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APAO response to CP No. 15/2020-21 dated 9 June 2020 in the matter of determination of aeronautical tariff for IGIA, Delhi (DEL) for the third control period (01.04.2019--31.03.2024)

From : snayar@apaoindia.com
Subject : APAO response to CP No. 15/2020-21 dated 9 June 2020 in the matter of determination of aeronautical tariff for IGIA, Delhi (DEL) for the third control period (01.04.2019--31.03.2024)

Fri, Jul 31, 2020 12:47 PM

 1 attachment

To : RAM KRISHAN <director-ps@aera.gov.in>

Cc : GEETHA SAHU <gita.sahu@aera.gov.in>

Shri Ram Krishan
Director (P&S),
Airports Economic Regulatory Authority of India (AERA),
AERA Administrative Complex,
Safdarjung Airport,
New Delhi – 110002

Dear Sir,

This is in reference to the **Consultation Paper No. 15/2020-21 dated 9th June 2020** issued by AERA in the matter of determination of aeronautical tariff for Indira Gandhi International Airport, Delhi (DEL) for the third control period (01.04.2019-31.03.2024) wherein written comments were sought from stakeholders.

Please find below the submission of APAO for the kind consideration of AERA.

1. Concession Agreement: The Concession agreement entered into between Government and the Airport Operators have to be honored in letter and spirit by the Authority and due regard should be given to the provisions while deciding matters relevant to the determination of airport tariffs. The concession agreements strictly lay down various parameters with relation to investments, treatment of revenues, segregation of type of operations viz. aero or non-aero and other concession terms. The airport bidders had estimated their business strategy in consonance with the concession agreement, which makes it all the more important to be abided by. In view of above the concessions provided as a grant under the concession agreement, have to be accorded by the Authority, we support the DIAL's claim on the following issues:

a. Base Airport Charges + 10%: GoI vide concession agreement has assured that at least a permitted nominal increase of 10% of the Base Airport Charges will be available to DIAL for the purpose of calculating aeronautical charges for any year. The Authority acknowledging the terms of the concession allowed DIAL to charge BAC+10% vide its order no 30/2018-19 dated 19th Nov'2018. However, while computing the Target Revenue for the third control period in Table 110 of the CP, the Authority has computed TR as per BAC +10% of Rs. 4,151.70 Crs. and Net Target Revenue as per Schedule 1 of SSA of Rs. 2,187.93 Crs. Based on this there is over recovery of Rs. 1,963.77 Crs. regarded as

true up as on 01st April 2019 by the Authority. Through this proposal, the Authority has disregarded the provisions of Schedule 6 of SSA entered with GoI, since DIAL in all practical terms shall be made available the least permitted aeronautical charges as per BAC + 10%. The BAC+10% is a sovereign assurance given by GoI and such minimum guarantee should not be taken back through true up by the regulator in its tariff determination exercise. Hence, BAC +10% as has been allowed in the 3rd control period, once accorded should be the eligible amount for the relevant period and the same should not be subjected to any adjustment or true-up in the subsequent period.

b. Exclusion of revenue from existing assets: The OMDA of DIAL excludes the revenues from *existing assets* to be treated for calculation of revenue from revenue share assets. The definition of non-aeronautical asset stated in the OMDA clearly considers that the revenue from demised premises and any asset owned other than by JVC or any third Entity should not be considered for cross subsidy. It is a clear grant under the OMDA to DIAL that such income should be excluded from the cross subsidization for determination of tariff. Authority's view that this submission seems to be an after-thought as no such issues were raised at the time of tariff determination for the last two control periods is not correct, since the two control periods were the initial ones and this anomaly in tariff determination was detected on deep analysis of the clauses in the Concession agreements and the actual state of affairs of DIAL. The Authority should therefore consider the same as per the concession and revisit its decision taken in the consultation paper.

c. Exclusion of Annual Fee in the calculation of cross subsidy, i.e., 'S' Factor: Clause 3.1.1 of the SSA provides that '...the Upfront Fee and the Annual Fee paid/ payable by the JVC to AAI under the OMDA shall not be included as a part of costs for provision of Aeronautical Services and no pass through would be available in relation to the same'.

Also, as per the definition of revenue from revenue share asset provided in the SSA the cost in provision of Non-Aeronautical Services shall not be considered while calculating aeronautical charges. However, the Annual Fee is not a cost in relation to revenue from revenue share asset. Hence, in terms of the definition the revenue from revenue share assets for cross subsidy purposes has to be considered **post annual fee**.

