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CIAL/FIN/MYTP-III/2021-22

Dated 12-072021

Shri Balwinder Singh Bhullar
The Chairman
The Airports Economic Regulatory Authority of India
Administrative Complex
AERA Building Safdarjung Airport Area
New Delhi - 110 003.

Sir,

Sub : Submission of CIAL's comments on Consultation Paper No. 08/2021-22 dated 15 June 2021

Kind reference is invited to the Consultation Paper No.08/2021-22 dated 15-06-2021 in the matter of determination of aeronautical tariffs for Cochin International Airport for the third control period beginning from 01-04-2021 to 31-03-2026.

At the outset, we express our sincere gratitude to the Authority for finalizing the Consultation Paper of Cochin International Airport for the third control period in a timebound manner.

As part of the stakeholder consultation process for the referenced consultation paper, please find below the comments of CIAL for kind consideration of AERA:

1) Cost of equity proposed by AERA for true-up of the second control period

A. Proposal of AERA:

Para 15.6.2 of the Order no. 07/ 2017-18 for second control period of CIAL: *"Cost of Equity: -The Authority notes that DIAL and HIAL started operations*

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recently as compared to CIAL and the Authority has taken a slightly higher cost of equity presuming that newly started companies have a greater risk. The Authority notes that Cochin is a well-established airport paying dividends and the risk profile is very low, investment are not heavy, cost is lower, traffic is stabilized and there is no volatility. The authority opines that "One size fits all" view for calculating CoE is not appropriate since each Airport is unique. The Authority also notes from a study of Key Economic Indicators published by Airports Council International that the return on Airport sector globally averages only between 6% and 8%. Though this rate needs to be adjusted for India where the cost of funds is higher, a 14% return on Shareholders' funds is quite reasonable. Meanwhile, the Authority shall carry out a study on Cost of Equity and take a view on the rate to be used for true up and for the third control period."

Further, Para 4.6.10 of the Consultation Paper no. 10/ 2021-22 for third control period of CIAL: *"In the Tariff Order for the Second Control Period, the Authority had decided to commission a study with regards to determination of Cost of Equity and then true up the same in the current Control Period. For the purposes of true-up for the Second Control Period, the Authority has decided to consider the rate of 14% for cost of equity, whereas, for the Third Control Period, the Authority will advise a rate based on the cost of equity study conducted by it."*

B. CIAL's proposal:

i. The tariff determination guidelines set by AERA provides a return to investors apart from covering costs pertaining to operating expenditure, depreciation, interest and tax. However, in case of older airports like Cochin, tariff determination before the application of regulatory framework was not linked to the capital investment and other costs.

ii. In fact, the tariffs charged or aeronautical revenues earned by Cochin airport was much lower than what would have been permissible under a generic cost-plus framework as espoused in AERA's tariff guidelines.

iii. During the initial years, the returns to CIAL's investors did not match the expected return to equity because of perpetual low tariffs that have benefited the users. Thus, CIAL deserves a cost of equity of 16% for the losses it has endured in the past.

iv. CIAL has noted that the Authority has proposed 14% cost of equity for CIAL, whereas it has allowed 16% cost of equity for other airports such as Mumbai, Delhi, Bangalore and Hyderabad. **CIAL strongly objects such discriminatory, prejudiced and unfair treatment given to CIAL.**

v. Such discrimination is also evident when compared with airports operated by AAI. FRoR allowed for AAI airports is 14% which has no debt and least risk due to sovereign holding whereas the Authority has proposed 14% as cost of equity for CIAL which has used debt for financing development of new international terminal and other capital expenditure. With the cost of equity of 14%, the resultant FRoR for CIAL as per AERA is 12.06% only. Given the nature of ownership of AAI and CIAL, cost of equity for CIAL is bound to be higher than AAI. However, AERA has adopted a lower cost of equity for CIAL.

vi. COVID19 pandemic has exposed the vulnerable side of the aviation sector and displayed the enormous risk the travel industry faces in case of such events. COVID19 pandemic has not differentiated between the airports. Its severe impact on the airport financials can be seen not only in the Indian airports but also across the global airports. COVID19 pandemic has increased the risk of the airport sector and it has to be accounted by the Authority accordingly in the cost of equity.

vii. The rational by AERA for providing a lower cost of equity to CIAL based on the lower risk profile is flawed and contradicted by AERA's own independent study on cost of equity which has used the same equity premium of 8.06% across all the private airports, which includes CIAL, BIAL, MIAL, DIAL and HIAL.

viii. CIAL strongly proposes that all the airport operators should be allowed reasonable return on equity and the cost of equity should be same and fair for all airport operators in India.

ix. Different cost of equity for different airport operators also leads to ambiguity and inconsistency for investors at a time when the Government is focusing on increasing the private sector participation in airports development and operations.

