

Delhi International Airport (P)Limited

Ref: DIAL/2010-11/Fin-Acc/2572

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Date: February 22, 2011

Dear Sir,

Sub: Submission of response on Consultation Paper No.13/2010-11

This is in reference to the consultation paper on "Economic Regulation of Services Provided for Airport Operators (Terms and Conditions of Tariff For Airport Operators) Guidelines, 2011" issued by Airport Economic Regulatory Authority (AERA) on 2nd February 2011.

In this regard, we submit the following:

- a) We have filed an appeal against Order number 13/2010-11 issued on 12th January, 2011 in the appellate tribunal on the limited issue of OMDA also being a concession document.
- b) As desired by AERA, we have vide our letter reference 'DIAL 2010-11/FIN-ACC/2488 dated January 9, 2011' and letter reference 'DIAL 2010-11/FIN-ACC/2536 dated February 17th 2011' communicated the principles as well as mechanics, as available in the State Support Agreement (SSA) and the OMDA, for tariff determination of Delhi International Airport Pvt. Ltd (DIAL). As stated by AERA in order no. 13 and draft guidelines dated February 2, 2011, we await a separate order in respect of DIAL.
- c) We understand that other airport operators have filed appeal against order number 13 of AERA.
- d) We also note that APAO has written to AERA that the draft guidelines may need modification depending on outcome of the appeal and have reserved its right to make submissions at later stage.

Without prejudice and subject to aforesaid we make the submissions as per **Annexure "A"**. We reserve the right to modify our submissions and/or make further submissions including that based on the outcome of (a), (b) and (c) above.

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DELHI INDIRA GANDHI
INTERNATIONAL AIRPORT

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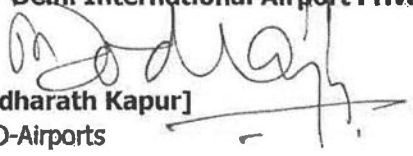
Delhi International Airport (P)Limited

In case, AERA requires any further clarification(s) on the response, we would be glad to address the same.

Thanking you.

Yours Faithfully

For Delhi International Airport Private Limited


for [Sidharath Kapur]
CFO-Airports

Enclosed: Annexure "A"

CC: The Secretary, Ministry of Civil Aviation, Rajiv Gandhi Bhavan, New Delhi.

Annexure A

**Response to Consultation Paper
On
Economic Regulation of Services Provided for
Airport Operators
(Terms and Conditions of Tariff for Airport
Operators) Guidelines, 2011**

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I. SINGLE TILL PHILOSOPHY

We do not agree with the regulatory philosophy of single till as in our view this is not the right approach considering:

- (i) The state of aviation infrastructure and the need for greater private sector participation in the humungous investment in this sector;
- (ii) The privatization of Greenfield airports happened before the regulatory oversight was created. These airports arranged, committed and invested large sums of capital based on the concession documents which have the underlying implicit assumption of at least a hybrid till if not a dual till;
- (iii) ICAO principles do not mandate single till; rather its wordings provide the clear direction of regulatory choice of till. It is our understanding that ICAO Economics Panel has recently revised the wording of the relevant para 37 (i) of Doc 9082 to make it clear that they do not support a particular philosophy on till –

“The cost to be shared is the full cost of providing the airport and its essential ancillary services, including appropriate amounts for cost of capital and depreciation of assets, as well as the costs of maintenance, operation, management and administration. Consistent with the form of economic oversight adopted, these costs may be offset by non-aeronautical revenues.”

Thus to state that ICAO dictates single till is incorrect. A single till is more apt in ICAO viewpoint in a government owned airport and single till do not go hand in hand with privatization;

- (iv) Globally no airports have been privatized on a single till basis;
- (v) The current state of infancy of non-aero revenues in Indian airports which need a boost would get a serious setback.

In our earlier response to the consultation paper we had submitted evidence backed facts supporting the following;

- It is not necessarily the case that single till regulation result in lower charges in all cases;
- **Cross-subsidy** which affects aeronautical prices in single till regulation removes the important link between prices and costs and therefore distorts airport and airline decision-making;
- The importance of dual till regulation for the creation of efficiency and quality incentives and present evidence which suggests that **quality delivered by dual or hybrid till airports is superior to quality delivered by single till airports**;
- **The benefits of dual till regulation** in light of the need to incentivise investment in India’s airport infrastructure and also the **government policy on airport infrastructure and developing commercial revenues**;
- **Privatization and single till do not go hand in hand**;
- **The unfounded concerns on cost and asset allocation.**

However Airport Economic Regulatory Authority herein referred to as ‘Authority’ has not considered the above submission in formulation of guidelines. No empirical data has been produced by Authority in support of single till.

