fair rate of return should be consistent with the risk free rate of the country.



5.2.1 AAI took following position in respect of the Consultation Paper:

- (a) It agrees with the rate of return approach for ANS.
- (b) It also agrees to tariff determination on the basis of rate of return regulation, annual compliance process and tariff proposals prepared by AAI, subject to user consultation.

5.2.2 It would be relevant to note here that in response to the White Paper the AAI had, inter-alia, stated that:

“As per AAI Act, 1994, the responsibility of providing Air Traffic and Air Navigation Services in the country is assigned to AAI. As such, the cost incurred for providing TNLC and RNFC are not necessarily attributable to a particular airport/ unit. In view of the above, single rate is to be fixed and levied uniformly at all the airports considering the total investment, revenue generated and recurring expenditure incurred for providing the services etc.”

5.3 Consistent with the position presented in the Consultation Paper the Authority believes that given the safety imperatives of ANS, it would not be prudent to impose a price cap regime for ANS, atleast for the present. As such, ANS will be subject to rate of return regulation.

6. ORDER

6.1 In this view of the matter and on careful perusal of all the submissions, views and opinions expressed by stakeholders, the Authority makes the following Order in relation to the approach and framework for economic regulation of Air Navigation Services.

6.2 Regulatory Objectives

The Authority hereby sets for itself following objectives, by which it will be guided, while discharging its functions under the Act:

- (a) Facilitating wider policy aims for the aviation sector through the regulation of major airports, recognising their role in the sector and economy;
- (b) Protecting and promoting the interests of existing and future users of aeronautical services at major airports and air navigation services through provision of quality services commensurate with the respective



tariffs/ charges, keeping in particular focus the interests of passengers and cargo facility users and the user expectations;

- (c) Promoting investment in airports and air navigation services and their effective management so that all reasonable demands for airport services are met efficiently.

6.3 The Authority will operationalise these broader regulatory objectives through, inter-alia, the following key parameters:

- (a) Specification of a framework and qualitative and quantitative parameters to ensure that the quality of service provided while determining tariffs is consistent with the net investment in those facilities and the user expectations.
- (b) Ensuring efficiency, adequacy and consistency in provision of air navigation services by encouraging efficient and appropriate investment through a fair rate of return.

6.4 Treatment of Civil Enclaves

The following is the overall approach and framework which the Authority hereby adopts to economic regulation of Air Navigation Services. The overall approach and framework specified hereinafter does not apply, ipso facto, to the two Civil Enclaves (at present, Goa and Pune) under the regulatory ambit of the Authority. Appropriate views in respect of the said Civil Enclaves would be taken by the Authority with the representation of the Ministry of Defence in accordance with the provisions of sub-section (1) of Section 4 of the Act.

6.5 Regulatory Philosophy and Approach in Economic Regulation of Air Navigation Services (ANS)

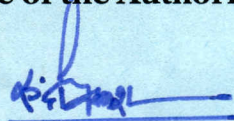
- (i) The Authority recognises that the safety imperative of ANS has important implications for the discharge of its functions in respect of ANS. The Authority, therefore, adopts a rate of return approach for ANS.
- (ii) The Authority shall apply rate of return approach in a manner that will permit ANS provider to recover actual net costs and a fair rate of return on its investment.
- (iii) The Authority may also specify incentive mechanisms, before the start of a Control Period or at any other time, in its discretion, to encourage timely investment in ANS infrastructure and facilities.
- (iv) The determination of tariff for ANS shall be undertaken on the basis of a Multi Year Tariff Proposal made by ANS provider for a control period



of 5 years and would involve annual compliance process, tariff proposals, user consultation and compliance of relevant regulations/ guidelines by the ANS provider.

- (v) As proposed by AAI, the Authority shall determine the tariff(s) for ANS on a uniform basis at all airports.
- (vi) The Authority will rely upon the periodic DGCA monitoring reports and updates of ANS performance standards. Additionally, the Authority may provide DGCA with such inputs, as it may consider necessary. The Authority is conscious of the need to evolve the systems/ procedures for monitoring performance standards and is minded to evolve such systems/ procedures based on stakeholder responses, collection and analysis of information on ANS performance standards during the first regulatory cycle.
- (vii) The Authority proposes to operationalise the regulatory philosophy and approach as decided above through detailed guidelines. A draft of the "The Airports Economic Regulatory Authority of India (Terms and Conditions for Determination of Tariff for Air Navigation Services) Guidelines, 2010" is being issued separately for stakeholder consultation before being finalised.

By the Order of and in the name of the Authority


(Sandeep Prakash)
Secretary

To,

**The Airports Authority of India
Rajiv Gandhi Bhawan
Safdarjung Airport
New Delhi – 110 003
(Through : Shri V.P.Agrawal, Chairman)**

