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ASSOCIATION OF PRIVATE AIRPORT OPERATORS

APAO

APAO/CP-10/AERA/ 2016- 17 **Date : 25 th May 2016**

Smt Puja Jindal,IAS
Secretary
Airport Economic Regulatory Authority of India
2nd Floor, Administrative Complex,
Safdarjung Airport, New Delhi

Sub: Response to the Consultation Paper No. 10/2015-16 of AERA on Determination of Aeronautical Tariff in respect of Chhatrapati Shivaji International Airport ,Mumbai for the Second Control period (1-4-2014 to 31-3-2019)

Dear Madam

A kind reference is invited to AERA Consultation Paper No. 10/2015 of AERA on Determination of Aeronautical Tariff in respect of Chhatrapati Shivaji International Airport, Mumbai for the Second Control period (1-4-2014 to 31-3-2019) inviting comments from all the stakeholders.

The comments / suggestions of Association of Private Airport Operators on the various issues mentioned in the AERA Consultation Paper is enclosed herewith for your kind perusal and consideration.

The above comments are framed based on the existing Regulatory framework and we would like to submit that APAO reserves its right to review the stand taken on any of the issues as the Regulatory process evolves.

We look forward to your kind consideration of our submissions on the Consultation paper. We will be pleased to provide any further information on the APAO submission, if required, by the Authority

Yours Faithfully
For Association of Private Airport Operators

Satyan Nayar

Satyan Nayar
Secretary General
Mob No + 91 98100 49839

Encl: as above

710, 7th Floor, Surya Kiran Building, 19, Kasturba Gandhi Marg, New Delhi-110001, INDIA
Phone No. : +91-11-41510916 Fax : +91-11-23329153
Website : www.apaoindia.com E-mail : snayar@apaoindia.com

Association of Private Airport Operators

Response to AERA's Consultation Paper No. 10 / 2015-16 dated 16th March 2016 on Determination of Aeronautical Tariffs in respect of Chhatrapati Shivaji International Airport, Mumbai for the Second Control Period (1-4-2014 to 31-3-2019)

25th May 2016

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Overall Principles

AERA has issued its Consultation Paper No. 10/2015-16 on Determination of Aeronautical Tariffs in respect of Chhatrapati Shivaji International Airport, Mumbai (CSI Airport/ CSIA) for the Second Control Period (1st April 2014 – 31st March 2019), ('Consultation Paper'or 'CP') on 16th March, 2016.

APAO appreciates the efforts put in by the Authority for a detailed and elaborate analysis laid out in its Consultation Paper. We welcome the steps taken by the Authority to invite comments and suggestions from the stakeholders on the tariff proposals and hereby present our comments in the following sections.

We request the Authority to favorably consider our submissions while finalising the Tariff Order for CSI Airport, Mumbai.

We note that the economic viability of CSI Airport shall be adversely affected if the proposals contained in the CP are not suitably modified while issuing the Tariff Order. Such proposals, unless modified, shall also have adverse impact on the operations of CSIA and may result in the postponement / shelving of many essential development works, in absence of sufficient funds at its disposal and the airport likely to face severe financial crunch and losses.

1 Economic viability of operations at CSIA

Authority's Proposal to decrease the tariff by 7.20% shall have far reaching consequences on the working of CSIA and puts a question mark on long term survival of MIAL.

AERA Act mandates AERA (Authority) to ensure economic viability under Section 13 (1)(a) of the AERA Act which reads as follows:

"to determine the tariff for the Aeronautical services taking into consideration: (iv) economic and viable operation of major airports"

Schedule 1 "Principles of tariff fixation" of SSA further states as under:

"*In undertaking its role, AERA will (subject to Applicable Law) observe the following principles:*

2. Commercial: in setting the price cap, AERA will have regard to the need for the JVC to generate sufficient revenue to cover efficient operating costs, obtain the return of capital over its economic life and achieve a reasonable return on investment commensurate with the risk involved."

AERA Act and SSA have mandated AERA to determine tariff ensuring economic and viable operations of the Airport, provide airport operator return of capital over the economic life and ensure that it achieves a reasonable return on investment commensurate with the risk involved. Contrary to this mandate, proposal of the Authority to reduce aeronautical tariffs by 7.2%, will lead to severe financial losses and entire Reserves and Surplus of MIAL will get eroded by end of FY 18 leave aside earning reasonable return on investment commensurate with the risk involved.

Such reduction in aeronautical tariff would have great stress on the cash flows of MIAL and it would be impossible for MIAL to meet its contractual obligations.

It is extremely alarming to note that the total retained earnings accumulated over the period of first eight years shall be completely wiped off due to proposed reduction in tariff proposed by AERA. Infact, the shareholders would not be getting any returns from their investments over the last eight years and not even for the next 5 years.

In view of the above, AERA is earnestly requested to review its proposals for reduction in tariff and instead provide a reasonable increase in tariff to ensure the economic and viable operations at CSIA coupled with sufficient revenue to cover efficient operating costs, obtain return of capital over its economic life and achieve a reasonable return on investment commensurate with the risk involved.In the absence of such a review it is certain that a wrong message would be getting conveyed to the investors / industry which shall discourage any investments in future PPP projects in the Airports sector.