x. CIAL would point out to AERA that AERA's rational on low volatility of traffic only for CIAL is incorrect as all the Indian private airports have seen similar growth rates in the past. CIAL's domestic and international traffic has plunged 69% and 80% in FY21. FY21 is part of the second control period and AERA should consider the traffic volatility while accessing the traffic risk for the second control period. Share of international traffic in total traffic at CIAL is the highest among the private airport operators at approximately 50%. COVID-19 pandemic has affected the international traffic more severely than the domestic traffic further compounded by longer recovery of the international travel to the pre-COVID levels. With lower international traffic for the medium term, COVID-19 pandemic impact on CIAL's financials is significantly higher in comparison to other private airports which entails a higher risk profile.

xi. Apart from traffic risk, CIAL faces operational risk from the natural calamities like flood which resulted in closure of the airport for 15 days and new airports (Kannur) commissioning within and outside the state.

xii. CIAL has submitted its bonafide forecast during the second control period which is evident from the fact that CIAL has shortfall in the true-up of the second control period due to the impact of COVID19 pandemic on the FY21 financials. CIAL noted that all the other private operators have an over-recovery at the end of the second control period which gives them with a cushion to face the current pandemic. However, CIAL's shortfall during the second control period puts it in dire financial state with an uncertain future and further increases its risk profile in comparison to the other airport operators.

xiii. CIAL requests AERA's support in acknowledging the higher risk faced by CIAL in comparison to other private airports.

xiv. Given the above facts the rate of return offered to CIAL of 14% is unfair and not commensurate with the associated risks and the complex ground realities.

xv. CIAL is seeking AERA for a non-discriminatory treatment on allowing consistent cost of equity of 16% for true-up of the second control period let alone the higher cost of equity it deserves on account of its higher risk profile.

2) Inclusion of profits of Cochin Duty Free Services Limited as part of the non-aeronautical revenues for true-up of the second control period and the ARR computation of the Third Control Period

A. Proposal of AERA:

Para 4.9.25: *"Based on the assessment of the financials of CDRSL, it was observed that the gross profit margin (gross profit/revenue from operations) for CDRSL excluding royalty paid to CIAL during the period FY 18-20 lies in the range 45-48%. As per the tariff order of the Second Control Period, the Authority had noted that the income would be earned by the wholly owned subsidiary of CIAL (i.e., CDRSL) from duty free operations and the Authority sees no reason in a part of the revenue earned by CIAL through its subsidiary to be kept outside the purview of being considered as Non-Aeronautical revenue and hence, the entire profits from that activity should be considered as Non-Aeronautical revenues for computing the Aggregate Revenue Requirement. In line with this, for the purposes of tariff determination and true up, the Non-Aeronautical Revenues for CIAL from duty free operations is proposed to be the sum of royalty received from CDRSL plus the net profits of CDRSL for any given year."*

Para 10.2.9 - *"CIAL has considered a 30% revenue share from CDRSL for the 3rd Control Period. The Authority notes that based on the decision taken regarding duty-free revenue in the 2nd Control Period Tariff Order, the entire profit of CDRSL should go to the CIAL (100% holding company of CDRSL). However, since forecasting profit of the subsidiary is difficult at this stage, the Authority proposes to consider a 30% revenue share during FY 2022 and FY 2023, owing to decline in international traffic due to COVID-19 pandemic. Further, the Authority proposes to consider 45% revenue share during the period FY 2024-2026 and true up the same based on actual revenues and profits."*

B. CIAL's proposal:

CIAL strongly objects AERA's treatment of profits of CDRSL as part of the non-aeronautical revenues on account of the following reasons which are explained in detail below:

a. Arm's length transaction between CDRSL and CIAL

b. CDRSL financial accounts are outside of AERA's jurisdiction

c. Need for consistent treatment to CDRSL based on the treatment of subsidiaries of other private airports – for e.g. Hyderabad Duty Free Retail Limited and Bangalore Airport City Limited – Consider only the revenue share, lease rent and dividend payment as non-aeronautical revenues

d. Change of decision of AERA from second control period order of CIAL

Arm's length transaction between CDRSL and CIAL

i. CIAL has entered into an arm's length transaction with CDRSL to derive the revenue share payable by CDRSL to CIAL. Arm's length transaction implies that the agreement between CDRSL and CIAL is independent and on an equal footing.

ii. Therefore, transaction between CDRSL and CIAL needs to be evaluated as any other third party transaction and similar treatment needs to be accorded.

CDRSL financial accounts are outside of AERA's jurisdiction

iii. AERA Act, 2008 (and its amendment) and the AERA guidelines does not grant AERA with the right to evaluate the financial statements of the non-aeronautical subsidiaries.

iv. Therefore, AERA has no jurisdiction to review the financial accounts of CDRSL, an entity providing non-aeronautical services.

