ASSOCIATION OF PRIVATE AIRPORT OPERATORS

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Kiran Kumar Grandhi
President

R.K.Jain
Vice President

Satyan Nayar
Secretary General

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APAO/CP-05/AERA/ 2010-11

Date : 15th September 2010

Mr. Sandeep Prakash
Airport Economic Regulatory Authority of India
2nd Floor, Administrative Complex,
Safdarjung Airport, New Delhi

Sub: Response to the Consultation Paper No. 5/2010-11 of AERA on Economic Regulation of Service Provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft.

Dear Sir

A kind reference is invited to AERA Consultation Paper No. 5/2010-11 on Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft dated 2nd August 2010 inviting comments from all the stakeholders.

The comments / suggestions of Association of Private Airport Operators on the various issues highlighted in the AERA Consultation Paper is enclosed herewith for your kind perusal and consideration.

The above comments are framed based on the existing Regulatory framework and we would like to submit that APAO reserves its right to review the stand taken on any of the issues as the Regulatory process evolves.

We look forward to your kind consideration of our submissions on the Consultation paper. We will be more than happy to provide any further information on the above if required by the Authority

Yours Faithfully

For Association of Private Airport Operators

Satyan Nayar
Secretary General, APAO
Mob No + 91 98100 49839

Encl: as above

4th floor, Birla Tower, 25 Barakhamba Road, New Delhi - 110001, India
Tel: +91 11 23766354-56 Fax: +91 11 23766352 Email: apaoindia@gmail.com

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[APAO/CP AERA/05/2010-11]
Consultation Paper -Response

Association of Private Airport Operators

Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft

New Delhi: 15th September, 2010

4th Floor, Birla Tower
25, Barakhamba Road,
New Delhi -110 001

TABLE OF CONTEXT

1 Executive Summary

The Authority's guidelines on tariff determination of cargo, fuel supply and ground handling services, comes in the wake of an era of growth and development of these services. These services are gaining importance in Airport Sector due to their significant contribution in providing quality service. The guidelines encompass the regulatory philosophy, approach and requirement for an independent service provider other than the airport operator providing the services.

Further, the Authority has also stated that a similar regulation for airport operators providing the said services will be issued. Thus, the regulatory approach in case where the airport operator itself is providing these services is still not clear. In order to clearly understand the market dynamics and business viability, the Authority needs to clarify on the regulatory approach to be adopted in case the airport operator is providing these services. This is not made available so far. Hence the benefit of having a meaningful comparison is lost.

1.1 Adherence to the existing Concession Agreements

APAO is of the opinion that the Authority must consider the terms and conditions of the agreements that the Government of India has entered into with private airport operators, while laying the guidelines for any services pertaining to the operation, maintenance and development of the airport. This would also be in line with the provisions of AERA Act which envisages that, these contracts with private airport operator be upheld, as the concessions were provided by the government to encourage inflow of private investment and growth in the sector.

APAO would like to bring to the kind notice of the Authority that the concession agreements for Mumbai International Airport Limited (MIAL) and Delhi International Airport Limited (DIAL), clearly categorizes the cargo services and ground handling as Non Aeronautical service. Fuel throughput fees is also not categoised as aeronautical service under the concession agreement. Further, according to the Concession Agreement for Bangalore International Airport Limited (BIAL) & Hyderabad

International Airport Limited (GHIAL) with the central government, regulated charges does not include charges for cargo facility, ground handling and supply of fuel.

Further AERA under section 5.4 of its Order No.O5/2010-11 in the matter of regulatory philosophy and approach in economic regulation of the services provided for cargo facility, ground handling and supply of fuel to the aircraft at the major airports has stated that the Authority will consider the provisions of the concession agreements. The relevant extract has been reproduced below:

"Airport Operators also highlighted differences in the definition of aeronautical services contemplated in the Act and the absence of such a definition in the concession agreements relating to the IGI airport, New Delhi and CSI airport, Mumbai, particularly in respect of cargo facilities and ground handling. In view of the explicit provisions of the Act, the tariff determination for these services would have to be made as required under Section 13 (1) (a) of the Act. However as noted in the Consultation Paper, the Authority will consider the provisions and the effect of concession agreements for the concerned airports when determining tariffs for airport operators as service provider for the first tariff cycle."

Thus, these services for the referred airports should be out of the ambit of these guidelines.

