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Mr Sandeep Prakash
Secretary
Airports Economic Regulatory Authority of India
AERA Building
Administrative Complex
Safdarjung Airport
New Delhi 110003

Dated 15th September, 2010

Subject: Submission of response on Consultation Paper No 05/2010-11

SM (CABS)

PWC

Dear Sir,

This is with reference to Consultation Paper No 05/2010-11 on Economic Regulation of Services provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft, issued by AERA.

At the outset, we would like to thank AERA for giving us the opportunity for participating in the development and evolution of the Indian airport sector's regulatory policy.

According to us the above Consultation Paper is deviating from and is detrimental to the OMDA, which had been the basis for private investors to enter the sector. The gist of our submission is that:

1. We were selected after an international bidding process and there are inbuilt clauses in our Concession Agreement to prevent any exploitation of market situation. The partners joined hands to create modern & efficient airport facilities, compared to earlier service providers. The tariff control regulation approach by AERA is a fundamental change in the economic environment, and this move is a clear shift from free market situation to a complex regulated one
2. It will not be financially viable to have three or more service providers for cargo service in every airport due to varying market and investment considerations. More players for the sake of competition shall create redundant capacity, which will make it impossible for any handler to have positive returns, thus making them sick. The past and current volumes do not justify more than two service providers given the level of investment associated with such operations
3. The airport cargo service is a Business to Business (B2B) business, where we do not deal directly with public consumers, and so cannot charge any price desired. Our customers, being airlines and customs agents, have strong bargaining power, and do tough negotiations to arrive at demanding service level agreements for the price they pay. Airlines usually sign annual agreements, which get renewed after fresh negotiations, again based on prevalent market scenario

4. According to us, the price fixation would happen through market forces, with two service providers competing with each other. And customers would move to other operator (or airport) if they are over-charged or get bad service
5. At this nascent stage of infrastructure development, it is best to take out the cargo facility and cargo services from regulatory purview. If at all deemed necessary in certain airports (on a case to case basis), the Light Touch approach may be used in such airports for such services, but it must not apply to all airports blindly
6. Such approach may be based on benchmarking process wherein the tariffs of all service providers for a particular service is benchmarked and a band for acceptable tariff is defined. And the band would have variations considering Quality, Scope & Efficiency of the Services provided. Alternatively, the current AAI rates, duly adjusted for inflation, can become the Benchmark Rates.

Our sector being self-regulated, and with two cargo operators, competitive enough with inherent checks and balances, and so does not require complicated price regulation. By adopting the above approach, AERA would truly usher into India, the best practices from the progressive economies worldwide, which will be welcomed by all.

We have provided our detailed comments and submission in the enclosed document, for the kind and favourable consideration by AERA.

Thanking you

Sincerely yours

For Celebi Delhi Cargo Terminal Management India Pvt Ltd


(Authorised Signatory)




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**CELEBI DELHI CARGO TERMINAL MANAGEMENT
INDIA PVT LIMITED'S**

response to the

Consultation Paper No 5/2010-11 issued by

**AIRPORTS ECONOMIC REGULATORY AUTHORITY
OF INDIA**

for

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

15 September 2010



Celebi Delhi Cargo Terminal Management India Pvt Ltd (“CDCTMIPL.”) welcomes the initiative of AERA (“Authority”) in formulating the policy in a collaborative manner.

Earlier the Authority had issued a White Paper on “Regulatory Objectives and Philosophy in Economic Regulation of Airports and Air Navigation Services” on December 22, 2009, and the Airport Operator had invited feedback from us. The gist of CDCTMIPL.’s earlier response to AERA dated 4th January 2010 is given below --

1. As per ministry of civil aviation, Policy on Airport Infrastructure

1.1. Except for user developmental fees, there will be total freedom for airport operators in the matter of raising revenue through non-aeronautical charges. The thrust of the Policy is to earn revenue from non-aeronautical sources which would be utilised for development of airport infrastructure so as to bring the Indian airports at par with international airports.

