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COCHIN INTERNATIONAL AIRPORT LTD.

CIAL/GH/AERA/2010

13.09.2010

Shri.Sandeep Prakash
Secretary
Airports Economic Regulatory Authority (AERA) of India
AERA Building, Administrative Complex,
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Sir,

Sub: Submission of Observations on AERA Consultation paper 05/2010-11
Ref: Your Letter DO.No.AERA/20019/CGF-G/2010-11/565

With reference to your above letter regarding AERA's Consultation Paper 05/2010-11 dated 2nd August 2010 on Economic Regulation of Services provided for Cargo Facility, Ground Handling & Supply of Fuel to the aircraft; wherein AERA has called for Stakeholders comments and views, we forward herewith the Observations and views of Cochin International Airport Limited (CIAL) on the Consultation paper 05/2010-11 for your kind perusal and for records.

Kindly acknowledge receipt of the same.

Thanking you.

Yours faithfully,
For Cochin International Airport

A.C.K. NAIR
Airport Director

(Handwritten signature)
13/09

SM (ARBS)

May pls furnish a
copy to PWC.

14/9/10

**Views, Comments & Suggestions of Cochin International Airport Limited (CIAL)
on AERA's Consultation paper 05/2010-11 - draft of
"Economic Regulation of Services Provided for Cargo Facility, Ground Handling &
Supply of Fuel to the Aircraft" released on 2nd August 2010**

AERA plans to regulate & control the Tariff Determination of regulated services viz., Cargo Services, Ground handling Services & Fuelling services and the draft regulations have been released in the Consultation paper 05/2010-11.

CIAL welcomes the approach of AERA for regulation of various aeronautical services. However, as this highly volatile and risky sector with international implications is subject to situations & problems which are unique and against existing market & economic assumptions, special considerations may please be made while determining the tariffs for the regulated services.

AERA may also consider the volume of operation in absolute terms to justify the economic viability of competition along with infrastructure availability and scope of its creation. CIAL welcomes a light touch approach, wherein the service providers are offered an equal and justifiable playing ground with reasonable controls against monopolistic tendencies while offering sufficient incentive for investment and a fair return on investment.

In AERA's stakeholder's meeting on 18.8.2010, the participants raised strong objections to the regulatory process for reasons ranging from change of business model proposed at time of investment, problems in fixing differential tariffs to agencies at the same airport to unattainable approach on recovery of ARR which was short collected, as proposed in the consultation paper. Accordingly Chairman AERA also welcomed suggestions on other regulating methodologies universally practised and acceptable in the industry and in line with the same, we would like to propose the following.

Ch. I : Maximum Price Cap Approach - A Proposal

- a. Airport modernisation & privatisation process in India is in its nascent stage. Govt. permitted private participation for creation of worldclass infrastructure and efficient airports for passenger convenience, operational capacity enhancement and to bring in professionalism in airport operations management & development. Along with Airport infrastructure, positioning experienced professional service providers is necessary to enhance operational capability & efficiency. As sufficient number of service providers selected on the basis of competitive bids as directed by MoCA, regulating tariff of individual bidders is against the principle of competition by market forces and against liberalisation and opening up of airport industry.
- b. Grown up airport industry in Europe underwent de-regulation by EU Council Directive 96/67/EC and SH&E Limited (EU Consultant's Final Report-Oct 2002) indicates that fair market conditions the rivalry among competitors, automatically bringing right number of effective players, market consolidation and effective working environment.

- c. To prevent undue customer exploitation & to provide value for money service to airline & FRoR to the Risk taking investor, AERA may fix a maximum price cap under which service provider may be permitted to operate irrespective of their investment or infrastructure. While investment requires a fair rate of return, the Service providers receive their revenue from the Quality of services rendered by them and not merely from the investment / infrastructure created. Higher investment or expenditure or infrastructure does not guarantee quality service and these being services, where human element is critical, manpower quality & service levels take predominance over infrastructure. However, rendering regulated service presupposes the availability of essential infrastructure.