II. REGULATORY ASSET BASE

The following are the observation w.r.t Regulatory Asset Base (RAB) initial determination and forecasting;

- We understand that Authority has advocated an approach for the provision of the **financing allowance i.e cost of debt on the opening WIPA_t**, and on the average of the capex (net of the grants if any and commissioned assets), for the project assets under construction. In the line with the aforesaid approach, this principle should be extended to the existing commissioned project assets. The **cost of equity on the equity financed portion** of the project assets should also be capitalized based on their respective commissioning dates and this should be suitably reflected in the Initial RAB. Suitable adjustment will be made in accumulated depreciation.
- In order to leverage an efficient financing capital structure, airport operators generally favour availing foreign currency loans to part fund their project investment. In such cases, at the time of reporting i.e at the end of the financial period, the current **carrying value of such loans is duly adjusted for forex fluctuation and the reported value at the time of submitting the Multi Year Tariff Proposal would be different** due to underlying movement in the foreign currency rate. Therefore, the Authority should at the time of annual compliance, true up for the variation in loan fluctuation.
- Further, the Authority has not considered any scenario wherein **any new capital investment is mandated to be undertaken within the control period by the Central or State Government or Competent Authority**. Despite the facts such investment were not envisaged at the time of Multi Year Tariff Proposal, the same should be considered on actual basis and appropriate correction to RAB and yield should be corrected.
- It may be difficult to **accurately project future capex value**. As such any variance thereof should be suitably adjusted to the RAB value at annual compliance.
- Due to uncertain market conditions it may not be practical to submit 10 year capital investment plan.
- If due to sudden variation in traffic, there may be a need to expedite the planned capital expenditure in earlier year. In such case Authority needs to consider the same in the annual review.
- We need clarification as regard to the projected investment consultation process, do we need to conclude consultation process before the start of the control period. If so, the time available would be too less to conclude the consultation and make a tariff filing.
- Since the master planning of the future capex is a time taking exercise Authority must mandate consultation only at the start of the actual project implementation.
- Profits on disposal should be shared between the airport and the passenger equally to incentivise the operator for a better upkeep of disposable assets.

III. RING FENCING AND REAL ESTATE

We wish to place our serious concern on the manner the Authority would treat the non-Airport assets including the surplus land to be used to develop aetropolis.

To start with the provisions of the order on the Ring fencing principles in its current form was not deliberated in the consultation process nor was any feedback from the stakeholders solicited. It has thus come as a surprise that a serious issue of this magnitude was introduced without prior consultation.

Generally private Greenfield airports to which the provisions apply do not have land on their books as land was leased to them. Further the land was leased to provide an incentive to develop airports in far flung areas through a bidding process. There have been instances where airport land was valued at market price and included in RAB for the purpose of Tariff Calculation. However the treatment meted out in the order to non-airport assets including land does not find a precedent anywhere. Such treatment was not contemplated as part of the concession documents thus leading to a situation of regulatory expropriation and needs to be retracted.

IV. FAIR RATE OF RETURN

The following are our observation w.r.t determining the fair rate of return computed using the cost of equity and debt;