1.2. Under the concession agreements of Delhi (and Mumbai), cargo is treated as non-aeronautical. Regulation of cargo will discourage the participation of the private sector which is one of the objectives of Civil Aviation Policy. In fact, the Policy recognises that private participation (including foreign participation) is a must for both raising resources as well as bringing greater efficiency and hence the spirit would be defeated by bringing such cargo services under the ambit of the regulator.

2. Service Quality received from Airport Operators

2.1. Cargo business, to be successful, requires (i) competitive prices and (ii) high levels of service quality i.e. providing lower turnaround times and on-time delivery to customers.

2.2. We feel that the Airport Operator may be adversely impacted by the Regulatory process due to adverse modifications in terms and conditions agreed upon by the Airport Operators in the Concession Agreements signed.

2.3. Airport Operators must be motivated to improve on their service levels on an ongoing basis. This will encourage them to build high quality non aeronautical assets and futuristic airport facility, which will attract more airlines and cargo.

3. Competition in Cargo business

3.1. **Competing Opportunities** – Each Airport has cargo operations and customers have the flexibility to shift operations to a different airport if an airport is charging more for cargo services. The competition among cargo operations are expected to stimulate competition among airport hubs in attracting container cargo bound to and from India and helps in boosting the Indian economy.

3.2. **Competition from other transport sectors** – Airports do not enjoy natural monopoly in transporting cargo as they face competition from other transport modes like Sea ports. With the increasing port capacity in the country and de-bottlenecking of ports, Sea ports would emerge as significant competitors to Airports. Domestically, both rail and road sectors offer formidable



competition to Air cargo operators.

3.3. **Greater competition in the cargo handling** business will improve the quality of service and bring down prices. Hence from a regulatory perspective it is more important to ensure high service quality levels for cargo operators rather than competitive prices as they would be the natural outcome of competition among airports and competition from other sectors.

4. AERA Act and Concession Agreements

4.1. Under AERA Act both cargo facilities and cargo handling services are included in aeronautical services. However under the concession agreements of Delhi and Mumbai, these are treated as non-aeronautical. When we executed our agreements, it was presumed that cargo will be out of the purview of regulation. Regulation of cargo will discourage the participation of the private sector which is goes against the objectives of Civil Aviation Policy.

4.2. Moreover, the principles of regulation in concession agreements mentions that price regulation should only occur in areas where monopoly power is exercised and not where a competitive or contestable market operates and so should apply only to aeronautical services.

4.3. The White Paper rightly highlights the policy framework that facilitates competition in ground handling and cargo operations. Hence the White Paper rightly observes "economic regulation may or may not be required to mimic competition". With the existence of competition in these segments, the ability of the operator to raise prices unreasonably is remote. Thus it may be appropriate to keep these services out of the tariff computation and regulation and treat the competition in these areas as a suitable mimic to regulation.

Now the Authority has issued on 02.08.2010, this consultation paper on ***Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft***, providing opportunities for the stakeholders to respond to the AERA's proposed approach in tariff determination.

CDCTMIPL would like to make following suggestions and observations on the proposed regulations –

- CDCTMIPL, as an Independent Service Providers ("ISP") and a concessionaire, was formed by experienced domestic & international players. We were selected after an international bidding process and there are inbuilt clauses to prevent any exploitation of market situation. The partners joined hands to create modern & efficient airport facilities, compared to earlier service providers. The tariff control regulation approach by Authority is a fundamental change in the economic environment, and this move is a clear shift from free market situation to a complex regulated one.
- The airport cargo service is a Business to Business (B2B) business, where CDCTMIPL does not deal directly with public consumers, and so cannot charge any price it desires. Its customers, being airlines and customs agents, have strong bargaining power, and do tough negotiations to arrive at demanding service level agreements for the price they pay. Airlines usually sign annual agreements, which get renewed after fresh negotiations, again based on

prevalent market scenario.