- d. Therefore, while Fixing Maximum Price Cap AERA may please consider unique factors as
 - 1. International Pricing: While equipments & manpower to handle A-320 or B-737 in domestic & international sector are the same prices for international sector are at least 3-4 times the domestic rate. While expenses remain the same, prices are different and accepted as the tariff levied is international & similar worldwide.
 - 2. Pricing on reciprocal basis: A GH agency handles B-777 at rates lower than A 320 even though B-777 requires more equipments & manpower. The rate for B-777 is also much lower than industry price and sole explanation is reciprocal pricing. Similar case exist on pricing higher than normal rates on reciprocal basis.
 - 3. Service Quality: While both GHAs have same equipments (same RAB) to handle aircraft, one agency is preferred over another for quality of service rendered. Quality is intangible & cannot be mathematically calculated.
 - 4. Premium Service: Airlines would pay more to GHA to extract premium service. So premium price could exceed maximum cap, if airlines are willing to pay.
 - 5. National Balance of Payment position: Indian carriers have to pay international price in airports outside India and prices lower than international price is discriminating Indian GHAs and carriers and favouring foreign carriers, which goes against the principles mentioned in AERA of India Act 2008, Ch. III 13.3.
 - 6. Non-Discrimination among competitors: Competition to be fair & equitable and to provide desired market equilibrium should establish level playing field and equal opportunity to competitors. Therefore, differential tariff tears apart competition.
 - 7. Non-Price (Non-economic) factors for Selection of Service Providers: When Non-price & non-quality factors like reciprocal service, national / international tie ups, bilaterals, stake/interest etc. have greater influence on selection of service provider than the price or quality of service, competition is thwarted and market share diminished. Therefore, quality service providers with lower investments should not

be offered lower tariff for lower investment, as cost of service is similar or more to the agency with lower market share.

8. **Investment Utilisation:** Optimum utilisation & allocation of GH resources results in Market share & Revenue generation even if investment is limited. Higher investment does not guarantee market share or quality service and offering higher tariff to such investor is unjustified and does not provide incentive to quality & efficient investor.
9. **Methodology for Fixing Modified Maximum Price Cap:** GH providers should be required to submit documented evidence of the GH rates from among 20 major airports in the world to which Indian carriers operate (rates from at least 7 airports is required) and based on the prevailing international prices & prices paid by international carriers, the national maximum price cap for GH service providers should be fixed, which provision for premium price if airlines want to pay. Separate rate cap may be fixed for various categories of aircrafts and should follow the normal service as per IATA SGHA. Separate Price cap for additional services can be fixed. AERA could also indicate which services are included in the price cap.
10. **Single National Price cap:** The maximum price cap fixed above should apply to all airports in India, as the equipments, manpower, skill & other operational facilities required to service an A-320 whether in London, Dubai, Singapore or Delhi or at Guwahati are the same. Technological factors & labour cost may differ, but fundamentally service and service requirements being the same, price cap should also be same leaving price determination to Market competition.

Chapter II

Comments on Draft Regulations in Consultation Paper 5

However, in case AERA would decide to consider only to the 2 approaches highlighted by AERA in the draft consultation paper, the following are some of CIAL's observations, apprehensions & suggestions.

1. This draft consultation paper is for the independent service providers and not for Airport Operators, even if they provide the regulated service.

It is requested that any regulation on Airport Operator as service provider should not be less favourable than to the service providers, as airport operators, are fairly new agencies, consigned to limited airports, whereas service providers have greater market share through their global presence, long experience & expertise & client support.

2. Changi International Airport with 240,360 movements and 16,33,791 MT of cargo (2009) appointed Swissport (with 178 airport presence in 38 countries) as third GH agency in 2004, based on competitive bid for 10 years & renewable. In 2009, Swissport left Changi mid way contract with US \$50 M as loss. Failure of Swissport, (a giant in GH arena

with large customer base) as 3rd handler in Changi which has more aircraft & Cargo movement than Mumbai (India's highest major airport) makes us ponder, whether there is sufficient market for 3 agencies.

