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07/09/10

September 3, 2010

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Chairman  
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30/9/2010  
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08/09/10

**Subject: Comments & submissions of the Federation of Indian Airlines (FIA) tendered in response to the Consultation Paper No. 5/2010-11 titled "Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft".**

Dear Sir,

SM (ABS)

Have FIA commented  
on CP. No. 4/2009-10?

The Federation of Indian Airlines an integral Stakeholder under AERA Act sincerely appreciates the Airports Economic Regulatory Authority of India (AERA) for having gone through a massive exercise of consultations with all the Stakeholders involved in the preparation of the Consultation Paper No.5/2010-11 titled "Economic Regulation of Services provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft".

Pls. confirm -  
also share this  
with PWC  
Amit  
08/9/10

FIA also wishes to extend its gratitude to AERA for inviting all the stakeholders in a meeting convened by AERA on 18.08.2010 on the above mentioned Consultation Paper No.5 and hearing out the views, suggestions and concerns of all the stakeholders present in the meeting.

FIA has always been very keen on consultation and deliberation among the stakeholders and the concerned authority as every issue is important for the holistic development of the aviation industry in India which is already going through severe economic crisis and depression in demand coupled with various avoidable levies/ fees and charges.

FIA is hereby placing on record the following response submitted which has been arrived solely from discussions, deliberations and past experiences for the consideration by the authority.

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07/09/2010

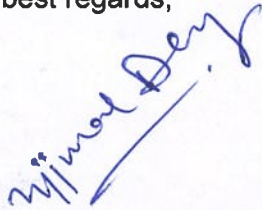
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Enclosed are the following documents for your kind consideration.

- Attachment –I, (Accounting Standards issued by ICAI)
- Attachment – II, Doc.9082 (ICAO's Policies on charges for Airports and Air Navigation Services).
- Attachment – III, Annex 15 to the convention on International Civil Aviation (Aeronautical Information Service).

Thanking you,

With best regards,



FEDERATION OF INDIAN AIRLINES

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## I. Background

1. The members of FIA wish to place on record its preliminary submissions on the Consultation Paper No.5/2010-11 issued by the Authority which relates to Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the aircraft. FIA welcomes the opportunity to engage in this one of the initial exercises undertaken by the Authority with respect to the principles, elements and methodologies of economic regulation, with a view to establish the principles governing the terms and conditions for determination of tariff for Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the aircraft ("**Draft Guidelines/Regulations**"). In line with the direction of the Authority (vide its Order dated 02.08.2010) that the stakeholders should confine their submissions to the Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the aircraft ("**Regulated Services**"), FIA is not commenting upon the regulatory philosophy and approach underlying the draft Guidelines.

2. Before making the submissions on the Consultation Paper, members of FIA deem it necessary to place on record the following relevant facts which are material for the decision making by the Authority:-

- (a) Pursuant to the enactment of the "The Airports Economic Regulatory Authority of India Act, 2008" (*Act*), the Airports Economic Regulatory Authority was established on 12.05.2009 to perform the functions vested under the Act, which inter alia includes determination of tariff for aeronautical services.
- (b) Under the Act, aeronautical services *inter alia* comprise of "ground handling services relating to aircraft, passengers and cargo at the airport, cargo facility at the airport and supplying fuel to the aircraft at an airport".
- (c) The International Civil Aviation Organization (*ICAO*), a specialized agency of the United Nations which was created pursuant to the Chicago Convention on International Civil Aviation, 1944 by 52 nations whose aim was to assure the safe, orderly and economic development of international air transport. India is one of the contracting states of the convention on International Civil Aviation and hence the effective implementation of the ICAO Convention is one of the important elements that must be borne in mind by the Authority in terms of Section 13(1)(a)(vii) of the Act and in view of Articles 73, 245, 246 and 254 read with entries 13, 14 and 29 of the Union List in the 7<sup>th</sup> Schedule of the Constitution of India. On perusal of the above provisions of the Constitution of India, it is clear that India being a signatory to the Convention is bound to give effect to the terms and conditions set out in the Convention. ICAO has prescribed various policies on charges for Airports and Air Navigation Services (Policy). The Eighth Edition of the Policy (Doc 9082) issued in the year 2009 inter-alia provides for various factors to be taken into account while determining the cost to be recovered from users.

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- (d) The Parliament enacted the Act, on 05.12.2008 which came into force on 01.01.2009 except chapters III and IV which came into effect on 01.09.2009. Section 13 (1) (a) (7) provides that the Authority shall while determining tariff for aeronautical services take into account any other factor which may be relevant for the purposes of this Act. In view of the provisions of the Constitution of India set out above and the Act, the Authority should consider the guidelines/terms set out by the ICAO policies while considering various factors for determination of cost for the abovementioned aeronautical services.
- (e) The present consultation process is confined to eliciting submissions and comments from the stakeholders only in respect of the Draft Guidelines and not question the regulatory philosophy and approach underlying the Guidelines. However, for the purposes of the present process, it is important to understand the basis and premise for such imposition to enable the Authority to take a considered decision on the issues that arise.
- (f) The consultation process has been initiated by the Authority under the mandate of the Act for determining the terms and conditions for ascertainment of tariff for aeronautical services.
- (g) To begin with, a white paper on 'Regulatory Objectives and Philosophy in Economic Regulation of Airports and Air Navigation Services' was issued by the Authority on 22.12.2009, which provided stakeholders an opportunity to consider the issues highlighted therein and submit their comments and suggestions as a part of the process leading up to the framing of appropriate procedures/systems for economic regulations.
- (i) Pursuant to the comments and suggestions received in response to the white paper, the Authority prepared a Consultation Paper delineating the cardinal issues having a bearing on the formulation of regulatory philosophy and approach and laying out its rationale for the approach it was minded to take. The said Consultation Paper (No. 3/2009 – 10) was issued on 26.02.2010 with the intention of providing a further opportunity to stakeholders to make relevant submissions to the Authority before it finalized its Regulatory Philosophy and Approach.
- (j) On 16.03.2010 the Authority convened a consultation meeting to elicit the views of the stakeholders and subsequent thereto, the Authority issued an Order (Order No. 05/2010-11, dated 30.07.2010), setting out the regulatory philosophy and approach in economic regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the aircraft.
- (k) Thereafter, on 02.08.2010, the Authority issued Consultation Paper No. 05/2010-11 on 'Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the aircraft', inviting comments, views etc from the stakeholder latest by 03.09.2010.