1.2 Proposed price cap approach is not suitable for the said services

While proposing the price cap regulation, Authority has followed a cost plus approach which was designed for network businesses like electricity and gas distribution, where there is incremental capital expenditure and marginal / variable cost is very low. Hence, the capital expenditure based return was appropriate for such sectors/ industries. This mechanism has been extended to other capital intensive sectors like power generation, ports and airports despite of the fact that the marginal / variable cost in these sectors are relatively higher. The implementation of the proposed regulation in such sectors has proved that this form of regulation is not the most appropriate form of regulation for these sectors and hence the

regulators have moved towards a more market driven regulatory approach.

The cargo, ground handling and fuel supply services have a lower incremental capital expenditure, larger marginal / variable cost component and are more service oriented. Thus, APAO strongly feels that the proposed regulation will not be most suitable for the said services.

1.3 Practical issues in implementation of the regulatory approach impacts feasibility of the business

In case of existence of multiple players for the said services, separate price cap for each of the players could arise purely out of accounting issues (lease vs. owned) and timing of investments. For example, a service provider might prefer to build the asset while another might prefer to lease the same asset, so the cost of the asset would be under capital expenditure in former case and under operating expenditure in the later case, leading to difference in cost structure.

Further, the timing of operation for each player will also drive the competitiveness of their price caps. Each player will be driven by two types of price cap i.e. price determined by the regulator (regulatory cap) and price determined by competition in the market (competition cap), which might lead to practical difficulties for the business economics. For e.g. a new entrants will have higher regulatory price cap based on its cost structure but competition in the market will lead them towards lower prices, thereby affecting their returns and impacting on the business viability.

1.4 Alternate forms of regulation should be evaluated and the proposed regulation should be used in the rarest of the rare cases

Considering the nature of these services, APAO feels that the alternate forms of regulations should be explored for these services. The decision for applying the form of regulation should be arrived at after giving due consideration to existence of market competitive forces and likely abuse of monopolistic power by a dominant player. Further, though the Act mandates determination of tariff, it does not prohibit the Authority to

adopt light touch regulation. It is a well considered opinion in all the Regulatory environments that light touch regulation is also one of the most effective ways of tariff regulation and encouraging competition. Few of the alternate forms of regulations are tabulated below:

Performance based regulation	Benchmark Regulation	Competition for the market	Trigger Regulation	Self Regulation in a Competitive Market
Intrusive ----------> Light handed				
• The tariffs are fixed on the basis of a detailed study of each of the service provider's cost and revenue streams. • There is a fair rate of return assured to the service provider either on the cost incurred or on the revenues being generated.	• There is only one regulated service provider. • Users are free to choose between the regulated service provider or any other service provider.	• There are significant entry barriers to the market and thus to enter a service provider faces huge competition ensuring competitive tariffs. • The regulator can oversee that the service provider and entry to the market can only be through a competitive bidding process.	• The market sets its own tariffs and the regulator intrudes only if there is any evidence of exploitation of market power.	• Competitors in the market keep the prices at an optimum range and there is very little need of regulation. • The regulator only keeps a check on the tariffs by ensuring sufficient competition in the market • Forbearance era

APAO requests the Authority to examine the various forms of regulations before finalising on a more intrusive regulation like the proposed cost plus regulation.

Further, APAO would like to reiterate that the light handed form of regulation might be most suitable for the said services as such regulations are designed to encourage investments that are exposed to market risks. Typically, it is seen in sunrise industries, where investors face significant demand risks, with competing alternatives and substitutes, and where

consumers have a high degree of bargaining power. A flexible light-handed regulation is able to absorb the external shocks that may plague the industry, and allow for the market forces to play out to equilibrium.

However, in cases where the Authority feels that the proposed regulation is the most suitable, our suggestion for improvement of the same has been detailed in the subsequent sections.

Specific Comments on Draft Regulations

Association of Private Airport Operators (APAO) welcomes the approach taken by AERA ("Authority") in devising this consultation paper on Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft and providing opportunities for the stakeholders to respond to the AERA's proposed approach in tariff determination.

APAO would like to make following suggestions/ observations on the proposed regulations:

2 General

2.1 The proposed regulations exclude the airport operators from its ambit:

'The Order lays down the regulatory philosophy and approach wherever aforesaid services are provided by the independent service providers. The Authority will set out its approach for airport operators, in respect of such services separately'.

APAO would like to state that absolute understanding of the regulatory philosophy and its likely impact on all the stakeholders can only come once the regulatory philosophy and approach for airport operators has been defined. Ideally, the regulations should cover all the stakeholders to ensure level playing field and reduce any uncertainty on account of different regulations for different players. In addition the benefit of a meaningful comparison between both of the approaches is lost.