2 Disallowed Project Cost

We note that MIAL inherited an airport with its lands encroached upon, laden with number of encumbrances and severe constraints to develop further. It had to develop the new integrated terminal without disturbing or paralyzing the existing operations, specially the international operations which were in immediate vicinity of the new developments being implemented by MIAL. In spite of scarcity of land coupled with many other challenges, MIAL has been able to construct and commission one of the world's best airport at CSIA, Mumbai and operating the same most economically and highly efficiently.

Developing of this magnitude a world class terminal and airport facilities , with virtually no spare land available, MIAL experienced some delay in project completion only due to delays in removal of encumbrances and obtaining various approvals. However it is critical to note that most of the reasons for delay were beyond the control of MIAL and removal of encumbrances and obtaining approvals were totally dependent on various government/ statutory bodies for which certainly MIAL cannot be penalized by disallowing the cost actually incurred by them and yet the facilities created are being utilised by the passengers and airlines. AERA has disallowed project costs aggregating Rs. 278 cr. in this Second Control Period which is in addition to the disallowance of Rs 260 cr. in the first Control Period.

Citing reasons such as improper planning and co-ordination resulting in delays, justification needed from AAI and that escalation & contingencies were earlier capped at Rs.630 crores, AERA has disallowed project cost aggregating Rs.278 cr. in spite of the fact that AERA itself has been observing implementation of this project very closely. Infact, it had visited the CSI Airport many a times during construction and were fully apprised of the constraints and challenges associated during project execution. Disallowance of such a huge amount of project cost which was genuinely incurred for implementation of the project would leave the investors without getting any return from this , including in future inspite of the fact that they have not got any return in last 10 years.

We also note that though saving in project cost of Rs.60 cr. on ATC equipment has been accounted for by the Authority in reducing project cost, the corresponding escalation aggregating to Rs.184 cr. has been disallowed which is completely unfair.

Considering into the reasons provided by MIAL for the escalation in project cost, which were beyond the control of MIAL, AERA should consider allowing the project cost aggregating Rs.278 cr. as part of approved Project Cost. In the absence of allowing such project cost, MIAL would suffer irreparable losses affecting its viability.

3 Disallowed Operational Capital Expenditure

Authority has partially allowed operational capex of Rs.857crs. and has disallowed operational capex aggregating to Rs. 655 crs., which shall result in non-availability of funds to carry out essential operational capex in the balance Control Period for safe, efficient and economic operations.

Authority has even disallowed operational capex already incurred and pending capitalisation (i.e. CWIP pending capitalisation) aggregating Rs.343 cr. as at 31st March, 2015.Out of this Rs.343 cr., Rs.120 cr. have been incurred essentially for aeronautical assets.

It is also observed that escalation in cost of operational capex aggregating Rs. 55 cr., have also not been considered by the Authority, though these projects are approved by the Authority, details of which are as follows:

(a) Increase in service tax - Tunnel under Runway 14/32 – Rs. 18 crs.

(b) Increase in scope / quantity :

i. Reconstruction of Apron "C" (increase in area) - Rs. 26 crs.

ii. Additional baggage reclaim carousals at T2

(Four carousals instead of two earlier) Rs. 21 crs.

iii. Reduction in other assets- net (Rs. 10 crs.)

Besides the above, Authority has decided, without providing any justification, not to approve many proposals such as Refurbishment of Terminal 1 (Rs 85 crs.), Development of Airside perimeter road (Rs 32 crs.), Construction of 2 parallel code c Taxiway (Rs 23 crs.) and miscellaneous assets aggregating to Rs 112 crs.

APAO urges the Authority not to disallow any operational capex, since the same would be trued up in the next Control Period and any excess tariff collected due to any shortfall in incurrence shall be clawed back later. However, allowing such operational capex shall ensure sufficient funds in the hands of MIAL to carry out the proposed development works, to ensure safe and efficient airport operations, which otherwise would be jeopardised.

In case Authority does not approve projects which are already under implementation (CWIP pending capitalisation), MIAL will be unable to complete these projects and that will render the amounts spent to sunk cost.

APAO also notes that the Authority has proposed to only allow the expenditure on development of airside perimeter road as repairs and maintenance under O&M expense instead of operational capex. The Authority must now then ensure that such expenditure of Rs. 32 crs. gets added /included under the O&M expenditure in the second Control Period.

4. Completion of DF funded capex considered in FY 14 , where the project has been completed in FY 16 and its impact on RAB

Deviating from its own philosophy and methodology decided and followed in the first Control Period for CSIA, AERA has abruptly and arbitrarily changed its approach and assumed that CSIA Airport development project got fully completed in FY 13-14 itself and have accordingly adjusted total DF against capitalised assets, while fact of the matter is that only part of T2 (International operations) was commissioned in FY 13-14 and the remaining part of T2 (Domestic operations) and related airside works were completed only in FY 15-16.

We therefore request AERA not to make any arbitrary adjustment and it should continue with its philosophy and approach of proportionate adjustment of DF against capitalised assets, as followed in first Control Period based on factual details instead of any assumption. The fact that part of T2 was commissioned in FY 13-14 and balance was commissioned in FY 15-16 is beyond any doubt and known to all stakeholders. Hence, the Airport development Project must be treated as fully completed only in FY 2015-16 and therefore DF should be proportionately reduced from capitalised assets during FY 2013-14 to FY 2015-16 as decided by AERA in the Tariff Order for first Control Period.

