Delhi International Airport Limited
(Formerly known as Delhi International Airport (P) Limited)

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Dated: 23rd November'2020

To
Director (P&S, Tariff),
Airport Economic Regulatory Authority
AERA Administrative Complex
Safdarjung Airport,
New Delhi-110002

Subject: Response to Consultation Paper no. 35/2020-21, for Mumbai International Airport Ltd for 3rd Control Period
Reference: Consultation Paper no. 35/2020-21 dtd. 21st Sep'2020

Dear Sir,

We write with in response to the consultation paper no. 35/2020-21 issued by the Authority for Mumbai International Airport for 3rd control period. Our response to the consultation is as follows:

1. **Concession Agreement:** In terms of the Section 13 (1)(a)(vi) of the AERA act 2008,the Concession Agreements entered into between Government of India and airport operator 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 lays down various parameters with relation to investments, treatment of revenues, classification of service viz. aero or non-aero and other concession terms. The airport bidders had formulated their business strategy in line with the terms of the Concession Agreements, which makes them 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 honoured by the Authority, we support the MIAL's claim with regard to the following issues:

    a. **Reduction of assumed value from the HRAB in respect of old T2 demolished in FY15:** Authority in the said consultation paper has proposed for adjustment of HRAB to the extent of demolition of Old T2 asset in case of MIAL. In this regard we would like to submit that as per SSA the RAB for first year of DIAL and MIAL specifically includes Hypothetical Regulatory Asset Base basis the formula provided in the SSA. The HRAB so derived becomes part of Regulatory Asset Base. The HRAB is not directly correlated to any

particular asset and it is a calculated asset base only. Authority in case of MIAL, has correlated the asset base and removed the HRAB proportion to Old T2 completely from the RAB which is not in consonance to the concession terms. The concession allows the recovery of HRAB over the period of useful life of the RAB. Accordingly, the HRAB should not be correlated and adjusted on account of T2 demolition. Even if Authority decides to adjust the HRAB then it should allow the airport operator to recover such adjustment of HRAB as loss on sale of asset as a part of aeronautical opex.

b. Fuel Throughput Charges (FTC) should have been considered as non-aeronautical revenue:

AERA in case of both Mumbai and Delhi Airport considered FTC as aeronautical. This approach of AERA is contrary to the provisions of the concession agreement i.e. OMDA. The fuel throughput charge is not a part of aeronautical service listed at Schedule 5 of OMDA. The only entry in Schedule 5 of OMDA remotely relatable to oil / aircraft fuelling is entry no.17 *'Common hydrant infrastructure for aircraft fuelling services by authorized providers'*. The service listed at entry no 17 of schedule 5 has been provided by a separate ISP and same has been regulated by the Authority. FTC is a royalty which is levied by MIAL in lieu of providing access right to fuel suppliers.
The section 2 (a)(vi) of the AERA Act, 2008 refers aeronautical service to mean any service provided *'for supplying fuel to the aircraft at an airport;'* The FTC levied by MIAL is not for supplying fuel to the aircraft at an airport.

Further, the provisions of ICAO document 9562 considers the revenue from fuel farm as non-aeronautical activity. ICAO document 9562 third edition 2013 defines the revenue from non-aeronautical activity in Chapter 4, extract of which is reproduced below:

"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 levied on Oil Marketing Companies for allowing them right to sell the fuel at the airport. The above provisions further reinforce the contention of MIAL that FTC should be treated as non-aeronautical activity. Hence, we request Authority to reconsider its proposal for considering the FTC as aeronautical and consider the same in terms of the respective concession agreement.

c. Grossing up of Cost of Equity:

Schedule 1 of SSA entered between MIAL and Central Government provides that for the purpose of return on RAB in tariff determination, WACC as nominal post-tax weighted average cost of capital, calculated using the marginal rate of corporate tax.

To give effect to the said definition of WACC, the rate of return on equity has to be grossed up by using the marginal rate of corporate tax and then it has to be employed in the calculation of WACC. As such, the return on equity is arrived at after employing the CAPM formula is to be grossed up using the marginal rate of corporate tax and the number then arrived at is to be used for the calculation of WACC as defined in the SSA. In case the return on equity to the investors 16% as calculated by AERA for the first control period and the second control period as the post-tax cost of equity, then the return on equity would have to be grossed up with the marginal rate of corporate tax, i.e., 30% to arrive at the post-tax cost of equity which is to be used for the calculation of WACC in terms of the SSA.