Consistent approach for subsidiaries of all airports

Hyderabad International Airport Limited

v. CIAL has noted that GMR Hospitality and Retail Limited is a 100% owned company of HIAL whose division is the Hyderabad Duty Free Retail Limited. In the recent Consultation Paper No. 11/ 2021-22 for HIAL, AERA has considered only the interest and dividend income of the subsidiary in the non-aeronautical revenues of HIAL. Below are the excerpts from the HIAL's consultation paper:

Para 3.2.19 of the Consultation Paper No. 11/ 2021-22 for HIAL – *"The Authority had noted that HIAL received interest and dividend income from two of its subsidiaries Hyderabad Duty Free Retail Limited and Hyderabad Menzies Air Cargo Pvt. Ltd. The Authority had also examined HIAL's* *comment on the treatment of dividend and interest income received from cargo and duty free subsidiaries. Given that the Authority has considered cargo as an aeronautical activity, the corresponding revenues from the cargo subsidiary have also been considered as aeronautical revenues. Similarly, revenues from duty free services have been treated as non-aeronautical income and accordingly, the Authority proposes to include the dividend and interest incomes received from Hyderabad Duty Free Retail Ltd as non-aeronautical income."*

Para 4.8.7 – *"The Authority proposes to treat the dividend income from duty-free subsidiary as nonaeronautical and cargo subsidiary as aeronautical revenue"*

Bangalore International Airport Limited

vi. CIAL has further noted that Bengaluru Airport City Limited is a 100% owned company of BIAL undertaking non-aeronautical activities at the airport. In the recent Consultation Paper No. 10/ 2021-22 for BIAL, AERA has considered only the revenues from BACL to BIAL in the non-aeronautical revenues of BIAL. Below are the excerpts from the BIAL's consultation paper:

Para 8.2.49 – *"The Authority had noted that BIAL has formed a subsidiary Bengaluru Airport City Limited (BACL) in January 2020 to carry out real estate activities. BIAL had submitted that the revenues from BACL to BIAL is nil in FY21. The Authority requested BIAL to submit the revenue projections from BACL to BIAL. The projections submitted by BIAL are considered as non-aeronautical revenue."*

Airports Authority of India (AAI)

vii. CIAL has noted that AAICLAS is a 100% owned subsidiary of AAI. However, during the tariff determination of AAI, AERA has not considered the profits of AAICLAS as aeronautical revenues while determining the true-up of AAI.

viii. CIAL requests AERA to adopt consistent treatment to CDRSL as given to subsidiaries of other private airport operators and consider only the revenue share and dividend as non-aeronautical revenues of CIAL.

Change of decision of AERA from second control period order of CIAL

ix. AERA has proposed a departure from its decision in the second control period. Such change of decision from one control period to the next control period does not offer the regulatory continuity required for preparing the long term strategy for the airport and leads to uncertainty in future.

x. Such departure in regulation creates uncertainty for investors which impacts India's position as an attractive investment destination for global investors.

Conclusion

xi. CDRSL has faced significant losses on account of COVID19 pandemic in FY21 due to reduction in international passenger and it is expected to post losses in next few years. Without prejudice to the position of CIAL that CDRSL's profits or losses should not be included in the non-aeronautical revenues, CIAL has noted that AERA has conveniently limited its position to the profits of CDRSL while losses of FY21 of INR 11.7 cr. have not been considered.

xii. Based on the above facts, CIAL requests AERA to not include the profits of the CDRSL in the non-aeronautical revenues of CIAL for true-up of the second control period and the ARR computation of the Third Control Period.

xiii. Further, CIAL notes that the AERA has considered higher revenue share of 45% during FY24 to FY26 in place of the profits of CDRSL. Based on CIAL's request of not considering the CDRSL profits, CIAL requests AERA to consider only the projected revenue share of 30% from CDRSL and the lease rentals for the entire third control period.

3) **<u>Exclusion of the flood mitigation expenses from the aeronautical operational expenditure and flood control measures outside the airport boundary from the aeronautical capital expenditure</u>**

A. Proposal of AERA:

Para 4.8.30: *"Since these measures benefit the general public in the adjoining areas of the airport that include farmlands and households, the responsibility of these measures cannot be entirely attributed to the Airport Operator. Based on the break-up of flood mitigation expenses provided by CIAL, the Authority* *proposes to consider only the expenses incurred within the airport area for ARR calculations."*

Para 6.2.21: *"The airport operations at CIAL were hampered due to severe floods that occurred in August 2018 leading to suspension of airport operations for 15 days. CIAL was also affected by floods in 2019. To address this issue, CIAL had undertaken flood mitigation expenses recommended by KITCO in the 2nd Control Period and has proposed additional capital expenditure in this regard in the 3rd Control Period.*

