Federation of Indian Airlines
E-166, Upper Ground Floor,
Kalkaji,
New Delhi - 110019.
Website: www.fiaindia.in

MOST URGENT

20 September 2021

To,
The Chairperson,
Airports Economic Regulatory Authority,
AERA Building, Administrative Complex,
Safdarjung Airport,
New Delhi – 110003.

Kind Attention: Shri. B.S. Bhullar, IAS

Sub: Response to Consultation Paper No. 13/2021-22 on determination of Fuel Infrastructure Charges in respect of Indian Oil Skytanking Private Limited (IOSPL) at Kempegowda International Airport (KIA), Bangalore, for the Third Control Period (01.04.2021 – 31.03.2026) ('Consultation Paper/CP')

Dear Sir,

At the outset, we would like to express our sincere gratitude to the Airports Economic Regulatory Authority of India (**Authority**) for acknowledging the impact of COVID-19 on the aviation sector.

Sir, you will appreciate that airlines which are the 'catalyst' for the global economy including the aviation sector, have been hit the hardest by COVID-19. Since February/March 2020, due to restrictions on the scheduled international and domestic air travel issued by the Ministry of Civil Aviation and Directorate General of Civil Aviation and other restrictions on inter/intra state travel ('collectively '**Government Restrictions**'), airlines' cash flows have been adversely impacted.

While the airline operations showed an upward trend from December 2020, however the brutal second wave of COVID-19 in March 2021 has again impacted the operations and resultantly prolonged the process of financial recovery. At present, the airlines' operations are barely at 60 - 65% (approx.) of the pre COVID-19 capacity and the passenger traffic at around to 50 - 60% (approx.) of pre COVID-19 levels. As per industry estimates issued by IATA and CAPA, it will take almost two (2)- three (3) years for airline operations to reach pre Covid-19 level, in terms of number of flights and passengers.

You will further appreciate that, while the low passenger demand for air travel/ load coupled with Government Restrictions including on fare and operational capacity, prevents airlines from generating adequate passenger revenue, airlines continue to incur high operational cost, including on account of high airport charges and taxes.

In the current situation, airlines in India are staring at a loss of USD 8.0 billion for the FY 2020-21 and 2021-22. With limited financial support from the Government, Airlines are constrained to implement severe cost control measures to sustain its operations.

In view of the above, our comments on the Consultation Paper are as follows:

1. Optimum Utilization of existing fuel infrastructure & deferment of non- essential capital expenditure

As mentioned above it will take around two (2) -three (3) years for the flight operations to reach to its pre COVID-19 peak levels. Accordingly, Authority and IOSPL need to review the optimum usage of existing 'Aviation Fuel Farm facilities' at KIA Airport, Bangalore to cater to the proposed traffic levels, without any new or additional investments, at the present stage.

In view of the above, to support the airlines to continue and sustain its operations, all non-essential capital expenditure proposed by IOSPL, should be put on hold/ deferred, unless deemed critical from a safety compliance perspective. Further, in case IOSPL wants to make capital expenditure, then it should be at no additional expense to the airlines until the project is completed and put to use by the airlines.

In particular, the Authority has taken a view that some of the CAPEX items for up-gradation & replacement can be deferred to the next years or even the next control period. However, in the CP, it is neither mentioned what could be deferred to the next control period, and nor is there any proposal for deferment of CAPEX to the next control period (Refer Table Nos. 5.5 and 26 of CP). Authority is requested to kindly clarify the same and reconsider CAPEX items that can be deferred to the next control period.

2. Review in Fuel Infrastructure Charges (FIC) & Into Plane Charges (ITP)

Airlines are now paying separately for FIC and ITP which was earlier part of ATF pricing. Such FIC and ITP along with GST thereon becomes part of ATF pricing and suffers from Excise Duty and Sales Tax. The additional burden of non-creditable taxes becomes sixty-four (64) % - seventy (70) % on the airlines.

We would also like to urge the Authority to pass an order stating that FIC and ITP should be directly invoiced by IOSPL or the services providers to the airlines to avoid circuitous billing and for the sake of 'Ease of doing businesses' and 'Transparency'. This will also help in avoiding unnecessary tax on tax to the tune of sixty-four (64) % - seventy (70) % sixty-seven (67) % to Airlines.