Accordingly, calculation of Post tax cost of equity as per SSA at cost of equity at 16% should be as 16 * [1/(1- 30%] i.e. 22.88%

However, the Authority while considering the definition of WACC for Tariff determination, has only considered first part of the definition i.e. "Nominal post tax WACC" and have ignored the second part of the definition "calculated using the marginal rate of corporate tax". The calculation of WACC has to be done by giving effect to the definition of WACC, accordingly it should be computed using the grossed up Rate of Return on Equity using the marginal rate of corporate tax to ensure the same return after tax for WACC computation.

Accordingly, Cost of Equity should be grossed up and WACC should be computed as per SSA considering cost 22.88% both for the first and second control period for the purposes of true up of their working.

2. Regulatory Principles:

The Authority in terms of Section 13(1)(a)(vi) of the AERA Act, 2008 has to determine the tariff for the aeronautical services taking into consideration:

'vi) the concession offered by the Central Government in any agreement or memorandum of understanding or otherwise;'

Accordingly, the Authority has to consider the provisions of SSA and OMDA while determining the tariff. Schedule 1 of SSA entered into between Government of India and MIAL inter-alia elaborates the Principles to be observed by the Authority while undertaking its role:

'4. Consistency: Pricing decisions in each regulatory review period will be undertaken according to a consistent approach in terms of underlying principles.'

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 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 issue needs to be considered by the Authority:

Other Income considered as part of S: Other Income which did not form part of 'S' In earlier control periods, for cross subsidization have now been considered as part of 'S'. Such other Income not being revenue from Revenue Share Assets should not be included for cross subsidization.

Further it is important to note that Authority while truing up the under/over recovery in following control period considers the over/under collection with time value or carrying cost at the value of WACC arrived. This inter-alia means that the authority has considered any potential interest on the surplus during the control period with a rate of WACC. Such interest relates to the investment which can be made from the surplus amount at much higher rate as compared to the actual and also is considered 100% aeronautical in nature. Considering the treasury income over and above the present value of the surplus would lead to double accounting of the same income.

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 15.13% return on equity in case of 3rd control period for MIAL which is far less than the assessment done by 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 MIAL has mainly considered developed countries. The Authority should have used beta of developing countries similar to India in order to arrive at true reflection of risk.

4. **Return on RSD:** Refundable Security Deposit is a long term deposit undertaken by the airport operator for overall airport development. The RSD so received has equity like features such as long duration of availability of funds and also it has no restriction of usage of this fund. Accordingly, the RSD is eligible for a return equivalent to equity. The expert like KPMG and CARE for DIAL have also opined that the RSD has equity like traits accordingly same is eligible for return equivalent to cost of equity. Following are the relevant extract of the expert view:

   Expert Opinion by CARE

   > *"In light of these facts, the amount mobilised through RSD exhibits equity like features and as such qualifies for being treated as quasi equity and thus being eligible for close to equity returns."*

   Expert Opinion by KPMG

   > *"The Authority has proposed to provide zero returns on capitalized airport asset funded through RSD. However, it is evident that there is an opportunity cost associated with RSD in terms of the forgone lease rentals. Also, lenders have treated the RSD funding as part of promoter's contribution (quasi-equity), therefore, RSD utilised to fund the capex is expected to have risk inherent to that associated with equity. Additionally, there are examples from other infrastructure sectors where regulator provides return on the capital employed by the Concessionaire and does not consider the cost of funds while calculating tariff."*

The MoCA had also initiated a study through SBI Caps which indicated that Quasi Equity be provided return between cost of debt and cost of equity depending upon the type and feature of the instrument. The same study indicated the rate of return should be 18.5% to 20.5%. This report was also sent to AERA by MoCA for consideration.

Accordingly, we request Authority to consider the RSD as Equity and allow return equivalent to cost of equity.

5. **Levy of 1% penalty in case of over-run:**

The Authority has proposed to introduce a penalty clause whereby if the project is committed to be completed by MIAL in each control period and if the same is not completed, then the ARR/ target revenue shall be reduced by 1% penalty of the total project cost.