2.2 The consultation paper is silent on issues pertaining to the implementation of new ground handling policy, which is awaiting

implementation. Changes in implementation or structure of such policies would lead to change in business plans and hence tariff requirements within a specified period. APAO would like to submit that any revisions or new regulations / policies / guidelines issued for any of the regulated services should trigger a review of the tariff guidelines in order to accommodate any changes caused.

2.3 The proposed Regulations do not provide the desired regulatory certainty in certain situations and has provisions for discretionary powers (e.g. Clause 5.1, Clause 8.2). APAO would like to submit that such discretionary clauses should be avoided as they greatly hinder in the process of providing a clear and unambiguous outlook to the regulatory structure.

2.4 Definition of "Service Provider" as per AERA Act Section 2 (n) defines that "Service Provider" means any person who provides Aeronautical services and is eligible to levy and charge user development fees from the embarking passengers at any airport and includes the Authority which manages the Airport.

By strict interpretation of this definition " the independent service providers" who are providing the service of Cargo facility, Ground Handling and Fuel supply but are not eligible to levy and charge user development fees do not fall within the scope of definition of service providers. We would request AERA to examine and clarify this aspect whether the services provided by them can be regulated under the existing provision of AERA Act before taking a final decision in the matter.

2.5 The Authority has mentioned that while calculating the Aggregate Revenue Requirement (ARR) for a control period it would treat any access fee related to Cargo Operators, Ground Handling Operators and Fuel Farm operators / Fuel Access providers for calculation of ARR. Under this approach all revenues from such services will be included as part of yield per passenger cap and would be subject to regulation. In this connection APAO wish to submit that in spite of concession agreement mentioning these revenues as Non Aeronautical the treatment proposed by AERA for consideration of these revenue streams for ARR calculation would result

into great financial risk to the Airport operators and may become the operation non viable. APAO request that these streams of revenue should not be taken into account for the purpose of ARR calculations of the Airport operators.

3 Existing Concession Agreements

3.1 APAO would like to reiterate its principled stand on ensuring sanctity of the existing agreements namely OMDA/ Concession agreements signed with the Central government. APAO would like to submit that the charges from the cargo services, ground handling services and the fuel throughput charges are amongst the most important sources of non-aero revenue that the operators plan to generate. Thus it would be detrimental to the airport operators if these charges are put in the regulated till. Also it would go against the spirit of the agreement signed by the airport operators and the Central government. This will also send wrong signal to potential investors in India's Airport Infrastructure.

3.2 It may be noted that many of the airport operators have entered into agreements with the service providers at their respective airports, based on the provisions of the concession agreements. Accordingly these service providers have already made investments and initiated operations. A post-facto imposition of regulation will lead to a variation of the business assumptions of the service providers, and increase uncertainties and risks for all stakeholders, including the airport operators. These existing contracts should be grand fathered for application of these regulations.

3.3 Further, the Act provides for the Authority under section 13 (a) (vi) to take into consideration "the concession offered by the Central government in any agreement or memorandum of understanding or otherwise".

3.4 The OMDA agreements of MIAL and DIAL clearly lays down cargo facility, ground handling as non-aero services. The Authority in section 13 (a) is only mandated to regulate the aeronautical services. As cargo and Ground Handling is listed as a non-aeronautical service, as per the concession to DIAL and MIAL, the Authority should uphold the agreement and refrain

from regulating cargo and Ground Handling at DIAL and MIAL. Also, it is pertinent to mention that Fuel throughput fees is also not categorized as Aeronautical service under the Concession Agreement.

3.5 According to the Concession Agreement for Bangalore International Airport Limited (BIAL) & Hyderabad International Airport Limited (GHIAL) with the central government, "Airport Charges means:

"(i) amounts charged or imposed by BIAL/GHIAL in respect of the provision or use of the facilities and services which are included within Airport Activities;

(ii) amounts charged or imposed by BIAL/GHIAL on or in respect of passenger and cargo movement or aircraft traffic into, on, at or from the Airport; and

(iii) any other amounts deemed by this Agreement to be Airport Charges and further including any amounts to be collected by BIAL/GHIAL on behalf of GoI, GoK/GoAP or AAI."

Further, according to Schedule 6 of the Agreement (Regulated charges section), it is clear that charges for cargo facility, ground handling and supply of fuel do not form a part of the "Regulated Charges".

As per Article 10.3 of the Concession Agreement allows BIAL/GHIAL to determine "Other Charges" at the airport without any restrictions for facilities other than which the Regulatory Charges are levied. Thus, BIAL/GHIAL should be free to determine and levy the charges related to cargo facility, ground handling and supply of fuel as they are not covered within the definition of "Regulated Charges".