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## **II. Scope of the Present Consultation Proceedings**

3. The scope of the present consultation proceedings is confined to the Guidelines pertaining to the terms and conditions for determination of tariff for Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the aircraft' as contained in the Consultation Paper No. 05/2010-11.

4. The said Consultation Paper prescribes the Draft Guidelines [Airport Economic Regulatory Authority of India (Terms and Conditions for Determination of Tariff for Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the aircraft) Guidelines, 2010], which contains the draft framework delineating the requisite terms, conditions, systems, procedures and information requirement for the determination of tariff for such services.

5. The Draft Guidelines is divided into following parts:-

- (a) Preliminary Chapter deals with the title, extent, commencement of these guidelines and definitions.
- (b) Chapter I provides for the approach to assessment of Materiality and Competition.
- (c) Chapter II provides for the procedure for submission and review of Tariff Proposals.
- (d) Chapter III deals with the procedure for determination of Aggregate Revenue Requirement for Regulated Service(s) deemed 'material and not competitive'.
- (e) Chapter IV deals with the procedure for determination of Tariff(s) for Regulated Service(s) deemed 'material and not competitive'.
- (f) Chapter V deals with the procedure for determination of Tariff(s) for Regulated Service(s) deemed 'not material'; but 'competitive'.

6. In addition to the aforesaid chapters, the Guidelines contains Appendices and the Schedule, which are summarized hereunder:-

- (a) Appendix I describes the procedure for, Collecting Data and Information Required; Preparing the Multi Year Tariff Proposal; Service Provider Business Plan; Information relating to Regulatory Building Blocks; Historical and Forecasted Volumes; Historical Revenues; Procedure for preparing the Annual tariff Proposal; Preparing the Annual Compliance Statement.
- (b) Appendix II provides for explanation of Materiality Assessment.
- (c) Appendix III provides for illustration of determination of Aggregate Revenue Requirement.
- (d) Appendix IV provides for illustration of determination of error correction procedure.
- (e) Schedule contains the various prescribed forms that relate to Specific Clauses (s) of the Guidelines or Section (s) of the Appendix.

## **III. Introduction & Preliminary**

**Privileged & Confidential**

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7. It is submitted that while fixing the tariff the Authority must bear in mind the prevalent financial realities of the industry in terms of Section 13(1)(a) of the Act, including:

- (a) Global economic downturn that gravely affected the aviation industry;
- (b) Considerable cost increase arising from airport development works in the form of additional fuel burns due to congestion both in ground and in air.

In this backdrop, the operators should not be saddled with a crippling cost burden, which might result in capacity curtailment.

8. The regulatory regime being established is a multi-year tariff regime for control-period blocks of 5 years each. In this context, the following are noteworthy:-

- (a) The regime must be a Performance Based Regulation ("**PBR**") mechanism that achieves the objectives of the Airports Economic Regulatory Authority Act, 2008, rewarding efficient operations while imposing prudence and securing the underlying principles of effective regulation in context of the inherent information asymmetry. The Guidelines should also account for incentives and disincentives based on the service level/performance to ensure better services to users and to not penalize the users for the inefficiencies attributable to the Service Provider.
- (b) The regime must provide clear guidelines regarding treatment of the controllable (like employee expenses, Administrative & General expenses, Repair & Maintenance expenses) and uncontrollable elements of tariff (like cost of Aviation Turbine Fuel) be considered.
- (c) Since the regulatory accounts of the service providers would be invariably governed by the Companies Act, 1956, it is recommended that the applicability of the Accounting Standards issued by the ICAI under the Companies Act, 1956 must be explicitly acknowledged – with industry-specific departures being provided for explicitly. A brief note on some of the Accounting Standards is attached herewith as **Attachment – 1**.

9. It is recommended that a consultation protocol similar to the one suggested by the Authority to guide the interaction between airports and their users should similarly be institutionalized for Regulated Services to facilitate the consultation process for Service providers and stakeholders in a more structured and efficacious manner.

10. It is imperative that the Service Provider is required to submit documented evidence to show that stakeholder consultations have taken place prior to submitting the Tariff Proposal. In addition to foregoing, it is also imperative that separate inputs from the stakeholders such as, airlines be sought by the Authority to obtain independent and first hand information on the key concerns of the stakeholders.

11. The Authority needs to examine the proposals of the Service Provider to analyze the cost effectiveness and operational efficiency.

12. It is recommended that the Service Provider should be required to submit its real time



performance indicators compared with best practice standards such as those for service performance and staff productivity to establish the performance baseline and track the movements of these indicators on an annual basis to ensure cost effectiveness of the services.

13. As per the present Draft Guidelines regarding the rate of return and adoption of error correction in annual tariff-setting, the risk faced by the Service Provider is minimal. Thus, the fair rate of return used should not exceed the risk free rate. Furthermore, the approach towards recovery of full cost should be a gradual progression and the government may choose to recover less than full costs in recognition of local, regional or national benefits.<sup>1</sup> The relevant extracts of ICAO Policy on Charges for Airports and Air Navigation Services (Doc 9082/8) are attached herewith as *Attachment-II*.

14. The Authority shall ensure that there is due consultation with Airport and the Airlines before any change in charging system or change in tariff is introduced. The purpose of the consultation is to ensure that Service Provider gives adequate information to users relating to the proposed changes and gives proper consideration to the views of users and the effect that the proposed change would have on the existing tariff. The aim is to reach an understanding between the Service Provider and users.