Here also Authority has commented that this issue, along with justification is being raised by DIAL for the first time and has not been raised in the earlier tariff proposals for the first two control periods or before the relevant courts, seems only an after-thought. This view of the Authority is not correct, since Tariff determination for the Airports in terms of OMDA & SSA was a new concept and this anomaly was detected on a deep analysis of the clauses of the concession agreements and the actual state of affairs of DIAL.

d. Fuel throughput Charges: Authority in the said consultation paper has considered Fuel Throughput Charges as aeronautical service. Fuel Throughput Charges (FTC) is being charged by the Airport Operator as a royalty from the Oil Marketing Companies doing business at Airport and not for providing any aeronautical service as stated in section 2(a) of the AERA Act.

The Section 2 (a) (vi) of the AERA Act refers to the service relating to the supplying of fuel to the aircraft at an airport. The FTC is not a service and also is not a charge

in relation to the supply of fuel to the aircraft. Hence, the same cannot be considered under the stated part of the AERA Act, 2008.

Also, Schedule 5 of OMDA which list down the aeronautical service at IGI Airport refer service related to fuel as "*Common Hydrant Infrastructure for aircraft fueling services by the authorized providers*". The said service is related to providing infrastructure for fuel farm. We understand that in the case of DIAL and which is similar to MIAL, a separate entity provides fuel farm infrastructure facility which are regulated by AERA separately. Accordingly, the royalty charge by the airport operator for allowing to do business at the Airport is not covered as part of aeronautical services listed in schedule 5 of OMDA. Hence, the FTC is not a charge for any aeronautical service and accordingly the revenue generated through FTC should be considered as non-aeronautical revenue while determining tariff.

ICAO Provisions: ICAO document 9562 also considers the revenue from fuel farm as non-aeronautical activity. In ICAO document 9562 at Chapter 4 the revenue from non-aeronautical activity is defined.

Following is the relevant extract:

"CHAPTER 4. The process of setting airport charges.....

.....Revenues from non-aeronautical activities

4.18 Aviation fuel and oil concessions (including throughput charges). All concession fees, including any throughput charges, payable by oil companies or any other entities for the right to sell or distribute aviation fuel and lubricants at the airport. Revenues from an automobile service station concession, including the sale of automobile fuel and lubricants, should be entered in the revenue accounts covering "Other concessions and commercial activities operated by the airport." (**Emphasis added**)

The FTC is also levied on OMCs in lieu of the right to sell the fuel at the airport. The above provisions further reinforces the consideration of the FTC as non-aeronautical activities. Hence, the Authority should revisit its proposal for considering the FTC as aeronautical and consider the same in terms of the respective concession agreement.

2. Regulatory Principles: The Authority as per the AERA Act has to determine tariff under the multi-year framework for each control period. The Authority deliberates carefully on all issues relating to the building blocks and decides on the treatment of each item. Thus, it becomes imperative that the treatment of each component of the tariff should be as per the prevalent laws governing the tariff for the particular airport and the concession agreement. The airport operator has to align its business strategy as per the approved treatment of each item of building blocks and it's treatment by the Authority. Therefore, the treatment of components of tariff in a similar till regime should be homogeneous in a similar environment and should not usually differ in different tariff determinations for the same operator. This would ensure the airport operators to efficiently manage their resources in line with the regulatory approvals. In this background the following issues need to be considered by the Authority:

a) Other Income: The Authority in the First Control Period of DIAL had not considered the revenues realised by DIAL on account of Interest Income, income from sale of investment, income from delayed payment, etc. as non-aeronautical revenue. Authority's stand for the first control period was clearly stated in the

Order no. 40/2015-16 for the second control period, the relevant extract from para 6.43 is reproduced below:

The Authority, during the determination of tariff for the first Control Period, had not considered the revenues realised by DIAL from "Other Income" (typically including Interest Received Deposit with Banks, Income from Current Investments, Income from Non-Current Investments, Interest received - Delayed payment, Sale of Others material/Scrap others, Profit on Sale of Depreciable Assets, Dividend income, Realized Foreign Exchange Gain/Loss, Misc. income Others, Liquidated Damages received, Management Fee, Tender cost recovery) as non-aeronautical revenue.