Para 6.2.22: *"During the site visit it was observed that the flood mitigation measures are necessary for continuing operations during periods of heavy rains. However, it was also noticed that some of these measures were carried out beyond the operational area of the airport, i.e., outside the airport premises, on public land. Since it is found that the measures undertaken outside the airport also benefit the adjoining areas of the airport, including farmlands and households, the responsibility of these measures cannot entirely be attributed to the Airport Operator. Therefore, only the work carried out on area belonging to the airport has been considered Aeronautical. The same has been discussed in the subsequent section on allocation of assets."*

B. CIAL's proposal:

i. CIAL has noted that AERA has excluded flood mitigation expenses of INR 23.54 cr. in the second control period and INR 11.49 cr. in the third control period from the aeronautical operational expenditure. Further, AERA has excluded the regulator cum bridge of INR 41.73 cr. from the aeronautical capital expenditure of CIAL.

ii. CIAL notes that AERA has acknowledged the necessity of the flood control measures which are essential for the business continuity during heavy rains. However, AERA has excluded the flood related works undertaken by CIAL outside the boundary of the airport.

iii. To set the context and highlight the gravity of the situation, CIAL has reproduced the paragraph from the KITCO report on the havoc caused by Aug, 2018 floods:

"The compound walls of the airport collapsed at several locations. The runways were all flooded and water even entered into the Terminal Buildings. It was an alarming situation for the airport and the adjoining areas."

iv. Photo of Cochin Airport of Aug, 2018 during floods is given below:

v. CIAL is situated within the river basin of Periyar and shares the boundary with the Chengalthodu, a branch of Periyar. KITCO report highlights that during the construction of the airport, the course of Chengalthodu was broken with 5 km in the upstream at north and 17 km in the downstream at south. Thus, the canal in place was diverted for construction of the airport and alternate drainage facility was required. The government had even directed CIAL to construct the diversion canal at the cost of CIAL which could not be undertaken till date for lack of funds.

vi. Due to repeated floods during the last few years, it has become imperative for the airport operator to complete/ rejuvenate the diversion canal to the adequate capacity level. It could be seen that basically flood related works are nothing but a postponed expenditure forming part of original runway construction and creation of proper drainage system for storm water and flood waters.

vii. KITCO report has thus suggested the flood control measures which among other things includes altering of course to the established flow of water of Chengalthodu, so that the airport area is least impacted. Since the

Chengalthodu's course lies outside the airport boundary, KITCO study has proposed the flood control works outside the airport area.

viii. As part of the flood related measures, after the canal is widened but naturally the corresponding bridge also has to be widened. Some of the bridges proposed by CIAL have one end within the airport boundary while the other end is outside the airport boundary.

ix. CIAL wants to clarify to AERA that it cannot safeguard itself by completing the flood related projects falling within the airport boundary. The flood related projects recommended by KITCO report are based on facts and detailed technical study. Projects outside and inside the airport are interdependent and integral for the airport's preparedness for the heavy rains and flood related matters cannot be looked from the narrow perspective of the land boundaries. CIAL requests AERA to appreciate the requirement of the flood related measures in its entirety.

x. CIAL's board had decided to undertake the flood related projects outside its airport boundary with the sole purpose of ensuring the safety of the airport and its airport users. The benefit to the adjoining communities is only incidental.

xi. All the stakeholders of the airport – passengers, airlines, ground handlers, fuel suppliers, including the surrounding communities have suffered during the floods of August, 2018. Airplanes were submerged in water, ground handler's equipment were damaged and passengers were inconvenienced due to these floods. Airport operator has faced losses however the aggregate losses incurred by all the stakeholders is much more.

xii. After the events of Aug 2018, all the stakeholders including the public institution had pitched to CIAL for urgent action to mitigate such future events.

xiii. Based on AERA's proposal, if CIAL suspends the flood related projects outside the airport boundary, the airport and its users (passengers, airlines, ground handlers, etc.) are bound to suffer severely during the heavy spell of rains. CIAL wants to take the liberty to ask AERA whether it is willing to compensate the loss of assets of airport, loss to airline community, losses to the passengers and higher insurance costs of the aviation stakeholders during the floods.

xiv. CIAL feels that AERA has missed to visualize the bigger picture and the proposal of AERA to disallow the essential flood related costs is unreasonable. The flood control measures are a one-time expense undertaken by CIAL for the benefit of the entire airport users. These costs are much lower than the anticipated losses from the floods/heavy rains of the future.

xv. CIAL wants to impress upon AERA that Cochin Airport is a public use asset whose safeguards are of utmost importance during the disaster situation like floods/heavy rains to carry out the rescue operations as well as supply of emergency kits. The limited view adopted by AERA in the Consultation Paper on mitigating the disaster situation like floods is not in favour of the airport users and the airport operator.

xvi. CIAL has also noted that AERA, as part of its Order no. 57/ 2020-21, has allowed the capital expenditure proposed by IGIA, Delhi for the construction of the Shiv Murthy Underpass which is outside the premises of Delhi Airport based on the need for the airport and its users. Based on the previous precedence, AERA can also allow the cost of flood control measures for CIAL.

xvii. CIAL requests AERA's support to mitigate the future floods by approving the operational expenses on flood mitigation expenses of INR 23.54 cr. in the second control period and INR 11.49 cr. in the third control period and the capital expenditure on regulator cum bridge of INR 41.73 cr.