15. As regards the allocation of costs in respect of the Regulated Services, it is recommended that the Authority should ensure that the users are not burdened with costs which are not properly allocable to them. The charges should not be imposed in such a way as to discourage the user facilities and services necessary for safety or the introduction of new aids and techniques. The charges should be levied in such a way that no service is charged for twice with respect to the same utilization. However, where there are certain facilities which have a dual utilization (For example, approach and aerodrome control as well as en-route air traffic control), their cost should be equitably distributed in the charges concerned.

16. The Authority may consider establishing a quality system and put in place quality management procedures at all stages of the aeronautical information/data process.<sup>2</sup> The quality system must be documented and demonstrable for each function stage, ensuring that the organizational structure, procedures etc are in place in order to detect and remedy any information/data anomalies. Annexure 15 to the Convention dealing with Aeronautical Information Services is attached herewith as *Attachment-III*.

17. The Authority may specify certain norms regarding quality of service. The Service Provider should propose a baseline and performance trajectory for all quality parameters. The Authority should also conduct periodic reviews on the performance of the Service Provider with respect to quality parameters.

18. In determining the cost for calculating the tariff, following should be considered by the Authority:

<sup>1</sup> As reflected in para 45 of ICAO's Policies on Charges for Airports and Air Navigation Services (Doc 9082/8)

<sup>2</sup> As per Annexure 15 to the Convention on International Civil Aviation dealing with Aeronautical Information Services.

- (a) the Aircraft operators and other airport users should not be charged for facilities and services they do not use.
- (b) an allocation of costs should be considered in respect of space or facilities utilized by Government Authorities.
- (c) the proportion of costs allocable to various categories of users should be determined on equitable basis, so that no user shall be burdened with costs not properly allocable to them.
- (d) to avoid undue disruption to users, increase in charges should be introduced on a gradual basis; however, it is recommended that in certain circumstances a departure from this approach may be necessary.

19. The Tariff Proposal should be duly served upon the stakeholders and should be posted on the website of the Authority. While submitting the Tariff Proposals to the Authority, the Service Provider shall indicate whether copy of the complete Tariff Proposal has been served on each of the beneficiaries and whether the application has been posted on its own website. The Authority should then invite comments and suggestions from the Stakeholders on the aforesaid Tariff Proposal. The accounts related statements submitted with the Tariff Proposal should be duly audited and certified.

#### ***Para-wise Suggestions***

20. **Para 3(a):** The Authority has stated that it will set out its approach for regulating airport operators in respect of the same services separately. It is imperative for creating a level playing field and securing equity that the approach for regulating airport operators in respect of Cargo Facility, Ground Handling and Supply of Fuel must be based on the same regulatory objectives/approach as for independent service providers and it should not be discriminatory<sup>3</sup>.

21. **Para 3 (c):** The proposed regime for regulating Material and non-competitive services is a price cap approach by setting a yield per unit and approval of tariffs annually. In this backdrop, it is important that this consultation focuses on the elements of the price cap regulation, and the treatment of the controllable (for e.g. employee expenses, Administrative & General expenses, Repair & Maintenance expenses etc) and uncontrollable elements of tariff (like cost of Aviation Turbine Fuel).

22. **Para 3(e):** It is proposed that the Authority shall determine tariff on the basis of Multi Year Tariff proposal which would involve annual compliance process, tariff proposals, user consultation and compliance of relevant regulations/guidelines by the service provider. In this context, it is not clear as to whether the Annual Compliance Process means that the truing up<sup>4</sup>

<sup>3</sup> Must be based on same regulatory objectives qua non discriminatory open access to the facility at reasonable prices.

<sup>4</sup> Truing-up exercise is a post facto verification of actual expenses and revenues as against the projected expenses and revenue approved in the Tariff Order.



exercise will be undertaken by the Authority?

23. **Para 3(h):** It belies regulatory oversight qua non discriminatory open access to facilities at reasonable prices. It does not deal with the uncontrollable elements and risks to be undertaken by the Service Providers. Since services relating to supply of fuel (uncontrollable factor) are covered under the commercially negotiated contracts between users and Service Providers, such contracts should have specific provisions (payment security mechanism) for risk to be undertaken by the Service Providers.

24. **Page 2 of the draft guidelines:** These guidelines are stated to have been issued under Section 15 of the Act. Section 15 empowers the Authority to issue directions. It is to be noted that under Section 52, the Authority has the power to make regulations to carry out the purposes of the Act. Therefore, these guidelines should be either termed as regulations or directions rather than guidelines to be binding and enforceable in court of law.

25. **Para 1.2:** These guidelines (to be reworded as Regulations) shall apply to Service Providers and airport operators are excluded. It creates a vacuum regarding the treatment to be provided to the airport operators. The Authority should not make provisions for any differential treatment to the Service Providers.

#### ***IV. Definitions (Inserts to be included).***

26. **Aggregate Revenue Requirement:** The applicable period is not clear/ specified.

27. The term "Appendix" has not been defined.

28. **Capital Asset Pricing Model:** It is to be noted that who is the deciding authority for the market portfolio, when and on what basis shall it be decided? Would it be based on normative?

29. Usage of the term "**prescribed**" in the guidelines. Section 2(k) of the Act provides that the term "prescribed" means prescribed by rules notified by the Government of India under the Act. As such, unless the reference is to any rule made by the Government, the term "prescribed" must not be used for guidelines/directions/regulations notified by the Authority. In stead either "stipulated" or "specified" could be used.

30. **Multi Year Tariff Framework:** It only sets the principles for the purpose of determination of the Aggregate Revenue Requirement and it does not deal with the determination of tariff nor with the true up process.

31. **Multi Year Tariff Proposals:** It refers to **Section** AI.2 whereas it should be **Paragraph** AI.2 of Appendix I hereto.

32. **Regulatory Building Blocks:** It only refers to the components for determining the Aggregate Revenue Requirement and does not deal with determination of tariff.

33. Usage of the term "**Section**": Section is normally used for provisions of a statutory enactment. It is recommended that this term should be replaced with 'Paragraph'.

