302/Secy (AERA)
30/5/2016

DELHI INDIRA GANDHI INTERNATIONAL AIRPORT

Delhi International Airport (P)Limited

भारतीय विमानपत्तन आर्थिक विनियामक प्राधिकरण
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25th May'2016

To,

The Chairman,
Airports Economic Regulatory Authority of India
AERA Building, Administrative Complex,
Safdarjung Airport, New Delhi – 110 003

Subject: Comments on consultation paper no. 10/2015-16 for Chhatrapati Shivaji International Airport, Mumbai (MIAL)

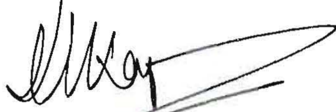
Reference: Consultation Paper no. 10/2015-16 dtd. 16th March'2016
Public notice no. 1/2016-17 dtd. 18th April'2016

Dear Sir,

With reference to above please find attached our comments on MIAL consultation paper for second control period as Appendix 1 to this letter.

Thanking You,

For **Delhi International Airport (P) Ltd.**



Sidharath Kapur
President (Finance & Business Development)

ASQ 2014 WINNER WORLD'S NUMBER ONE AIRPORT

Appendix - I

Response to the Consultation Paper issued by AERA for tariff determination of Chhatrapati Shivaji International Airport (CSIA), Mumbai

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1. Cost of Equity

Authority's view

The Authority has noted that from the Tariff Model that MIAL has applied 16% rate of return on equity for the purpose of WACC estimation in the 1st Control Period. The Authority has also noted MIAL's submission regarding cost of equity at 23% for the second Control Period based on the analysis by KPMG and reviewed the KPMG report.

MoCA also had forwarded a report of M/s. SBI Capital Markets Ltd. (SBI CAPS) on the fair return on equity for the Indian Airport sector which had opined that a return on equity in the range of 18.5% to 20.5% would be reasonable for airport sector in India. This report was discussed extensively in Authority's Order No. 3/2012-13 dated 24.04.2012 for tariff determination of IGI Airport, Delhi and the Authority had provided reasons for not considering the return on equity in the range of 18.5% to 20.5%. Further, the Authority had appointed the National Institute of Public Finance and Policy (NIPFP) as its financial advisor and commissioned a study to estimate the fair rate of return for private airports at Mumbai, Delhi, Bangalore, Hyderabad and Cochin. Vide its study submitted on 17th September 2012 the cost of equity was determined to be between 11.64% and 13.84% in respect of the CSI Airport, Mumbai, using the CAPM methodology. NIPFP has commented on all the elements of the CAPM model, namely the risk free rate, equity risk premium as well as equity beta.

MIAL has considered the cost of equity has 23% in order to compute the WACC. The Authority has noted MIAL's submission on this aspect for the second Control Period and has not found any new grounds to alter its approach or decision taken at the time of Order No. 32/ 2012-13. Accordingly, the Authority does not feel that any change in its approach for determination of Cost of Equity is warranted.

Thus, the Authority proposes to consider the Return on Equity (post tax Cost of Equity) as 16% for the WACC calculation. The Authority also proposes to consider the same rate of return as of equity, i.e., 16%, for Reserve & Surpluses / Accumulated Profits (Retained Earnings).

DIAL comment

In above decision, the reliance placed by AERA on the NIPFP report is flawed as (a) the Asset Beta derived by NIPFP is based on developed countries and is very low; (b) it has taken 10 year GoI bond yield for the period 2001-2010 to arrive at the risk free rate.

MoCA issued a direction to AERA on 12.03.2012 pertaining to the rate of return on equity and recommended a rate of 18.5%-20.5% based on the "Report on Fair Rate of Return on Equity for Indian Airport Sector" prepared by SBI Capital Markets Limited which was also enclosed along with the said letter.

AERA has not considered the SBI Caps report provided by the Government, which is in the nature of a policy directive as per Section 42 of the AERA Act, but has adopted a return on equity of 16% - far below the rate recommended by the expert authorities.

The 16% rate of return given by AERA is inadequate and insufficient, and contrary to settled regulatory principles. This is contrary to the requirements of Section 13(i)(iv) of the AERA Act as well as SSA under which the MIAL is entitled to a reasonable rate of return.
Also, as per Section 13(1) (a) (iv) of the AERA Act, AERA has to determine tariffs in a manner which will ensure economic and viable operations of MIAL. The 16% rate of return given by the AERA is inadequate and insufficient which would lead to further erosion of the net worth of MIAL

According to the industry experts the adequate return for the Airport Sector would be 24%. Such return on equity for CSI Airport Mumbai in specific could be even higher keeping in view the capacity constraint on handling of aircraft and passengers and imminent threat due to eating up of traffic by airports planned in close vicinity of CSI Airport, which are additional risks for MIAL. AERA must protect the economic viability of the MIAL while determining tariffs and must provide for a reasonable rate of return on equity to which MIAL is entitled under the concession agreements and as assured by the Government policy.