APAO earnestly requests AERA to ensure consistency in its own approach and methodology and should continue with proportionate adjustment in each year, with remaining balance DF adjustment in FY 2015-16 when the project got fully completed.

5. Reduction of losses from Reserves and Surplus for calculation of WACC and treatment of MAT credit

Whilst calculating eligible amount of equity for the purpose of working out Weighted Average cost of Capital (WACC), authority has removed MAT credit from Reserves & surplus (R&S) mentioning that these are provisions only and MAT credit entitlement does not arise at this stage.

This kind of unilateral adjustment for MAT credit is without any basis and seems to be completely arbitrary and not in accordance with any of the Accounting Standards or Indian GAAP. Proposed adjustment has not been done for tariff fixation for any of the major airports. It's completely incorrect to single out one item from P&L account (MAT Credit) and deduct the same while arriving at PAT to be transferred / added to R&S without any proper justification. In fact Authority itself has not done this adjustment while determining tariff for first Control Period for CSIA, Mumbai.

In computation of Target revenue, the Authority has calculated Tax as Nil. If Tax amount which was debited to the Books itself is not being considered, the question of considering MAT Credit does not arise.

APAO further wants to state that balance in Profit &Loss account, whether transferred to Reserves or retained in the P&L account, once retained in the business and **used for the project development / funding**, such funds cannot be taken out or reduced and therefore any adjustment to the same subsequently on account of future losses is incorrect. Subsequent losses though eat into the Reserves and Surplus as per books of accounts (Theoretically), they do not in fact reduce the investment already made into project development. Hence reducing the same for the purpose of calculation of WACC is not correct treatment. Airport operator gets return only on RAB, which itself gets reduced by depreciation as well as other deductions if any and the return to airport operator keep getting reduced. The rationale of reducing the Reserves and Surplus further on account of the subsequent losses is totally flawed. **We fail to understand how losses for future (though only for accounting purposes since otherwise there is a cash profit) could undo/ change the investment already made into the project by the Company.**

With such reduction in Reserves and Surplus for the losses on one hand and reduced return on RAB due to lower WACC on the other hand results in a double loss to MIAL / Airport operator.

It would not be out of place to mention that it would have been a better option for MIAL to circumvent this reduction in WACC by first distributing the dividend out of retained earnings to the Shareholders and thereafter bring back the same amount as equity share capital from the Shareholders, thereby increasing the share capital which is being protected by the Authority. Such an action would have clearly made the Authority provide a return on the same funds coming in the business.

APAO requests the Authority to protect the internal accruals / generation utilized for funding of the project in addition to Equity Share Capital.

6. Determination of Equity Share Capital by ignoring Share Application Money

The Authority has considered Equity Share Capital as Rs 846.15 Crores for FY 2011-12, by ignoring Rs 200 Crores of share application money pending allotment as on 31st March, 2012.

AERA has ignored the Share application money available with MIAL as at close of 31st March, 2012 since shares were not allotted on that date. Shares against such application money were allotted on 16th April, 2012 just 16 days after the balance sheet date. This unfair treatment by AERA has resulted in no return available to MIAL on this amount for entire one year, since such application money aggregating Rs.200 cr. has been eliminated both from closing as on 31st March, 2012 as well as opening as on 1st April, 2012. Allotment on 16th April, 2012 does not in fact change the status of this fund which was available in hands of MIAL for its use.

APAO earnestly requests the Authority to kindly consider the share application money available in the hands of MIAL as closing on 31st March, 2012 as well as opening as on 1st April, 2012 as part of equity so that MIAL does not suffer by computation of lower WACC due to lower share capital. It is very disheartening to note that the Authority is revisiting its own decision without any need / proper justifications. In this case also while determining tariff for first Control Period, AERA had considered Share Application Money as part of equity capital / shareholders fund but now Authority has decided to exclude the same without any justification.

7. Capping the Cost of Debt

Based on the material before the Authority, it has decided to consider weighted average cost of debt at 11.64% for FY 2014-15 and 11.06% for FY 16 to FY 19 and has capped the cost at 11.56%.

With strained cash flows due to proposed reduction in aeronautical tariff by the Authority, the cost of debt, which is subject to prevailing market conditions and risks, is bound to go up. With proposed reduced tariff, there are chances that the advantage of falling interest rate regime may not be available to MIAL. In view of this capping the rate of interest for debt at 11.56% shall put MIAL in a disadvantageous position. MIAL will have practically no control over such market and risk driven rate of interest.

Recent loan availed at 12.05% itself is an indication about non availability of low rates to MIAL, therefore capping the rate of interest for debt at 11.56% should not be resorted to. Such proposal or decision shall result in limiting the ability to even obtain loans thereby affecting safe, smooth and efficient operations at CSIA Mumbai.

APAO earnestly requests the authority to remove such cap and allow the market driven cost of debt for future and the authority may review the reasonableness at the time of next determination of tariff.

8. Zero Return on Refundable Security Deposit raised against Real Estate

AERA has considered RSD of Rs.207 cr. raised by MIAL as a means of finance but at zero cost / return to MIAL. In spite of a target to raise Rs.1000 cr. from RSD for financing the project cost, MIAL could raise only Rs.207 cr. from RSD due to unfavourable market conditions.

