

ASSOCIATION OF PRIVATE AIRPORT OPERATORS



APAO/AERA/2017- 18

Dated 1st May 2017

To,

The Chairman

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

Subject: AERA consultation paper no.8 dated 31st March 2017, in the matter of Capping the percentage of Royalty / Revenue Share payable to Airport Operator as a “Pass through” Expenditure for the Independent Service Providers providing Cargo facility, Ground Handling and Supply of Fuel to the Aircraft at Major Airports

Dear Sir,

A kind reference is invited to AERA Consultation Paper no.8 in the matter of capping the percentage of Royalty / Revenue Share payable to Airport Operator as a “Pass Through” expenditure for the Independent Service Providers providing Cargo facility, Ground Handling and Supply of Fuel to the Aircraft at Major Airports issued by the Authority on 31st March 2017 followed by a Stakeholder Consultation Meeting held on 24.04.2017 where in APAO has presented its view points.

At the outset APAO thanks the Authority for considering our request for extension of time for submitting the written comments on the Consultation Paper.

APAO would like to submit the following comments/suggestions on the above consultation paper and requests the Hon. Authority for its favorable consideration.

- 1) The Authority after undergoing elaborate consultation process had issued Orders and Guidelines regarding tariff regulation of Cargo, Ground Handling and Fuel throughput services. In the said regulation notified by AERA it was mentioned that if the quantum of service provided by ISPs at the Major Airport is not material and if material but competitive then the tariff is determined on ‘Light Touch Regulation’. In such a situation fixing a cap for royalty /revenue share by AERA is totally against AERA’s own mandate. A Light Touch Regulation approach cannot have a predetermined cap for royalty.
- 2) Authority in its Order considered the competition as criteria to allow light touch approach for various ISPs across India and because of this the royalty/ license fee today are market driven. As such there should be a soft touch approach for the service and royalty / license fee for ISP business. The consideration of 30% limit is totally arbitrary and not supported by any sound reasoning or justification. The artificial cap on license fee/royalty at 30% will also lead to inefficient price discovery as concession fee determination is dependent on several factors including quantum of Capex investments made, business volumes, prevailing competition etc.



3) It is worth noting that the license fees from ISPs are a key source of revenue for any Airport Operator and these revenues ultimately subsidize airport user charges. Thus, in the event of any reduction in the overall revenue of an Airport Operator due to the implementation of the Authority's proposal, it will lead to higher airport user charges. Also important is the fact that the revenue from these sources have been forecasted by airports based on existing concession terms. Any change in terms with ISPs will lead to actual revenue being lower than revenue forecasted in airport's tariff model. This will lead to worsening the financial position of airport operators. Further, a cap on royalty percentage may not necessarily bring in reduced ground handling rates as this percentage is applied on a range of rates. Hence, if percentage is reduced, market tends to fix the rates at the highest range of rates. If at all a cap on royalty is to be made, then the percentage may be arrived on some rationale basis or on a detailed guidelines. The guideline can inter-alia look into the rates based on the average of the rates prevailing in major airports arrived through open competitive process and not based on an imposed percentage arrived without any scientific/ analytical basis. Further, if the royalty rate is capped at the hands of the Ground handling service providers which will eventually only benefit the airlines. Hence the airlines alone will derive unjust enrichment from the hands of Ground handling operators and airport operators.

4) If the proposal to exclude royalty beyond a certain limit (say 30% of Gross Turnover of Regulated services) were to be implemented, all ISP's paying more than 30% will become loss making. For example an ISP having

- a) Turnover of Rs.500 Crore
- b) Revenue share of 36%
- c) Equity Rs.100 Crore

will incur huge losses as under:

	Rs.in crores
Turnover	500
Revenue Share Paid @36% (contractual obligation)	180
Revenue Share allowed @30%	150
Deficit due to Authority's stand	30
Return on Equity allowed@16%	16
Loss of ISP	14

The above example clearly indicates that how the ISPs would become unviable by adopting the AERA proposed approach

5) The Authority has proposed that the pass-through of royalty will be restricted up to 30% of Gross Turnover of Regulated services. In such a scenario the additional license fee/royalty over and above 30% will not be allowed to be passed-through and would be borne by the ISPs which will make their business model unviable and restrict the overall growth of aviation in India. When the concessionaire for Regulated Services had bid and obtained the contracts there were no such criteria envisaged. The concessionaire had bid for and agreed to pay the current revenue share based on the fact that the same would be allowed as an operating expenditure. Now by changing the ground rules, the ISP will be required to pay the actual revenue share whereas the operating cost thereof, being restricted by the Authority. This proposal if implemented would alter the contractual arrangement based on which the concessionaires bid for these concessions. This will mean that the ISP will get into losses and their business will become unviable. This proposal would also prejudicially impact the concessionaires financial projections based on which concessionaires would have obtained loans from lenders and would lead to poor infrastructure being provided and no funds being available for further expansion. This could also lead to potential litigations by such concessionaires against the airport



operator and likely result in the fall of revenues of the airport operator, thereby affecting their already precarious financial position. This ultimately would result in fall in revenue share to AAI by the PPP airports. Thus, this proposal if implemented would be against a healthy development of aviation sector. This will also be against the very objective of the recent National Civil Aviation Policy (NCAP) related to enhancing ease of doing business through deregulation as well as promotion of entire aviation sector chain.

6) This proposal of Capping Royalty by the Authority is flawed because all ISPs cannot be treated under single category. There are different categories of concessions with varying competition level at different Airports. One such category can be of a concession where entire assets created by the Airports or existing assets belonging to Airport operator are made available to concessionaire resulting into higher revenue share where depreciation and return on RAB is not there in such concessionaire. Hence users may continue to pay lower charges in spite of higher revenue share. Another category can be of a concessionaire, who creates a new cargo facility and in turn will get compensated for RAB and Depreciation. In such cases Revenue share should be lower. Third category can be of Greenfield facility under competition with other facility which is with or without Revenue share to the Airport Operator. In view of the above a general stand by the Authority, considering all categories in the same manner is totally flawed and unjustified. In view of the aforesaid and unique nature of each of such concession, it is necessary that each case is dealt by the Authority individually on its merit.

7) Investments for a regulated utility like Airport sector will continue to be forthcoming only if investors receive a return on their investment commensurate with the perceived risks. Investors are vulnerable to Regulators changing the rules of the game after the investments have been made. In such situations they will be less willing to invest additional funds if they are not certain of the broad rules of the game. This uncertainty will discourage the potential investors in investing in Indian Airport infrastructure. The framework for economic regulation should provide a stable and objective environment enabling all stakeholders to anticipate the context for future decisions and to make long term investment decisions with certainty. Piecemeal, ad hoc or unanticipated changes in regulatory decisions like this are likely to erode investor confidence and increase the overall cost of Airport services. AERA must be consistent in its approach in regulating the ISP business. Setting a cap on Royalty /License fee for a business which is already regulated in the Light touch regime will definitely send the wrong signal to potential investors in this sector.

In view of the above APAO would earnestly request the Hon'ble Authority, not to proceed further with the present proposal. We would request AERA to kindly consider our submissions favorably and would be pleased to provide any additional inputs/ clarification, if required.

Thanks & Regards,

For Association of Private Airport Operators

Satyan Nayar
Secretary General
Mobile: +91 9810049839