2. Return on Refundable Security Deposit (RSD):

Authority's view

"To consider RSD already raised by MIAL (at Rs. 207 crore) as a means of finance at zero cost"

DIAL Comments

In terms of the concession agreement MIAL is eligible for commercial exploitation of stipulated area of land. MIAL had accrued refundable security deposit (RSD) from such commercial exploitation. The RSD though being derived from non-airport asset (non transfer asset) was used for funding capital expenditure.

RSDs have been raised from Non-Transfer Assets [as per Article 1.1 of OMDA]. Revenues from Non-Transfer Assets are outside the purview of the regulator. Since the RSDs are raised from Non-Transfer Assets, they could have been used for any purpose. MIAL has used the RSDs for part financing the Project Cost. RSDs are akin to equity and should have been treated as quasi equity for which AERA should have provided a fair return to MIAL.

MoCA has also given a policy directive in this regard. The expert report conducted by MoCA, through SBI caps has concluded that the rate of return would depend on the type and features of the instrument being used for such form of finance. The report further states that in case of Quasi Equity, the risk/ return profile lies above that of debt and below that of equity. Despite the Policy Directive, AERA has not considered return on RSD even in the tariff order for the First Control Period and again proceeded on the erroneous premise that there is no cost associated with RSD.

The tariff determination in so far as RSDs are concerned is unfair as there is a opportunity return associated with RSDs which could have been utilized by the MIAL for other commercial activities and on which MIAL could have secured a return.

The amounts generated as Refundable Security Deposits are invested back in the airport project from the surplus generated. Thus, MIAL is entitled to a return on RSD, which should be treated as quasi-equity.

Authority also proposed to review the matter of return on RSD and will appropriately true up the second control period which clearly shows that the Authority also understands that RSD is eligible for return. However, it is pertinent to mention here that the study would have been optimal if done before fixation of the final tariff for MIAL.

3. Treatment of revenue from Land lease as non-aeronautical for cross subsidisation

Authority's View

The Authority has requested AAI and MoCA to provide their considered view on mechanism for land monetization by MIAL in future and the formulation for treatment of revenue generated by MIAL from monetization of land earmarked for commercial development

DIAL Comments

The Real Estate Development does not get qualified under the definition of Revenue Share Assets, any revenue / proceeds from Real Estate Development is completely outside the purview of cross subsidization in accordance with the provisions of SSA and therefore in no way any such revenue / proceeds can be utilized for cross subsidizing aeronautical charges. In view of absolutely clear provisions under the SSA and OMDA, we are of the view that, there was no need to refer this matter to MoCA and AAI.

In this connection we would like to state that the position in this respect is very clear and revenue from such monetization is not to be used for cross subsidizing the target revenue and there is no obligation on the airport operator for using the funds mobilised from land monetization for airport business.

It will not be out of place to mention here that the Authority had already analysed this issue thoroughly while determining tariff for first Control Period and had taken a decision accordingly and therefore reviewing / revisiting its own decision is undesirable and uncalled for.

4. Treatment of Other Income

Authority's view

The Authority proposes to consider the same and is of the view that, all components of "Other Income" should be accounted under aeronautical or non-aeronautical categories, in the future, as far as possible. Going forward, the Authority expects MIAL to classify all revenue heads, including other income as either aeronautical or non-aeronautical while submitting its proposal for the third Control Period.

DIAL comments

The other income does not accrue from Revenue Share Assets and therefore cannot be taken into consideration to cross subsidize the aeronautical charges.

Such earnings, i.e. interest income, treasury income, etc. relate to investment of interim surplus funds and the retention of the share-holders' funds in the business till the same are paid out as dividends. Such incomes do not form part of either aeronautical or non-aeronautical revenues. Accordingly, AERA has no jurisdiction to consider interest income as non-aero.

That investments in mutual fund or similar treasury instruments or bank deposits are all part of the cash flow management exercise of the Airport Operator and accordingly there is no basis to treat bank deposits differently from any investment in mutual fund.

Hence, the direction to identify 'other incomes' under the head of Aero and Non-Aero is neither possible nor is in accordance with the scheme of the OMDA and the AERA Act and is liable to be set-aside.

5. Calculation of tax under aeronautical P&L on standalone basis

Authority's view

The Authority maintains its view, that tax being a statutory payment, its calculation on theoretical basis in any methodology of working that must lead to a situation of enrichment of the airport operator is not appropriate

The Authority thus continues to consider computation of tax on the basis of earnings pertaining to aeronautical services including Annual Fee / Revenue Share as an element of cost.