Due to separate treatment of income from Aeronautical Assets, Non-Aeronautical Assets and Non-Transfer Assets, the Airport business is bifurcated into segments i.e. Aeronautical business, Non-Aeronautical business and Real Estate business (Non-Transfer Assets). Even if funds belonging to Real Estate business are used / to be used for Aeronautical business, a reasonable return equal to/ at least cost of debt should be allowed by the Authority. Such payment of interest shall also ensure that transaction between the two businesses segments are executed at arm's length basis.

APAO would also like to point out that the State Support Agreement executed between MIAL and Govt. of India also does not require any form of cross-subsidization, either towards revenue requirement or capital expenditure, from deposits raised or revenue earned from Non-Transfer Assets (i.e. assets other than Revenue Share Assets) and providing funds to aeronautical business at zero cost is a direct 100% cross subsidization of aeronautical charges.

With such treatment of RSD at zero cost, even an opportunity cost is being denied to the Real Estate business of MIAL.

APAO would also like to point out that Lenders treat such Security Deposit as quasi – equity in nature, while determining Debt Equity Ratio for pricing the debt.

Precedent from other infrastructure sectors

There are examples from other infrastructure sectors, where regulator provides return on the capital employed by the concessionaire and does not consider the means or source of funding while calculating tariff.

Petroleum and Natural Gas Regulatory Board (PNGRB) allows return to concessionaires on the basis of the capital employed. It even recognizes that the security deposits received by the concessionaire would exist as liability and these should not be reduced from the total capital employed while determining tariff. Relevant extracts from the guidelines issued by PNGRB for determination of network tariff for city or local natural gas distribution network and compression charge for CNG have been reproduced below:

"Entity [1] may collect refundable interest free security deposit as specified under the Petroleum and Natural Gas Regulatory Board (Authorizing Entities for Laying, Building, Operating or Expanding City or Local Natural Gas Distribution Networks) Regulations, 2008. Such deposit is towards the safe-keeping of the meter and is to be refunded in full to the domestic PNG customer in case of a disconnection. Further, since the amount collected as interest-free refundable security deposit shall exist as a liability in the books of accounts of the entity, the same shall not be reduced from the total capital employed while determining the network tariff.

The reasonable rate of return shall be the rate of return on capital employed equal to fourteen percent post-tax considering the rate of return on long-term risk-free Government securities and the need to incentivize investments in creation of CGD infrastructure"

Other factors to be considered from the CGD guidelines:

(a) PNGRB allows the security deposits provided by end users to be invested in the business and earn return on such investments, whereas in case of MIAL, security deposits have been availed from lessees of Non Transfer Asset.
(b) **Demand risks are less for a CGD network** as compared with traffic risk at an airport. Additionally, tariffs for CGD networks are for an essential commodity.
(c) Guidelines issued by PNGRB are one of the **most recent** guidelines in the Infrastructure sector in India and could be considered as learning from other regulated sectors.

Port Sector: Tariff Authority for Major Ports (TAMP) sets tariff for Major Ports and offers a uniform rate of return on all kind of capital employed including Net Working Capital, which would include amounts collected through deposits and a Uniform return of 16% is provided on the entire capital employed.

Relevant extracts from the regulation have been reproduced below:
"Return will be allowed on Capital Employed (ROCE), both for Major Port Trusts and Private Terminal Operators, at the same pre-tax rate, fixed in accordance with the Capital Asset Pricing Model (CAPM)."

"Capital Employed will comprise Net Fixed Assets (Gross Block minus Depreciation minus Works in Progress) plus Working Capital (Current Assets minus Current Liabilities)"

APAO earnestly requests the Authority to provide a return equivalent to equity, or in the worst case, equivalent to a rate between debt and equity on Refundable security deposits used to finance Aeronautical Assets.

9. Low Cost of Equity

The Cost of Equity proposed at 16% by AERA is too low in the context of emerging country airports operating in condition where retail inflation is about 7.31%.

While proposing cost of equity of 16%, AERA has underestimated the riskiness of CSIA's business or for that matter of the major PPP airports. PPP Airports are vulnerable to regulatory risk as has been experienced in case of DIAL and now of MIAL. Airports business with such regulatory sword hanging becomes far more riskier than other sectors. Such low cost of equity proposed by the Authority shall restrict flow of investments to the airports sector which will work counterproductive.

High revenue share payable to AAI by both MIAL as well as DIAL, though a contractual obligation, also has a role to play in the determination of cost of equity, which can be termed as a specific airport related risk factor, which shall always play a major role in determination of cost of equity.

APAO also observes that other risk factors very relevant to CSI Airport are regarding the risk emerging from a second competing airport, coming up at Navi Mumbai International Airport, which shall certainly eat into the traffic volumes catered by CSI Airport and adversely impact its revenues due to limited growth potential in respect of non-aeronautical revenue at CSI Airport. Besides, the financing risk also exists at CSIA, where Authority itself has acknowledged a gap in the means of finance of Rs.819 cr. which in effect is a gap of Rs.1347.74 cr. and the means of finance to bridge such gap are yet to be identified/ raised. Such risks increases vulnerability and deteriorate the risk profile of CSIA.

Such low cost of equity of 16% coupled with liability to pay 38.7% towards Annual Fees shall result in a return of only 9.8%, which is way below the reasonable rate of return expected by investors.

APAO further notes that the cost of equity estimated by CRISIL, SBI Caps, KPMG and Leigh Fisher are all much higher than the cost of equity of 16% proposed by AERA.

