AIRPORTS COUNCIL INTERNATIONAL

17 May 2016

OSD-II to Secretary
Airports Economic Regulatory Authority of India
AERA Building,
Administrative Complex
Safdarjung Airport
New Delhi 110003
Email: radhika.r@aera.gov.in

In the matter of determination of aeronautical tariffs in respect of Chhatrapati Shivaji International Airport, Mumbai for the second control period (FY 2014–15 to FY 2018–19)

Sir,

Airports Council International (ACI) thanks the Airports Economic Regulatory Authority of India (AERA/Authority for providing ACI the opportunity to present through this written submission its viewpoint, in response to the Matter of Determination of Aeronautical Tariffs in respect of Chhatrapati Shivaji International Airport, Mumbai (CSIA, Mumbai) for Mumbai International Airport Pvt. Ltd. (MIAL) for the Second Control Period (1.4.2014–31.3.2019) on Consultation Paper No.10/ 2015–16 dated 16 March 2016 (the "Consultation Paper").

ACI is the only global trade representative of the world's airports, representing the interests of 592 members operating 1,853 airports in 173 countries with governments and international organizations such as ICAO. It is ACI's mission to develop standards, policies and recommended practices for airports and to provide information and training opportunities to raise aviation standards around the world.

ACI's comments on the Consultation Paper are detailed below:

Part I - General comments

1. Economic development and private sector involvement

Globally over the past 20 years, airports have evolved from publically owned utilities to sophisticated, efficient, hi-tech, business-oriented service providers. The deregulation of the aviation industry in many parts of the world and the progressive participation of the private sector in the funding and management of airport infrastructure has led to radical change in

the way airports operate. A variety of airport ownership and governance models have emerged.

Over the last six years (2010–2015), the growth in passenger traffic in India has been higher than the majority of other regions in the world[1], amounting to a growth of 8.6% against a worldwide average growth of 5.3%. Preliminary analysis from ACI foresees that this pace of percentage growth will be experienced at the national level over the next 5 years. Mumbai Airport passenger traffic has been consistent with this growth, with its passenger traffic volume increasing over the same period by 7.6%. Due to its infrastructure and space constraints, Mumbai continuously needs to invest to keep it safe and efficient through various operational and capital expenditure programs.

With the objectives of meeting the increasing demand in terms of passengers and cargo, and enhancing the quality of public infrastructure, many governments are turning to private operators and investors to develop (or upgrade) strategic airport infrastructure. The Government of India also recognizes that participation of the private sector can play a significant role in improving airport infrastructure with the ultimate aim of bringing airports in India to world-class standards and facilitating the development of aviation hubs within the country.

The process initiated by the Government is a welcome step and should be supported by AERA to ensure that the regulatory framework in place will provide confidence in the market, create the right incentives to stimulate economic growth and employment generation, foster healthy competition among major airports and encourage investment in airport facilities. An investor-friendly regulatory regime is fundamental for India to attract private investors to infuse the required funds for the growth of airports in India.

As recommended by ICAO, the regulatory approach for airports should derive from the specific objectives and context of each country. India's policy framework for airports should therefore be aligned to the country's vision of becoming the third-largest aviation market by 2020. The regulatory philosophy should encourage the world's best airport developers to invest in India's airports and judiciously balance the expectations of airport users and investors.

2. Adherence to concession agreements

To create confidence in the market, adherence to a signed concession agreement must be respected as it is termed as sovereign risk. Any attempt to relook at the concession after investment has been made will adversely impact the credibility of the Government as a party to the agreement, with a possibility of steering away potential investors. We urge

[1] Over the same period the Asia-Pacific Region grew by 7.7%, Latin America by 6.7%, Europe by 4.5%, North America by 2.5% and Africa by 1.1%. 2015 figures are preliminary.

AERA to ensure that it adheres to concession agreements in full. AERA should look at the concession agreements holistically and allow airport operators all concessions envisaged in the agreement.

3. Don't damage the success of future privatization projects

A sound regulatory framework should provide confidence that regulatory decisions are made on an objective, impartial and consistent basis. The following are areas that require AERA's attention to ensure the success of future airport privatization projects:

a) **Avoid regulatory uncertainty**: Regulatory decisions should be consistent from one control period to another.

b) **Reasonable return on investment**: The return allowed (i.e., the net amount available to the investor) must be reasonable to make an investment attractive.

c) **Level of airport charges**: The level of airport charges should be just and reasonable, allowing investors to make a reasonable return while running the airport in an efficient manner.

d) **Sustainable industry**: Continuous losses in the airport sector will mean that all stakeholders, including banks, will not be able to recover their investments, which will lead to an unsustainable economic environment. This will result in lower capacity hampering the growth of airlines and consequently passengers that will not be able to get the infrastructure they expect and deserve.

e) **Impact on the economy**: Airports are key economic drivers of the economy. If the airport industry is not financially healthy the associated developments will not take place, thus impacting the country's economy as a whole.