34. **Regulated Service** may be qualified by inserting 'with respect to these Regulations'.

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35. **Tariff Year:** Instead of 'the Control Period' it should be 'a Control Period'.
36. **User:** It is not clear whether 'user' here would mean the same as defined under the Act "Airport User" or otherwise?
37. **Weighted average gearing** is not a defined term.

#### *V. Chapter I: Approach to Assessment of Materiality and Competition*

38. **Para 3.2:** The word '**deemed**' should be replaced with the word '**found**' or '**determined**' since deeming is an assumption and finding/determination is decision-making.
39. **Para 3.2(i):** It is recommended that this may be substituted by: "material and not competitive", the Authority shall determine Tariff(s) for Service Provider(s) based on price cap approach for the duration of Control Period. The Authority shall determine Aggregate Revenue Requirement according to Chapter III and determine Tariff(s) according to Chapter IV".
40. **Para 3.2(ii):** ) It is recommended that this may be substituted by "Either 'not material' or 'material but competitive', the Authority shall determine Tariff(s) for Service Provider(s) based on light touch approach, according to Chapter V for the duration of Control Period".
41. **Para 3.4:** Should be deleted as the same has been incorporated in Para 3.2(i).
42. **Para 3.5:** Should be deleted as the same has been incorporated in Para 3.2(ii).
43. **Para 3.6, 3.7, 3.8:** Would accordingly be renumbered as 3.4, 3.5, and 3.6 respectively.
44. **Para 3.7:** The Authority must clearly indicate the timeline for submissions and process with respect to the existing Service Providers and new Service Providers.
45. **Para 4.1(ii):** It is important to ascertain that the 5% level is as per International best practice, or to evaluate that this test is appropriate.
46. **Para 4.3(i):** Does 'international aircraft movements per annum' cover both landings and take offs?
47. **Para 5.1:** The competition assessment must mandatorily include barriers to effective competition in and for the market also access/choice to consumers/users.

#### *VI. Chapter II: Procedure for submission and review of Tariff Proposals*

48. **Para 6.1:** The word 'guidelines' should be replaced with 'regulations'. The expression 'Section AI.2' should be replaced with Para AI.2. The word 'prescribed' may be replaced with the word 'specified' or 'stipulated' since the word 'prescribed' under the Act is limited to the Rules made by Government.
49. **Para 6.2:** The timelines in Para 6 must ensure completion of the entire process 4 to 6

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months before the commencement of Control Period<sup>5</sup>.

50. **Para 6.6:** Service Providers may consider submitting audited quarterly progress reports while submitting an Annual Compliance Statement before the Authority.

51. **Para 6.7:** In context of the extension of time for submission of Multi Year Tariff Proposal, Annual Tariff Proposal, an Annual Compliance Statement, after the words '**the Authority may grant to the said Service Provider(s) such extension of time**', the words '**on terms and conditions specified in the order**' may be inserted.

***VII. Chapter III: Procedure for determination of Aggregate Revenue Requirement for Regulated Service(s) deemed "material and not competitive"***

52. **Para 7.2:** The term '**deemed**' may be replaced with '**determined**' or '**found**'.

53. **Para 7.2(b):** '**Fair Rate of Return on the Regulatory Asset Base (FRoR x RAB)**' should be replaced with '**Fair Rate of Return applied to the Regulatory Asset Base**']

54. **Para 7.2(b):** "**Operating Expenditure**" may be reworded as "**Operation and Maintenance Expenses**" failing which Maintenance expenditure seems to be excluded for the purposes of calculating the Aggregate Revenue Requirement.

55. **Para 7.2 (e):** Section 13 of the Act provides the following factors which are to be taken into consideration by the Authority while determining tariff for Aeronautical Services:-

- (a) Capital expenditure incurred and time investment in improvement of airport facilities
- (b) Services provided, its quality and other relevant factors, the cost for improving efficiency, economic and viable operations of major airports,
- (c) Revenue received from services other than aeronautical services
- (d) Concessions offered by the Central Government in any agreement or Memorandum of understanding or otherwise
- (e) And any other factor which may be relevant for the purposes of the Act.

**Some of these [(b) & (d) above] factors do not seem to have been taken into account while providing a formula for determination of tariff under these draft Guidelines.**

56. **Para 7.3:** Illustration – first bullet – the word '**nominal**' should be replaced with '**an illustrative**'

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<sup>5</sup> Section 64 of the Electricity Act, 2003 provides for 120 days for the Commission to issue a Tariff Order after consider all suggestions and objections. The said timeline is not enough. The idea is to freeze the Tariff 15 days before commencement of the Tariff Year so that there is no regulatory overhang. This would also lead to carrying out the truing up process in a timely manner. In case, the entire exercise of Tariff determination is not conducted in a timely manner, it would have to grant carrying costs to the Service Providers. The concept of carrying cost is well settled by the Appellate Tribunal for Electricity in its Judgment dated 30.07.2010 passed in Appeal No. 153 of 2009 and Judgment dated 23.05.2007 passed in Appeal No. 265 of 2006.

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57. **Para 8.1.1** :  $R_d$  is the pre-tax cost of debt which is an uncontrollable cost and needs to be adjusted annually or would entail the benefit of carrying cost on truing up.  $R_e$  is the post tax cost of equity which should take into account treatment of internal accruals.

58. **Para 8.1.2**: The word 'nominal' should be replaced with 'normative'.

59. **Para 8.1.3(a)**: The expression 'for each Service Provider' shows that the estimated cost of equity will vary from Service Provider to Service Provider. There should not be any differential treatment.

60. **Para 8.1.4(a)**: Instead of 'the forecast cost of existing debt subject to the reasonableness of such costs', it should be linked to 'the Prime Lending Rate of the State Bank of India' or some similar benchmark.

