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Federation of Indian Airlines

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September 28, 2010

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Chairman
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Subject: Comments & submissions of the Federation of Indian Airlines (FIA) tendered in response to the Consultation Paper No.6 (Revision of Fuel Throughput charges by Airport Operator).

May 02 file

Dear Sir,

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15/10/10

The Federation of Indian Airlines a key Stakeholder under AERA Act sincerely request the authority to analyze the impact of fuel throughput charges in the context of the fact that cost of aviation fuel (ATF) constitutes around 40% of the operating cost of an airline and it is more important because there exist a direct correlation between the fuel throughput charges and ATF, therefore, any hike in the fuel throughput charges necessarily entails an increase in the cost of ATF.

The FIA through its representations at various forums have brought to the kind attention of authorities that a lower ATF prices will provide fillip to the aviation sector and help airlines who have been long demanding the rationalization of taxes on jet fuel due to protracted economic recession that been plaguing the airline operators.

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.

Enclosed is the submission on behalf of FIA for your kind consideration.

Thanking you,

Yours Sincerely,

Nirmal Dey

FEDERATION OF INDIAN AIRLINES

464/C1/1024
15/10/10

I. Introduction & Preliminary Submissions

1. Based on request of the Airport Operators¹, discussed below, the Consultation Paper No. 6/2010-11 dated 14.09.2010 titled "Revision of Fuel Throughput charges by airport operators" (**Consultation Paper**) was issued by the Airports Economic Regulatory Authority (**the Authority**). The members of FIA hereby place on record their submissions and comments on the proposal to enhance the Fuel Throughput charges by 5% for 9 of the 10 airports and by 20% for Cochin. A summary of the Background leading to this Consultation Paper is set out in the **Attachment I** hereto.

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

(a) Pursuant to the enactment of the "The Airports Economic Regulatory Authority of India Act, 2008" (**the Act**), the Airports Economic Regulatory Authority was established on 12.05.2009 to perform the functions vested under the Act, which includes determination of tariff for aeronautical services.

(b) As per Section 2(a) of the Act, any service provided for supplying fuel to the aircraft at an airport is an 'aeronautical service' and the tariff for such aeronautical service at a major airport is to be determined by the Authority after taking into consideration various factors as provided under Section 13 (1)(a), being:-

(i) the capital expenditure incurred and timely investment in improvement of

¹ Being the Airport Authority of India for seven Airports (Chennai, Kolkata, Trivandrum, Ahmadabad, Calicut, Gawahati and Jaipur); the Mumbai International Airport Limited (MIAL); the Delhi International Airport Limited (DIAL); and the Cochin International Airport Limited (CIAL).

- airport facilities;
- (ii) the service provided, its quality and other relevant factors;
 - (iii) the cost for improving efficiency;
 - (iv) economic and viable operation of major airports;
 - (v) revenue received from services other than the aeronautical services;
 - (vi) the concession offered by the Central Government in any agreement or memorandum of understanding or otherwise;
 - (vii) any other factor which may be relevant for the purposes of this Act.
- (c) Thus the Authority is vested with the statutory responsibility to regulate Fuel Throughput Charges, which is subject matter of the present Consultation Paper.
- (d) Besides the factors specified in Section 13(1) (a) (i) to (vii), while undertaking such regulatory exercise, the Authority is obliged to bear in mind all applicable laws and treaty obligations under the International conventions/treaties to which India is a signatory and is bound by law to abide by the same under Section 13(1) (a)(vii). One such convention is the Chicago Convention on International Civil Aviation, 1944 under the aegis of which the International Civil Aviation Organization (**ICAO**), where India is one of the contracting states of the convention. 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 7th Schedule of the Constitution of India. ICAO has published 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. Copy of the relevant extracts of the ICAO policy is set out as **Attachment II**.

II. Scope of the Present Consultation Proceedings

3. The consultation process has been initiated by the Authority under the mandate of the Act for approving the revision in the Fuel Throughput Charges with effect from 01.04.2010 as proposed in para 5 of the Consultation Paper. The present consultation process seeks to elicit feedback, comments and suggestions from the stakeholders on the aforesaid proposal to approve the revised Fuel Throughput Charges retrospectively.