In this connection, we wish to state that COVID-19 has affected the industries across the board including aviation as well as construction, the future scenario is still uncertain. In view of this pandemic the projects planned may not be executable as planned, due to various reasons viz. non-availability of human resources, scanty availability of funds to execute them, etc. In view of such unprecedented situation, such proposal to levy penalty should not be introduced when issuing the final order.

6. **Amortization of expense on re-carpeting of Runways, Taxiways and Apron over 5 years as part of O&M cost, without allowing carrying cost on the unamortized balance for each of the 5 years :**

In terms of provisions of AERA Order no. 35/2017-18 dated 12th January, 2018 in respect of useful life of assets, the Authority has allowed the expense incurred on re-carpeting of runways, taxiways and apron as O&M expenses to be amortized over a period of 5 years. However, the Authority has not provided a carrying cost on the balance unamortized portion of such expense incurred by MIAL which will accrue in future whereas the expense has already been incurred. This results in lower return of expense incurred over the economic life by 20% at the current WACC of 12.81% in present value terms. Denying carrying cost to the airports on such unamortized balance, shall prove to be counter-productive and would not encourage efficiency while incurring such important expense directly related to safety at the airport.

7. **Marketing Fund (MF) treated as Non Aeronautical Revenue:**

The marketing fund is a special purpose deposit received from the retailers. The fund is earmarked for promotion of retail revenue at the Airport and it is monitored by a committee which has representative from both retailers and airport operator. For accounting purpose, it is treated an earmarked fund at liability side of the airport operator balance sheet which needs to incur for the given purpose. The Authority has, disregarding the fact that such Marketing Fund is for making promotional expense for the benefit of the concessionaires and that MIAL cannot use the funds for its own purposes, has proposed to treat MF as non-aeronautical revenue. This shall be a taxing proposal for the airport, since as per the terms of MF, MIAL is not entitled to use the MF for its

own purposes or expenses. This proposal by the Authority shall result in lower promotional events and would ultimately result in lower non aeronautical revenues.

In light of the above we would like to put forth humble submission to the authority that the marketing fund has provided significant boost to the non-aero revenue at airport and if authority consider it for cross subsidy then it will derail the retail promotion and adversely impact non-aero revenue at the airport which may in a way lead to increase in tariff.

8. Impact of COVID on traffic

In light of present situation, we note that the passenger traffic considered by the Authority is not practical specially for FY21, FY22 and FY23. The Authority has considered passenger traffic for FY21 - 50% of traffic for FY20 (22.94 mn.), for FY22 - 75% of traffic for FY20 (34.41 mn.) and for FY23 – 100% of traffic for FY20 (45.88 mn.). As of now, the international flights are suspended till 30th November, 2020 and there is no sign yet for their start in December, 2020, which normally is the peak season for international travelling. The Authority should obtain the revised traffic projections along with revised Non-aeronautical revenue projection in light of so many concessionaire outlets closing down / pruning their operations with re-negotiated terms, leading to lower revenues. The Authority should rework the Target Revenue in light of the pandemic before the final tariff order is issued by the Authority.

9. Non aeronautical revenue considered by the Authority

Authority for the purpose of tariff determination in case of MIAL has reduced the non-aeronautical revenues however same is not aligned the actual trend witnessed and to be witnessed by the airport operator in current pandemic situation. Current pandemic situation has shaken the economy of the whole world and in this scenario deep economic impact, loss of jobs, corporate revenue losses, income reductions, salary cuts, etc. have put sever constraints on disposal incomes, COVID 19 will have long lasting impact on economy and accordingly the revenue from revenue share assets will see major effect on this account. In light of pandemic Covid-19 and no sight of its end, the non-aeronautical revenues need to be considered as assessed by the Airport operator in the given circumstances.

10. Adhoc UDF request by MIAL:

Current Pandemic has put severe stress on airport revenue and operating margin. The Airport operators face severe challenges in meeting its debt and operational obligations and accordingly requested for an Ad-hoc UDF. In order to ensure viable airport operations, we request the Authority to provide much needed cash supports to airports so that it will help them to sustain operation in current pandemic scenario. Further, as a recovery mechanism we also suggest that the Ad-hoc UDF should be recovered in future without any carrying cost. This measure will put lessor burden on passenger.

We request the Authority to consider the above issues, before issue of final order for determining the aeronautical tariff for CSMI Airport, Mumbai.

Yours Faithfully,
For **Delhi International Airport Ltd.**

K Narayana Rao
Director