- a. It implies that even India's biggest airport may not take 3 service providers
 - b. Competition is also based on non-economic factors.
3. **Materiality in Cl.4:** AERA may consider fixing absolute numbers to denote materiality rather than fixing percentage, as even with increased operations, today's "material" airports can turn immaterial tomorrow, if other airports grow faster. Absolute Figure fixed should ensure sufficient operational volume & ROI on investment.
 4. Airports which are termed "material" category with required percentage, **do not have sufficient volume for competition.** To equate 65,200 flights to 13,500 flights or 230,000 movements to 52,000 Movements (which differ 4 fold), compare & regulate them on equal footing defies sound logical reasoning & principles of natural justice. Therefore benchmarking/ standards for comparison need to be more equitable and justifiable.
 5. Therefore, **materiality index determination in Cl.4.1 (ii), Cl.4.2 (ii) & Cl.4.3 (ii) should minimum be 10% (or higher percentage to be fixed) and within a minimum of "X" (wherein X is an absolute figure (different for fuel, cargo & GH) which needs to be indicated.)** Airports which fulfill both the criteria should be termed material, otherwise, it will lead us to unjustifiable comparison of 2,30,000 and 52,000 on same footing.
 6. Clause 5.1 states that there should be at least three (3) service providers in GH, cargo and fuelling to ensure competition. However, airports with less than 100 international movements per day, does not support competition by more than 2 agencies. Therefore, the number of service providers required for competition to be fixed to 2 agencies.
 7. Competition in regulated services is NOT SOLELY on PRICE, but on factors like reciprocal service, national tie ups, bilateral, service quality, interest/stake etc. Moreover self-handling airline who is also a 3rd party GH service provider possess a huge financial advantage over his non-airline competitor. These non-price factors which are intangible cannot be measured, esp. in terms of regulatory asset base/investment. As AERA regulates only economic factors, it may not be able to ensure equal or justified competition in regulated services like GH or Cargo service, as service agreements may be reached on non-price & non-economic factors.
 8. Competition & Self Handling: Study on Swissport's failure in Changi showed that with market share upto 80% by SATS, the then subsidiary of Singapore Airlines, doing self handling, distorted market even for giants like Swissport & Dnata backed CIAS.

Changi's final 4 bidders for 3rd party GH service include Jet Star, Air Asia beside SIA Engineering and Aircraft service International. Plunge of Jet Star, the low cost carrier

into arena where Swissport failed, is on the fact that it Jet Star can self handle their flights (1200 per week) & service their mother carrier, Qantas, the 2nd largest operator in Changi. Therefore, they can survive even without another customer.

Third Party GH service by self handling airline is an entry barrier and monopoly position acquired through statute or by virtue of Govt. Company, which forms restrictive practice as per Competition Act of India. Therefore fair competition scope is nullified by self handler providing 3rd party GH service.

AERA may clarify the manner of Treatment of Revenue (esp. revenue for handling own flights, which is self handling) of the Self handling 3rd party GH service provider, as no income accrues directly, but results in gigantic profits, as third party service in most cases is extensive utilisation of GH resources for self handling.

9. Competition, Materiality & Infrastructure: Airport infrastructure esp. cargo was built as per then business plans before even AERA was thought of. Special agreements were reached with sponsoring agencies. The new regulations point to competition, where infrastructure may need to be duplicated, which may not be physically possible. Govt. realising this constraint has limited number of agencies, which may not be in tune with AERA requirement. Please clarify who would have precedence and how?
10. While Service provider in GH can be easily identified, AERA may clarify how service providers in cargo & fuelling will be distinguished. AERA may define the services which will make agency qualify to be counted separately.
11. Statutorily a single agency may be appointed as service provider eg. Warehouse licence holder or customs approved agency which was approved before AERA originated. AERA may clarify how these conflicting requirements (esp. statutory) be reconciled.
12. AERA Act Ch.III, 13.2 states AERA shall "determine the tariff ONCE in 5 years" and considered appropriate, amend from time to time, the tariff so determined. AERA now proposes (Ch.II, 6.3) ANNUAL tariff Proposal & approval processes, which is not in line with the directives of AERA of India Act 2008 itself.
13. Aggregate Revenue Requirement (ARR) Ch.III- Cl.7 includes Operating expenses to determine the ARR. The operating expenses of an agency (say PSU), would be higher than another (private player). If Tariff approved takes into account high operating expenditure, efficiency is punished & overheads rewarded. If tariff does not care about expenses, the tariff will lead to losses. AERA has to devise before tariff determination, the maximum permissible operating expenditure bracket applicable for service provider, depending upon the level of operations.