A report on Study by CRISIL Risk and Infrastructure Solutions (CRISIL)for 'Estimation of Cost of Equity for MIAL' submitted on 11th April, 2012 suggests the cost of equity in the range of 18.16% - 20.44%(CAPM) and 21.09% - 23.71% (APM- Arbitrage Pricing Model).

SBI Capital Markets (Report on fair rate of return on equity for Indian airport sector) suggested cost of equity in range of 18.5% - 20.5% while KPMG (Cost of Equity Estimates of Indian Airport Industry) have estimated it to be in range of 20-23%. All such studies suggest a higher cost of equity than NIPFP. However, the Authority has formed its opinion based only on NIPFP's proposal on cost of equity. Leigh fisher had recommended cost of equity at 25.1% which is infact higher than all the suggested rates.

Benchmarking of returns with other regulated sectors – The Authority has benchmarked the returns on equity with other regulated sectors. There are key differences, some of which have been detailed by the Authority, between aviation sector and the above mentioned infrastructure sectors.

(a) The volatility of revenue drivers such as units of electricity consumed is lower than the volatility of revenue drivers in airport viz. traffic.

(b) In the airport sector return (i.e. WACC) is provided on the Regulatory Asset Base which is depreciated each year as against return provided to equity in case of power sector which is not depreciated i.e. equity is not reduced with depreciation of assets. In effect this means that 16% return proposed by AERA will be decreasing every year as RAB depreciates every year and for a concession period of 30 years a 16% return on equity proposed by AERA would actually translate to a much lower return which is grossly inadequate and which will discourage any further investments in the sector by prospective investors.

(c) The terms of concession for Highway and Port sectors are different from aviation sector with a pre-determined tariff/ toll charge.

There is no regulation on the revenue or profits earned on a project. The return to the equity investors is based on project assumptions which may be significantly different from actual growth of revenue drivers. For example, the equity IRR of 16% in NHAI projects is used to determine the minimum revenue share or maximum viability gap funding for the project for a toll project assuming a traffic growth of 5% or alternatively the maximum annuity payments required to meet the benchmark equity IRR of 18%. The actual traffic growth may be significantly different for a project as is evident from the average return of 20%-23% earned by the investors in road projects.

As per CERC guidelines, tariff for supply of electricity comprises of capacity charge for recovery of Annual Fixed Cost and energy charge. Relevant extract is provided below:

"The tariff for supply of electricity from a thermal generating station shall comprise two parts, namely, capacity charge (for recovery of annual fixed cost consisting of the components specified to in regulation 14) and energy charge (for recovery of primary fuel cost and limestone cost where applicable)."

Following comprises Annual Fixed Cost of a generating or a transmission system:

a. ***Return on equity;***
b. ***Interest on loan capital;***
c. ***Depreciation;***
d. ***Interest on working capital;***
e. Operation and maintenance expenses;
f. Cost of secondary fuel oil (for coal-based and lignite fired generating stations)
g. Special allowance in lieu of R&M or separate compensation allowance,

Return on Equity is calculated on the equity considered as part of the Capital Employed. As a result, even though CERC guidelines provide a return on equity equivalent to 16%, actual returns available to the equity investor is higher than 16%. In comparison, return to equity investors of airport companies is based on ***Regulated Asset Base which depreciates over the life of the assets***. The diminishing returns for investors in Airport Company are thus lower than those for investors in electricity generating or transmitting companies.

Authority has disregarded the submission regarding AAI clarification during bidding process that WACC of 11.6% had been considered based on cost of equity and debt of 22.8% and 6%, mentioning that it was only indicated for comparison purposes and cannot be construed as an assured return by any stretch of imagination. However, Authority has failed to appreciate the fact that the bidders had prepared their bids on the specific cost of equity and debt as indicated by AAI and accordingly quoted higher revenue share number / percentage. Now, after having privatized airports on the basis of higher revenue share percentage quoted by bidders and AAI benefiting from higher revenue share throughout the entire concession period, it is totally unfair to change this critical assumption itself which was certainly one of the most important parameter (change in cost of debt is irrelevant as it is a pass through) and thereby affects viability of airport operators adversely.

APAO wants to point out that the Authority has a responsibility to ensure the economic and viable operations of the airport, both under the AERA Act and State Support Agreement (SSA) entered into by MIAL with the Government of India. The relevant extracts are reproduced below:

Section 13(1)(a) of the AERA Act requires the Authority to determine tariff for the aeronautical services taking into consideration :

"*economic and viable operations of major airports.*"

Schedule 1 of SSA provides that ".... *in undertaking its role, AERA will observe the following principles:*

"2. *Commercial – In setting the price cap, AERA will have regard to the need for the JVC to generate sufficient revenue to cover efficient operating costs, obtain the return of capital over its economic life and achieve a reasonable return on investment commensurate the risk involved*."

From the above it is evident that the Authority needs to provide a reasonable return on the investment so that CSI airport is able to generate sufficient revenues which after meeting cost of operation are able to provide reasonable return to the investors. The Authority has taken a position in the case of tariff determination for Delhi airport that while ensuring viability of the airport, it will not consider Annual Fee (revenue share) payable to AAI since the same is not a pass through cost as per SSA. While it is a fact that

Annual Fee is not a pass through cost in accordance with SSA and has not been included by the Authority while calculating Target Revenue, it however cannot be totally ignored while considering economic viability of the airport, as Annual Fee is a contractual and legal obligation which airport has to meet. Therefore to ensure the economic viability of the CSI airport, Authority should have considered this fact also and provided commensurate return on equity.