We strongly urge the Authority to undertake a thorough investigation retrospectively to determine the actual cost of efficient operations and revenues collected by IOSPL till date. All excess recoveries to be passed on to the airlines and future tariff to be determined based on actual cost of efficient operations.

3. **Review of Operational Expenditure**

FIA is unaware as to whether IOSPL has taken cost cutting measures including re-negotiations of all the cost items on its profit and loss account. It may be noted that cost incurred by IOSPL impacts the airlines, as such cost is passed through or borne by the airlines.

Further, in view of industry reports from IATA and CAPA, which foresee a minimum period of two (2)-three (3) years for air traffic and flight operations to reach pre COVID-19 levels, we request Authority should:

(a) Put on hold any increase in operational expenditure by IOSPL;

(b) Advise IOSPL to review its spending on operational expenditure and re-negotiate all the operational expenditure costs in a significant manner and address any increase in fees sought by IOSPL. It may be noted that across various industries, instead of cost escalations, all the costs have been renegotiated downwards substantially. Accordingly, IOSPL needs to significantly reduce all such costs in a very aggressive manner. IOSPL may be advised to reduce its cost by at least 35% and no escalation should be permitted; and

(c) In view of the above, IOSPL should be directed to pass on cost benefits to the airlines.

(d) In particular, FIA submits that:

(i) The O&M CAGR proposed by IOSPL is between 5 - 10% (in para 9.5 of the CP). Instead of a significant reduction in cost items of operating expenses, Authority has considered (as per Table No. 39 of the CP) a percentage increase in OPEX between 4.6 - 8%. Such an increase in the name of escalation, in a highly uncertain environment, where airlines are operating under curtailed operations (60-65%), appears without any rationale and should be avoided.

(ii) <u>Payroll Cost</u> (Refer 9.8.1 and Table No. 40):

Although the activity level has gone down drastically, rather than significant reduction in the cost, the employee expenses have gone up for IOSPL, between 8% to 36% as compared to base year of 2021-over five (5) year control period. Employee Benefit/ Expenses as proposed by the Authority for Third Control Period (Ref Extract of Table No. 40 of CP):

(In Rs. Lakhs)

Particulars	2021-22	2022-23	2023-24	2024-25	2025-26
Payroll Cost	470.44	508.07	548.72	592.62	640.02
YOY % Increase		8%	8%	8%	8%
Increase On base year 2021-22		8%	16.6%	25.9%	36%

FIA submits that while the aviation sector, including airlines have incurred huge losses and are struggling to meet their operational costs, and are not able to pay even to the support staff, on the other hand IOSPL seems to have paid/will pay incremental salaries which may not appear prudent considering the significant losses incurred by the aviation sector. It appears that IOSPL wants to recover its full employee cost from the airlines, which are facing significant challenges to meet its operating expenses.

FIA submits that there should not be any increase in manpower till the existing manpower is effectively utilised as it will take another two (2)- three (3) years to recover. Existing manpower can be reviewed and any additional costs due to contract manpower or otherwise should be reduced. It is also pertinent to note that due to high VAT on ATF in Karnataka, and much lower VAT at neighboring states the Fuel Offtake will be lower and hence manpower resizing and other related costs needs to be reviewed and optimized.

Without prejudice to the above, IOSPL needs to considerably restructure its employee benefit expenses and other expenses and hold any revisions at least for the next two (2) years.

4. Review of Tendering Process

Authority should ensure that in the tendering process adopted by IOSPL, the tenders are awarded to only those parties which provide the competitive costs with best-in-class services. Any attempt to award the contracts on the highest revenue share basis to IOSPL should be discouraged as it leads to increasing the royalty for the airport operator and additional cost to Airlines. It is general perception that IOSPL has <u>no incentive to reduce their expenses as any such increase will be passed on to the airlines through tariff determination mechanism process</u> and indirectly airlines will be forced to bear these additional costs. There needs to be a mechanism for incentivizing the parties for increasing efficiencies and cost savings which in turn can be passed on to Airlines.

5. Review of Abolishment of Royalty Charges

As you are aware, royalty is in the nature of market access fee, charged (by any name or description) by the Airport operator under various headings without any underlying services. These charges are passed on to the airlines by the airport operator or other services providers. The rates of royalty at some of the airports are as high as forty-six (46) %. It may be pertinent to note that market access fee by any name or description is not practiced in most of the global economies, including European Union, Australia etc. Sometimes it is argued by the airport operators that ‘Royalty’ on ‘Aero Revenues’ helps in subsidizing the aero charges for the airlines, however royalty in ‘Non-Aero Revenues’ hits the airlines directly without any benefit.