61. **Para 8.1.5** provided that Authority shall not consider financing costs of any short term debt with maturity of less than 12 months in its weighted average cost of debt. It is to be reviewed in terms of Operating Expenditure as per Clause 8.4. It is submitted that not considering the financing cost may result in any unfair denial. Moreover, financing cost for long term debt as a factor for Aggregate Revenue Requirement has not been taken into

62. **Para 8.2.4(b)**: The Original Cost of Fixed Asset as indicated in the last audited accounts may be replaced by Original cost of fixed assets at the end of the Base Year available for use and necessary for the purpose of Service Provider.

63. **Para 8.2.6 (b)** : It is recommended that this para which deals with Regulated Asset Base ("**RAB**") may be changed to read as follows: "The Authority shall determine the value of RAB (for the second and subsequent Control Period), prior to the start of subsequent Control Period, upto the last Tariff Year for which the actuals are available."

64. **Para 8.3 (a)**

(a) The words "over the useful life of asset" may be added after the words "calculated using the straight line method of Depreciation"

(b) Following sub-clauses may also be added in Clause 8.3:

(i) Depreciation shall not be allowed on assets funded by any capital subsidy / grant.

(ii) The residual value of assets shall be considered as 10% and depreciation shall be allowed to a maximum of 90% of the original cost of the asset. Land is not a depreciable asset and its cost shall be excluded while computing 90% of the original cost of the asset.

(iii) Depreciation shall be charged from the first year of operation of the asset. In case, the operation of the asset is for a part of the year, depreciation shall be charged on a pro rata basis<sup>6</sup>.

<sup>6</sup> Reference may be drawn to the Judgment dated 29.09.2006 passed by the Appellate Tribunal For Electricity in Appeal No. 38 of 2005 wherein it was held that depreciation being

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- (iv) In addition to allowable depreciation, the Service Provider shall be entitled to Advance Against Depreciation, computed in the manner given hereunder:

AAD = Loan (raised for capital expenditure) repayment amount based on loan repayment tenure, subject to a ceiling of 1/10th of loan amount minus depreciation as calculated on the basis of these Guidelines;

Provided that Advance Against Depreciation shall be permitted only if the cumulative repayment up to a particular year exceeds the cumulative depreciation up to that year;

Provided further that Advance Against Depreciation in a year shall be restricted to the extent of difference between cumulative repayment and cumulative depreciation up to that year.

On repayment of entire loan, the remaining depreciable value shall be spread over the balance useful life of the asset.

65. **Para 8.4: Operating Expenditure** does not take into account the Maintenance Expenditure but only takes into account the Operating Expenditure. Clause 8.4 has also not taken into consideration the expenses related to salaries, wages, pension contribution and other employee related costs and also repair and maintenance cost.

66. **Para 8.4(a)(i)** has not taken into consideration that the base line Operating Expenditure should be based on the latest available audited accounts, business plans, estimates of the actuals for the base year, prudence check alongwith the underline factors impacting variants over preceding years.

67. **Para 8.4(a)(ii)** uses the term controllable cost which is not a defined term. Under the prevailing tariff regimes, all costs excluding fuel cost are usually taken into account as controllable costs.

68. **Para 8.5:** It is recommended that the following may be inserted: "The income tax actually payable or paid shall be included in the ARR. The actual assessment of income tax should take into account benefits of tax holiday, and the credit for carry forward losses applicable as per the provisions of the Income Tax Act 1961 shall be passed on to the users."

#### ***VIII. Some regulatory concepts/practices of other regulatory regimes commended for the consideration of the Authority***

69. **Concept of Regulatory Asset:** Creation of a Regulatory Asset is a mechanism to carry forward a portion of the revenue requirement for a particular year that has not been included while designing the tariffs for that year. The amount equivalent to the Regulatory Assets is thus effectively removed from the revenue requirement for the year in question.

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an allowable expenditure cannot be denied. The said judgment was upheld by the Hon'ble Supreme Court in its Judgment dated 15.02.2007 reported as (2007) 3 SCC 33.

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Such a situation generally arises when the projected revenues are significantly lower than the revenue requirement and it is not feasible to recover the entire amount either through increase in tariffs or through other means such as Government subsidy during that year. In such situations, the Regulator may choose to create a Regulatory Asset equivalent to the uncovered expenses and allow the service provider to amortise the same over a period of time. The Regulatory Asset mechanism is resorted to mainly to avoid tariff shocks to the consumers in a given year, while at the same time allowing the utility to recover the costs in a reasonable manner so as to protect its interests as well as those of the consumers<sup>7</sup>.

70. **Advance against Depreciation ("AAD"):** AAD is cumulative repayment allowed less cumulative depreciation allowed. The purpose of AAD is to have adequate cash flow to meet repayment obligations. AAD is "income received in advance" subject to adjustment in future<sup>8</sup>. [Note: AAD has been included above].

71. **Truing Up:** Concept of truing up, i.e. comparing estimates figures at the beginning of the Tariff Year with the actual figures at the end of that year, has not been accounted for in the draft Guidelines. Since the Control Period is for 5 years and the tariff for the said Control Period is to be determined on the basis of provisional data/estimations, there should be a provision of truing up in order to avoid any surprise by way of disallowances of legitimate expenses<sup>9</sup>.

72. **Quality of Supply and Services:** The quality of supply and the user service parameters shall be monitored as per the Section 13(1)(d) of the Act.

The Service Provider shall propose baseline and performance trajectory for all quality parameters to be specified by the Authority under Section 13(d) of the Act.

The Authority shall make an assessment on reliability of baseline data and may prescribe the performance trajectory for each identified parameter for the Control Period. The Authority shall develop a performance framework to encourage Service Providers to improve quality of supply and services.

The Service Providers shall submit the performance on each parameter in the form and manner as may be directed by the Authority. The Authority shall conduct periodic reviews on the performance of the Service Provider with respect to quality parameters.

The concept of business plan filings by the Service Provider at the beginning of the Control Period which would include demand supply forecast, capital investment plan, O& M costs,

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<sup>7</sup> Reference may be drawn to the judgment dated 21.07.2006 passed by the Appellate Tribunal for Electricity in Appeal No. 156 of 2005 wherein the Appellate Tribunal condemned the creation of regulatory asset.

