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MIAL/PR/151

14<sup>th</sup> September, 2010

Mr. Sandeep Prakash  
Secretary  
Airports Economic Regulatory Authority of India  
AERA Building, Administrative Complex,  
Safdarjung Airport  
New Delhi – 110 003.

Send to PWC

OSD-II  
15/16/9

SM (ARBS)

Dear Sir,

**Subject:** Comments on AERA's Consultation Paper No. 05/2010-11 dated 2<sup>nd</sup> August 2010 containing Draft Guidelines on Economic Regulation of Services provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft

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Please find enclosed comments of Mumbai International Airport Pvt. Ltd. with respect to the above-mentioned Consultation Paper (refer Annexure).

We hope you will find the same in order.

Thanking you,

Yours sincerely,

For Mumbai International Airport Pvt. Ltd.

(R. K. Jain)  
President

Encl. : as above



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**Comments on AERA's Consultation Paper No. 05/2010-11 on Economic Regulation of Services Provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft containing Draft Guidelines on Terms and Conditions for Determination of Tariff for these Services**

The Airports Economic Regulatory Authority (AERA/ Authority) had issued Order No. 05/2010-11 and Consultation Paper No. 05/2010-11 on 2<sup>nd</sup> August 2010 laying down detailed guidelines for Economic Regulation of the services provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft at the major airports.

It is understood that aforesaid guidelines shall be applicable only to the independent service providers providing these services at the airports and shall not be applicable to the Airport Operator if these services are being provided by the Airport Operator itself, nevertheless, implication of these Guidelines will affect Airport Operators also.

There are two brownfield airport projects which were awarded through competitive bidding process with very clear demarcation of aeronautical and non-aeronautical revenues. It is envisaged in the agreements signed with Government of India (State Support Agreement) that 30% of gross non-aeronautical revenue shall be utilised to cross-subsidise aeronautical charges. This was stated in the tender documents based on which bids were submitted with very high revenue share for both Mumbai and Delhi airports. AERA Act, 2008 specifically recognises that it is essential to consider concession agreements while determining tariff. Three revenue streams, Ground Handling, Cargo and Supply of Fuel to aircrafts are covered under aeronautical revenues in AERA Act. Supply of fuel is considered as an aeronautical service. However, by extension, AERA is considering even throughput fees as aeronautical revenue, which needs to be revisited.

Vide Para 3 (f) of the preface to Guidelines, it is stated that the Authority shall take into consideration payments required to be made by independent service providers of cargo facility, ground handling, fuel farm / access facilities (these terms are coined by AERA but are not in existence in the Act) to the airport operators as part of the passenger yield cap calculation for airport operators. It clearly means that in spite of concession agreements, considering these three revenue streams as non-aeronautical, the treatment proposed by AERA will result in revenues from these streams to form part of the Till which is not as per concession agreements and will erode financial viability of the Airport Operators, unless correspondingly, revenue share payable to AAI is adjusted to maintain status quo. We are not able to comment whether adjusting revenue share is within the purview of AERA, which is governed by a specific agreement; and as a corollary, AERA should not put revenue from these streams in the Aeronautical Till of Airport Operator. However, a regulatory oversight may be observed to

ensure there is no monopolistic abuse. AERA Act nowhere stipulates that all aeronautical revenues as defined in the Act should be fully considered for the purpose of determination of aeronautical charges. Hence, for the sake of natural justice, it is essential to ensure that airports, which are bound by concession agreements, are not put to economic jeopardy as compared to concession agreements based on which bids were submitted by respective bidders.

Because of seriousness of considering three revenue streams (which are contemplated as non-aeronautical revenue under OMDA / SSA) as aeronautical revenue by AERA, we enclose a detailed note for your ready reference. (Annexure A).

Authority has diverged from its own views put forward in its Consultation Paper No. 3 dated 26th February, 2010, about honouring concession agreement as per provisions of the Act and also treating two or more service providers as a fulfilling condition required for competitiveness by now considering three or more service providers for the purpose of assessment of competition. Thus, the basic principle of competition has been altered by the Authority by this about turn. Further, a point can be raised as to why presence of three service providers will be considered competition and why not minimum four or five. According to our view, presence of even two service providers ensures competition.