4. It is respectfully submitted that the following are critical aspects to be borne in mind by the Authority in taking a considered decision on the issues that arise in the present Consultation.

5. As per the ICAO Policy on User Charges (Doc 9082), the throughput charges should be on "cost" basis. It is noteworthy that there appears to be no filing based on audited accounts, accounting standards and norms to establish the "cost" basis of the Fuel Throughput charges being imposed presently by the Airport Operators. Being an economic regulator functioning under the framework of the Act, in particular Section 13(1)(a), it is incumbent upon the Authority to discover the "cost" basis and satisfy the "prudence" and "reasonability" of the charges being recovered as also the enhancement being proposed by the Airport Operators. Copies of the relevant judgments are annexed hereto and marked as

Attachment III².

6. The infrastructure for fuel supply at the airports fall under AERA's purview and revenue calculated from it is considered as aeronautical charges by the airports operator. This aspect is enshrined in para 4.9 of the Consultation Paper No.3/2009-10 issued by the Authority on 26.02.2010.

7. There exists a direct correlation between the Fuel Throughput charges and cost of aviation fuel and any hike in the Fuel Throughput charges necessarily entails an increase in the cost of fuel. In this context, the Authority must bear in mind that:-

- (a) Fuel Throughput Charges are recovered by the Airport Operator from Oil Companies supplying aviation fuel and the Oil Companies invariably pass on the burden to the airlines, who have not alternative but to pay increased costs for the aviation fuel.
- (b) The overriding concern of the Airline Operators across the world has been the high cost of the aviation fuel that is having a crippling impact on the aviation business globally.

8. It is submitted that the impact of Fuel Throughput charge needs to be analyzed in context of the fact that the cost of the fuel constitutes around 40 per cent of operating cost of an airline and lower fuel prices would provide fillip to the aviation sector and help airlines who have been long demanding the rationalization of taxes on jet fuel due to protracted economic recession that been plaguing the Airline Operators.

² G.V.K. Power Ltd. Vs. PSERC before APTEL [2009 ELR (APTEL) 193]; NDPL Vs. DERC & Ors [2007 ELR (APTEL) 193]; KPTCL Vs. KERC & Ors [2007 ELR (APTEL) 223]

9. It is submitted that a reduction in the cost of fuel cost has a discernible impact on the airline balance sheets which are dampened with already high taxes, cost of aviation fuel & airport charges. Any distortion in fuel price by the domestic Oil Companies and the taxation structure results in a huge cost burden on the Airline Operators by making airlines in India uncompetitive and unattractive for equity capital and debt financing. Therefore there is a need for rationalization of fuel prices for domestic operations, to international benchmarks which would result in considerable savings for the airline industry, which is cash strapped.

III. Comments and Suggestions

10. The present consultation deals with the revision in Fuel Throughput charges without first analyzing whether there is any real cost basis for the same. If any such data is available, the same must be made available to all stakeholders to make the consultation effective and comply with the requirements of the Act. It is submitted that the said imposition itself has no justification and as such the charging of such a Fuel Through fee is not justified.

11. It is pertinent note that as a regulator under the Act, the Authority is entrusted with the task of determining the tariff for aeronautical services, which inter-alia includes 'supplying fuel to the aircraft at an airport' and in doing so Section 13(1) of the Act makes it mandatory for the Authority to take into consideration various factors such as -

- (a) capital expenditure incurred;
- (b) investments in improving the airport facilities;
- (c) service provided, its quality and other relevant factors;
- (d) cost of improving efficiency;

- (e) economic and viable operation of major airports;
- (f) revenue received from services other than aeronautical services;
- (g) the concessions offered by the Central Government; and
- (h) any other factors like the ICAO policy and prudence, which may be relevant for the purpose of the Act.

12. It is submitted that the Authority acting within the purview and statutory mandate of the Act is under a statutory obligation to carry a detailed exercise taking into consideration various factors as indicated in the Act and any other factors which may also be relevant for the purpose of regulating the tariff. It is further submitted that the Authority in determining the rate of Fuel Throughput charges cannot not merely revalidate the existing commercial arrangements between the Airport Operators and Oil companies except to the extent they are cost based. The existing commercial arrangements between the Airport Operators and Oil Companies is only one of several factors, and not an overriding factor. The basis for such commercial arrangements that lead to an additional cost burden has also to be separately looked into by the Authority. In this regard the Airport Operators and the Oil Companies have to submit data which will form the basis of the said Throughput charges.