APAO requests the Authority to ensure that reasonable returns are made available to investors which suitably cover the risk associated with the assets, enable airport operators to have viable operations and provide an incentive for attracting new investments in the sector considering risk reward available for the airports sector. Risk factors specific to CSIA need to be given due credence.

APAO earnestly requests the Authority to provide return on equity of 24% which would enable CSIA to remain viable and provide efficient operations to airlines/ passengers.

10. Equity Share Capital reduced to the extent Upfront Fee paid to AAI for calculation of WACC

AERA has decided to reduce Equity Share Capital to the extent payment of Upfront Fee to AAI on the assumption that Upfront Fee has to be met out of Equity Share Capital which has no basis.

APAO does not find any provision in the SSA or OMDA which stipulates that Upfront Fee payment has to be paid out of Equity Share Capital only or AERA needs to do one to one mapping for Upfront Fee payment against means of finance for the purpose of WACC calculation. Exclusion of Upfront Fee payment of Rs.153.85 cr. from project cost does not imply that the equity contribution by shareholders in MIAL has reduced by this amount, the investment by shareholders remain unchanged.

Though SSA precludes Upfront Fee from forming part the regulatory asset base but it neither says that this amount would not be part of overall project cost of MIAL nor has to be paid out of Equity only. It is part of the overall project cost of MIAL and hence overall WACC should be applied to this payment as well instead of linking specific payment to specific means of finance only for this one component while for rest of the project cost applying blended WACC.

Equity contribution to the project by the shareholders remains same even after exclusion of Rs. 153.85 cr from the project cost. Even the lenders consider the same as equity contribution from the shareholders and have sanctioned the debt accordingly.

WACC calculated without considering this amount of Rs.153.85 cr.as Equity is flawed and totally unfair to the shareholders who have brought in the money as Equity Share Capital.

Authority would have allowed this fees in case it was considered as revenue expenditure, which is an accepted and valid way to treat such payment.

APAO earnestly requests the Authority to calculate WACC without reducing the Equity Share Capital to the extent of Upfront Fees paid to AAI.

11. Corporate Tax

Authority has erroneously considered Annual Fees as a pass through while calculating corporate income tax, on aeronautical income of MIAL, which is one of the building blocks for determining aeronautical tariff.

AERA should have calculated the corporate tax as illustrated in Schedule 1 to SSA, where corporate tax is calculated after grossing up [(RAB x WACC) – Interest expense]. [(RAB x WACC) – Interest expense] is specifically considered as the profit after tax (PAT). Using the corporate tax rate, the tax expense can be back-solved using the following formula.

$$\text{Tax expense} = \frac{\text{PAT x Tax Rate}}{(1 - \text{Tax Rate})}$$

Corporate tax being a regulatory building block has to be first calculated on the basis of Target Revenue Requirement (TRR). AERA should have followed the methodology given in the illustration in Schedule 1 to SSA.

AERA on one hand has not considered Annual Fee as cost pass through for computation of allowable operating expenditure but has adopted a reverse stand by considering the Annual Fee as a pass through while calculating corporate tax on aeronautical income.

It was on the basis of this illustration in draft SSA that the prospective bidders had quoted the Annual Fee considering the projected earnings and corporate tax as explained above. Disregarding this important component of building Block in an unjustified manner has put MIAL in a great loss and denial of its legitimate returns though specifically provided in SSA.

APAO earnestly requests the Authority to reconsider its proposal to consider the Annual Fee on aeronautical incomes as a pass through while computing corporate tax for arriving at Target Revenue Requirement (TRR). Such an approach adopted by AERA has made one important component of TRR / building block completely redundant. With such approach adopted by the Authority there would never be any tax payable as part of this building block which has been rendered redundant. Authority should re-compute corporate tax disregarding Annual Fee to AAI as per the principles laid in SSA.

12. Non-Aeronautical Revenues (NAR)

AERA has considered Other Income earned i.e. interest from banks and others, income from investments and others for cross-subsidizing the aeronautical income.

AERA has considered the projections made by MIAL in respect of Non Aeronautical revenues as minimum / floor for the current control period.

APAO observes that True- up should be done based upon actuals and projections by MIAL for the second Control Period should not be considered as minimum/ floor for true up in the third Control Period.

APAO would like to state that the Shared Till approach relevant for MIAL encourages growth in non-aeronautical revenues by the Airport Operator. It acts as a natural incentive to MIAL for increasing non aeronautical revenues. With this mechanism and safe guard already in place, providing such minimum /floor is not necessary to treat projections of NAR submitted as minimum / floor. It will be only in case of a genuine reason that MIAL may not be able to achieve the projections, which should be considered acceptable to AERA.

True up of actual NAR, if at all is to be done should be both for increase as well as decrease in actual NAR over the projected NAR, on cumulative non aeronautical revenues instead of comparing each individual line item of such NAR.

APAO notes that Authority has wrongly proposed to treat other income earned by MIAL mainly including interest income on fixed deposits and dividends from temporary investments, which does not involve provision of any kind of services. As per provisions of section 13 (a)(v) of AERA Act, 2008, the tariff for aeronautical services is to be determined taking into consideration revenue received from ***services*** other than the aeronautical services.