There is a living example of Ground handling with presence of two major Ground handlers selected by competitive bidding process and ceiling on charges imposed by Airport Operators has resulted in intense competition reflected in sharp fall in Ground Handling charges for International flights, whereas earlier, in spite of multiplicity and fragmented services, Ground Handling charges were very high. Hence, Authority may please review the same.

Further Authority has totally ignored the fact that in case of Mumbai there is direct competition between ports (Mumbai Port Trust and Jawaharlal Nehru Port Trust) and CSI Airport. Secondly, airports near Mumbai like Ahmedabad, Nagpur, Chennai, Hyderabad, and Bangalore are directly competing with Mumbai.

Authority has totally ignored the fact that in a severely land-constrained airport like Mumbai, there is no possibility to provide space for inducting third cargo service provider. It has also ignored the fact that at an airport like Mumbai, service provider may have to spend substantial amount in enabling projects which are not backed by physical assets and hence will not appear in the Balance Sheet; but such expenditure has to form part of RAB.

We strongly feel that the Order and the Guidelines are being brought out by AERA without considering these important facts which will harm airports in the long run.

Our detailed comments on various issues are as under:

## 1. More clarity required to derive overall implication

On 26<sup>th</sup> February, 2010, AERA had issued Consultation Paper on the Regulatory Philosophy and Approach in Economic Regulation of Airports and Air Navigation Services. This consultation paper enunciated, Regulatory Philosophy for Airport Operator, Air Navigation Services and Cargo Facility Operator, Ground Handling Operator and Fuel Farm Operators/ Fuel Access Provider respectively and required stakeholders' comments on the same. Accordingly, comments on the aforementioned Consultation Paper were submitted to the Authority by MIAL on the holistic basis.

On 2<sup>nd</sup> August, 2010, AERA has issued an order ("Order") which lays down the regulatory philosophy and approach for the economic regulation of the services provided for Cargo Facility, Ground Handling and Supply of Fuel to the Aircraft, provided by the independent agencies / licensees.

However, this economic regulation for the independent service providers, though not directly related, to a very large extent is intermingled with the economic regulation for Airport Operators and would have far reaching consequences. Hence, to arrive at implications of the aforementioned order, it has to be seen in conjunction with the economic regulation for Airport Operators, which is yet to be issued by the Authority. **Moreover, the Authority has made no provision for the concession offered by the Central Government in any agreement or memorandum of understanding or otherwise, especially in the light of intention made abundantly clear by the AERA Act, 2008. For example, the said Order prescribes that the Authority shall take into consideration payments required to be made by independent service providers of cargo facility, ground handling, fuel farm / access facilities to the Airport Operators as part of the passenger yield cap calculation for Airport Operators, which is not in line with the agreement signed by MIAL with AAI / MOCA as these three services are defined as Non Aeronautical services.**

MIAL would like to reiterate its view pertaining to "observance of the provisions of the concession offered by the Central Government in any agreement or memorandum of understanding or otherwise" and state that many airports have entered into concession agreement or memorandum with the service providers. Hence it is inappropriate to consider these types of payment received by the airport operator in the passenger yield cap calculation of the airport operator, without considering the provisions of pre existing concession agreement and Memorandum entered into with service providers. AERA's proposed approach to consider payments to Airport Operators by the independent service providers in the passenger yield cap implies that such payments are considered as 'aeronautical' , whether or not they are 'aeronautical' in nature as per the agreements signed between the Airport Operator and AAI / Gol. In addition to this, it may be noted that payments by independent service providers are in the form of concession fees, license fees, utilities recovery charges, etc. which do not fall under the 'aeronautical services' as defined by AERA Act. Further, this will also

deviate from AERA's original approach of considering concession agreements of Airport Operators wherein these services are clearly treated as non-aeronautical. **We request AERA to take into consideration provisions of agreement between MIAL and AAI/MOCA while finalizing these guidelines since these provisions would have serious implications for the MIAL / Airport Operators.**

## 2. Competition Assessment

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':*

MIAL would like to highlight the provision pertaining to the competition assessment stated in the section 1.21 of part IV (Page 137 of 279) of the consultation paper "Regulatory Philosophy and Approach in Economic Regulation of Airports and Air Navigation Services" dated 26th February, 2010. This section states that the Authority will presume to have a degree of competition to protect users' interest where two or more operators are present. Further, OMDA contemplates requirement of only two service providers in respect of cargo service so as to create enough competition.