4) Airline space rentals considered as aeronautical revenues in second control period and third control period by AERA

A. Proposal of AERA:

Para 4.10.16: *"The Authority observes that in the Tariff Order for the 2nd Control Period, Airline space rentals were proposed to be considered as Aeronautical revenues basis which the Authority proposes to consider Airline space rental as Aeronautical revenue for the 2nd Control Period."*

Para 10.2.6: *"Airline Space Rentals –The Authority proposes to consider all rentals collected from Airlines as Aeronautical revenues."*

B. CIAL's proposal:

i. CIAL has noted that AERA has treated the airline space rentals for all the private airports DIAL, MIAL, HIAL and BIAL as well as for AAI airports as non-aeronautical revenues.

ii. AERA has considered the airline space rentals in case of CIAL as aeronautical revenues. This is a clear case of discrimination against CIAL.

iii. CIAL strongly objects AERA's inconsistent approach on the treatment of the airline space rentals.

iv. CIAL's submission in the 3rd control period MYTP on the inconsistent approach have been conveniently ignored by AERA without giving any rationale.

v. AERA Act, 2008 and the AERA guidelines do not consider the airline space rental as a aeronautical revenues. Further, AERA does not regulate the airline space rental at Cochin Airport. Thus, the proposal of AERA does not conform to its Act and guidelines.

vi. ICAO's Policies on Charges for Airports and Air Navigation mentions that airline space rentals are non-aeronautical in nature while airlines may be providing services aeronautical in nature. Below is the excerpt from the ICAO's policy:

"Revenues from non-aeronautical sources. ***Any revenues received by an airport in consideration for the various commercial arrangements*** *it makes in relation to the granting of concessions, the rental or leasing of premises and land, and free-zone operations,* ***even though such arrangements may in fact apply to activities which may themselves be considered to be of an aeronautical character*** *(for example, concessions granted to oil companies to supply aviation fuel and lubricants and the rental of terminal building space or* ***premises to air carriers****). Also intended to be included are the gross revenues, less any sales tax or other taxes, earned by shops or services operated by the airport itself."*

vii. CIAL emphasizes to AERA the need for consistent treatment of the airline space rentals and requests AERA to consider the airline space rentals as non-aeronautical revenues in the true-up of the second control period and the third control period.

5) **CSR expenses excluded by AERA from the aeronautical operational expenditure for true-up of the second control period and the third control period**

A. Proposal of AERA:

Para 9.2.18: *"The Authority notes that CIAL has excluded CSR expenses for the 3rd Control Period, which is in line with the decision taken by the Authority in this regard in the previous tariff order."*

B. CIAL's proposal:

i. As per TDSAT judgement dated 16 December 2020 for BIAL, CSR expenses are allowed as part of aeronautical operational expenditure. Below is the excerpt from the TDSAT judgement:

"The decision of the Authority to not allow CSR expenditure as a cost of the Airport Operator is not proper and is set aside. The Authority shall pass consequential orders so as to prevent loss of or reduction in the determined fair return to the equity holders. Necessary truing-up exercise shall be done accordingly. (Para 81)."

ii. CIAL has noted that in the recent consultation paper for Hyderabad Airport and Bangalore Airport have allowed the CSR expenses as part of the aeronautical operational expenditure.

iii. CIAL's requests AERA to maintain consistency in approach and allow the CSR expenses in the aeronautical operational expenditure for the true-up of the second control period and for the computation of ARR for the third control period.

iv. CSR expenses of CIAL for the second control period are given in the table below:

Year	**2017**	**2018**	**2019**	**2020**	**2021**	**Total**
CSR expenses (INR cr.)	4.00	5.89	10.00	5.43	4.99	**30.31**

v. CSR expenses of CIAL for the third control period as per CIAL's MYTP submission are given in the table below:

Year	2022	2023	2024	2025	2026	Total
CSR expenses (INR cr.)	1.89	1.17	2.68	8.52	12.89	**27.14**

6) **Normative gearing ratio for the computation of WACC during the third control period**

A. **Proposal of AERA:**

Para 7.3.3: *"Authority proposes to consider a notional debt equity ratio of 48%:52% as recommended by the Study on Determinants of Cost of Capital of CIAL."*

B. **CIAL's proposal:**

i. CIAL has noted that AERA has applied a normative gearing (debt to equity) ratio of 48%:52% as per the study on determinants of cost of capital of CIAL.