13. It submitted that the Airport Operators have not provided any documents and data, whatsoever, which will justify the 5% or 20% (as applicable) increase in the Fuel Throughput charges except for a statement that the commercial agreements provide for a 5% or 20% increase (as applicable).

14. It is submitted that while allowing the Airport Operators to levy Fuel Throughput Charges 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 particularly when there is no cost basis, as it might result lead the whole aviation industry in a serious predicament.

15. It is pertinent to note that Aviation Fuel which is a critical factor in the economy of flight operations accounts for a large proportion of airline costs. This makes it increasingly important that refueling costs are both transparent and fair. The industry is already operating under unceasing serious financial constraints arising out of myriad political, social, technical, geographical and economic facets, which pose an unfeigned threat to its existence. Given the existential realities coupled with the ubiquitous economic uncertainty, the Airline industry is simply not in a position to absorb unjustified increase in over all fuel costs.

16. At the Airports, the Fuel suppliers are already paying exorbitant land rentals for making available the land for anchoring the fuel facility. In addition to land rentals the Airport Operator have been charging a Fuel Throughput Fees, which has no cost basis and which is invariable factored in by the Oil Companies who are unrelenting in absorbing the said costs.

17. The discernible fact, which ought not to be overlooked by the Authority is that Fuel Throughput cost as applied by Airport Operators, is effectively in the nature of a tax since it has no cost basis and that it is an impost not on the Oil Companies but on the airlines as the said cost has a direct significant impact on the fuel prices to airlines who have virtually no

alternative whatsoever. Thus, in the form of Fuel Throughput costs the airlines face a very real cost impost as the airlines cannot avoid purchasing fuel at locations with Fuel Throughput Charges, which is being charged by the Airport Operators over and above the normal lease rental. Furthermore, such an imposition of Fuel Throughput cost outweighs any savings which may have accrued as a result of initiatives taken by the oil companies to make refilling safer and more efficient.

18. Internationally, in vast majority of cases the overseas Fuel Throughput Fees are either fees to recover the operating and capital costs of fuelling facilities, or the income generated from the Fuel Throughput Fees are used to offset or reduce the basket of aeronautical charges.

19. It is important to understand that the economic impact of a Fuel Throughput levy is similar to the economic impact of a tax on fuel. Already the airlines are subject to high rate of customs duty, excise duty & sales tax, with the imposition of Fuel Throughput charges the situation has only worsened, adding to the woes of the airline industry.

20. It is submitted that the cost allocation methodology and other assumptions should be made transparent and agreed with major customers to ensure that all airport charges properly reflect the underlying cost of providing a service or facility, which is in line with the requirements under International convention (*'ICAO'*). In this context, it is recommended that the Authority should initiate a cost exercise pertaining to the refueling services before even allowing imposition of such charges let alone the question of revision of the charges.

21. It is submitted that absence of increased costs or offsetting reductions in charges raises competition law issues, being reflective of the Airport Operator taking advantage of market power that it might have in setting prices. In a monopoly market, it is not appropriate

to increase existing charges or levy airport users for no additional service or facility, as competitive forces do not moderate aggressive pricing practices and in such a situation it becomes even more incumbent on the Authority acting as a regulator to safeguard the interest of the Airline Operators who are at the bottom of the service industry and have a direct interface with the end users. In view of the vulnerability of the airline operators to the exercise of monopolistic possibilities by the Airport Operators, the Authority should consider stricter forms of prices oversight for refueling services particularly when the fuel price cost amounts to almost 40% of the costs for airlines.

22. It is pertinent to note that the Airport Operators contribute one component of refueling services, which is the land for provision of airport refueling infrastructure and activities. It is the ownership of land that creates the potential for airport operator market power in the provision of aircraft refueling services. When considered together with the monopoly nature of the market for land for refueling facilities, the lack of alternatives to refueling at some airports reinforces the airports' market power. Further, when analysed in light of the lack of any cost related justification for the levies, or offsetting reduction in charges, there is a strong case that the imposition of a Fuel Throughput levy is taking advantage of market power.