- In the original scenario, the price fixation would happen through market forces, and customers would move to other operator (or airport) if they are over-charged or get bad service.
- With increased improvement in sea port & railroad network, the airport cargo operators are going to face formidable competition, and hence regulation would kill the initiative for improvement in the sector, at this nascent stage of development.
- In airports like Delhi, it is unviable to have more than two Cargo Service operators or providers. If increased, for the sake of having more players, it will lead to large scale duplication of infrastructure beyond minimum economic levels. The past and current volumes do not justify more than two service providers given the level of investment associated with such operations. Moreover, this has been objectively captured in concession agreement, where threshold to introduce a third handler is clearly defined.

For example, large international airports with only 2 or 3 players, handle ten times the cargo volumes vis-à-vis Delhi airport. India's share of world cargo is just 1.63% of the global volume, as shown hereunder:

India's share in world Trade	Export	Import	Total
Total World	12147	12385	24532
India	155	244	399
Percentage	1.28%	1.97%	1.63%

(Source: WTO: 2010 PRESS RELEASES/PRESS/598/26 March 2010)

And Delhi's share in world cargo trade comes to 0.0085412% as calculated hereunder:

Delhi's share in international Cargo














Item	Percentage	Value	Source
Total World Trade		100	
India's share	1.63%	1.63	WTO report
Air cargo's share in above	Approx 2%	0.0326	Market knowledge
Delhi's share in above	26.20%	0.0085412	AAI data

World over most of the cargo operations are outside regulations which provides a free hand to cargo operator. International players looking at India as a destination for investment shall find the heavy handed regulations to be detrimental for Investment.

ICAO has published the 2009 cargo volumes of the major airports of the world:

Rank	Airport	Code (IATA/ICAO)	Total Cargo (Metric Tonnes)
1.	 Memphis International Airport	MEM/KMEM	3,697,054
2.	 Hong Kong International Airport	HKG/VHHH	3,385,313
3.	 Shanghai Pudong International Airport	PVG/ZSPD	2,543,394
4.	 Incheon International Airport	ICN/RKSI	2,313,001
5.	 Paris-Charles de Gaulle Airport	CDG/LFPG	2,054,515
6.	 Ted Stevens Anchorage International Airport	ANC/PANC	1,994,629
7.	 Louisville International Airport	SDF/KSDF	1,949,528
8.	 Dubai International Airport	DXB/OMDB	1,927,520
9.	 Frankfurt Airport	FRA/EDDF	1,887,686
10.	 Narita International Airport	NRT/RJAA	1,851,972
11.	 Singapore Changi Airport	SIN/WSSS	1,660,724



12.	 Miami International Airport	MIA/KMIA	1,557,401
13.	 Los Angeles International Airport	LAX/KLAX	1,509,326
14.	 Beijing Capital International Airport	PEK/ZBAA	1,475,649
15.	 Taiwan Taoyuan International Airport	TPE/RCTP	1,358,304
16.	 London Heathrow Airport	LHR/EGLL	1,349,571
17.	 Amsterdam Airport Schiphol	AMS/EHAM	1,317,120
18.	 John F. Kennedy International Airport	JFK/KJFK	1,144,894
19.	 O'Hare International Airport	ORD/KORD	1,047,917
20.	 Suvarnabhumi Airport	BKK/VTBS	1,045,194
21.	 Guangzhou Baiyun International Airport	CAN/ZGGG	955,270
22.	 Indianapolis International Airport	IND/KIND	944,805
23.	 Newark Liberty International Airport	EWR/KEWR	779,642
24.	 Tokyo International Airport	HND/RJTT	779,118
25.	 Luxembourg-Findel Airport	LUX/ELLX	628,667



In comparison to above the following are the cargo data of Indian airports. As such Indian airports cargo volumes are very small compared to world standards.

