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COCHIN INTERNATIONAL AIRPORT LIMITED

CIAL/FIN/AERA/101 28.06.2017

Let us finalise the Tariff order.

Shri S. Machendranathan
Chairman
Airports Economic Regulatory Authority of India
Safdarjung
New Delhi - 110003

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Secy.

ACM(F)
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DGM(Fin)

Dear Sir,

Sub: Submissions by CIAL to Multi-Year Tariff Proposal published by the Authority for Cochin International Airport

Ref: Consultation paper No. 06/2017-18 dated 12.05.2017

At the outset, we thank AERA for the release of consultation paper No. 06/2017-18 in the matter of determination of tariffs for Aeronautical Services in respect of Cochin International Airport, Cochin for the second control period on 12th May 2017.

The stakeholders have submitted their comments on the said consultation paper. CIAL has reviewed the comments submitted by the stakeholders in response to the proposals put forth by the Authority. CIAL's submissions to the stakeholders' comments are listed in the table below for your consideration:

No.	Reference	Stakeholder's submission	CIAL's submission
		IATA	
1.	Proposal 7	In addition to the comments provided earlier in asset allocation (which would affect the RAB calculations), it would be essential that any future true ups of capital expenditure are also accompanied with a capital efficiency study. Otherwise, CIAL will not be incentivised to deliver its capital program efficiently (moreover, such analysis should have been done ex-ante and ex-post).	1. Cochin International Airport is widely recognized as a low-cost functionally efficient airport. Historically, the interest of travellers has always been given due consideration in all decisions taken by CIAL. The world-class infrastructure is provided at affordable rates to users. 2. CIAL has been successful in developing a low cost airport with a relatively low capital expenditure. This has been made possible through: a. Modular expansion philosophy b. Award of multiple contracts competitively tendered as opposed to a single large turnkey contract c. Simple and no-frills development model d. Use of locally available materials e. Prudent financial management

			3. CIAL's focus on efficient cost for development of infrastructure has not been compromised even for construction of the new international terminal. The cost of the new international terminal and associated infrastructure is almost half of comparable airport terminals built in the country on a cost/sqm basis and well within the normative benchmark provided by AERA. Cost per square meter of newly constructed airport is Rs62917 which below the normative rates prescribed by AERA. 4. CIAL will continue to focus on developing affordable infrastructure for its customers as specified in the normative norms of the Authority.
2.	Proposal 8, Point i	Reducing the employee costs attributed to aeronautical from CIAL's 96.4% to 82%. A comment regarding the staff count for non-aeronautical which seems exceptionally low; only 4 staff for duty free and 3 staff for Golf and Country club operation which either imply a small and insignificant operation or an error in correctly identifying the number of staff correctly.	1. At Cochin International Airport, majority of non-aeronautical services are outsourced to more experienced concessionaires to bring in efficiency in non-aeronautical revenue generation. Therefore, only few employees are involved in managerial activities for non-aeronautical services and majority of employees are involved in aeronautical activities. Additionally, with the duty free operations outsourced to independent entity, the existing duty free employees have been re-allocated to other aeronautical services. 2. Based on CIAL's estimates, the aeronautical component of employee costs is 96.4% whereas the Authority has taken 82% as aeronautical employees. CIAL requests the Authority to adopt 95% to 5% ratio for allocation of employees' costs in line with the decision taken for similar airports in the region.
3.	Proposal 8, Point ii	Salary costs growth projection is brought down by AERA as well to a more reasonable level from 50% to 25% in 2017 and thereafter capped at 7% every year instead of 10%. This is a	1. CIAL has continuously endeavoured to provide reliable and efficient services to users at very reasonable tariffs (lowest compared to other privately managed airports).

		step in the right direction but more can be done. Again, the focus should be on cost control initiatives to do more safely, securely, efficiently and sustainably.	2. The revision in personnel costs for staff cadre and officer's salary is as per actual plans of increase by 50% in FY2018. 3. Additionally, the salaries are revised by 10% year on year and is as per actuals based on past trends. 4. CIAL requests the Authority to adopt the increase in salaries as submitted by CIAL.
4.	Proposal 10	The cost of equity return at 14% determined by AERA is still on the high side, especially in the backdrop of consistent CIAL's profitability and issuance of dividends. Additionally, AERA should consider a notional gearing (one that defines an optimal capital structure), rather than using actuals. As well. care must be taken when truing up the cost of debt, as this practice would not incentivise the airport to manage its finances in the most efficient manner.	1. The tariff determination guidelines set by AERA provides a return to investors apart from covering costs pertaining to operating expenditure, depreciation, interest and tax. However, in case of older airports like Cochin, tariff determination before the application of regulatory framework was not linked to the capital investment and other costs. 2. In fact, the tariffs charged or aeronautical revenues earned by Cochin airport was much lower than what would have been permissible under a generic cost-plus framework as espoused in AERA's tariff Guidelines. 3. Revenues earned by CIAL have not been able to cover its costs entirely in the initial years let alone compensating its investors. 4. Historically, the profitability of CIAL is due to the prudent cost management and focus on increasing non-aeronautical revenues and cannot be linked to applicability of regulatory framework for 2nd control period with lower cost of equity. 5. The Authority has proposed 14% cost of equity for CIAL whereas it has allowed 16% cost of equity for other airports such as Delhi, Mumbai, Bangalore and Hyderabad. 6. As per the recent order for Trivandrum airport, FRoR allowed for AAI airports is 14% which has no debt whereas the Authority has proposed 14% as cost of equity for CIAL which has used debt for financing development of new