In view of the above, we urge Authority to abolish such royalty which may be included in any of the cost items.

6. Review of Fair Rate of Return

Presently, the Authority provides a Fair Rate of Return (**FRoR**) to IOSPL towards their investment. While such fixed/ assured return favours the service provider, it creates an imbalance against the airlines, which are already suffering from huge losses and bear the adverse financial impact through higher tariffs. However, due to such fixed/assured returns, service providers like IOSPL have no incentive to look for productivity improvement or ways of increasing efficiencies, take steps to reduce costs as they are fully covered for all costs plus their hefty returns.

Such a scenario breeds inefficiencies and higher costs, which are ultimately borne by airlines. In the present scenario any assured return on investment to any services providers like IOSPL, in excess of three (3) % (including those on past orders), i.e. being at par with bank fixed deposits, will be onerous for the airlines (Refer 8.5 of the CP).

Without prejudice to the above, in case the Authority is unable to accept FIA's recommendation mentioned above, the Authority is requested to conduct an independent study for determination of FRoR to be provided in favour of IOSPL. Such independent study can be exercised by the Authority in terms of powers conferred under the Airports Economic Regulatory Authority of India Act, 2008, as amended, and in line with studies being conducted by Authority in case of certain major airport operators.

7. <u>Other comments on the Consultation Paper/CP are as under</u>:

(i) **Review of Concession Agreements**

Length of Concession Agreements (Refer 1.1 of the CP)

Authority should ensure that instead of the Concession agreements being for a period of 20 years, the same should not exceed five (5) years such that there is no monopolistic situation, and in a fair and transparent manner, with the agreement awarded to only those parties which provide the competitive costs with best-in-class services, from at least three to four parties, based on cost of efficient operations.

(ii) **Penalty – Second Control Period** (Refer 3.13 of CP):

It is noted that capex projects of Rs. 2917.00 lakhs were cancelled in the second control period. We would request the Authority to apply a penalty of 1% on the projects not undertaken, as reasonable.

(iii) **Over Recovery – Second Control Period** (Refer 3.7 and 3.29 of CP):

IOSPL has calculated an over recovery of Rs. 1034.69 Lakhs during the Second Control Period. Authority has proposed an excess recovery (claw back) amounting to Rs. 2683.60 Lakhs of the Second control period to be adjusted out of the Third control period. The Authority and IOSPL should undertake a detailed scrutiny (including independent studies/audits) and other appropriate measures to ensure that there are no cases of over recovery, which will assist in lowering the burden of tariff on airlines/ passengers. It appears that the costs are exaggerated/inflated, and revenues suppressed in the projections, which leads to over recoveries.

Not only the above measures, the interest due to over recoveries should also be clawed back, as over a period of five (5) years, the interest earned on monies received but not spent are significant amounts.

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(iv) **Fuel Throughput Forecast – Third Control Period** (Refer 4.5 of the CP)

The Authority has sought to take into consideration stakeholder's view on the proposed Fuel Throughput Forecast. FIA is in agreement with the Authorities' view in reference to Table No. 23 of the CP.

(v) **Penalty – Third Control Period** (Refer 5.8.2 of CP):

While the airline industry has been cutting down the capital expenditure to mere bones in the face of current extra ordinary situations, we suggest that that the Authority may consider more stringent penalties in excess of 1% in the event of any delay or significant reduction in the execution of capital expenditure as finally approved for the third control period such that efficiencies in the system are encouraged and inefficiencies discarded.

While we appreciate the reduction in rates of FIC by Authority in the present CP (Refer 13. 4, Table No. 48 of CP), Authority may review further reduction in FIC, in view of above recommendations.

We hope that your good self will positively consider the above recommendations/ comments as it will help in achieving the affordability and sustainability of the aviation sector including the airline, which is also outlined as a key objective in the National Civil Aviation Policy, 2016. Needless to state that sustainability of airlines will be key for continuity of IOSPL and other service providers in the aviation sector.

We look forward to your continued support in these challenging times.

Thanking you,

Yours faithfully,

For and on behalf of Federation of Indian Airlines

UJJWAL DEY
Associate Director

<u>Copy to:</u>
Director (P&S Tariff), Airports Economic Regulatory Authority of India (**AERA**)