ii. The existing cost of debt of CIAL is 7.8%, which is among the lowest in the airport operators. CIAL has been able to lower its cost of debt through its prudent cost management and its established record of creditworthiness. Airport users have benefitted from the lower cost of debt at CIAL.

iii. CIAL has always thrived to adopt the efficient capital structure and it has financed the construction of the international terminal through debt.

iv. Given the above facts, normative gearing ratio of 48%:52% is arbitrary and it does not correctly depicts the financing options available to CIAL. AERA is penalizing the shareholders of CIAL for their prudent management of finances by adopting the normative gearing ratio.

v. CIAL has noted that AERA in the recent consultation paper for Chandigarh Airport had allowed actual gearing ratio:

Para 6.3.1 – *"To consider FRoR at 14% for Second Control Period considering that it would have sufficient internal accruals to fund proposed additions to RAB during the control period but advises CHIAL to evaluate efficient means of financing."*

Para 6.3.2 - *"To true up the FRoR based on actual debt-equity ratio and the cost of debt and equity as determined at the time of determination of aeronautical tariff for the third control period."*

vi. CIAL strongly objects to the inconsistent treatment adopted by AERA when compared with Chandigarh airport.

vii. CIAL assures that it will fund the capital expenditure through efficient means of capital so that the costs are lower for the airport users.

viii. CIAL proposes to AERA to apply consistent approach and consider the actual gearing ratio of CIAL while truing up the weighted average cost of capital at the end of the third control period. CIAL would like to clarify to AERA that the actual gearing ratio for the third control period might also benefit the airport users in case it is higher than the normative gearing ratio.

7) **Land lease rentals from coast guards, navy considered as non-aeronautical revenues for the true-up of the second control period and the computation of ARR for the third control period**

A. Proposal of AERA:

Para 4.10.12: *"Further, there were some other revenues which had been considered as Non-Aeronautical Revenues by the Airport Operator under the head – 'Land space excluding BPCL fuel hydrant rent'. On obtaining clarifications from this aspect from CIAL, the Authority noted that land lease from Coast Guard and Navy are considered as Non-Aeronautical. The same have been proposed to be reclassified as Aeronautical revenues."*

B. CIAL's proposal:

i. CIAL has noted that AERA has considered the land lease rentals from Coast Guard and Navy as aeronautical revenues. CIAL notes that such treatment is unprecedented, arbitrary and it lacks merit.

ii. AERA Act, 2008 and the AERA guidelines do not consider the lease rentals from Coast Guard and Navy as an aeronautical revenue. Further, AERA does not regulate the lease rentals from Coast Guard and Navy at Cochin Airport. Thus, the proposal of AERA does not conform to its Act and guidelines.

iii. ICAO's Policies on Charges for Airports and Air Navigation mentions that lease rentals are non-aeronautical in nature while the entity may be providing services essential to airport. Below is the excerpt from the ICAO's policy:

"Revenues from non-aeronautical sources. ***Any revenues received by an airport in consideration for the various commercial arrangements*** *it makes in relation to the granting of concessions, the rental or leasing of premises and land, and free-zone operations,* ***even though such arrangements may in fact apply to activities which may themselves be considered to be of an aeronautical character*** *(for example, concessions granted to oil companies to supply aviation fuel and lubricants and the rental of terminal building space or* ***premises to air carriers****). Also intended to be included are the gross revenues, less any sales tax or other taxes, earned by shops or services operated by the airport itself."*

iv. CIAL has noted that it is a general practice of giving the space to the Indian Army, Navy and Air Force based on their needs and the lease rentals received from these entities have been considered as non-aeronautical revenues by AERA for all major airports including AAI airports.

v. CIAL requests AERA to consider the land lease rentals from Coast Guard and Navy as non-aeronautical revenues in the true-up of the second control period and the ARR computation of the third control period.

8) <u>Exclusion of land not in use</u>

A. Proposal of AERA:

Para 8.2.9 - *"The Authority noted that the land for New Import Cargo Complex (4.1 acres), Future T3 apron expansion (33.6 acres) and the land for CISF quarters (5.4 acres at Akaparambu) have been considered in the computation of land cost for Aeronautical purposes. However, the Authority notes that according to Clause 3.5.3 of Order No. 42/2018-19 dated 05 March 2019 regarding FRoR to be provided on cost of land, the Authority only considers capitalised assets for providing a return and on the same lines would consider only value of land put to use by the Airport operator. The remaining land would be considered as and when the land is put to use. The Authority proposes to exclude such land earmarked for future use from the computation of return on land and proposes to true up the same based on actual usage."*