			international terminal and other capital expenditure. 7. With the cost of equity of 14%, the resultant FRoR for CIAL is 11.2% only. Given the nature of ownership of AAI and CIAL, cost of equity for CIAL is higher than AAI. However, Authority has provided a lower cost of equity for CIAL. 8. All the airport operators should be allowed reasonable return on equity and the cost of equity should be same and fair for different airport operators in India. 9. Different cost of equity for different airport operators also leads to ambiguity and inconsistency for investors at a time when the government is focused on increasing private sector participation in airports development and operations. 10. Therefore, CIAL requests the Authority to consider cost of equity at 16%. 11. CIAL has taken debts to finance recent capital expenditure and it is not reasonable to shift to normative capital structure in short period of time. Using normative capital structure instead of actuals will penalize the CIAL for effectively utilizing internal accruals for capital expenditure. Therefore, CIAL requests the Authority not to adopt normative capital structure in line with decision taken for other similar airports in the region.
		FIA	
5.	Point 16	CIAL's first control period is not over yet, wherein AERA stated that CIAL rates will continue at the existing level on ad-hoc basis. It further states that MYTP for the second control period will be determined by incorporating the actual financials of 2014-15, which would be examined by the	1. CIAL has presented the following unique features of Cochin Airport while presenting a case for light touch regulatory approach for first control period and the same were considered by the Authority: a. Aeronautical tariffs at Cochin Airport are among the lowest in

		AERA along with the aggregate revenue requirement for the first control period. This means AERA need to do the true-up of first control period financials, which is pending before finalizing the tariff for second control period.	India and have remained unchanged since 2001. b. Historical tariffs at Cochin Airport had not been linked to capital investment and other costs. The aeronautical revenues tariffs at Cochin Airport have been much lower than what would have been permissible AERA's under its tariff guidelines. c. CIAL had kept the tariffs low to make travel affordable to passengers. d. CIAL's investors also had foregone their dividends during the initial period of operations with the expectation of earning higher returns with growth of traffic and profitability. e. There was a mismatch of investment cycle with regulatory control period cycle resulting in a unique adverse situation for CIAL, unlike for other private or government run airports in the country f. It was also pointed out that an abrupt administration of tariff guidelines in the prevailing situation would result in a tariff shock for CIAL 2. AERA had taken due cognizance of the factors listed above and allowed CIAL to continue with the prevailing tariffs for the first control period. AERA had given detailed reasoning on continuation of existing tariffs in its consultation paper. The consultation paper also underwent a detailed user consultation process during 1st control period. 3. Moreover this non truing up matter was deliberated during the stakeholders meeting for the first control period and none of the stakeholders including FIA has objected to it. It is not clear as to why FIA raises this matter in the stakeholder consultation for the second control period. This matter being

			discussed and finalised during the first control period, a revisit on the matter is not warranted at all.
6.	Point 17	We witnessed a substantial jump in the landing charges of 54% & cargo charges in the very first year, which should rather be increased gradually over the period.	1. The aeronautical Cochin Airport are among the lowest in India and have remained unchanged since 2001. 2. The increase in aeronautical tariffs is proposed after 17 years and is due to significant investments for capacity expansion and upgradation. Morevoer, unlike in other airport, we have not proposed in increasing the tariffs of all aeronautical tariff heads. In order to mitigate the hardships to passenger we avoiding charging any UDF too. 3. CIAL therefore submits that the proposed increase in tariffs is justified based on the ARR approved by the Authority.
7.	Point 18	AERA proposes FRoR of 11.17% to CIAL, whereas the financials submitted by CIAL depicts that there is a substantial jump in Dividend payout from 18% (Rs. 55 crores) to 27% (Rs. 135 crores) during the period 2011 to 2014. Therefore, financial requirement should be first met out from internal accruals rather than increase in tariff charges.	1. The tariff determination guidelines set by AERA provides a return to investors apart from covering costs pertaining to operating expenditure, depreciation, interest and tax. However, in case of older airports like Cochin, tariff determination before the application of regulatory framework was not linked to the capital investment and other costs. 2. In fact, the tariffs charged or aeronautical revenues earned by Cochin airport was much lower than what would have been permissible under a generic cost-plus framework as espoused in AERA's tariff Guidelines. 3. Revenues earned by CIAL have not been able to cover its costs entirely in the initial years let alone compensating its investors. 4. Historically, the profitability of CIAL is due to the prudent cost management and focus on increasing non-aeronautical revenues and cannot be linked to applicability of regulatory framework for 2nd control period with lower cost of equity. 5. The Authority has proposed 14% cost of equity for CIAL whereas it has