<sup>8</sup> Hon'ble Supreme Court of India in the matter of NHPC Vs CIT on 05.01.2010 in Civil Appeal No 6 of 2010 reported as (2010) 3 SCC 396 has interpreted AAD has as a timing difference, it is not a reserve, it is not carried through profit and loss account.

<sup>9</sup> The reference may be drawn to the Judgment dated 10.08.2010 passed by the Appellate Tribunal for Electricity in Appeal No. 37 of 2010 and Judgment dated 12.11.2009 wherein the concept of truing up was explained by the Appellate Tribunal.



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depreciation, external parameters used for indexation etc. can also be considered.

73. **Contingency Reserve:** The formation of contingency reserve by the service Providers in order to maintain tariff stability and passing of benefits achieved to the users under the Multi Year Tariff framework.

The Service Provider may create a Contingency Reserve at the beginning of the Control Period. The revenue surplus, if any, generated by Service Provider shall be transferred to its Contingency Reserves at the beginning of the Control Period.

The Service Provider shall maintain separate accounts in their books and reflect the balance in the Contingency Reserve Account in the balance sheet. There shall be yearly additions and draws to/from these Contingency Reserve accounts based on the annual review and performance of the Service Provider.

Fund under Contingency Reserve shall be kept in a separate bank account and shall be effectively invested and managed to earn returns based on market conditions ensuring adequate liquidity. This fund shall not be utilized for speculative purposes. The use of these funds in any other manner shall be only with the prior approval of the Authority.

74. **Classification of Controllable and Uncontrollable expenses and annual true-up of uncontrollable expenses**<sup>10</sup>

75. **Foreign Exchange Rate Variation** has not been specifically dealt with in respect of debt/equity/Fair Rate of Return.

#### *IX. Some proposed inserts to the miscellaneous provisions.*

76. **Issue of Orders and Practice Directions:** Subject to the provision of the Act and these Guidelines, the Authority may, from time to time, issue Orders and Practice directions in regard to the implementation of these Guidelines and procedure to be followed on various matters, which the Authority has been empowered by these Guidelines to direct, and matters incidental or ancillary thereto.

77. **Powers to remove difficulties:** If any difficulty arises in giving effect to any of the provisions of these Guidelines, the Authority may, by a general or special order, not being inconsistent with the provisions of these Guidelines or the Act, do or undertake to do things or direct the Service Provider to do or undertake such things which appear to be necessary or expedient for the purpose of removing the difficulties.

78. **Power of Relaxation:** The Authority may in public interest and for reasons to be recorded in writing, relax any of the provision of these Regulations.

79. **Interpretation:** If a question arises relating to the interpretation of any provision of these Regulations, the decision of the Authority shall be final.

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<sup>10</sup> Reference may be drawn to the Judgment dated 10.08.2010 passed by the Appellate Tribunal for Electricity in Appeal No. 37 of 2010 wherein the principle of classification of controllable and uncontrollable expenditure is well recognized. (Para 33)

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80. **Saving of Inherent Powers of the Authority:** Nothing contained in these Regulations shall limit or otherwise affect the inherent powers of the Authority from adopting a procedure, which is at variance with any of the provisions of these Regulations, if the Authority, in view of the special circumstances of the matter or class of matters and for reasons to be recorded in writing, deems it necessary or expedient to depart from the procedure specified in these Regulations.

81. **Power to Amend:** The Authority, for reasons to be recorded in writing, may at any time vary, alter or modify any of the provision of these Regulations by amendment.

*Attachment - 1***Accounting Standards issued by ICAI****1. *Accounting Standard – 1 (AS-1): Disclosure of Accounting Policies***

AS-1 requires that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. Hence, an enterprise should disclose the criteria applied for recognition and measurement of the derivative instruments which are used by the enterprise for hedging or for other purposes and the criteria applied for recognition and measurement of income and expenses arising from such instruments.

**2. *Accounting Standard – 5 (AS-5): Net Profit or Loss for the Period, Prior Period Items and Change in Accounting Policies:***

The objective of this Accounting Standard is to prescribe the criteria for certain items in the profit and loss account so that comparability of the financial statement can be enhanced. Profit and loss account being a period statement covers the items of the income and expenditure of a particular period. This accounting standard also deals with change in accounting policy, accounting estimates and extraordinary items. It also deals with prior period items that could be income or expenses, which arrives, in current period as a result of error or omission in the preparation of financial statement of one or more prior period. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

**3. *Accounting Standard – 6 (AS-6): Depreciation Accounting :***

Depreciation is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use and passage of time. Depreciation is nothing but distribution of total cost of assets over its useful life. There are two methods of Depreciation i.e. (i) Straight line method; and (ii) Written down value method.

The following needs to be disclosed:

- (i) Total depreciation for the period of each class of assets.
- (ii) Accumulated depreciation of each class of assets.
- (iii) Depreciation method.
- (iv) The depreciation rates and the useful lives of the assets are disclosed only if they are different from the principal rates specified in the status governing the enterprise.
- (v) Change in method of depreciation.

(vi) Effect of the revaluation of the fixed asset on the amount of depreciation.

4. ***Accounting Standard – 7 (AS-7): Construction Contract:***

The primary objective of this Accounting Standard is the allocation of 'contract revenue' and 'contract cost' to the accounting period in which the construction work is performed. Construction contract is a contract specifically negotiated for the construction of an asset or combination of assets closely interrelated or interdependent.

5. ***Accounting Standard – 11 (AS-11): Effects of Changes in Foreign Exchange Rates:***

A foreign currency transaction should be recorded by Indian branches and integral foreign operations, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of transaction. This Accounting Standard allows, for practical reasons, the use of a rate that approximates the actual rate at the date of the transaction.

