APAO/2020-21/ AERA **Date: 23rd November 2020**

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

Subject: **APAO response to Consultation Paper No. 35/2020-21 dated 21st September 2020 in the matter of determination of tariffs for aeronautical services in respect of CSMI Airport, Mumbai for the third control period.**

Dear Sir / Madam,

This is in reference to the **Consultation Paper No. 35/2020-21 dated 21st September 2020** issued by AERA in the matter of determination of aeronautical tariff for Mumbai International Airport, Mumbai 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 agreements (MODA and SSA) entered into between Airports Authority of India (AAI) / Government of India and MIAL 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 formulated their business strategy in line with 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 on the following issues:

    a. **Computation of Hypothetical Regulatory Assets Base (HRAB) considering the entire revenue for FY09:** HRAB needs to be computed in the manner elaborated by MIAL considering the entire revenues of MIAL in FY09 in terms of the methodology given in Schedule 1 to SSA. Authority should have kept in view the response of AAI on the White Paper no. 01/2009-10 dated 22nd December, 2009 issued by it, where AAI had stated that their tariff were being approved by Government of India and that they were following 'Single Till' methodology where there was no distinction between aeronautical and non-aeronautical revenues. The entire non-aeronautical revenue was being used to finance / cross subsidize the aeronautical operations / charges.

    The cross subsidization from non-aeronautical revenues only started from FY10, when the Authority had to determine the aeronautical tariff. Prior to that both MIAL as well as DIAL were using the entire non-aeronautical revenues for

subsidizing the aeronautical operations. In view of above, the entire revenues in the year preceding the date of computation of HRAB (FY09) should have been considered for computation of HRAB.
In fact the Authority while computing the HRAB for the FCP tariff order, should have suo-moto considered the entire revenues of FY09, since the response to white paper by AAI was made to the Authority itself and it was in full knowledge of this fact.

It would also be not out of place to mention that the Authority had never advocated and supported 'Dual Till' methodology in its philosophy, but followed the Dual Till while computing the HRAB for MIAL as well as DIAL.

The Authority should also note that its Counsel had before the Hon'ble TDSAT during the hearing on Appeal filed by MIAL had requested that since the matter of HRAB considering the entire revenues was being raised for the first time, it be remanded to the Authority.

b. **Reduction of assumed value from the HRAB in respect of old T2 demolished in FY15:** The proposal of the Authority to reduce from HRAB of Rs.966.03 cr. amount towards the wdv of the old T2, assuming arbitrary value to old T2 is not justified. As the name suggests HRAB is a hypothetical value allowed as per the provisions of SSA and there is no provision in the SSA for reduction in value of HRAB, except through depreciation.

   If at all such wdv is to be reduced from the HRAB value, it should be allowed as an enabling cost for construction of assets on removal of old T2.

c. **Fuel Throughput Charges (FTC) should have been considered as non-aeronautical revenue:** The Authority should have honored the OMDA and its Schedule 5, while considering the Fuel Throughput Charges as aeronautical revenue. The fuel throughput charge is not covered in 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'*. MIAL has neither provided the common hydrant infrastructure for aircraft fuelling services nor is it an authorized provider of such services. In fact any Airport Operator is not eligible to be an authorized provider.

   Even 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;'* Here also MIAL has neither supplied fuel to the aircraft nor is it eligible to supply fuel to the aircraft.

   Even provisions of ICAO document 9562 considers the revenue from fuel farm as non-aeronautical activity. ICAO document 9562 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, the Authority should revisit it's proposal for considering the FTC as aeronautical and consider the same in terms of the respective concession agreement.

d. **Corporate Tax computed by considering the Annual Fee (AF) as an expenditure in contravention of the provisions contained in clause 3.1.1 of SSA:** Clause 3.1.1 of SSA states *"Provided however, the Upfront Fee and the Annual Fee paid / payable by the JVC to AAI under the OMDA shall not be included as part of costs for provision of Aeronautical Services and no pass-through would be available in relation to the same."*

Contrary to the provisions of clause 3.1.1, the Authority has considered the Annual Fee paid to AAI as an expenditure for computation of taxable income and the Tax thereon, which has to form part of Target Revenue allowed by the Authority. This has resulted in making T, one of the building blocks for computation of Target Revenue as per SSA, redundant.

e. **Grossing up of Cost of Equity:** Schedule 1 of SSA entered between MIAL and Central Government defines 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 calculated by using the marginal rate of corporate tax and then it has to be employed in the calculation of WACC. As such, whatever rate of return 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 rate of return 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 rate of return 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.

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. **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.

5. **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 forgot to provide a carrying cost on the balance unamortized portion of such expense incurred by MIAL. 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.

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

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. The Authority is requested not to consider this MF as non-aeronautical revenue in the final Order to be issued by it.

7. **Over ambitious Traffic considered by the Authority:**

In light of present situation, we note that the passenger traffic considered by the Authority is over ambitious 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. Even the O&M expenses need to be rationalised. The Authority should rework the Target Revenue in light of the pandemic before the final tariff order is issued by the Authority.

8. **Over ambitious Non aeronautical revenue considered by the Authority:**

Though the Authority has reduced the non-aeronautical revenues but it has been based on the over ambitious traffic. In light of pandemic Covid-19 and no sight of its end, the non-aeronautical revenues need to be further scaled down for the entire third control period.

9. **Ad-hoc DF:**

In view of severe impact on revenue due to reduced traffic and to meet its cash obligations MIAL has requested for an Ad-hoc UDF in the Annual Tariff Proposal submitted by them. APAO supports such additional revenue through Ad-hoc UDF till March, 2023 which is in nature of temporary funding to partly bridge the cash shortfall of MIAL. This Ad-hoc UDF should be recovered in future without any carrying cost. This measure would help MIAL achieve economic and viable operations, which is one of the criteria to be considered by the Authority while determining tariff for the aeronautical services at the major airports.

We request the Authority to give a serious consideration to the points raised by us in the above response, before issue of final order determining the aeronautical tariff for CSMI Airport, Mumbai.

In case any other information/ clarification is required in this connection, please inform the undersigned.

Thanks and Regards
For Association of Private Airport Operators

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