- We note that the Authority shall determine the cost of equity by following the CAPM Model. In this context, it would be pertinent to bring out that the **airport operators should be allowed to make reasonable estimate of the cost of their own equity capital**. The airport operators should be allowed to demonstrate the reasonable assumptions considered while determining the cost of equity.
- We note that Authority has taken a position for considering the **Interest free loans utilised in the funding of RAB** while estimating the cost of debt. In continuation of our earlier submission in the white paper and the consultation paper, we reiterate the fact that such interest free deposits are in the nature of quasi equity contributions. Therefore, the aforesaid deposits funds utilised towards RAB should carry the cost of equity.
- We understand that capital structure of the company shall undergo changes on account of **varying gearing level due to adjustment of foreign exchange fluctuations** in the outstanding debt for the respective tariff year within the control period. In such circumstances, appropriate adjustment on account of revised gearing should be incorporate at the time of annual compliance.
- The Authority has proposed a uniform cost of equity during the control period as against the weighted average cost of debt. However, the ancillary effect of the change in the gearing as discussed in the forgoing paragraph and also due to increase/decrease of debt due to other factors would be on the equity beta which is a key input while determining the cost of equity.
- While the Authority maintains that it provides a fair rate of return, this contention may not be correct given that many risks are not a pass through in the true up mechanism thus leading to the situation that the fair rate of return may only be on paper. Such risks, inter alia, include:
 1. *Risk of change in traffic mix*
 2. *Risk of traffic within the traffic band*
 3. *Forex fluctuation*
 4. *Increase on operating costs for reasons beyond control of airport not fully compensated by WPI increase*
 5. *Increase in Capex/opex as mandated by government post tariff fixation.*
 6. *Non remunerative assets of Non Aero being excluded by the Authority*
 7. *Now allowance of bad debts*
 8. *Disallowance in capex*
 9. *Changes in rate of interest*
 10. *10% depreciation on RAB not being allowed*
 11. *Shortfall in Non Aero revenue*
 12. *Mandated discounts is not allowed*
 13. *Non achievement of X (efficiency factor)*
 14. *Force majeure*
 15. *Change in Tax Rates and Penalties and Interest on Taxation*

- Additionally, profits retained by the airport operator which are subsequently deployed in any non-regulated activity ought not to be under regulatory review and the income from such investments, in any form, should not be used for future tariff determination.
- Similarly, profits retained by the airport operator which is subsequently deployed in any regulated activity should be treated as equity on which CAPM based equity return be provided and interpolated in the fair rate of return computation.

V. OPERATION AND MAINTENANCE EXPENSES

The following are our observation w.r.t operation and maintenance expenses as covered in the guidelines;

- We differ with the Authority view that in its assessment, the following cost are controllable;
 - Foreign Exchange Fluctuation
 - Bad Debts
 - Force Majeure conditions
- In case where the operator has certain expenses to be incurred in foreign currency, the same would have to be forecasted at the beginning of the Multi Year Tariff Proposal at the notional prevailing exchange rate. It is understood that at the time of actual settlement of such costs, there would be variation from the earlier forecast due to change in the market rate for such foreign currency. Such situation may lead to an exchange gain or loss from the earlier estimate. Since, the Authority treats foreign exchange fluctuation as controllable, such gain or loss would not be considered while doing error correction at the time of annual compliance. In our view, it would be unfair to expose the operator, who has no control over the fluctuation in the foreign currency rate, to such market fluctuation.
- The operator would not be in a position to absorb any impact of bad debt. The Authority should allow the bad debt subject to its satisfaction that that the operator had made and demonstrated that reasonable effort were made for the recovery of the said dues but could not be realised to factors beyond the control of the operator. It may be noted that provisions exist in the Income Tax Act, 1961 to consider impact of bad debts.
- Any substantial change in the forecasted traffic will also entail change in forecasted expenditure. An allowance to this account should also be permitted by the Authority through its error correction mechanism at annual reviews.
- It is assumed that operation and maintenance of non-aeronautical assets would also be allowed irrespective by what so ever name it may be referred to.
- Further, the Authority has not considered allowance of any operating and maintenance cost for any new capital investment mandated, and undertaken within the control period, by the Central or State Government or Competent Authority. The operator would not be in a position to envisage such events and costs at the time of Multi Year Tariff Proposal. Therefore, such expenditure should be considered on actual basis and appropriate correction the allowable yield should be made through error correction mechanism.
- There may be instances where the date required in the attached formats or the period sought may not be available. It is presumed that in such circumstances the operator shall submit details to the extent possible.
- The Base Line expenditure at the start of the control period must be realistic based on the business environment contemplated by the airport operator.