DIAL comments

The SSA entered between the MIAL and the Government of India lays down the methodology of fixation of Aeronautical Charges. Tax is a building block towards the target revenue as per the formula in Schedule 1 of the SSA. 'T' in the formula in Schedule 1 means 'Corporate Taxes on earnings pertaining to Aeronautical Services'. Thus as per the SSA, it is only tax on aeronautical services which is to be considered while determining the target revenue.

AERA has proposed to determine MIAL tariffs by taking into account the actual tax as per books. This is contrary to the terms of the SSA and the OMDA. In accordance with the concession agreement revenue share is excluded as a cost for the provision of Aeronautical Services. Thus, the revenue share cannot be considered as expense for tax calculation.

In line with the concession agreement, AERA has not considered the revenue share while calculating the operating expenses for building blocks considered for tariff, but has taken into consideration the revenue share as part of operating expenses for the purpose of calculating tax.

The key principle underlying the concessions granted to MIAL and the AERA Act is that the MIAL will have two separate tax calculations, one regulatory and the other statutory. They both have different purposes. The statutory tax is calculated as per Income Tax Act for payment of income tax whereas aeronautical tax is to be calculated as per provisions of the SSA and is limited to tax on earnings from aeronautical services only.

The effect is that the MIAL gets a lower tax add-on in the building block. This is contrary to the express provisions of the SSA and is entirely arbitrary. Accordingly we propose that the tax should be considered as per the provisions of the concession agreement and thereby the revenue share should be excluded from tax computation.

6. Reimbursement of expenditure related to security incurred from PSF(SC) escrow account

Authority's view

Authority has not considered carrying cost on amounts to be reimbursed under directions of MoCA and also not considered amount incurred on CWIP related to security. Condition for reimbursement of amount to PSF(SC) escrow account prior to finalisation of tariff order by Authority has been put.

DIAL comment

Carrying cost on the amounts to be reimbursed should be allowed along with the amount of CWIP incurred from the said escrow account. Condition to make the payment before passing of Order by Authority is a nearly impossible condition put in, it would not be possible for an airport to arrange such a large fund for reimbursement at a short notice. As requested by MIAL, a separate component towards PSF (SC) should have been proposed by the Authority.

7. Allocation ratio for Aeronautical: Non Aeronautical expenses:

DIAL comment

Since, cargo operation forms significant part in overall expense of an Airport Operator, authority should consider the change in allocation due to discontinuation of cargo operation by MIAL. While considering the allocation into aeronautical and non-aeronautical expenses for the second control period AERA has to take into account the fundamental change in the nature of operation or expense if any.

Hence, during FY 2015-19 there would be no expenditure done by MIAL for cargo operations. Accordingly, it is necessary to consider the revised allocation ratio.

8. DF adjustment

DIAL comment

Authority in its order Order No. 32/ 2012-13, had considered DF adjustment proportionally as per the methodology for the determination of RAB. Hence, the current position of Authority adjusting 100% DF in FY'14 i.e. year of commissioning of Terminal 2 is arbitrary and going away from its own decision.

Based on MIAL submission, Terminal 2 was commissioned in FY 14. However, the 100% completion of T2 is expected to complete in FY 16 and also we understand the DF amount collected was utilized for Terminal 2 as well as some air-side projects.

Accordingly, DF should be proportionately reduced from assets in FY 14-FY16.

9. Proposal to adopt normative approach

Authority's view

To follow the Normative Approach for determination of Building Blocks, except incentivisation of NAR, to the extent the Authority decides it to be applicable for MIAL.

DIAL comment

Authority's view of adopting Normative approach for MIAL will have serious ramifications on the contractual rights of MIAL. The concession agreement does not envisage using normative principles for tariff determination. The use of norms by AERA in the place of detailed examination of individual airport performance is a major change in regulation which was not foreseeable when current privatization took place, and would alter the economic balance of those concessions.

Since each Airport has its own dynamics and challenges, the tariff determination should be on a case to case basis keeping in view specific requirements of an airport. Accordingly, in view of the concession agreement the normative approach should not be applied on MIAL or DIAL. DIAL has provided its detailed response on the normative approach which is attached herewith as **Annexure 1**.

10. Viability of the Airport

The result of the treatment of the issues discussed above is that they will erode the net worth of MIAL and affect its viability. This will in turn affect the operation and management, maintenance and service quality at the CSI Airport.

That under Section 13 (1)(a)(iv) of the AERA Act, 2008, AERA has to take into consideration economic and viable operation of major airports. This is in line with the overarching principles in

the Project Agreements, the Airport Infrastructure Policy, 1997 and the AERA Act, 2008, which is to ensure sustained economic viability.

The Authority has a duty under the statute to ensure economic viability by giving a return on investment for the Major Airports through the tariff, which it would fail to do so with the proposed tariff determination.