Globally, the trend is moving towards deregulation, even with reference to airports with high volumes of passenger and cargo traffic. For instance, in London, Stansted Airport has been removed from specific economic regulation and Gatwick Airport's regulatory framework has been relaxed. Experience in other mature aviation markets has demonstrated that proportionate regulation offers the opportunity for airports and airlines to increasingly negotiate individual contracts with specific terms and conditions reflecting individual circumstances. This transformation of the airport-airline relationship to a more commercial and responsive one has the potential to benefit all players in the aviation sector, including the travelling public.

In India, on the contrary, heavy-handed regulation continues to be applied. ACI urges AERA to avoid micro-management. Any regulatory intervention should be kept to a minimum and must be cost-effective (i.e., the direct and indirect costs of regulation should not outweigh its benefits).

Part II - Detailed discussions

1. Economically viable operations with reasonable return on investment commensurate with risk

ACI notes from the Consultation Paper that AERA has proposed a reduction of 7.2% in aeronautical charges as a cumulative result of its various proposals in the Consultation Paper. This is in stark contrast to the increase proposed by MIAL in its submissions and could potentially test the viability of the airport, as the reduction may mean that the operator is not enjoying a reasonable rate of return.

With the lower tariffs as proposed in the Consultation Paper, MIAL would be incurring substantial losses in the second control period which will completely wipe out its Reserves and Surplus in next few years and leave it in a position where it may not be able to finance the much needed airport investment. Against this background of increased credit risk, MIAL would be unlikely to find sources to finance an efficient service to the air carriers and the passengers.

CSIA, Mumbai is the gateway to the financial capital of India and is a significant contributor to the economic growth of the western region and India as a whole. Any strain on MIAL's financials may have a direct impact on the quality of services rendered at the airport, which shall not be a welcome situation for stakeholders (i.e., the airport, airlines, passengers, the Government, investors/shareholders, etc.).

ACI urges AERA to determine the tariff for MIAL for the second control period in such a way so as to ensure that the regulator continues to incentivize investment in the airport sector, as well as ensure economically viable operations at the airport together with generation of sufficient revenue to cover operating costs, obtain a return on capital over its economic life and achieve a reasonable return on investment commensurate with risks.

2. Decisions contrary to the concession agreements and inconsistency in its own decisions

ACI is of the view that the current proposals in the Consultation Paper fail to abide by the relevant concession agreements signed by the Government of India and Airports Authority of India (AAI) as its representative, in some major areas discussed in this submission. Such deviations and inconsistencies would send a negative signal to new or existing airports coming under public-private partnership (PPP), and to other sectors. This may hamper the privatization process.

a) Methodology for calculation of income taxes as per State Support Agreement (SSA):

Adherence to the concession agreement with respect to the methodology for calculation of a building block of income taxes should be ensured. When the annual fee is not being considered as a pass-through expenditure (as per the provisions of the State Support Agreement) when calculating aeronautical charges, it likewise cannot be considered as an expenditure for the calculation of income taxes.

This is clear from the methodology and illustration given in the State Support Agreement: Income taxes on aeronautical earnings need to be calculated separately and added to the other building blocks, and cannot be linked to the overall tax liability of the company. If an annual fee is to be borne by the airport operator solely and cannot be passed through to users, then all the advantages/disadvantages associated therewith should be borne by the airport operator alone.

If there is income tax savings at the company level due to payment of an annual fee from the company, then applicable tax savings should also be available to the airport operator and should not be taken away by the regulator.

In adherence to the concession agreement, ACI urges AERA to compute taxation on aeronautical revenue in terms of SSA, ignoring the annual fee as a pass-through expenditure as per the specific calculation in SSA.

b) Incorrect classification of revenues and change in classification between control periods:

AERA has treated the fuel throughput charges as aeronautical in nature, despite the fact that CSIA, Mumbai receives only concession fees from such service providers. This is in contrast to the international standards set out in ICAO Document No.9082, which in its definition of non-aeronautical revenues specifically includes concession granted to oil companies to supply aviation fuel and lubricants. Likewise, the Operation, Management and Development Agreement (OMDA) does not define fuel throughput charges as aeronautical revenue.

This categorization is also inconsistent with the definition provided in the previous control period. Such unwarranted changes in classification should be avoided as they add uncertainty to the entire regulatory process and send the wrong signal to worldwide investors for the entire infrastructure sector.

Based on the above, ACI urges AERA to consider revenue from fuel throughout charges as non-aeronautical.

c) Change in methodology with regard to adjusting Development Fee (DF) funded assets from Regulatory Asset Base (RAB):

In the first control period tariff order, AERA decided to follow a methodology of proportionate adjustment of DF against capitalized assets until project completion.

In the Consultation Paper for the second control period, AERA decided to adjust the entire DF balance for the financial year 2013–14 when part of the new T2 was commissioned for international operations. This was contrary to AERA's own decision of proportionate adjustment until completion of the project. It is worth noting that commissioning of a part of T2 in FY 2013–14 cannot be considered as completion of the project, which is supposed to be completed only in FY 2015–16. Such an arbitrary proposal has resulted in lower addition to RAB in FY 2013–14 and FY 2014–15, and hence lower returns to the airport operator.