APAO requests the Authority to consider the Concession agreements and keep cargo, Ground Handling and fuel farm beyond the ambit of its regulation for BIAL and GHIAL.

4 Definition

4.1 The tariff guideline does not clearly lay down the definition of the fuel service provider, the services that would be under the ambit of the

regulation and the charges that it intends to regulate. APAO's understanding of the fuel supply services is limited to the services involving supply of fuel directly into the aircrafts. APAO would like to request the Authority to provide clarification on the same.

5 Materiality Assessment

5.1 The Indian air cargo industry is nascent and fast growing as compared to International air cargo industry. The volume of cargo in Delhi and Mumbai airports combined is 2.16% of the total air cargo of the leading 50 airports across the globe *(Source: ICAO)*. The air cargo industry has witnessed a growth of around 24% in domestic cargo and 11% in international cargo during the last year compared to the global cargo industry which has grown at a mere 2.8% growth in domestic cargo and 2.4% growth in international cargo *(Source: AAI Traffic Tracker)*. Also, the Indian share in the global airfreight operations was a mere 0.72% in the year 2008 in terms of value *(Source: Data monitor Report)*, thus hinting at immense growth potential.

5.2 The fuel materiality index defined for fuelling does not take into account the element of discretion in usage, as it is not just the number of aircrafts that determine the fuel off-take, but is also impacted by the local taxes/ state government levies. A more suitable measure of materiality would be the number of aircrafts actually refueling at a particular airport.

5.3 Further, the air cargo services at major airports are likely to face competition from Cargo Hubs which are being developed across the country and the Cargo materiality index calculation should account for the volumes from these cargo hubs.

5.4 AERA in its tariff guidelines has prescribed threshold level of 2.5% for cargo and 5% each for fuel & ground handling services but not provided any reason/ benchmarks for the suggested limits. Considering the nascent stage of the industry for these services, APAO would like to request the Authority to increase the threshold for materiality up to 10% for Cargo, Ground Handling and Fuel Services. India's share in world trade is

approximately 1.6% of the total trade value out of which the value of air cargo movement is less than 2%. Hence the threshold of 2.5% for cargo is not appropriate. Further comparing to the Cargo volume of major airports of the world, the cargo volume of an Indian Airport is approximately 1/10th of the average business of the world's leading Airports. While deciding the materiality, India's share in the international trade may also be taken into account.

5.5 Moreover, APAO would like to suggest that a light handed approach for these services would be appropriate form of regulation at this stage.

6 Competition Assessment

6.1 Section 5.1 of the Consultation paper (Page 10 of 85) provides that

"Where a Regulated Service is being provided at a major airport by three or more Service provider(s), it shall be deemed as „competitive at that airport. If a Regulated Service is provided by two or less Service Provider(s), it shall be deemed to be "not competitive"

The Competition Act of India (U/S 4) has identified the following factors that may be considered while assessing whether a company enjoys a dominant position in the market or not:

- Market share of the enterprise;
- Size and resources of the enterprise;
- Size and importance of the competitors;
- Economic power of the enterprise including commercial advantages over competitors;
- Vertical integration of the enterprises or sale or service network of such enterprises;
- Dependence of consumers on the enterprise;
- Monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;

- Entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;
- Countervailing buying power;
- Market structure and size of market;
- Social obligations and social costs;
- Relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;
- Any other factor which the Commission may consider relevant for the inquiry

6.2 Further CAA in UK is conducting a consultation process to assess competition in the airports. In the report on "Market Definition of Airports" by David Starkie and George Yarrow presented during its consultation process, the following factors were identified for assessing competition:

- Competition from existing supplier within defined market.
- Competition from existing supplier providing substantial product defined to lie outside the market.
- Threat of new entrant
- Market power of buyers
- Market power of input supplier

6.3 As exemplified by the definition of market power in the national and international domain, the measure of competition in a market cannot be simply deduced from the number of players in that market. In its endeavor to protect the abuse of market power by the service providers, the Authority needs to take in consideration other factors such as those highlighted above.

6.4 Further as stated above, the Authority also needs to consider the significant impact on competition in the cargo market from the coming up of the new cargo hubs such as Nagpur and Asansol as well as airports coming up in SEZ regions, which can provide direct competition to the cargo being handled by major airports. The Authority also needs to clarify if the air cargo facilities coming up in such cargo hubs would be regulated by the Authority, as the definition of a major airport, which are in the ambit of regulation by the Authority, is based only on passenger traffic and not the cargo volumes.