However, in the same order Authority itself, at para 19.15 had changed its stance and opined that the interest income will be treated as non-aeronautical revenue at the time of true up. Following is the extract of para 19.15 of the order:

"The Authority, for the time being, had projected this sub-head at 'nil' value for the second Control Period. However the Authority proposed to true up the "Other Incomes" based on the actual values realized by DIAL during the second Control Period at the time of tariff determination for the third Control Period."

We request the Authority to be consistent with the approach in determination of tariff and consider the other income as considered in the first control period order for DIAL.

3. Cost of Equity: Historically, the matter has been deliberated by the Ministry on many occasions. In this regard it may be pertinent to mention that to attract investors in the airport development it is essential to accord an optimal rate of return for equity investments. The Ministry of Civil Aviation had appointed SBI-CAPS to conduct a study in order to arrive at an optimal rate of return on equity to cover the risks of an investor. The results of the study indicated that the rate of return for the airport operator considering all risks should be in the range of 18.5% to 20.5%. However, the Authority considered return on equity at 16% for the 1st and 2nd control periods and has provided only 15.41% return on equity in case of 3rd control period for DIAL which is far less than the assessment done by the Ministry through SBICAPS. Therefore, **it is suggested that the airport operators be accorded adequate return, in this regard Authority should allow the Return on Equity requested by the respective airport operators.**

Further, IIM B while evaluating beta for return on equity for DIAL has majorly considered developed countries. In order to arrive at a true reflection of risk the Authority should have used beta of developing countries similar to India.

4. Project Cost: DIAL has proposed to consider the project cost at Rs. 9794 Crs. for the expansion of the Delhi Airport. The project cost so derived is an outcome of the international competitive bidding. The Authority in its order has considered the Project cost at Rs. 9126 Crs. The project cost which has gone through the test of the market and competition thereof should not be reduced, else it may lead to a cash flow deficit to DIAL. The project cost arrived is a result of international competitive bidding process which is certainly an efficient cost, accordingly the entire project cost arrived through price discovery should be considered for the return on regulated asset base.

Further, the authority has also suggested to levy 1% penalty in case of time over-runs in the Phase 3 A expansion. The COVID-19 has affected the industry at large and the impact on the sector and construction is uncertain. In any case if the completion is delayed due to any unprecedented reasons the impact on tariff shall be captured through true up in the next control period along with carrying cost. In view of the above **we suggest that such penalties should not be introduced.**

5. Foreign Exchange Rate Variation: DIAL had availed External Commercial Borrowing before the Authority came into existence. This was done to ensure that the cost for the passenger was lowered. On availing the ECB facility, DIAL has been able to reduce the interest cost on borrowed funds. The associated benefit of lower borrowing cost gets disseminated ultimately to passengers. However, in all ECB facilities there is an associated risk of forex rate fluctuations.

The Authority while truing up the WACC has considered the benefit of lower cost of ECB for the first and second control period but did not allow the Forex fluctuations associated in full for the same period. It is therefore **requested that the forex fluctuation should be allowed on actual basis.**

6. S-Factor in calculation of Tax: Hon'ble TDSAT, in case of MIAL appeal no 4 of 2013 against the 1st Control Period Tariff order of MIAL, in its order dated 15th November, 2018 at para 15 opined that:

"...by the provision in the Agreement, 'S' is an element of revenue on aero side and by the same yardstick must be added while calculating the 'T'. We find some merit in these arguments."

Accordingly, Hon'ble TDSAT vide Judgment at Para 41(i) remanded the matter of considering the S-Factor as part of revenue in calculation of tax, to AERA.

In accordance with the SSA, while determining tariff, Authority subsidises the eligible aeronautical revenue of DIAL calculated as per building block, by 30% of revenue from revenue share assets. In other words, a part of the aeronautical revenue is expected to be recovered through cross subsidy by revenue from Revenue Share Assets (RSA). However, while computing tax for the 1st control period, the Authority has not considered this 30% of revenue from RSA as aeronautical revenue for the FCP.

The Authority should consider such cross subsidisation as part of Aeronautical Income while calculating tax, since it is replacing the aeronautical revenue to the extent of S.


Accordingly, **we request the Authority to kindly take a positive view on the above matters.**

We look forward to the kind consideration of our above submissions on the Consultation Paper.

Please contact the undersigned, if required, for any further information / clarification from our end.

Thanks and Regards

Satyan Nayar
Secretary General

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