VI. DEPRECIATION

The following are our observation w.r.t depreciation allowance as covered in the guidelines;

- The Authority proposes that only **90% of the asset value** be allowed for computing depreciation. This is in **contradiction with the Companies Act, 1956** and it is suggested that **95% of asset value** be allowed for computing depreciation.
- We understand that Authority has advocated an approach for the provision of the financing allowance i.e cost of debt on the opening WIP_{t-1} and on the average of the Capex net of the Grant and Commissioned Assets, for the Project Assets. In line with the aforesaid approach, this principle should also be extended to the existing commissioned project assets. **Thus the cost of equity on the equity financed portion of the project assets should also be capitalized based on their respective commissioning dates and this be suitably reflected in the Initial RAB with corresponding adjustment in accumulated and current depreciation.**
- Depreciation on **assets funded by grants/ development funded assets** should be allowed as the same is permitted in other regulated sectors (e.g. Power)

VII. TRAFFIC

- Authority has **not considered change in ATM** as change in volume estimate while doing the error correction mechanism. **Variance in ATM traffic mix is dependent on the airlines** and the airport operator has no control over the **forecasted mix**. **Therefore, the adjustment of variation in the actual yield** due to such event must be suitably addressed at the time of annual compliance with appropriate correction in the allowable yield.
- We understand that in respect to the traffic estimate submitted by the operator, **the Authority may accept or approve a different traffic forecast**. If actual traffic falls short of such stretched traffic estimate, the airport operator should not be called for to make up the loss in the traffic.
- The Authority has sought a long term **15 years traffic forecast which is difficult to predict and may not be accurate**. Additionally **10 year historical data has been sought which may not be entirely available with the operators**. Therefore, we request Authority to kindly re-visit the said requirement.
- **Considering the above provisions of traffic forecast, it is difficult to understand the need for user consultation** in traffic forecast which may not be stipulated.
- **Basing the traffic forecast on historical growth may be erroneous as historical growth would be on a low base which may not be a sustainable scenario into the future.**

VIII. TAXATION

- In the normal process of assessment of taxation, various contentious issues may come up having an impact on taxation that may need to be appealed and contested. Consequently penalties and interest on taxes may be imposed and should be allowed as a pass through vide error correction mechanism.
- It is hereby re-iterate that any tax benefits provided by the Government to attract investment should not be taken away and the computation of taxation done without considering tax benefits and incentives.
- In normal course of business there may be a situation that any additional tax demand may become payable due to difference in legal interpretation or assessment of past years. This should be allowed as a pass through an error correction mechanism.
- The operator should be allowed to retain the tax shield i.e notional tax on expenditure not considered in a regulatory determination.
- Further, Authority has not considered any change in the corporate tax rate for the purpose of error correction in the allowable yield. We are of the view that such implication may be suitably incorporated at the time of annual review and not at the end of control period.

IX. ERROR CORRECTION

- Authority has been mandated to fix the yield for quinquennia. If the Airport operator by any circumstance, including but not limited to market conditions, is not able to recover the entitled yield for a particular tariff year, the deficit if any should be allowed to be recovered in the subsequent tariff year within the control period. If during any tariff year within the quinquennia the airport operator has not been able to charge the mandated yield rate he should have the liberty to recover the shortfall in any further year within the quinquennia.
- The following cost should be considered by Authority for effecting error correction;
 - Foreign Exchange Fluctuation
 - Bad Debts
 - Force Majeure conditions
 - New Capex/Opex mandated by the Central/State Government or Competent Authority.
 - Change in the Interest rate of debt from the forecasted rates.
 - Variation in Discount
- It is difficult to accurately project future capex value. There can be a cost variation and/or time variation in future projected capex. A time variation due to reasons beyond the airport operator's control should be suitably adjusted in error correction mechanism. Similarly reasonable cost variations should be suitably adjusted to the RAB value in annual compliance.
- Further, error correction mechanism should suitably address any variance in ATM traffic mix since the airport operator has no control over the same. Therefore, the adjustment of variation in the actual yield due to such an event must be suitably addressed at the time of annual compliance with appropriate correction in the allowable yield.
- Further, we understand that in respect to the traffic estimate submitted by the operator, the Authority may accept or approve a different traffic forecast. If the actual traffic falls short of such stretched traffic estimate, the airport operator need not be called for to make up the loss in the traffic.