6. ***Accounting Standard – 21 (AS-21): Consolidated Financial Statements:***

The objective of this statement is to present financial statements of a parent and its subsidiary(ies) as a single economic entity. In other words, the holding company and its subsidiary(ies) are treated one equity for the preparation of these consolidated financial statements. Consolidated profit/loss account and consolidated balance sheet are prepared for disclosing the total profit/loss of the group and total assets and liabilities of the group. As per this accounting standard the consolidated balance sheet, if prepared, should be prepared in the manner prescribed by this statement. Consolidated financial statements are not the substitute for separate financial statements of a parent and its subsidiary(ies). In other words a parent and its subsidiary(ies) shall prepare separate financial statements as per governing law. The consolidated financial statements made by a parent are in addition to the separate financial statements. A parent which is required to prepare the consolidated financial statements, should consolidate the financial statements of all its subsidiary(ies), whether domestic or foreign.

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Doc 9082



# ICAO's Policies on Charges for Airports and Air Navigation Services

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Approved by the Council  
and published by its decision

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International Civil Aviation Organization

### III. ICAO'S POLICIES ON CHARGES FOR AIR NAVIGATION SERVICES

#### The cost basis for air navigation services charges

42. The Council considers that as a general principle, where air navigation services are provided for international use, the ANSPs may require the users to pay their share of the related costs; at the same time international civil aviation should not be asked to meet costs which are not properly allocable to it. The Council therefore encourages States to maintain accounts for the air navigation services they provide in a manner that ensures that air navigation services charges levied on international civil aviation are properly cost based.

43. The Council considers that an equitable cost recovery system could proceed from an accounting of total air navigation services costs incurred on behalf of aeronautical users, to an allocation of these costs among categories of users, and finally to the development of a charging or pricing policy system. In determining the total costs to be paid for by charges on international air services, the list in Appendix 2 may serve as a general guide to the facilities and services to be taken into account.<sup>7</sup> Moreover, the Council specifically recommends that States consider the application, where appropriate, of internationally accepted accounting standards for ANSPs.

44. The Council recommends that when establishing the cost basis for air navigation services charges, the following principles should be applied:

- i) The cost to be shared is the full cost of providing the air navigation services, including appropriate amounts for cost of capital and depreciation of assets, as well as the costs of maintenance, operation, management and administration.
- ii) The costs to be taken into account should be those assessed in relation to the facilities and services, including satellite services, provided for and implemented under the ICAO Regional Air Navigation Plan(s), supplemented where necessary pursuant to recommendations made by the relevant ICAO Regional Air Navigation Meeting, as approved by the Council. Any other facilities and services, unless provided at the request of operators, should be excluded, as should the cost of facilities or services provided on contract or by the carriers themselves, as well as any excessive construction, operation or maintenance expenditures.
- iii) The costs of air navigation services provided during the approach and aerodrome phase of aircraft operations should be identified separately, and so should the costs of providing aeronautical meteorological service, when possible.
- iv) Costs for certain security measures of a preventive nature for the provision of air navigation services, which are specifically related to civil aviation and performed on a routine basis, may be included in the cost basis for air navigation services charges to the extent that they have not already been considered in the context of safety-related measures. Civil aviation should not be charged for any costs that would be incurred for more general security functions performed by States such as general policing, intelligence gathering and national security. Further, costs associated with airport security should not be combined with security costs incurred with regard to air navigation facilities or services.

7. Guidance on accounting contained in the *Manual on Air Navigation Services Economics* (Doc 9161) may be found useful in this context, although there are other approaches.



- v) Air navigation services may produce sufficient revenues to exceed all direct and indirect operating costs and so provide for a reasonable return on assets (before tax and cost of capital) to contribute towards necessary capital improvements.

45. The Council observes that in determining the costs to be recovered from users:

- i) Governments may choose to recover less than full costs in recognition of local, regional or national benefits.
- ii) It is for each State to decide for itself whether, when, and at what level any air navigation services charges should be imposed, and it is recognized that States in developing regions of the world, where financing the installation and maintenance of air navigation services is difficult, are particularly justified in asking the international air carriers to contribute through user charges towards bearing a fair share of the cost of the services.
- iii) The approach towards the recovery of full costs should be a gradual progression.

**Allocation of costs of air navigation services among aeronautical users**

46. The Council recommends that the allocation of the costs of air navigation services among aeronautical users be carried out in a manner equitable to all users. The proportions of cost attributable to international civil aviation and other utilization of the facilities and services (including domestic civil aviation, State or other exempted aircraft, and non-aeronautical users) should be determined in such a way as to ensure that no users are burdened with costs not properly allocable to them according to sound accounting principles. The Council also recommends that States acquire basic utilization data in respect of air navigation services, including the number of flights by category of user (i.e. air transport, general aviation, and other) in both domestic and international operations, and other data such as the distance flown and aircraft type or weight, where such information is relevant to the allocation of costs and the cost recovery system.<sup>8</sup>

**Air navigation services charging systems**

47. The Council recommends that States ensure that systems used for charging for air navigation services be established in accordance with the following principles:

- i) Any charging system should, so far as possible, be simple, equitable and, with regard to route air navigation services charges, suitable for general application at least on a regional basis. The administrative cost of collecting charges should not exceed a reasonable proportion of the charges collected.
- ii) The charges should not be imposed in such a way as to discourage the use of facilities and services necessary for safety or the introduction of new aids and techniques. The facilities or services provided for in the ICAO Regional Air Navigation Plan(s) or in any recommendations of the relevant ICAO Regional Air Navigation Meeting as are approved by the Council, are, however, considered to be necessary for general safety and efficiency.

8. Guidance on cost allocation is contained in the *Manual on Air Navigation Services Economics* (Doc 9161), although States may use any accounting approach they consider meets their particular requirements.

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The Convention on  
International Civil Aviation

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**Annexes 1 to 18**

International Civil Aviation Organization

**ANNEX 15  
to the Convention on  
International Civil Aviation**

**Aeronautical Information Services**

One of the least known and most vital roles in support of international civil aviation is filled by the aeronautical information service (AIS). The object of the aeronautical information service is to ensure the flow of information necessary for the safety, regularity and efficiency of international air navigation.