Para 8.2.10 - *"Land to the extent of 23 acres (at Nayathode) has been earmarked by the Airport Operator for rehabilitation activities. The Authority notes that as per Clause 3.6.1 of Order No. 42/2018-19 dated 05 March 2019 regarding FRoR to be provided on cost of land, return would be provided on land for rehabilitation and resettlement if the state government is involved in the process and that such return would only be provided on lands purchased after the issuance of the said order. Since in the case of CIAL, the land had already been purchased prior to the issue of the Order No. 42/2018-19 dated 05 March 2019 regarding FRoR to be provided on cost of land, the Authority proposes to provide no return on the land that is earmarked for rehabilitation activities."*

B. CIAL's proposal:

i. As per Order No. 42/2018 – 19, AERA has given return on land to CIAL for the 3rd Control Period.

ii. AERA has revised the land classification with changes from CIAL's submission as shown below:

Description	As per CIAL	As per AERA
Rehabilitation land Nayathode	Aero	Non – Aero
Rehabilitation land Akaparambu (CISF)	Aero	Non – Aero
Import cargo complex (new)	Aero	Non – Aero
Future T3 apron expansion	Aero	Non – Aero

iii. AERA has stated that it will give return on the value of land put to use by the airport operator.

iv. CIAL requests AERA to give return on the land earmarked for future expansion also as:

a. acquiring land in future is not viable due to high land cost

b. it disincentivizes the airport operator to acquire land now for future phases

v. If AERA proposes to consider only the land for the capitalized assets, CIAL requests AERA to give return at the fair value of the land at the time when it is put to use instead of its book value.

vi. CIAL has noted that the entire lease rent is allowed as passthrough (4.1.3) if it is agreed between govt. and airport operator even if the land is partially used. CIAL considers the view of AERA in this regard favouring the arrangement of state/ central government with the airport operator while penalizing airport operator for acquiring land.

vii. Based on the above facts, CIAL requests AERA to give the return on the entire land including the land earmarked for future aeronautical expansion.

9) **Useful life adopted by AERA for determination of depreciation for the true-up of the second control period and the computation of the third control period**

A. **Proposal of AERA:**

Para 4.5.9 – AERA has revised the useful life of Building – False Ceiling, Handrails and Façade Works, Building – Interior, Flooring, roofing and finishing

B. **CIAL's proposal:**

i. AERA has revised the depreciation rates as follows:

Item Description	**FY of Commissioning**	**Useful Life (CIAL)**	**Useful Life (AERA)**	**Year of Expiry (AERA)**
Building – False Ceiling, Handrails and Façade Works		20	30	
Building – Interior, Flooring, roofing and finishing		15	30	
Original Runway	2000	15	30	2030

First re-carpeting	2010	15	20	2030
Second re-carpeting	2021	5	9	2030

Useful life of Building – False Ceiling, Handrails and Façade Works and Building – Interior, Flooring, roofing and finishing

ii. CIAL prepares its books of account based on the Companies Act. The Ind-AS accounting has been made applicable from FY16 onwards for companies above INR 500 cr. turnover, thus applicable to CIAL

iii. Order no. 35/2017-18 of AERA on useful life is not consistent with the Ind-AS standards on asset accounting. The Companies Act, 2013 provision stipulates that in case the useful life of an asset is not available in its Schedule II – Useful lives to compute depreciation, the useful life if any, arrived by the sectoral regulator of the industry can be used. However, this stipulation does not change the mandatory componentization of assets under Ind-AS standards. The decision of AERA for CIAL has resulted in non-componentization of assets which have varying useful life.

iv. Ind-AS accounting mandated component accounting of assets, that is, in case an asset has various components, the useful life of those components shall be determined based on the technical study. CIAL has complied with the provisions of the Ind-AS accounting and componentized the assets which have varying useful life.

v. Accordingly, CIAL had set-up a technical committee to arrive at the useful life of the components. Thereafter, the useful life of certain industry specific assets has been adopted based on the AERA specified rates while for the rest of the cases, the rates applicable under Companies Act read with Ind-AS standards were continued/ applied. Technical committee report is submitted to AERA as part of the response to queries.

vi. Alternatively, AERA may issue useful life of assets in the industry which invariably requires componentization so that consistency is brought between Ind-AS and AERA guidelines.

vii. Based on the above, CIAL requests AERA to consider the useful life of Building – False Ceiling, Handrails and Façade Works and Building – Interior, Flooring, roofing and finishing and runway recarpeting as 20 years and 15 years respectively in compliance with Ind-AS standards.