1	Mumbai	582,636
2	Delhi	497,386
3	Chennai	322,675
4	Bangalore	174,644
5	Kolkata	106,585
6	Hyderabad	66,459
7	Cochin	40,636
8	Trivandrum	33,150
9	Ahmedabad	22,675
10	Pune	17,845
11	Calicut	17,500
12	Jaipur	6,209
13	Guwahati	5,037
14	Goa	4,377

- There is strong co-relation between the service level provided and the price charged. But the Authority in first bringing in Tariff control, it will later bring the procedure for monitoring the performance standard. As per Section 13(1)(d), the Authority ought to monitor the set standard of quality, but it is making a disconnect in timing between control of pricing and monitoring the services quality.
- CDCTMIPL provides cargo facility and the tariff charged comprises of only 3-7% of the total shipping cost incurred by shipper. So regulation of our tariff is of little significance to the ultimate customer.
- The Public Private Partnership (PPP) is a progressive concept that is globally popular. lately catching up in India. CDCTMIPL's concession agreement offers it an opportunity to modernise, operate, and transfer the existing cargo terminal at New Delhi, but it does not guarantee volumes at the cargo terminal. CDCTMIPL does not have off-take contracts with customers alike PPP projects, hence we face & bear the volume risk.
- We would like to stress that it will not be financially viable to have three or more ISPs in every airport due to varying market and investment considerations. More players for the sake of competition shall throw excess capacity, which will make it impossible for any handler to have positive returns.

- We therefore propose that the Authority relooks at the competition clause 5.1 of the Guideline and relate the number of ISPs to the sustainable available volumes and not apply blanket philosophy across the stations. If at all minimum players have to be defined for competition then it should be two, and not three (as is AERA's current view point).
- Further, considering the reasons mentioned above, airport operator has already included clauses for entry of third player in the market after it crosses certain level of cargo volumes. This is to protect economic vitality of service provider. The airport operator is cautious of the fact that excess investment would lead to high cost of operations. Moreover, the concession agreements also prevent cargo handler to charge rate higher than that prevailing at neighbouring airports.
- Points regarding the Revenue streams –
 - Demurrage revenue should neither be treated as Non Cargo Revenue nor Cargo revenue, but should rather be outside the regulatory purview of the Authority. This is primarily because Demurrage revenue is not controllable by the ISP. It is not related at all to the cargo volumes, and free storage period is defined by Ministry of Civil Aviation, from time to time. Demurrage cannot be forecasted as these are one-time events of inefficiencies due to different stakeholders other than ISP. Further, as per Ministry of Civil Aviation, an exporter gets a free period of 24 hours & importer gets 72 hours to clear the cargo from customs and take delivery. If clearance is delayed for any reason, a penalty in the form of demurrage is collected from importer at the time of actual clearance. Depending on the number of days of delay beyond free period, the penalty rate and amount increases. Incidentally, almost 65% of the cargo gets cleared within respective free period.
 - Non-Cargo Revenue like office rent is subject to market forces and therefore we do not believe this requires controlling. Typically, rental rates of offices are guided by market forces of real estate in the surrounding area.
- In the Guidelines' ARR approach, CDCTMIPL will not be compensated for its global expertise which is unfortunate, and also against the rationale of the PPP & its original aim. 'Cost plus approach' is not an ideal mechanism to bring efficiency in business. Mathematical formulas for efficiency index cannot bring efficiency in the overall logistics system and deliver quality to the customer. The price is relative to service. If that relation is challenged, the motivation of ISP to provide quality service will be lost. If profit is linked to revenue, then the service provider would be motivated to increase volumes, provide better service, make prudent investment and offer competitive rates. Efficiency mechanism build in the guideline is penalizing rather than rewarding. It completely passes on the benefit to the trade and de-motivates the operator to improve.
- Fair Rate of Return (FRoR): We welcome the approach taken by the Authority to determine ARoR but disagree on use of un-modified Capital Asset Pricing Model for determining cost of equity R_e for Project Specific business like ours. The approach also determines the weighted average cost of debt for arriving at FRoR. Further, FRoR determined by AERA can itself be challenged by other players, who may not have the same returns, notwithstanding the fact that they operate in different business environments.