14. Clause 8.1 Fair Rate of Return: AERA indicated 16% as Fair ROI which does not provide any incentive to the investor. The Regulated Airport services require huge investment and operations are highly volatile. Moreover any over recovery has to be shared (CI9.15.2), but AERA does not guarantee appropriate return in case of short recovery and the method proposed is not feasible. The high risk is not properly rewarded.
15. AERA had projected in consultation paper of Feb 2010 cl.1.32 that AERA would intervene only when there is no sufficient competition or where the intervention will have material benefits. But in the present consultation paper 5/2010 chapter V.cl.10, calls for a huge documentation for tariff fixation, where, borrowing AERA's own words "cost of regulation will outweigh the benefits". Therefore, it is proposed that based on the operational volume, a maximum price cap may be fixed upto which airports may be free to charge. Airports requiring greater revenue may be directed to approach AERA with their tariff proposals.
16. While deciding on materiality & competition and while tariff determination, AERA may consider agreements entered into even before AERA originated and they should not be subject to regulation and should be left to the agreement between the parties.
17. FROr for a category of Service providers in various airports should lie within a homogenous bracket and should not vary too much wherein various agencies can be put to difficulties.
18. In cl.8.6 Revenue from services other than regulated services AERA propose to include them in the gross revenue. This should not be done, as services provided are different and beyond regulation.
19. AI.3.1 provides for 10 year Business plan, while some of the contracts with service providers are for lower periods. There is a need to define, how long term investments & short term investments would be calculated for FROr purpose.
20. Regulatory Asset Base or its value is not equivalent to quality service in aviation, as manner of providing service, skill, accuracy, exactitude and timeliness of service provider are considered more important and premium rates are paid for service levels. Therefore, regulating the tariff for services or fixing yield based on real asset /investment and not considering the intangible assets, which are quintessential in service, will defeat the purpose of efficient operations.
21. Investment by GH agency depends on the customer airlines and the GH requirements and their purchasing models and priorities may differ. Agencies with greater market share have to invest more while those serving lesser market have lower investment. But as the service being provided is the same and equipments being the same, fixing differential tariffs just based on the investment defeats the purpose of equality and fair competition. This affects the smaller players giving scope for monopoly & cartels in the national level, which is dangerous to the market and also safety & security.

22. Cl.9.15.2 indicates sharing of over recovery, (which will be accepted by users) and under recovery, which is not practical, as higher tariff will alienate customers whereby loss will lead to further loss. While AERA plans to regulate profits, AERA does not have any guarantee for making up of loss. Regulating profits alone without providing for loss recovery is discouraging & punitive to investors.
23. Cost of Equity & Cost of Debt: Cl.8.1.4 considers cost of debt for FRoR calculation. AERA may clarify whether market rate would be taken for debt free companies. Further, as cost of debt may vary based on many factors including non-economic factors, loans from group companies etc. AERA would need to devise a cost of debt deriving a national average.
24. Cl. 8.2.4(b) (i) requires proof of competitive procurement. Priorities of agencies while procuring equipments vary from immediate requirement, uniform equipments in multi stations, ease of operation, Equipment life, Govt. procedures & allowance, etc. which would be non-price factors. There is a need to formulate a process on how comparison of these assets would be made.
25. **Aircraft Fuelling Service:**

CIAL had granted the exclusive right for Aircraft Fuelling service to BPCL, a Govt. of India company, for which BPCL got the approval of the Central Govt. and the facility is for a period of 20 years, during which no similar facility can be granted by CIAL as per the terms of the MoU entered into with BPCL in May 1997 & subsequent agreement.