Useful life of runway recarpeting

viii. AERA has assumed a notional useful life for original runway which is written off. The original runway is fully depreciated before the issue of the order thus outside the purview of AERA's order.

ix. In case AERA is assuming a notional life of original runway then it should also give adequate return to CIAL by including it in RAB and depreciation.

x. The current methodology adopted by AERA for determining the useful life of runway recarpeting will fall apart for runway recarpeting undertaken after 2030, when the remaining notional life of existing runway would be nil. CIAL suggests AERA to find out a permanent solution to determine the useful life of runway recarpeting.

xi. CIAL is of the view that the runway re-carpeting has to be looked independently from the life of the original runway.

xii. CIAL would suggest to AERA that it should delink the useful life of runway and the useful life of runway recarpeting. AERA may specify to the airport operators an useful life for the runway recarpeting or provide the independence to the airport operator, subject to the Technical Study, to determine the useful life of the runway recarpeting so that such issues will not arise in future.

10) <u>Financing allowance excluded by AERA in the true-up of the second control period and the ARR computation of the third control period</u>

A. Proposal of AERA:

Para 4.4.38 - *"The Authority noted that the Airport Operator has considered a Financing Allowance (as provided in Direction 5 – Airport Guidelines) of INR 11.9 Crores, against Interest During Construction (IDC) on the Work-in-Progress (WIP) assets worth INR 158 Crores projected to be capitalised in FY 2021.*

Para 4.4.39 - *The Airport Operator has computed Financing Allowance on the entire WIP amount whereas the Authority is of the view that such allowance is* *essentially the IDC for a project and should be provided only on the debt portion of the project fund. Accordingly, the Authority has considered IDC to be provided based on the changes in aeronautical capital additions discussed above and the average gearing considered for the Second Control Period (refer Section 4.6)."*

Para 6.2.61 - *"The Authority noted that financing allowance and the methodology for computation of the same was detailed in the airport guidelines and the same would need to be provided to the Airport Operator. However, the Airport Operator has computed financing allowance on the entire WIP amount being capitalised, whereas the Authority is of the view that such an allowance is essentially the IDC for a project and should be provided only on the debt portion of the project funds. Accordingly, the Authority has considered IDC to be provided based on revisions in the proposed capital expenditure discussed above and the notional gearing considered for the Third Control Period (refer Section 7). IDC as considered by the Authority is given below."*

B. CIAL's proposal:

i. AERA has agreed in the consultation paper that the financing allowance and its methodology for computation is detailed in the airport guidelines and the same need to be given to CIAL.

ii. Further, AERA guidelines in para 5.2.7 clearly specify that the capital work in progress assets will be given return based on the computation of the financing allowance.

iii. In the previous orders of AERA, financing allowance was allowed in the second control period of CIAL, BIAL and HIAL.

iv. AERA's proposal to exclude the financing allowance does not conform to the AERA guidelines and is a change of decision by AERA from the second control period order

v. As per the AERA guidelines, CIAL requests AERA to consider the financing allowance on the capital expenditure of INR 46.3 cr. based on its MYTP for the third control period.

11) Revision of terminal area ratio

A. Proposal of AERA:

Para 4.4.35 – AERA has revised the combined terminal area ratio from 7.19% to 8.94%.

B. CIAL's proposal:

i. CIAL requests AERA to consider the below requests related to the terminal area ratio:

   a. Terminal area (old viewers gallery) of domestic terminal is not used for non-aeronautical purposes by CIAL and no revenue is generated by CIAL. Therefore, it should be considered as aeronautical area.

   b. Circulation area of international terminal is used by passengers; shops have been separately considered as non-aeronautical and therefore, circulation area should be considered as aeronautical.

   c. Forecourt is an essential area for travelers and therefore, it should be considered as aeronautical

12) Interim review of tariffs at the end of FY23

A. Proposal of AERA: Nil

B. CIAL's proposal:

i. COVID-19 pandemic has significantly affected the aviation sector and the trajectory of COVID-19 pandemic is uncertain. During February, 2021, when it was thought that India has seen the last of COVID-19, we were hit by second wave which was worse than the first wave. Second wave has again affected the once improving domestic air traffic and pushed forward the recovery period of international traffic.

ii. AERA will appreciate that during these uncertain times it is exceedingly difficult to forecast the traffic and the building blocks for the determination of the ARR of the third control period. Though CIAL has taken the assumptions to the best of its knowledge based on the information available today, these assumptions are most likely to undergo a change.

iii. Given these unprecedented situation, it is a humble request to AERA to allow CIAL to undertake an interim review of tariffs at the end of FY23. CIAL would like to clarify that it does not expect the interim review to be a detailed exercise of tariff determination but expects it to be a simplified version of tariff determination to quickly revise the aeronautical tariffs based on the actuals of FY22 and FY23.

iv. AERA will appreciate that the interim review will surely reduce the uncertainty faced by the airport operator and will go a long way in building confidence and resilience in the entire airport operator community.

It is requested that the Authority may arrive into the final Aggregate Revenue Requirement of the third control period only after taking into consideration our above submission on the Consultation Paper.

Soliciting the continued support and co-operation of the Authority,

Thanking you,

Yours faithfully,

Suhas S, IAS

Managing Director