Authority may clarify reasons for change in its earlier stance pertaining to competitiveness and we would strongly recommend that Authority should maintain the consistency in the economic regulation as frequent changes in the policy could send negative signal to the investor community at large. Moreover Authority should consider assessing competitiveness at each airport separately after taking into consideration, concession agreement signed with the Central Government and existing agreements entered into by the Airport Operators with various concessionaries for provision of these services, as in the airport like Mumbai, increase in the number of service providers could lead to further congestion and may result in the redundancies / inefficiency in infrastructure given the already existing space constraints.

In case of Cargo, express cargo service providers should also be counted along with normal cargo service providers for the purpose of competition assessment.

## 3. Materiality Assessment

Under section 4.1, AERA has prescribed materiality assessment criteria for fuel supply services, wherein fuel supply service at particular airport shall be considered as material if the total aircraft movements at the airport are more than 5% of the total aircraft movement at the major airports.

MIAL is of view that, given the difference in the pricing of aviation fuel at various airports across the country due to factors like transport cost and taxation, currently there is enough incentive for airlines to buy fuel at airport other than origin point; hence it is appropriate to consider percentage of fuel off take at any airport to total fuel off take at major airports for the materiality assessment of fuel supply services rather than air traffic movements.

#### **4. Return on Work in Progress**

AERA in its consultation paper prescribes no return on the WIP assets prior to commissioning. To this, MIAL would like to reiterate its view that, rolling up of assets and adding them upon commissioning is more complex and results in the charges increasing sharply when a large capital asset is added into RAB at one stage.

If AERA proceeds on the basis of outline in the consultation paper, it would be crucial to roll up capital investment at full WACC rather than cost of debt, to maintain consistency. If this is not done then the cost of capital applied to the WIP after commissioning needs to be adjusted upwards so that required WACC is secured over the full life time of the asset.

#### **5. Revenues from the services other than Regulated Service(s)**

As per section 7.2 of paper (page 13 of 85), Authority emphasises on considering the revenue from the services other than regulated service, for determining the aggregate revenue required of regulated services. Besides under section 8.6 (page 27 of 85) AERA is considering to commission an expert for benchmarking of revenue levels and to identify the opportunities where such revenues are under exploited.

MIAL is of view that, considering revenue from the services other than regulated services for cross subsidising and commissioning expert for identifying underexploited revenues is unwarranted.

#### **6. Assessment of efficiency improvement**

As per the section 9.6 (page 30 of 87) states that Authority will consider target efficiency improvement while setting the value of "X" so as to promote competitive environment in the non competitive situation.

Further Authority itself states that *"The assessment of efficiency improvement can be complex and therefore requires a variety of considerations to be taken into account including key performance indicators relating to trends in costs per unit, efficiency factors applicable to other utilities in the country, impact of various levels of efficiency factor on revenues, operating expenditures and returns and historical profitability and performance."*

MIAL would like to highlight that, for meeting the service quality standards that affect customers' perception, service provider needs to spend on several elements. However, the relative output is not immediately measurable. Hence relating the service quality and operating expenditure for efficiency may be too early at this stage, and we suggest that linking efficiency and operational cost should be done once all the stakeholders involved are able to gain sufficient experience in understanding the relation between operating expenditure and service quality. Besides method for calculation of "X" should be more elaborate and transparent.