			allowed 16% cost of equity for other airports such as Delhi, Mumbai, Bangalore and Hyderabad. 6. As per the recent order for Trivandrum airport, FRoR allowed for AAI airports is 14% which has no debt whereas the Authority has proposed 14% as cost of equity for CIAL which has used debt for financing development of new international terminal and other capital expenditure.With the cost of equity of 14%, the resultant FRoR for CIAL is 11.2% only. Given the nature of ownership of AAI and CIAL, cost of equity for CIAL is higher than AAI. However, Authority has provided a lower cost of equity for CIAL. 7. All the airport operators should be allowed reasonable return on equity and the cost of equity should be same and fair for different airport operators in India. 8. Different cost of equity for different airport operators also leads to ambiguity and inconsistency for investors at a time when the government is focused on increasing private sector participation in airports development and operations. Therefore, CIAL requests the Authority to consider cost of equity at 16%.It is a fact that CIAL paid dividend of 25% during FY 2015-16 amounting Rs 103.60crore. 9. CIAL has taken debts to finance recent capital expenditure and it is not reasonable to shift to normative capital structure in short period of time. Using normative capital structure instead of actuals will penalize the CIAL for effectively utilizing internal accruals for capital expenditure. Therefore, CIAL requests the Authority not to adopt normative capital structure in line with decision taken for other similar airports in the region.

8.	Point 19	CIAL is the only airport, which charges for X-ray in addition to the PSF. In parity with other airports the X-ray charges should be withdrawn, when PSF is being collected.	1. X ray charges are essentially aeronautical charges and are charged to recover significant capital expenditure and operational expenditure incurred by CIAL for related systems and equipment over the years. Unlike most of other airport operators , CIAL renders the service of security screening of baggages at airport and collect revenues against it . These charges are fixed at the same level when Air India was rendering the security screening services to airlines. This activity was taken over by CIAL by investing capital expenditures and operational expenditures towards maintenance and staff costs. We continue to levy what had been levied by Air India while rendering the same service to airlines. As such we haven't changed any methodology or rates in this regard. 2. Given the nature of X-ray charges as aeronautical charges, there is no additional impact on total cost to the passengers.
9.	Point 21	In addition to the above, there is substantial increase in Salary, Electricity Charges and water charges, which needs rationalization.	1. With the commissioning of new international terminal and significant increase in area of terminal operations, new employees have been recruited which has increased the employee costs. Additionally, the salaries are revised in FY 2017-18 due to revision in pay scale. 2. Increased area of new international terminal has also impacted consumption of electricity and water. The growth in consumption of electricity and water has resulted in increase in utility costs at CIAL. The details have been submitted along with the break-up of costs as part of MYTP submissions and clarifications provided thereof.
10.	Point 22.1	AERA has mentioned that after the commissioning of the new International Terminal, the	1. The existing old domestic terminal was developed in 1999 and has a maximum peak hour handling capacity of 800

		existing International Terminal would be converted as the new Domestic Terminal, with a fivefold increase in area. However, projected growth of pax during the second control period is only 44% (for Domestic) and 48% (for International). Thus, there is no significant justification of the proposed expansion.	php. The domestic terminal was operating beyond its maximum passenger handling capacity and was facing severe congestion related issues because of which the passenger service quality levels were getting impacted. 2. The existing old international terminal had a maximum peak hour handling capacity of 2,400 php. 3. CIAL could have built a new domestic terminal to handle the increased domestic traffic with significant capital expenditure. After few years, existing international terminal would have become congested and required additional capital expenditure towards construction of new international terminal. 4. Instead, to manage the capital expenditure prudently and use the terminal assets effectively, to lower the burden on the passengers and to address the capacity constraint at the domestic terminal as well as cater to future growth in international traffic, CIAL decided to develop a new international terminal at the airport. The existing international terminal would thereafter be converted to a domestic terminal, thus enhancing both the domestic and international passenger handling capacity at the airport. 5. CIAL submits that comparing the 5 years traffic growth in the second control period with the increased terminal area is not correct as the existing old terminals were already congested and the increased terminal area will support the traffic growth beyond second control period as well.
11.	Point 22.7	AERA proposes to adopt growth rate as proposed by CIAL without taking into consideration that with introduction of new International Terminal, there would be more scope for growth in both domestic and	1. The existing old domestic terminal was developed in 1999 and has a maximum peak hour handling capacity of 800 php. The domestic terminal was operating beyond its maximum passenger handling capacity and was facing severe congestion related issues