6.5 APAO would like to bring to the kind notice of the Authority that in the consultation paper on *"Regulatory Philosophy and Approach in Economic Regulation of Airports and Air Navigation "Facilities"*, dated 26th February 2010, under section 2.13 the Authority noted:

"Consistent with the Authority's overall regulatory approach outlined above with respect to regulation of tariff / end user charges for cargo facilities, ground handling services and fuel farm / access facilities, the Authority proposes to presume a degree of competition wherever ***two or more*** *cargo facilities are operational at airports. In such cases, the Authority proposes to approve tariffs based on submissions with respect to* ***broad level justification*** *by the operators."*

APAO agrees with the assessment made in the above text that competition would be adequate with their being two service providers at an airport as the condition of monopoly has been clearly defined as presence of single player in the market. Also, the Authority may clarify the

rationale behind the change in its stance over the issue of competition assessment.

6.6 Further, the OMDA for Delhi & Mumbai Airports provides for:

"Without prejudice to the generality of the other provisions hereof, the JVC shall ensure that, within six (6) months from Effective Date, ***at least two unrelated (non-Group) Entities*** *(of which one may be the JVC) are responsible for provision of cargo handling services at the Airport so as not to create a monopoly, or monopolistic arrangements and one sub-contractor is not unfairly discriminated against in comparison with any another sub-contractor. Until such time this arrangement for cargo handling services is put in place, JVC shall ensure that the then applicable charges for cargo as levied by AAI shall be charged at the Airport."*

Thus the OMDA of DIAL and MIAL also envisages adequate competition with two service providers.

6.7 It may be noted that many of the airport operators have entered into agreements with the service providers at their respective airports, not to let any other player in the market until a certain volume of cargo handled at the airport is reached, to protect the economic viability for the service provider in the market. Further, the number of service providers constituting competition needs to be viewed from a business viability perspective. The volumes in some of the airports may not be sufficient to support multiple players while competitive market could exist from user standpoint.

6.8 In the International context, European Union directives on ground handling allow airports with more than 3 million passengers to limit the number of service providers to no less than 2 players, implying that two service providers would provide enough competition to each other.

6.9 Also in its consultation paper on "Regulatory Philosophy and Approach in Economic Regulation of Airports and Air Navigation Facilities", dated 26th February 2010, under section the Authority noted:

"Under the overall approach enunciated earlier in this Part, given the competitive environment that currently exists for ground handling, the

Authority would not expect to set tariffs / end user charges for ground handling, unless there is clear evidence provided by users that there is ineffective competition. The Authority will, instead, expect ground handling agencies to submit prices for approval."

APAO would like to point out that, as noted by the Authority above there does exist a competitive environment for ground handling and thus it should not be regulated under a price cap regulation.

6.10 Thus, competition has to be measured in terms of market power of the players involved, in terms of the various factors identified by the Competition Act and also their relevance to the business of the services, rather than by defining the number of players for deciding whether the market is competitive or not.

6.11 APAO also suggests that AERA may assess the market power based on a two stage analysis i.e. in the first stage the competitiveness is measured based on the market share of the service provider being high or low (a measurable parameter has to be decided upfront) and in the second stage the reason of high market share is analyzed to check whether the same is due to certain anti-competitive measure adopted by the service provider. AERA may undertake detailed scrutiny in case it is found that the service provider is sustaining such high market share due to some anti-competitive measures adopted by it.

7 Form of Regulation

7.1 AERA in its consultation paper has stated that price cap regulation shall be applicable in case of services that are 'material' but there is 'insufficient competition' in provision of the services at a major airport. Whereas in case of service that are 'not material' and services that are 'material' and there is 'sufficient competition' in provision of the services at a major airport, light touch regulation shall be applicable.

However, APAO would also like to highlight the following issues that may arise in case of two players being governed by cost plus regulation:

- Two service providers within the same airport may have different service levels, cost structures, market share forecasts. A cost-plus-return approach would result in different tariffs for the two service providers. This can lead to the service provider with a larger share of the market become more dominant and the other; because of differential price capping get even lesser market share.
- If the infrastructure for a particular service is shared between the two competitors with one leasing it out to the other, under the price cap regime, this may lead to the lesser to charge an exorbitant amount to force the other to duplicate existing infrastructure and thus leading to gross inefficiencies in the system. e.g. storage space being shared between multiple cargo service providers
- Since the rate of return is linked to the capital investment, both the competitors may only focus on a part of the market where the capacity requirement is high and thus there is need of capital investment. This will lead to neglect of the other part of the market where capital investments and volumes are low. This would also lead to duplication of infrastructure because of higher focus in a part of the market.
- If there are two competing operators, both being given a bare minimum rate of return, and revenues limited through price cap, they will lose the flexibility needed to make business decisions in a competitive market, such as giving competitive discounts to users with higher business volumes.
- The competitive advantage would be lost when the service providers have to file for tariff every year, making public certain critical business information to the other competitor.