Annex 15 defines how an aeronautical information service shall receive and/or originate, collate or assemble, edit, format, publish/store and distribute specified aeronautical information/data. The goal is to satisfy the need for uniformity and consistency in the provision of aeronautical information/data that is required for the operational use by international civil aviation.

The ICAO Council first adopted the original Standards and Recommended Practices in 1953. Annex 15 has its origins in Article 37 of the Chicago Convention. The first requirements for the Annex were developed by the ICAO Air Navigation Committee (now the Air Navigation Commission), following recommendations from regional air navigation meetings, and were published by the authority of the Council as *Procedures for International Notices to Airmen* back in 1947.

"International notices to airmen" is a phrase which led to the birth of an early aeronautical acronym: NOTAM. In 1949, a special NOTAM meeting reviewed and proposed amendments to these procedures, which were later issued as *Procedures for Air Navigation Services* that became applicable in 1951. A total of 33 amendments updated Annex 15 over the years to meet the rapid changes brought about by air travel and associated information technology. In recent years, Annex 15 amendments have reflected the increased need for the timely provision of quality aeronautical information/data and terrain data as they have become critical components of data-dependant on-board navigation systems. The Annex now contains many provisions aimed at preventing corrupt or erroneous aeronautical information/data which can potentially affect the safety of air navigation.

The operator of any type of aircraft, be it small private aircraft or large transport aircraft, must have available a variety of information concerning the air navigation facilities and services that may be expected to be used. For example, the operator must know the regulations concerning entry into and transit of the airspace of each State in which operations will be carried out, as well as what aerodromes, heliports, navigation aids, meteorological services, communication services and air traffic services are available and the procedures and regulations associated with them. The operator must also be informed, often on very short notice, of any change affecting the operation of these facilities and services and must know of any airspace restrictions or hazards likely to affect flights. While this information can nearly always be provided before take-off, it must, in some instances, be provided during flight.

The philosophy underlying Annex 15, which stems from Article 28 of the Convention on International Civil Aviation, is that each State is responsible for making available to civil aviation interests any and all information which is pertinent to and required for the operation of aircraft engaged in international civil aviation within its territory, as well as in areas outside its territory in which the State has air traffic control or other responsibilities.

The information handled by an AIS may vary widely in terms of the duration of its applicability. For example, information related to airports and its facilities may remain valid for many years while changes in the availability of those facilities (for instance, due to construction or repair) will only be valid for a relatively short period of time. Information may be valid for as short a time as days or hours.

The urgency attached to information may also vary, as well as the extent of its applicability in terms of the number of operators or types of operations affected. Information may be lengthy or concise or include graphics.

Therefore, aeronautical information is handled differently depending on its urgency, operational significance, scope, volume and the length of time it will remain valid and relevant to users. Annex 15 specifies that aeronautical information be published as an integrated aeronautical information package. It is composed of the following elements: the *Aeronautical Information Publication* (AIP), including amendment service, AIP supplements, NOTAM, pre-flight information bulletins (PIB), aeronautical information circulars (AIC), checklists and lists of valid NOTAM. Each

element is used to distribute specific types of aeronautical information.

Information concerning changes in facilities, services or procedures, in most cases, requires amendments to be made to airline operations manuals or other documents and databases produced by various aviation agencies. The organizations responsible for maintaining these publications usually work to a pre-arranged production programme. If aeronautical information were published indiscriminately with a variety of effective dates, it would be impossible to keep the manuals and other documents and databases up to date. Since many of the changes to facilities, services and procedures can be anticipated, Annex 15 provides for the use of a regulated system, termed AIRAC (aeronautical information regulation and control), which requires significant changes to become effective and information to be distributed in accordance with a predetermined schedule of effective dates, unless operational considerations make it impracticable.

Annex 15 also specifies that pre-flight information must be made available at each aerodrome/heliport normally used for international operations and sets the content of aeronautical information provided for pre-flight planning purposes as well as requirements for the provision of that information through automated aeronautical information systems. Additionally, there are requirements to ensure that important post-flight information provided by aircrews (for example, the presence of a bird hazard) are relayed to the AIS for distribution as the circumstances necessitate.

The need, role and importance of aeronautical information/data have changed significantly with the evolution of the Communications, Navigation and Surveillance/Air Traffic Management (CNS/ATM) systems. The implementation of area navigation (RNAV), required navigation performance (RNP) and airborne computer-based navigation systems has brought about exacting requirements for the quality (accuracy, resolution and integrity) of aeronautical information/data and terrain data .

The users' dependence on the quality of certain aeronautical information/data is evident from Annex 15, paragraph 3.2.8 a) which, when describing critical data, states: "There is a high probability when using corrupted critical data that the continued safe flight and landing of an aircraft would be severely at risk with the potential for catastrophe".

Since corrupt or erroneous aeronautical information/data can potentially affect the safety of air navigation because of the direct dependence upon it by both airborne and ground-based systems, it is imperative that each State ensure that users (aviation industry, air traffic services, etc.) receive timely and quality aeronautical information/data for the period of its intended use.

To achieve this, and to demonstrate to users the required information/data quality, Annex 15 provides that States must establish a quality system and put in place quality management procedures at all stages (receiving and/or originating, collating or assembling, editing, formatting, publishing, storing and distributing) of the aeronautical information/data process. The quality system must be documented and demonstrable for each function stage, ensuring that the organizational structure, procedures, processes and resources are in place in order to detect and remedy any information/data anomalies during the phases of production, maintenance and operational use. Explicit in such a quality management regime is the ability to trace all information/data from any point, back through the proceeding processes, to its origin.

Of all the activities in international civil aviation, the provision and sustaining of aeronautical information services may not rank among the most glamorous and indeed the complexity of AIS information supplying data-dependant on-board navigation systems may be transparent to the user, but without this service a pilot would be flying into the unknown.