Civil Aviation Ministry in similar instance has stated that law passed subsequent to such an agreement would not have the power to nullify the agreements entered into before the effective date of the new act.

Further, as per the arrangement between Govt. owned Oil companies, IOCL and HPCL have been permitted by BPCL to provide refuelling service to aircrafts and collect charges for the same, utilising hydrants owned by BPCL.

Under such a circumstance, we would seek clarification from AERA on

- a. Whether presence of IOCL, HPCL, along with BPCL is competition enough?
- b. As fuelling hydrant infrastructure cannot be duplicated as it will affect the entire airport operations, can the above be treated as competition?

It is also requested that the MoU made in 1997 and subsequent agreement, and its terms and conditions may be held valid and applicable as pre-existing arrangements.

26. **Cargo handling Services**

Cargo handling infrastructure and procedures were established and relevant agreements signed with statutory and Govt. agencies with pre-existing business plans

in 2000-01 and so on. Agreements with APEDA restrict the charges that can be levied for certain services, thereby limiting the revenue from cargo operations.

Therefore, it is requested that AERA may approve and specially consider the business plan and cargo volume in determining competition requirement. Even central Govt. in GH policy has opined that Govt. may decide on the number of agencies based on the infrastructure availability.

Moreover, as Cargo operations involve regulation, licensing & compliance to more than a single Ministry, AERA may please consider the implications of infrastructure, licencing, security, costing and revenue from all concerned ministries before deciding on regulating tariff alone, as other aspects of cargo operations would be adversely impacted, in the absence of a viewpoint from multifarious stakeholders in cargo operation, esp. the statutory and sponsoring / funding agencies.

Definition of Cargo Service Provider and services that would be regulated also needs to be specified for greater clarity for regulation & implementation.

27. Infrastructure creation & Ensuring Competition: Airport infrastructure has been built & resources engaged based on business plans made, which may pre-exist AERA, where to ensure competition, creation (duplication) of infrastructure may be required, which will nullify the present infrastructure created, as business has to be shared, which may be considered when fixing competition requirements.
28. While AERA has indicated that pre-existing agreements could be considered while tariff determination, AERA may also give weightage to the business plan pre-AERA since the new regulations would adversely impact some of the basic assumptions on which regulated services would have been provided.
29. Most importantly, AERA proposes to focus on benefits to end-user while fixing tariff. In aviation industry, in which market is highly volatile and risky and huge investment required, AERA has to fundamentally focus on the benefit & survival of the investor since he is the sole entity directly and primarily affected. AERA may not be in a position to ascertain that benefits are passed on to the end user. Therefore, AERA may place focus and stress on investors' benefits, as he is the primary target of regulation & most directly impacted. AERA may ensure that monopolistic regime does not evolve. Any tariff fixation should consider the risk, profitability, survival, chances of loss and benefit to ALL STAKEHOLDERS (esp. investor / service provider) and not just the end-user. Regulation should not lead to situations graver than monopoly.
30. While the entire economy has been de-regulated and opened up and Airports made investor friendly, AERA may adopt the policies of IRDA, TRAI & other regulators, who have established a benchmark to be followed rather than individual regulation, which is costly, cumbersome and will defeat the purpose of fair market & competition.

31. We also support the views of the APAO submitted to AERA for consideration while formulating the guidelines for the regulated services.

CIAL once again would like to welcomes the AERA initiative to regulate Cargo, Ground handling and Fuelling Services, and would request that as aviation and airport operations are highly volatile and risky sector where an external unrelated events have caused huge drop in traffic, special considerations may please be made whole determining the tariffs for the regulated services. Aviation has seen many failures due to its volatile nature and it would be in the interest of investors & stakeholders that market forces determine the pricing, for which AERA may define the rules and regulations, so that airport services remain competitive and efficient.