23. It is submitted that first and foremost the Authority should determine whether there is any cogent basis for recovery of such charge by the Airport Operators. It is only on having satisfied the test of rationality based on cost, that the reasonableness of the returns could be examined. There are two possible approaches for considering the reasonableness of returns:-

A. To consider only returns on the service in question based on an identified cost base.

B. To consider overall returns on the airport, and to consider the Fuel Throughput levy in terms of its impact on those returns. This effectively amounts to a 'single till' approach.

24. Coverage of refueling charges through a price cap raises a number of implementation issues such as whether to apply a separate cap to refueling services or include them in the existing price cap; starting point prices for aircraft refueling services; the X value to apply to aircraft refueling services; the start and finish date for inclusion of aircraft refueling services in a price cap, which are succinctly dealt with hereunder:-

(a) Aircraft refueling charges could be included in the existing price cap on aeronautical services. This would allow aircraft operators to rebalance charges between aircraft refueling charges and other charges in the price cap. For example, it would allow airport operators to introduce or increase Fuel Throughput levies with compensating reductions in charges for landing aircraft or other services already covered by the price cap. An alternative option is to apply a separate cap to aircraft refueling services. This could be achieved by introducing a new declaration relating only to aircraft refueling services. The approach of using a separate cap has the effect of quarantining aircraft refueling charges from other charges in the cap. It allows airport operators to rebalance refueling charges within the separate cap, for example, by introducing or increasing Fuel Throughput levies but with compensating reductions in existing aircraft refueling lease or licence charges. However, it does not allow rebalancing of charges with other services and may not be advisable.

(b) The starting point prices should not include existing or proposed refueling levies introduced post privatisation except to the extent that they are cost justified. The

Authority in determining the rate of Fuel Throughput charges should not merely revalidate the existing commercial arrangements between the Airport Operators and Oil companies except to the extent they are cost based.

- (c) A useful approach in assessing appropriate starting point prices may be to consider the leases in place at the time the airport leases were granted and relevant changes since then. Relevant issues could include changes in the costs to Airport Operators associated with providing refueling services; additional costs imposed on airport operators since the sale process was completed.
- (d) The starting point for the Fuel Throughput charges is something which needs to be considered after conducting the cost based exercise in relation to the cost for providing fuel to the airlines.

25. It is submitted that as per the settled position of law, the start date of such revision cannot be retrospective as the purpose of regulation cannot be merely revalidation of the existing commercial arrangement between the parties. This is particularly since the Act does not empower the Authority to give retrospective effect to any tariff elements approved by it. Copies of the relevant judgments are annexed hereto and marked as **Attachment IV**³.

³ Meghalaya State Electricity Board Vs. Meghalaya State Electricity Regulatory Commission [Appeal No. 37 of 2010 before APTEL]; Jawahar Singh alias Bhagatji Vs. State of GNCT of Delhi [(2009) 6 SCC 490]; Zile Singh Vs. State of Haryana & Ors [(2004) 8 SCC 1]

Attachment 1: Background

1. As per the contractual arrangements entered into with the Oil Companies, the Airport Operators have been recovering Fuel Throughput Charges from the Oil Companies, which is in addition to the lease rental for making the refueling facility available at the airports.

2. The International Air Transport Association (**IATA**) informed the Authority by its letter dated 18.06.2010, that:-

(a) The Fuel Throughput charges have been increased with effect from 01.04.2010 at a number of Indian airports, including the major airports at Mumbai, Delhi, Cochin, Hyderabad, Chennai, Kolkata, Ahmadabad and Trivandrum.

(b) Under the Act, supply of fuel at any airport is a regulated activity and the tariff including Fuel Throughput fees has to be as approved by the Authority since 01.09.2009. As such, the unilateral hikes in Fuel Throughput charges without prior approval by the Authority, being not based on cost. Simply passing it onto the airlines is violative of the Act and undermines the role of the Authority.

