ASSOCHAM
INDIA

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

D S RAWAT
Secretary General

18th May, 2016

Respected madam,

Sub: ASSOCHAM response on Consultation Paper No. 10/2015-16 dated 16th March 2016 for determination of aeronautical tariffs in respect of CSIA, Mumbai for 2nd Control Period (FY 2014-15 to FY 2018-19)

We appreciate Authority's efforts in issuing very detailed Consultation Paper and giving us an opportunity to comment on the same.

As an apex association of India representing the interests of trade and commerce in India, with more than 4,50,000 Members, the Associated Chambers of Commerce and Industry of India (ASSOCHAM) acts as an interface between industry, government and other relevant stakeholders on policy issues.

The quality of airport infrastructure contributes directly to a country's international competitiveness and economic growth by facilitating the smooth movement of people and high value cargo, while spurring trade and tourism. Increased air connectivity also enables manufacturing enterprises to exploit the speed and reliability of air transport to ship components across firms that are based in different and distant locations thereby minimising the inventory cost. Countries with better connectivity are also regarded as more successful in attracting Foreign Direct Investment (FDI).

To meet the growth projections in aviation traffic, airport development has to keep pace with the growth of the economy. India will require $40 billion (over Rs. 2.20 lakh crore at a rate of Rs. 55 to a dollar) in developing its airports by 2025 to meet the needs of its growing air passenger traffic, Centre for Asia Pacific Aviation (CAPA) has said in its report.

Therefore it is of utmost importance that interest of investors is kept in forefront to ensure sustained growth in airport infrastructure development which is key to all other economic growth,

ASSOCHAM would like to submit its feedback on certain aspects as discussed in the paper as under:

- Deviations witnessed from the Concession Agreement
- Irrational methodology adopted on various proposals

Our detailed response on the said Consultation Paper is enclosed as **Annexure**.

Thank you with warm regards,

Yours sincerely,

(D. S. Rawat)

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Encl: as above.

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Annexure

1. Significant losses to MIAL under current methodology of tariff determination:

Existing private airport investors are suffering significant losses. For example, MIAL has suffered Rs. 300 Crore loss in FY 15 and likely to lose more than Rs. 1000 Crore in 2nd Control Period if tariff proposed by AERA (reduction of 7.2%) are implemented which will erode all reserves of the company.

With the current policies, these airports are not financially viable. The authority must outline its plan to deal with the financial failure of these airports.

2. Stability in regulatory system:

There is a severe lack of consistency in authority's principles.

The authority has changed its treatment between control periods. This is internationally seen as a bad practice and investor shy away from such policies.

The concession agreements of the current airport operators also mandate that there must be consistency across regulatory periods.

There are several instances of change in principles by Authority like:

a. Adjustment of remaining balance DF against capitalized assets in FY14 instead of continuing with its own approach and methodology of propionate adjustment till project completion (i.e. up to FY16).
b. Reducing Reserves on account of MAT credit entitlement and subsequent losses on random basis.
c. Not providing any return on Shareholders fund i.e. share application money which is not justified
d. Change in the allocation mechanism of airport operator fee in aeronautical and non-aeronautical component.
e. Other income treated as non-aeronautical and considered for cross subsidization.
f. Disallowance of project cost to the extent of Rs 278 crores without any justification after completion of the Project

Assocham feels that the stand of the regulator has to be consistent with respect to all proposals and discretion should be avoided.

This is bad economics and bad regulation and needs to be avoided.

3. Sovereign Risk:

The authority has also not honored the Concession Agreement.

This is being cited as sovereign risk by many investors. This means that Govt. and regulator are working in opposite directions. Following is the illustrative list where regulator has not honored the provision of the Concession Agreement:

a. AERA has proposed to calculate the corporate tax entitlement considering the revenue share as a pass through operating cost, which is against the Concession Agreement where it is categorically specified not to be considered as pass through.
b. AERA has not allowed any return on RSD which means it has in effect assumed 100% cross subsidy from funds collected through Real Estate development (Non Transfer Assets) whereas Concession Agreement clearly excludes any subsidy from Non Transfer Assets.
c. AERA has considered Concession Fee received from fuel supplies (normally called Fuel Throughput Charges) as aeronautical charges which is clearly against the provision of Concession Agreement and ICAO provisions.
d. AERA has not calculated hypothetical RAB in accordance with the provisions of Concession Agreement.

Authority must ensure that Concession Agreement is honored holistically so that investors are able to get returns which were envisaged at the time of committing investments.

4. Low Returns:

The authority has proposed a return on equity of 16% which is significantly lower than other sectors and is not commensurate with the associated risk of the sector.

The SBI-Cap report, initiated by the MoCA on request of the authority, clearly states that the return on equity should be between 18.5% and 20.5%.

The diminishing returns for investors in airport companies are lower than those for investors in electricity generating or transmitting companies.

Also, for the petroleum sector the return on capital employed is 14% which at 80:20 debt/equity ratio and a cost of debt of 12% provides a return on equity of 22%.

The authority must also appreciate that the materiality of aeronautical charges on airlines in minimal. Aeronautical charges have been observed to be less than 4% of the operating costs of the airlines world over, for the last 25 years. Therefore, the cost of regulating the prices of Indian airports is not likely to result in significant benefits.

The Authority has also not provided any return on Refundable Security Deposit from Real Estate development utilized by the Company for Project Funding assuming that it has no cost and it is free money. These amounts also have opportunity cost and therefore Authority should provide refund at least at the Cost of Debt if not at the Cost of Equity. Precedence in this regard is available from other sectors in India. For example, TAMP, offers a uniform rate of return of 16% on all types of capital employed – which includes amounts collected as deposits. SBI-Cap also in its report had mentioned that risk profile of RSD lies in between Equity and Debt.

5. Viability of Airport

As per the statue under which AERA has been created, it is mandated to ensure the economic viability of the airport. But with the proposals in question it will lead to a situation for the company, where its entire net worth will be washed out in next couple of years. Hence, there is a deviation from the statutory function of AERA and AERA has to ensure the viability of the airport.

The authority must also take a long-term view on regulation. In the Indian scenario, airport supply has always lagged demand, causing severe constraints in service quality and therefore, adequate capacity planning should be seen as a welcome change. These capacity additions should be supported by adequate returns. This will ensure that, in the long-run, Indian airports sufficiently meet the demand, which is in the interest of passengers and the aviation industry at large.

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