Hence, it merits considering other regulatory approaches before coming to the conclusion that the cost-plus-return approach is the best option.

7.2 In case of light touch regulation as envisaged by AERA in the tariff consultation paper, may be re-looked into considering the following:

- The form of Light Touch Regulation envisaged by AERA is not in line with national and international practices of light touch regulation. Annual tariff determination may be avoided and the regulator should have the right to intervene only in case of complaints and evidence of abuse of market power.

- Light Touch approach needs to be clarified as to how the user consultation process is going to be followed. The information sought by the authority should also be considered from competitive business perspective and Authority should ensure that the details sought should be restricted to the least possible so as to avoid any adverse impact on the competitive advantage of a particular player. Also the authority should prevent further discussion and analysis on the tariffs after the user consultation.
- Typical cost includes revenue share to the airport operator and should be included in the operating cost for the service provider

7.3 Due consideration needs to be given to the fact that the Authority will be required to govern large number of players, and an elaborate process would lead to the enormous efforts from regulators end and high regulatory overheads.

7.4 Although the Act envisages regulation of the services underlined under Aero services, the Authority can also forebear the right to regulate if it feels that a particular service or service provider is not abusing market power. For example, in India, Telecom Regulatory Authority (TRAI), a regulator in the telecom sector appointed by the TRAI Act of 1997, has amongst its functions listed under section 11 (2):

"Notwithstanding anything contained in the Indian Telegraph Act, 1885, the Authority may, from time to time, by order, notify in the Official Gazette the rates at which the telecommunication services within India and outside India shall be provided under this Act including the rates at which messages shall be transmitted to any country outside India;"

This clause gives TRAI clear mandate to regulate tariffs for all the services under its purview. In its Telecommunication Tariff Order 1999, TRAI let some charges be unregulated under the 'Forbearance' clause defined in the section 2 (g) of the order as:

""Forbearance" denotes that the Authority has not, for the time being, notified any tariff for a particular telecommunication service and the service provider is free to fix any tariff for such service."

TRAI does not regulate a large range of service charges although it had a clear mandate to do so. Also, the service provider is not required to file for any approval of tariff to TRAI, it only has to notify TRAI within 7 days about any new tariff / changes in the existing tariffs. TRAI has, in its subsequent amendments to the tariff order, increased the number of services under forebears after it observed that there was adequate competition in the market.

The Authority can also forebear the right to regulate the service charges where it does not observe any regulation necessary, and can even do away with the light touch regulation. This will reduce the regulatory costs and ultimately lead to user benefit.

7.5 APAO feels that the "form of regulation" needs to be largely Light Touch regulation. APAO also suggests that AERA may look in to the merits of regulating the service providers based on benchmarking approach wherein the tariffs of all service providers for a particular service is benchmarked and a band for acceptable tariff is defined. AERA may however intervene and conduct a detail review of a service provider in case of variation beyond the defined band of tariffs or clear evidence of market power abuse or in case of no consensus between the stakeholders during the user consultation process.

7.6 Internationally there are not many examples available where Cargo Facility, Ground Handling and Fuel supply to Aircraft etc are kept within the regulatory purview. Hence, in growing sector like India the emphasis should be on increasing competition for these services rather than imposing intrusive regulatory regime which will discourage investment in this sector.

8 Efficiency and quality of service

8.1 Achievement of service quality parameters (especially with regards to factors like availability etc) may require the operator to build in redundancies in their investment and operational deployment as well as increase the risks. This would inevitably result in greater costs than would

normally have been deemed efficient, if determined independently and without considering these subjective metrics. Therefore it will not be appropriate for AERA to independently determine upfront target efficiencies for the airport service provider in a "CPI – X" formula.

8.2 Under clause 3(g) and 3(h) of the preamble of the consultation paper, AERA has recognized the fact that performance / quality of service levels expected of the service providers are covered under the service level agreement. Thus it is important that AERA looks in to the capital expenditure plan of a service provider in conjunction with the performance / quality of service level already specified in the agreements, so that the approved capital expenditure aids them in meeting the required service levels.