#### 7. More clarification on the RAB

As per Section 8.2.4 (page 18 of 85), "Initial RAB" provides "The initial RAB for the determination of Aggregate Revenue Requirement for the first Control Period shall be the fixed assets indicated in the last audited accounts of the Service Provider". This clause does not cover the assets which are created by Airport Operator and the independent service provider merely operates such assets for providing these services. For example, MIAL may have to relocate certain cargo facilities and/or create new facilities for NACIL (independent service provider) at its cost as a part of overall Cargo development plan. In this case, confirmation is required that such assets will be as a part of RAB.

#### 8. Interest free loan should not be considered

As per section 8.1.4 "Cost of Debt" weighted average cost of debt shall be calculated as total interest expenses during the control period divided by total debt proposed to be raised during control period. MIAL would like to highlight the fact that some of the Airports by virtue of state support agreement have been provided funds which are interest free loans or in the form of subsidy. In such cases, these loans need to be excluded while calculating weighted average cost of debt.

#### 9. Typographical error:

MIAL would like to highlight the typographical error in Illustration 9 (page 34 of 85) "Estimated Maximum Allowed Yield per Unit". In this table, formula for calculation of term "a" is wrongly mentioned as  $E_{t-2} \times (1+r^2)$  instead of  $E_{t-2} \times (1+r)^2$ . The same may be rectified.

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**MUMBAI INTERNATIONAL AIRPORT PVT. LTD.**

**Annexure A**

**Note on treatment of three revenue streams, namely Cargo, Ground Handling, Fuel Concession Fees**

**Treatment of three revenue streams.**

When Delhi and Mumbai airports were privatised under Public Private Partnership through a process of international competitive bidding, it was clearly defined what are aeronautical charges and what are non-aeronautical charges.

Aeronautical charges were envisaged to be regulated and non-aeronautical charges were envisaged to be fixed by Airport Operator at its discretion.

Accordingly, very high percentage of revenue share were quoted for both Mumbai and Delhi Airports based on this understanding -- as high as 38.7% for Mumbai and 45.99% for Delhi Airport. Secondly, revenue share (Annual fee) which is payable to AAI is not considered as cost while determining Aeronautical Charges (Tariff).

The Main stream of non-aeronautical revenues are as follows:

1. Cargo services
2. Concession fees from cargo service provider
3. Fuel Supplies
4. Airport charges on fuel sale commonly known as "Oil Throughput Charges".
5. Ground handling services
6. Concession fee from Ground Handling Service providers
7. Lease rentals and space rentals
8. Retail including Duty Free and F & B
9. Advertisement
10. Communication charges like IT ports, CUTE etc.

Revenue composition of MIAL for the financial year 2009-10 comprises of Ground handling concession fee, Cargo services, Oil throughput fees being 3%, 20% and 7% of the total revenues respectively i.e. 30% in aggregate.



AERA Act, 2008 vide section 2 (a) includes services for ground handling, cargo and services for supplying fuel to aircraft at an airport as aeronautical services. It may be pointed out that AERA Act does not mention that there will be single till, dual till or hybrid till except that it mentions in Section 13(1)(a)(v) that the AERA shall determine tariff for aeronautical services taking into consideration, inter alia, revenue received from services other than aeronautical services.

However, Proviso to Section 13 (1)(a) mentions that different tariff structure may be determined for different airports having regard to all or any of the above considerations specified under section 13 (1)(a) (i) to (vii). Clause (vi) to Section 13 (1) (a) clearly envisages that while determining tariff, AERA has to take into consideration the concession offered by the Central Government in any agreement or memorandum of understanding or otherwise.

From the above, it is clear that Concession Agreements already entered into have to be adhered to.

The matter of three charges is specifically discussed below;

1. **Cargo Services** – OMDA clearly envisages in case of Mumbai and Delhi Airports vide Schedule 6 that cargo services are non-aeronautical services.
2. **Ground Handling Services** -Ground handling services are also listed as non-aeronautical services vide Schedule 6 of OMDA.
3. **Oil Throughput Fees** - Oil Throughput Fees is not listed in any schedule of services i.e. Schedule 5 – Aeronautical services , Schedule 6 – Non-Aeronautical Services.