- Cost of Equity: AERA proposes to use Capital Asset Pricing Model ("CAPM") for determining cost of equity for CDCTMIPL. We are a Special Purpose Vehicle (SPV) entity especially created to manage the cargo services at New Delhi airport. This SPV manages a Public Private Partnership type of business for limited concession period. Using CAPM in our case is not an appropriate measure, since we are not like normal business that has no defined end.

- Cost of Debt: AERA proposes to review the reasonableness of sources, procedures and methods of raising finance before considering it for cost of debt. We believe these are financing decisions taken in history with constraints and situation prevailing at the time. We may or may not be in a position to undo the whole historical financing transactions. We also believe that this is outside the purview of AERA Act. We have certain financing arrangements in place which are legal binding on CDCTMIPL. The cost of debt determination process must take these legal binding agreements and liabilities into account

- Regulated Asset Base: Per Sec 8.2.2 of Guidelines, AERA has defined Regulated Asset Base (RAB) as net investment made by ISP's. According to us, the Authority should consider, in all fairness, the un-depreciated Capital Cost, and the interest-free Security Deposit given by CDCTMIPL to the grantor of concession, as a part of the total Asset Base. Otherwise, substantial investments made by Concessionaire will be ignored for calculation of Fair Rate of Return (FRoR).

RAB is depreciated every year with fair rate and taken average of before taking FRoR percentage on it as profit. We think this treatment is incorrect because the estimated asset net of depreciation mixes up the economic measurement of business profitability with accounting measure of profitability. On one hand AERA allows usage of Stock Market to determine cost of equity and on the other hand applies book value concept of depreciated asset. Capital Asset Pricing Model is an economic measure and correspondingly economic definition of Depreciation is more appropriate in this case. AERA, in deducting depreciation for arriving RAB, makes implicit assumption that the depreciation cash is distributed back to shareholders periodically. Per Company's Act 1956 Section 205, the cash distribution to shareholders is limited to available profits for the year only. Depreciation cash retained in the business is never distributed to shareholders under normal continuous business operation. The equity holders only have residual claim on the company assets. This internally generated cash always gets re-invested into the business which is expected to deliver given FRoR. AERA recognizes that re-investments in the form of subsequent capital expenditure should give profits at the rate of FRoR but omitted to recognize the opportunity cost, in this case FRoR, of depreciation cash locked in the business.

- Accumulated depreciation: The Authority proposes to take book accumulated depreciation for calculating initial RAB. We believe, AERA should take into account the real useful life of assets rather than book depreciation arrived at using the Companies Act. Currently, we depreciate the asset per the concession period or actual useful life whichever is lower. Here again AERA is mixing up issue of book representation with economic evaluation

Conclusion

In summary, CDCTMIPL's submission to the Authority for consideration regarding the evolving form of regulation vis-a-vis AERA's draft proposal is given below:

It will not be financially viable to have three or more ISPs in every airport due to varying market and investment considerations. More players for the sake of competition shall create redundant capacity, which will make it impossible for any handler to have positive returns, thus making the companies sick. In fact, Price Cap has been an utter failure in United Kingdom, and the Ministry of Transport in UK has announced the scrapping of the current regulation & plans to replace it with mandatory service standards instead.

The best form of regulation, at this nascent stage of infrastructure development, ought to be to take out the cargo facility and cargo services from regulatory purview. If at all deemed necessary in certain airports (on a case to case basis), the Light Touch approach may be used in such airports for such services, but it must not apply to all airports blindly.

It may be based on benchmarking process wherein the tariffs of all service providers for a particular service is benchmarked and a band for acceptable tariff is defined. And the band would have variations considering Quality, Scope & Efficiency of the Services provided. Alternatively, the current AAI rates, duly adjusted for inflation, can become the Benchmark Rates.

Our sector being self-regulated, and with two cargo operators, competitive enough with inherent checks and balances, and so does not require complicated price regulation. By adopting the above approach, AERA would truly usher into India the best practices from the progressive economies worldwide, which will be welcomed by all.