8.3 Further under Section 9.6 (Page 29 of 85) AERA has defined a targeted efficiency factor which will be used to adjust the yield per unit for future years:

The Authority shall review the forecast of changes in WPI as submitted by the Service Provider and shall determine the Yield per Unit for the second Tariff Year onwards using the following formula:

Yt = Yt-1 * (1+WPIt – Xt)

where:

Yt-1 is the Yield per Unit for the Tariff Year preceding Tariff Year t and for the first Tariff Year shall be determined by the Authority in Multi Year Tariff Order (in accordance with Clause 9.3);

WPIt is the forecast of change in WPI for Tariff Year t as determined by the Authority;

Xt is determined by the Authority for Tariff Year t in the Multi Year Tariff Order.

Explanation: Xt is a term which shall be determined, by the Authority, separately for each Tariff Year t in the Multi Year Tariff Order, and

represents an underlying rate reduction in the Yield per Unit (or rate of increase in the event is negative) is expressed as a percentage such that 10% is interpreted in formulae as the decimal number 0.1.

The Authority will set the value of X taking into consideration number of factors as indicated in Clause 9.3.

APAO would like to emphasize that the X factor is purely a mathematical outcome of the equations, since all efficiency improvements have already been factored into the cost projections. There should be no further subjective determination of X, since that would lead to double counting. AERA should clearly demonstrate rationale and calculation of the X factor.

The indicated efficiency target is more suited for a utility industry, rather than Airport where the softer aspects of service quality needs to be addressed.

Also, the calculation of Y_t for the first year, by the Authority, on the basis of some subjective factors (listed under section 9.3) is not justified as it may severely affect the tariffs for the first year and subsequent years after that.

9 Building Blocks of ARR

9.1 In the tariff guideline AERA has specified the building blocks for ARR and has also detailed out on the same. APAO would like to put in the following issues regarding the components of the building blocks:

Typical cost for the service provider includes revenue share to the airport operator and it should be included in the operating cost for the service provider.

The paper only talks about the corporate tax on profits from assets and services. Clarity needed on the issue of whether cess and surcharge on taxes and dividend distribution tax are included in the tax structure.

Effect of variation in foreign exchange rates is not underlined and it is proposed that it be a pass through cost

The WIP should be carried at WACC instead of cost of debt.

- In Sec 8.2.4 (b) *"Evidence that investment was made in accordance with the capital investment plan duly approved by the competent authority"*. Clarity needed as to who the competent authority is in this case. It would not be valid for service providers who have signed the contracts with airport operators.
- In section 8.2.6 (c) of the consultation paper, the disposed assets are defined as: *"Disposals: Represents the higher of the proceeds or fair market value in respect of forecast disposals or deemed disposals (transfers out of the RAB) for Tariff Year t."* Clarification on the deemed disposal clause is needed. Further, the necessity of arriving at a fair market price for every asset being disposed should not be needed if there is actual data for disposal.
- Other infrastructure requirements for cargo such as cold storage might be common to many service providers and thus needs to be clarified as to which header cost of such specialized infrastructure would be considered under.
- Financing Allowance, as defined in Sec 8.2.7 (a) should be WACC instead of being considered in the cost of debt (Rd).

9.2 Sec. 8.2.1 of the draft regulations mentions that:

"The assets that substantially provide services not related to or not normally provided as part of Regulated Service(s) may be excluded from the scope of RAB by the Authority, in its discretion."

At the same time Section 7.2 states that the aggregate revenue for regulated service(s) will be calculated based on (among other things), *"Revenues from services other than Regulated Service(s) (NAR)"*.

The above two positions taken by Authority will result into double impact while arriving at ARR as the assets are not being considered in the RAB, the revenues being generated from the non regulated revenues are being used to offset the revenue requirement. The Authority hence needs to correct the method of calculation of the ARR in order to avoid this double counting.

9.3 APAO would like to reiterate its principled stand of opposing any cross-subsidization in the aspect of airport regulation. Further, it is to be noted that autonomous service providers providing Cargo, Fuel Facilities and Ground Handling services would have little or no scope for generation of revenues from outside their core areas of operation. Further, in case Indian Oil Corporation (IOC) is a service provider, Authority will have to consider the other revenues of IOC as per this provision which is inappropriate.

10 Annual Tariff Proposal

10.1 The basic objective of bringing in a multi-year tariff regime is to bring in larger regulatory certainty for the stakeholders. The yearly review and correction is not as per the spirit of the MYT regime. Further, keeping in mind the fact that the traffic and cost estimate for cargo and ground handling are highly volatile, it would be better for the Authority to allow the dynamics of the business to handle the volatility for a longer period, and allow the correction factors to manifest at the end of the review period. This would make tariff designing more predictable and less complex.