ACI urges AERA to consider the completion of the project in FY 2015–16 and make the necessary DF adjustments proportionately to the RAB.

d) No return on share application money and reduction of reserves:

In the first control period AERA considered share application money pending allotment as part of shareholders' funds and allowed equity return on the same. In contrast with this, for the second control period AERA proposes to allow no return on the same only based on the fact that shares were allotted in the month of April and not March. This treatment defies any logic and the fact remains that the shareholders brought funds into the company and therefore should be given equity return on the same. AERA should also refrain from changing its own decisions unless there is a dire need to do so. This is not the case in this instance.

AERA has further proposed to reduce reserves (part of equity) to the extent of credit taken in the Profit and Loss account for minimum alternate tax (MAT) and future losses. Both the adjustments are completely arbitrary. MAT credit entitlement is a statutory adjustment and arises because of payment of excess taxes in present, for which set off would be available in the future. When AERA has disallowed the amount of income tax, it should correspondingly allow for MAT credit entitlement.

e) Equity reduced on account of upfront fee:

Different from what has been provided for in the concession agreement and OMDA, AERA has proposed to reduce equity brought in by the investors/shareholders to the extent of the upfront fee paid to AAI. This is incorrect as the upfront fee payment to AAI is part of RAB and therefore overall Weighted Average Cost of Capital (WACC) should also be applied on this payment instead of carving out this one payment and matching means of finance of the same.

f) Other income:

AERA has contrary to its earlier decision on "other income", which includes interest from banks and others, income from investments and capital gains etc. as non-aeronautical revenue for the purposes of cross subsidizing the aeronautical charges. Such "other income" does not fall within the definition of income from revenue share assets under SSA or OMDA and need not be considered for cross-subsidization.

ACI suggests that non-aeronautical income should not be subject to any other interpretation except as defined in Schedule 6 of OMDA. In fact, this is also against the provision of the AERA Act.

3. Other issues:

a) Operating expenses allocation ratio:

AERA has considered expenses allocation ratio based on such expenses for FY 2013-14, where cargo was also being handled by MIAL and therefore the non-aeronautical expense ratio was high due to cargo handling expenses, which are a non-aeronautical expense. During the entire second control period all of the cargo operations were concessioned out. In view of this, the AERA should consider the correct expense allocation ratio for FY 2014-15 instead of continuing with old ratio.

b) Allocation of T2 cost on an unjustified and incorrect basis:

AERA has proposed to allocate the cost of T2 at CSIA, Mumbai based on the cost of T3 at Delhi Airport without providing any solid justification.

ACI urges AERA to allocate the T2 cost relative to the area detail of T2 and not based upon the ratio at T3, which has no connection whatsoever.

c) Increase in project cost disallowed:

AERA has disallowed an increase in the project cost, aggregating Rs. 278 crores in spite of providing full justifications by MIAL. AERA is fully aware of the unprecedented challenges that MIAL had to face while constructing the new T2. Such escalations have been incurred due to reasons beyond control of MIAL and through no fault of the airport operator. Such disallowance of the project cost is a direct loss to the airport operator. ACI also notes that AERA has considered substantially lower operational CAPEX, overlooking the genuine needs of the airport and leaving insufficient funds in the hands of the airport operator to implement these CAPEX. Delayed or non-implementation of such CAPEX could hamper the efficient and safe operation of CSIA, Mumbai

d) WACC and its components:

AERA has considered the cost of equity at 16%, capped the cost of debt at 11.56% and allowed no return on usage of real estate security deposits.

Cost of equity of 16% has been considered assuming lower risk for the airport sector, which is altogether contrary to the actual risk involved for CSIA, Mumbai. CSIA, Mumbai has high risk due to a second competing airport in its close vicinity, which is likely to cannibalize part of the passenger traffic the airport currently enjoys. Besides the traffic risk, regulation is also a substantial risk if no modification to the current regulator's proposal is made with reference to, for instance, disallowance of project cost actually incurred, change in the classification of revenue and non-adherence to SSA and OMDA. Such risks justify warranting a high cost of equity and a high cost of debt, determination of which is directly related to such risks.

ACI urges AERA to consider a reasonably higher cost of equity considering such risks. ACI likewise urges AERA allow the actual cost of debt instead of 16%, and to cap at 11.56%.

ACI notes that WACC is pulled down due to not allowing any return on funds mobilized through real estate security deposit and used for aeronautical projects funding.

ACI urges AERA to allow a return that is at least equal to the cost of debt, if not equity, and notes that the airport operator could have alternatively mobilized such funds and could have earned a return. It cannot be assumed that these funds have no cost.

ACI thanks AERA for the opportunity to present this submission and looks forward to continuing its cooperation with AERA on economic and regulatory issues related to the Indian airport industry.

Yours sincerely,

Angela Gittens
Director General
ACI World

Patti Chau
Regional Director
ACI Asia-Pacific