X. QUALITY OF SERVICE

- **The concession agreement of airport operators lays down quality parameters.** The relevant provisions of the concessions have mandated the standards and time frame for achieving the same. Therefore the provisions of the relevant concession documents should be followed in this respect.
- As per the AERA Act, 2008 Authority has been mandated to **only monitor** the pre-set quality standards. Any new standard prescribed by Authority goes beyond the mandate.
- Further any **penalty for non-achievement should not be imposed over and above the penalty provisions as prescribed in the concession documents.**

XI. INCENTIVES

- In order to encourage time and efficient investments, Authority may specify a RAB adjustment. **The consultation paper does not elaborate further on the mechanics of computing the said incentive which may please be done.**
- Further, appropriate incentive mechanism should be **embedded in the tariff determination process so as to encourage the airport operator to meet the target ASQ** as given in the concession agreement.
- Any savings in the opex achieved by the airport operator should be allowed to be benefitting him in deciding the base airport operating expenses of the next quinquennia. Due consideration to the saving achieved in the last year of the control period must be given for incentivising the airport operator.

XII. CARGO, GROUND HANDLING AND FUEL FARM

- We welcome the light touch regulation the Authority proposes to follow in respect of cargo, ground handling and fuel farm services.
- **Given the light touch regulation, revenue from outsourced independent service providers should not be regulated or used in tariff determination.**
- **From the reading of the consultation paper, it is presumed that the profit/loss from these services would not be used in determining tariffs as this would lead to double control of the service. This may be suitably clarified.**
- **Demurrage charges are in the nature of rentals which are non-aeronautical and are not in nature of cargo handling charges and as such should be excluded from tariff fixation.**
- **Authority has required the airport operator to maintain separate account for the aforementioned three services. This is an onerous exercise and may please be dispensed with.**
- **Fuel Throughput charges are non-aeronautical in nature and their regulation is also against the provisions of concession agreements.**
- **Clarity is also sought in circumstances where a service provider is providing service to end users who have all signed agreements and a soft touch regulation has been approved and later on a new end user joins who do not have user agreements. It is presumed that once the approval is received for 5 years it will prevail.**
- **The consultation process in a scenario where competition is already there does not have any purpose and the same may be dispensed with.**
- **We also seek Authority's support in laying down the time frame taken by the Authority in final tariff approval.**
- **We also seek clarification on data submission.** There may be instances where the date required in the attached formats or the period sought may not be available. It is presumed that in such circumstances the operator shall submit details to the extent possible.

XIII. OTHER ISSUES

- a. **Force Majeure:** Specific provision to address force majeure situations need to be there in the order.
- b. **Discounts:** Discounts which are transparent and non-discriminatory in nature, including the ones mandated by Government should be allowed to be part of tariff determination. Disallowance of the same tantamount to reduction in fair return.
- c. **X Factor:**
 - i. Mechanism of fixation of X Factor has not been explained in the consultation paper and may please be suitably explained.
 - ii. Reasonable and achievable efficiency target i.e 'X' should be given.
 - iii. There should be provision for a reasonable time lag to achieve efficiency.
- d. **Confidential Information: Security related information** should also be treated as confidential.
- e. **Control Period:** More clarity is required to assess how the historical losses would be covered in tariff fixation in the first control period.
- f. **Period for Tariff Filing:**
 - i. The Sixty days period for Multi Year Tariff Proposal is an onerous target and should be suitable addressed.
 - ii. The Authority may also provide time lines it would take to approve tariff proposals.
 - iii. In case of annual compliance, an extension for annual review should be allowed if the annual account finalization has been extended by Registrar of Companies.
- g. **Efficiency for Existing Assets (Already capitalized):** It is presumed that the efficiency of assets already capitalized in the books of accounts will not be questioned and the proviso related to efficient procurement of assets exceeding 5% of assets will not be applicable to historical assets.
- h. **Consultation Process**
 - i. **Investment in Non-Aeronautical Activities** should not be part of Consultation process
 - ii. **Consultation for Future Capex, in order to be effective should be taken up only at the time of actual implementation of the said capex.**
- i. **Dividend from Investment** is an activity outside the airport business and as such should be outside the regulatory purview. Investment in these activities as well as dividend thereof should not form part of tariff determination.
- j. **Pricing:** Authority has given the preference for airline charge. However, it should be left to the respective airport operator to devised an efficient pricing structure which is non-discriminatory.

XIV. LIMITED RESPONSE

The present reply is limited to issues that may have a possible bearing on the determination of tariff. It might not have dealt with some of the general issues raised in the Consultation Paper which are not likely to affect tariff determination in view of the principles applicable to it under the concession agreements. The response being filed should be considered in relation to the specific issues identified in the response. We may file further responses including amending, adding, deleting or editing the responses in this submission if so deemed necessary.