In schedule 5, entry no. 17 states “**Common hydrant infrastructure for aircraft fuelling services by authorised providers**”. But this asset of hydrant infrastructure and any charges levied for aircraft fuelling by service provider should not be confused with oil throughput fees which is charged by Airport Operator to oil companies for selling fuel at airport, and is similar to fees charged from flight caterers for supply of food to airlines and other concession fees from other businesses at airport.

Absence of this revenue from definition of Aeronautical Services as well as Non-Aeronautical Services does not mean that it is to be treated as Aeronautical Service, even though common hydrant systems are included in aeronautical assets. There are instances where a particular revenue stream is not mentioned in any of the schedules, for example, advertising. In such case, common practice has to be

taken into consideration. ICAO vide Appendix – 3 to Doc No. 9082 (Policies on Charges for Airports and Air Navigation Services) clearly mentions as follows:

*“ Revenues from non-aeronautical sources,: Any revenue received by an airport in consideration for the various commercial arrangements it make in relation to the granting of concessions, the rental or leasing of premises and land, and free-zone operations, even though such arrangements may in fact apply to activities which may themselves be considered to be of an aeronautical character (for example, concessions granted to oil companies to supply aviation fuel and lubricants and the rental of terminal building space or premises of air carriers). Also intended to be included are the gross revenues, less any sales taxes, earned by shops or services operated by the airport itself.”*

Worldwide cargo is considered as non-aeronautical revenue, ground handling services is a mixed bag as some airports treat it as aeronautical service while others treat it as non-aeronautical service. Similarly supply of oil might be considered as aeronautical services, but the Airport Fee is a concession fee which is clearly mentioned in ICAO document No. 9082 as a non-aeronautical revenue. Similarly ground handling services might be treated as aeronautical services but the concession fee being charged by Airport Operator is not aeronautical service. Fact remains that airport operator is not providing any service and it is sharing revenue to allow ground handlers to carry on the business of ground handling at Airport similar to license fee that is being charged for any other businesses like retail, duty free, flight catering etc.

**In view of the above, following emerges;**

- 1) Concession agreement needs to be adhered to in letter and spirit
- 2) Oil throughput fee is a non-aeronautical revenue as abundantly clarified in ICAO document.
- 3) Even if AERA Act includes certain services as aeronautical which were non aeronautical as per OMDA, it does not imply that 100% revenue of airport operator from these services should go for subsidising aeronautical services charges.
- 4) To summarise,
  - i) A service may be aeronautical but concession fee related to these services to airport need not be aeronautical. ICAO document quoted above confirms that.

- ii) Ground handling charges levied by ground handling service providers may be regulated by AERA and the concession fee to airport paid by ground handling service providers may be treated one of expenses of the ground handler. Same is the case for Oil throughput fees and cargo service providers where Airport operator gets only concession fee. If Airport Operator provides cargo service, then its charges could be regulated, subject to adherence to Concession Agreement which means in case of Mumbai and Delhi the same should be treated as non-aeronautical revenue only.

In case of ground handling, the policy formulated by Government of India vide AIC No. 3/2010 dated 02/06/2010 clearly envisages revenue share by ground handlers with airport operator as per clause 2 (A) (iii) which is reproduced as below:

**“ Any other ground handling services provider selected through competitive bidding on revenue sharing basis by the airport operator subject to security clearance by the Government and observance of performance standards as may be laid down by the airport operator.”**

The practical solution for these three revenue streams , including concession fee from service provider to airport operator, is that they should not form part of Till but AERA may oversee to rule out any abuse of power. Consequently, revenue from these three streams to the extent of 30% may be used for subsidising aeronautical charges as per respective Concession Agreements.

Worldwide, oil throughput charges are not at all 'price controlled and outside the purview of aeronautical charges, few examples are, Airports in Australia, New Zealand, Amsterdam, Greece, Paris, Copenhagen, Budapest and Brussels.

If these three revenues viz, concession fee from ground handlers, provision of cargo services and oil throughput fees are taken to the Till, then even reducing cross subsidization from 30% to 0% shall not be able to make airports operations viable.

Hence, in order to honor Concession Agreements, these three revenue streams need to be kept out of Till. AERA may regulate to ensure that charges for these services are not excessive and there is sufficient competition.

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