By proposing to treat such other Income as NAR, AERA is deviating from AERA Act and also from its own principle adopted while determining tariffs for first Control Period. Further such other Income does not fall under definition of Revenue Share Assets under SSA/ OMDA and therefore should not be considered for cross-subsidization.

APAO earnestly requests AERA to apply the principles in respect of treatment of other Income on consistent basis as done for the first Control Period. APAO also requests AERA to not treat the projections given by MIAL in respect of NAR as minimum / floor to be trued up at the time of determination of tariff for the third Control Period.

13. Reimbursement of funds used for Security related expenditure out of PSF(SC) Escrow account - Precondition to pay prior to issue of Tariff Order, omission of CWIP incurred and the carrying cost thereon by AERA

Though Authority has proposed reimbursement of Rs.309 crores to PSF(SC) escrow account, it has put pre-condition of actual payment of the funds prior to issue of tariff order, before it allows determination of tariff in this respect by issue of Tariff order.

Authority has not considered reimbursement to be made by MIAL for amount of Rs. 17.19 cr. towards Capital Work in Progress to the PSF(SC) escrow account.

Authority has not considered the carrying cost payable when it refunds the funds to PSF(SC) escrow account as per the Order of Ministry of Civil Aviation.

Authority has not considered a separate tariff component towards reimbursement of capital and operating expenses towards security to be incurred by MIAL as requested by the Airport Operator.

APAO earnestly requests the Authority on not putting the pre-condition for reimbursement of Rs.309 cr. to PSF(SC) escrow account , since it would not be possible for MIAL to arrange for such big amount along with carrying cost thereon at such a short notice.

APAO further requests the Authority to allow reimbursement of Rs.17.19 cr. towards expenditure on capital work in progress from PSF(SC) escrow account, which has not been considered by it along with reimbursement of Rs.309 cr.

APAO further requests the Authority to allow payment of carrying cost on funds required to be reimbursed to PSF(SC) escrow account, while finalising the Tariff Order.

APAO also requests the Authority to determine tariff in respect of Rs.309 cr., Rs.17.19 cr. and carrying cost in respect of them, as a separate component identifying the same as towards PSF(SC) reimbursement. This shall enable MIAL to obtain funding from Bankers, since lump sum payment would be required when such amount shall be reimbursed to PSF(SC) escrow account. Besides, since security is a sovereign function and any tariff received in lieu thereof should not be covered for payment of Annual Fee, as such annual fee on these amounts shall tantamount to be an unjust enrichment of AAI at the cost of MIAL.

APAO firmly believes that security is a sovereign function and in case an airport operator is incurring such expenditure, it is only for the sole purpose of performing a sovereign function. With increasing requirements to counter any terrorism threats, more and more state of the art sophisticated technology would be required to be used in future. If AAI starts getting Annual Fees on such increasing security related costs it would be a tax on the airport operator, but on the other hand providing unjust enrichment to AAI.

APAO would also like to draw the attention of AERA towards Consultation paper No. 17/2010-11 dated 24th March, 2011 issued by it, proposing guidelines for terms and conditions for determination of PSF at major private airports. Purpose of these guidelines was to lay down ground rules for determination of PSF for security expenditure being incurred through PSF (SC). Such Guidelines clearly mentioned that expenditure being incurred through facilitation component will be considered for remuneration through other tariff components as may be proposed by the airport and approved by the authority. In view of such CP also, it is imperative for Authority to determine a separate component for PSF(SC) reimbursements required.

14. Fuel Throughput Charges and Into Plane concession Charges

Authority has proposed to consider revenues from Fuel Throughput Concessions (FTC) and ITP services as aeronautical revenues.

APAO would like to draw attention of the Authority to Section 2 (a) (vi) of the AERA Act which limits the scope of "aeronautical services" only to the extent of "services provided for supplying fuel" (and not to privileges of access to the airport by the fuel supplier) is in consonance with the ICAO Document No.9082 wherein the "revenues from non-aeronautical sources" is defined to include concession granted to oil companies to supply aviation fuel. The privilege/concession of grant of access to airport does not involve the provision of any services. The charge for such grant of concession/ privilege falls under revenue from non-aeronautical sources.

It would be worthwhile to refer Extract from Appendix 3 - Glossary of Terms in Document 9082 (Eighth Edition – 2009) of International Civil Aviation Organization (ICAO) titled "ICAO's Policies on Charges for Airports and Air Navigation Services" reproduced below:

"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.

Salient features of supply chain of fuel at CSI Airport are as follows:

(i) fuel is brought by oil companies to respective fuel farm (s) at airport.

(ii) fuel is supplied from fuel farm either through hydrants or bowsers into plane.

(iii) fuel farm as well as hydrant systems belongs to oil companies.

(iv) land for fuel farm has been leased to the oil companies.

(v) ownership of fuel is with respective oil companies till fuel reaches aircraft. There is no role for MIAL to play in this supply chain other than lessor of the land for which lease rentals are charged.

MIAL has no contract with any airlines for supply of fuel and charging fuel price is the right of oil companies only. AERA is not regulating supply of fuel, since it is not a service but sale. Even into plane services are not being regulated since it is also a sale of goods, where ownership of goods get transferred to airlines once product reaches the aircraft.

Para 41 of Document 9082 of ICAO, clearly mentions that the level of FTC may reflect the value of concession granted to fuel suppliers. It further says if any facility is provided, in such case, any portion of charge for such facilities should reflect cost. Corollary of which is that pure concession fee is not related to cost.