3. Taking note of the IATA's submissions on 24.06.2010, the Authority issued a communiqué advising the Airport Operators including Hyderabad International Airport Limited:-

(a) Stating that under the Act, charges for supply of fuel to an aircraft at any airport is to be regulated by the Authority and any new charge/revision would require its prior approval.

- (b) To withdraw any increase effected by them and furnish a status report with comments in the matter to the Authority for its consideration.
4. The Airport Operators responded by submitting that:-
- (a) The revision of Fuel Throughput Charges at the airports was made through a commercial agreement between the Airport Operators and Oil Companies which covers many airports, including those which are not under the purview of the Act or the Authority.
- (b) These agreements were entered into with the Oil Companies based on the outcome of a competitive tendering process and further pre-determined increase has already been factored by the Airport Operators in calculations while seeking permission for levy of UDF at airports.
- (c) In support, they relied upon clause 4.11 of Part IV of Consultation Paper No. 03/2009-10 dated 26.02.2010 which states that:
- “ in case the material common access/fuel farm facilities are provided as well as operated by a licensee, the Authority will take into account the structure and agreements between the airport operator and fuel facility provider....”*
5. In spite the communiqué dated 24.06.2010 issued by the Authority, none of the Airport Operators have confirmed the stoppage or withdrawal of the levy of Fuel Throughput Charges at higher rates.
6. On 15.07.2010, DIAL wrote another letter to convey to the Authority the following:-

(a) In early 2009 (date not specified), DIAL along with other airport operators has initiated a dialogue to arrive at a long-term and stable pricing of throughput charges.

(b) On 25.01.2010, the parties arrive at a 15 year agreement on escalation mechanism. A copy of any such agreement has not been furnished so far.

7. Consequently, to secure compliance with the Act and its directions, the Authority was constrained to issue directions, under Section 15 of the Act, directing the Airport Operators to immediately stop charging the suo-moto revised Fuel Throughput Fee, at the respective major airports, until their request for approval for such revision is decided by the Authority. A copy of the said direction has not been made available.

8. Thereafter, in the meeting held on 26.08.2010⁴, the Authority observed that:

(a) Any increase in Fuel Throughput Charges without the previous approval of the Authority is a contravention of the provisions of the Act since:-

(i) As per section 2 (a) of the Act, any service provided for supplying fuel to the aircraft at an airport is an "aeronautical service"; and

(ii) The tariff for such aeronautical service at a major airport is to be determined by the Authority after taking into consideration various factors as provided under Section 13 (1) (a).

(b) The Airport Operators have revised the Throughput Charges based on the commercial agreements between them and the Oil Companies.

⁴ It is not clear as to what was on agenda, who all attended, what was the position taken by different stakeholders?

- (c) The Airport Operators in their request for approving the revision in Fuel Throughput Charges have relied upon Para 4.11 of Part IV Consultation Paper No. 03/2009-10 dated 26.02.2010, which states that the Authority will take into account the structure and agreements between the Airport Operator and the Fuel facility provider.
- (d) The relevant Para 4.11 of Consultation Paper No. 3/2009-10 dated 26.02.2010, which has been relied upon by the Airport Operators to seek approval for the increase in the Fuel Throughput Charges, does not cover the revenues accruing to the Airport Operators from the Oil Companies. The issue of revenues to Airport Operators from aviation related fuel access charges is covered in para 4.9 of the Consultation Paper wherein the Authority has indicated that it will consider such revenues as part of the passenger yield cap calculation.
- (e) The said mechanism of considering such revenues accruing to Airport Operators from Oil Companies as a part of the passenger yield cap calculation will provide for protection of user interests wherein passenger yield determined by the price cap formula will take into account extent of such payments. Therefore, in case the access fees such as throughput fee are kept at a higher level, the airlines would bear the higher Fuel Throughput Charges, but the impact of the same is likely to be neutralized/mitigated through lower airport charges, since the accruals from the higher fees would be considered towards the passenger yield cap calculation.
- (f) While there is an economic rationale for charging access fees such as throughput charges, there is no definite formula through which such charges can be determined.

Therefore, conventionally such charges are negotiated between the access provider and the access seeker. In this case, such contractual commitments have been disclosed by the Airport Operators.