10.2 Thus APAO would like to propose that AERA may consider limiting the number of reviews and may have one at the end of the control period, to cumulatively decide on tariff adjustments based on the under/over-recovery of the previous years. However for the first control period, AERA may consider a 2 stage review process as MYT is being implemented for the first time in the sector i.e. one at the end of 3rd year and one at the end of control period, to cumulatively decide on tariff adjustments based on the under/over-recovery of the previous years.

10.3 In the case where the contract period for a service provider ends within a tariff control period, there would be an issue with the under-recovery/over-recovery adjustments as there is a two year lag between the timing of occurrence of the actual costs and recovery of the same. In such a case, the service provider's revenues for the last two years of the contract would not be adjusted and would lead to irregularities in the

system, leading to either overcharging the users or being detrimental to the service provider. The Authority thus needs to specify how it would adjust the revenues in such a case.

10.4 The demand variation band needs to be same for all and should be specified by the Authority to maintain a transparent and open process. It should not be a source for judgmental risk adjustments on the part of the service provider.

10.5 The commercial sensitivity of the data provided, particularly where there is competition and light touch approach is applied, should be kept in mind.

10.6 As the Authority seeks the tariffs to be approved on yearly basis, the service provider would plan on a shorter horizon, limiting its liabilities and risks significantly. This would lead to slow growth in service quality levels.

11 Requirement of a business plan

11.1 The tenure of the agreements of service providers other than cargo service providers are for a limited period. Further, it should further be noted that the policy changes on Ground Handling are yet to be implemented. In the absence of business clarity, in an industry where the regulatory set up is just being developed, it would be difficult for the service providers to develop a business plan for such a long horizon.

11.2 Further the MYT proposal may be modified by AERA based on its judgment on efficient cost and thus the reconciliation between the business plan and the MYT order might be difficult.

11.3 A clarification needs to be sought from AERA whether the said business plan is one time requirement or has to be updated on a rolling basis.

12 Need for a clear exit clause for regulation

12.1 APAO would bring the attention of the Authority to the fact that the contracts of the service providers with the airports and the users are for

varying durations ranging from 5 to 20 years. This would raise multiple challenges for the service provider because of the following reasons:

In the event of a new player entering the fray in an airport, or when an incumbent player exits the fray within a given control period, the demand and forecast assumptions by the remaining players will be subject to substantial shocks, that may not be sustained till the end of the tariff review period. This could be avoided by triggering an immediate tariff review at the option of the service providers.

Further, in the event that the competition clause of the service provider is fulfilled within the tariff control period by entry of more players (by appointment of the airport or by policy changes), continuing tariff regulations for the existing players will render them unable to respond to the new signals. A trigger for a review of the tariff regime to remove regulations should be considered as soon as such an event happens.

12.2 The Authority should thus clearly specify these exit clauses within the control period, as also to clarify on the events that would trigger a review of the tariff process.

13 Asset Base Calculation

13.1 In section 8.2.4 (b) of the consultation paper, the original cost of assets has been defined as follows:

"The original cost of fixed assets as indicated in the last audited accounts, (excluding any re-valuation other than adjustments for impairment or such other adjustments that the Authority may consider appropriate) shall be included in the scope of the RAB"

APAO submits that AERA should clarify the meaning of "revaluation of existing assets". Due to the advent of new accounting standards, including IFRS, service providers will be required to re-compute their existing books, which may involve a substantial revaluation of the assets. AERA should clarify on the extent to which such revaluation will be considered

in the regulatory asset, as against the historic cost approach, that may be available based on asset investment records.

Service provider may have to incur costs for creating assets for other (affected) stakeholders at airport in order to develop infrastructure. Such assets may not appear in the audited accounts of the service provider as the ownership is with the other affected stakeholders. However, Authority will have to consider such expenditure for the purpose of calculation of RAB of such Service Provider.

Finally we wish to submit that the observation made by the Authority in the *"Regulatory Philosophy and Approach in Economic Regulation of Airport and Air Navigation Services"* is relevant here for deciding the regulatory approach for regulating services of Cargo facility, Ground Handling and Supply of Fuel to the Aircraft, the Authority has observed that:

- *The Authority also believes that the potential benefits from giving airports the flexibility in setting tariffs, in detail, under an aggregate price cap are likely to exceed the potential for a detriment.*
- *Elsewhere, the cost of tariff regulation could outweigh the benefits and the Authority would not seek to intrusively regulate tariffs and would only approve annual tariffs.*
- *A number of academic commentators have argued that the intrusive process of regulation itself creates distortions that can be worse than the effects of monopoly abuse and that light touch regulatory approaches can deliver better performing sectors than formal price control.*

From the above it is clear that Light Hand Regulation is the most suitable Regulatory approach for the Cargo, Ground Handling and Fuel Services.

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