Classification of FTC as non-aeronautical revenues has been clearly stated in ICAO Document No. 9562 - "Airports Economic Manual". Paragraph 3.40 and 3.49 of "Part B: Accounting" in "Chapter 3: Airport Financial Management" of Document 9562 clearly categorise Aviation fuel and oil concessions (including throughput charges) as the first item under the "Revenue from Non-aeronautical Activities" and not under "Revenue from air traffic operations", which is aeronautical revenue. The distinction is also unambiguously brought out in paragraphs 4.46, 4.49 and 4.50 of Document 9562 under "Part C: Determining the Costs Attributable to Concessions and Other Non-Aeronautical Activities" wherein it is specifically stated that "4.49 The policy reference given in paragraph 4.46 noted that the full development of revenues from non-aeronautical activities is encouraged, except for concession directly associated with the operation of air transport services such as fuel, in-flight catering and ground handling.

Chapter 6 of Document No. 9562 of ICAO, specifically deals with Development and Management of non-aeronautical activities. Under Section B – 'non-aeronautical activities' – of this Document, types of concessions which are most frequently found at international airports are mentioned. Table 6-1 & paragraph 6.5 of Document No. 9562 lists such concessions and it is pertinent to mention that concession granted to aviation fuel suppliers has been listed as item no 1. Same intention is also reflected in paragraphs 6.32, 6.33 and 6.34 of Document 9562 of ICAO.

On 'Form J' used by ICAO Contracting States to report financial data of airports "**Aviation fuel and oil** –all concession fees, including any throughput charges, payable by oil companies for the right to sell aviation fuel and lubricants at the airport" are included as a concession (Item 3), being, non-aeronautical revenues.

APAO earnestly requests the Authority to consider concession fee from Fuel Throughput & Into Plane as revenues from non-aeronautical services.

15. Operating expenses – Allocation ratio

Authority has proposed considering Operating expense allocation ratio for Aeronautical and Non-Aeronautical expenses for First Control Period as allocation ratio for Second Control Period.

Applying the allocation ratio based on operating expenses for the first Control Period to the second Control Period would not be a correct decision, since operating expenses for 2013-14 being the last year of the first Control Period included expenses on account of cargo handling operations which were outsourced to 'Concor Air' by MIAL, with effect from 17th February, 2014 and there would not be any cargo related expenses in subsequent years, during the second Control Period. In view of this the correct operating expense ratio for allocation purpose should be considered by the Authority.

Correct ratio to be considered for such allocation of expenses could be derived from the study done by the Cost Auditors of MIAL for FY 15, according to which 92.08% expenses are aeronautical expenses.

APAO earnestly requests the Authority to apply the correct allocation ratio relevant to the second Control Period instead of expenses of FY14 which are not comparable to the second Control period.

16. Reduced Operating expenses considered by AERA

Authority has proposed to consider certain expenses for second control period as follows:

a.	Working capital interest	Rs 6.30 Crores for each year
b.	Financing charges	Rs.9.34 Crores for each year
c.	Collection Charges on DF	Nil

APAO earnestly requests the Authority to allow the actual interest on working capital funding and financing charges which would be commensurate with the actual requirements and utilization of limits, etc. by MIAL. Requirement of working capital funding depends on the volume of debtors, which increase in tandem with the increase in business / billing of charges to airlines, time lag between receipt of funds from debtors and the payment of statutory dues like service tax as per due dates, prior to receipt of payment from the airlines.

APAO also requests the Authority for allowing the collection charges on DF as operating expenses, in absence of which MIAL is getting reduced receipt of DF due to such collection charges deducted by the collecting airlines. In case Authority does not allow such collection charges on DF as operating expenses, it is requested that DGCA should be appropriately advised by AERA to withdraw the collection charges, since the airlines are being paid for collection charges separately for UDF, PSF and DF and such amounts collected remain with the airlines for at least 3-4 weeks without payment of any interest to MIAL.

Alternatively, Authority should either allow pass through of DF collection charges or consider net DF amount (net of collection charges) for computing DF collected, since MIAL has no other alternative to make good this cost.

17. Rate Card and Variable Tariff Plan

Authority has proposed to waive landing charges for aircraft with maximum certified capacity of 80 seats for scheduled domestic operators and helicopters.

APAO earnestly requests the Authority not to recommend the application of such an old circular which was issued much prior to taking over of CSI Airport operations by MIAL. It is pertinent to mention that the circular specifically excludes the only private airport (Cochin) at that point of time and the airports in defense enclaves. It is a known fact that at that point of time none of the other private airports were in existence. Moreover, applying any such waiver at CSI airport, Mumbai, which is a capacity constrained airport, would lead to pre mature saturation of capacity to handle passengers at CSIA. Such a waiver would also be counterproductive to the efforts and objective of MIAL to maximize the passenger handling at the capacity constrained CSI Airport, Mumbai.

APAO also understands that MIAL had submitted a proposal to implement Variable Tariff Plan with the objective to encourage wide bodied aircrafts, operations in off peak hours, dis-incentivize the usage of airport during peak hours with sole purpose to maximize the passenger handling within the existing constraints at CSI Airport. This plan was also presented before the stakeholders consultation meeting held on 6th April, 2016. Authority is requested to include the same in the Tariff Order so that MIAL is able to implement the same.

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