		international passenger traffics. If AERA expects a normal growth of 10%, it should justify the introduction of new International Terminal. Further, vide 5.2.5 AERA has accepted that ATM of CIAL in the year 2021 would be in line with the Pax per ATM trends at BIAL and HIAL's airports. Therefore, AERA needs to undertake comparative study of the ATMs between CIAL vis-a-vis BIAL and HIAL before accepting the traffic growth mentioned by CIAL	because of which the passenger service quality levels were getting impacted. 2. To address the capacity constraint at the domestic terminal as well as cater to future growth in international traffic, CIAL decided to develop a new international terminal at the airport. The existing international terminal would thereafter be converted to a domestic terminal, thus enhancing both the domestic and international passenger handling capacity at the airport. 3. AUCC was conducted in FY 2013-14 to construct the new international terminal wherein the need for construction of new terminal was justified to all the stakeholders based on the historical traffic growth and capacity of then existing terminals. All the stakeholders had agreed for development of new international terminal. FIA and IATA were also included as the members of AUCC and invited for stake holders meeting. However, they have informed their inability to attend the meetings due to other preoccupations. All the rest of participants including the operating airlines in this airport has welcomed the expansion program and accordingly we went ahead with the major capital expansion project and we have completed before time and within the normative costs and terminal is functioning well. Hence, the apprehensions raised by FIA is a misplaced one.
12.	Point 22.11	A 100% subsidiary (CIAL Duty Free and Retail Services Limited CDRSL) was set up which commenced operations in June, 2016. This we believe has been set-up in order to take the advantage of Hybrid till approach. Accordingly, there is significant reduction in the revenue that can be charged to cross-subsidize Aero cost from	1. Historically, CIAL has been managing the duty free operations at Cochin International Airport and has gained significant experience in the same. CIAL wants to build on this experience and develop a new business line to tap the duty free operations at other airports. CIAL is partnering with a specialized agency for operations of duty free business to put in place

		Rs 212.49 crores in year 2016 to Rs 60.14 crores in year 2017.	international best practices for the new international terminal. CIAL is desirous of increasing the volume of the duty free operations significantly and bringing greater operational expertise and efficiencies into the duty free business which will eventually will be benefited by all stakeholders as the enhanced revenue earnings will also be used for cross subsidization.
BPCL,HPCL, IOCL			
14	Fuel Throughput Royalty	It is observed that, substantial increase in the Throughput charges. is proposed as compared to existing charges. We request AERA to review the proposed increase in Throughput charges as the increase appears-to be steep: We further request that any revision in Fuel Throughput charges should be approved on prospective basis only.	The fuel through put royalty prevailing in the airport is Rs 209 per Kilo liter receivable from the exclusive right holder namely BPCL. The agreement with BPCL was renewed on financial year 2015 for another period of 30years. As per the revised agreement, the royalty receivable from M/s BPCL is Rs 758.17 per kl w.e.f 1st April 2016 with an annual escalation of 5%. However, this revision was subject to AERA approval being an aeronautical revenue. Hence, for want of final approval of AERA the revised rates could not be effected from 1-04-2016 and under recovery of this revenue was to the extent of Rs 16.71 crore. As rightly pointed out by HPCL and IOC, we need to implement the rate revision only on prospective basis as it will be difficulty for petroleum companies to collect any retrospective charges from their clients. Hence ,we reworked the agreed rates on a prospective basis and arrived at the revised royalty figure of Rs 936.53 for the financial year 2017-18 and 5% escalation thereafter. This was discussed and agreed upon by M/s BPCL with the agreement exists and have the exclusivity contract for next 30 years. As such HPCL and IOC does not have any privy to this agreement. Moreover, as fuel throughput royalty is

			also classified under aeronautical charges, there is no additional impact on total cost to the passengers and airlines.

We request the Authority to give due considerations to our submissions.

Thanking You

Yours faithfully,

V J Kurian
Managing Director