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December 14, 2022

To,
The Chairperson,
Airports Economic Regulatory Authority,
AERA Building, Administrative Complex,
Safdarjung Airport,
New Delhi – 110 003.

Kind Attention – Shri. Balwinder Singh Bhullar Ji

Subject: Response to the AERA Consultation Paper No. 13/2022-23 dated November 25, 2022 on determination of tariff for Cargo Handling Services for M/s Delhi Cargo Service Center Pvt. Ltd. at Indira Gandhi International Airport, Delhi for the Third Control Period (FY – 2021-22 to FY 2025-26)

Dear Sir,

We write in response to the Consultation Paper No. 13/2022-23 issued on November 25, 2022 by the Airports Economic Regulatory Authority of India ("AERA" or "Authority") in the matter of determination of tariff for Cargo Handling Services for M/s Delhi Cargo Service Center Pvt. Ltd. (DCSC) at Indira Gandhi International Airport, Delhi for the Third Control Period (FY 2021-22 to FY 2025-26) ('Consultation Paper' or 'CP').

At the outset, we would like to express our sincere gratitude to AERA for inviting stakeholder comments on the Consultation Paper, and further acknowledging the impact of COVID-19 on the aviation sector.

Sir, you will appreciate that airlines which are the 'catalyst' for the global economy including the aviation sector, have been adversely impacted due to significant headwinds, including travel and fare restrictions during COVID-19, increase in prices of Aviation Turbine Fuel (ATF) and fluctuation in foreign exchange *etc.*

While the airline operations showed an upward trend from December 2020, however the brutal second wave of COVID-19 in March 2021 and subsequent emerging variants of COVID-19, as well as the geo-political instability caused due to the Russian – Ukrainian conflict which have resulted in adverse impact on global supply-chains, increase in inflation, triggered increased interest rates, devaluation of Rupee, decrease in consumer spending as well as looming recession fears and job cuts have again impacted the operations to a certain extent and resultantly prolonged the process of financial recovery.

It appears as per the recent industry outlook reports issued by CAPA, airlines in India are estimated to make a loss of approx. USD 1.4-1.7 Billion in the current fiscal year FY 23. It also appears from the industry reports that the traffic recovery (number of flights and passengers) would take almost another one to three years for airline operations to reach pre COVID-19 levels. In the current situation, airlines in India are staring at significant losses and with limited financial support from the Government, airlines are constrained to implement severe cost control measures to sustain their operations. On the other hand, the same report mentions that Indian airports are expected to report significant profits in the region of USD 420 million for the FY23. In the given circumstances, it is humbly submitted that it is imperative that AERA does not take any steps, including by way of approving the proposed high tariffs, during the Third Control Period, which would precipitate further adverse financial impact on the airlines.

In this regard, we appreciate AERA's proposal to extend Tariff Rates prevailing as on 31.03.2021 to continue up to the end of FY 2024-25. In addition, it is suggested that since the subsequent control period (4th Control Period) would commence shortly thereafter from FY 2026-27, and as tariff determination process is a detailed and time consuming procedure, it may be more practical to extend the Tariff Rates prevailing as on 31.03.2021 to continue up to the end of FY 2025-26, and that a fresh analysis be done for the 4th entire control period, given the uncertain scenario described above.

Without prejudice to the above, and as desired by AERA, please find below our recommendations/ comments on the Consultation Paper:

1. **Review of Tendering Process**
(Refer 1.1.1 of the CP)

Authority may kindly note that "guiding principles issued by the International Civil Aviation Organization (ICAO) on charges for Airports and Air Navigation Services (ICAO DoC 9082), which lays down the main purpose of economic oversight which is to achieve a balance between the interest of Airports and the Airport Users. This policy document categorically specifies "that caution be exercised when attempting to compensate for shortfalls in revenue considering its effects of increased charges on aircraft operators and end users." The said policy document also emphasizes on balancing the interests of airports on one hand and aircraft operators, end users on the other, in view of the importance of the air transport system to States. This should be applied particularly during periods of economic difficulty. Therefore, the policy document recommends that States encourage increased cooperation between airports and aircraft operators to ensure that the economic difficulties facing them all are shared in a reasonable manner."

It is a general perception that service providers have no incentive to reduce its expenses, as any such increase would be passed on to the airlines/stakeholders through the tariff determination mechanism process, and indirectly airlines would be forced to bear most of these additional costs. There needs to be a mechanism for incentivizing the parties for increasing efficiencies and cost savings and not for increasing the royalty for the airport operator.

Sir, as this is particularly a period of economic difficulty for airlines, AERA is humbly requested to ensure that Airport Operator does not take the decision to award concession agreements solely on the revenue share being offered. Basing decisions solely on highest revenue share being offered breeds inefficiencies and tends to disproportionately increase the cost, as envisioned in the abovementioned guiding principle.

2. Cargo Volume Projections
(Refer 3.1.4 & 3.2.3. 3.2.4 and Table 3 & 5)

It is humbly submitted that the impact on cargo volume loss, if any, due to apprehension of shifting of Air Asia & Vistara's Cargo Operations from DCSC's Cargo Terminal to Air India's Domestic Cargo Handling Facility may be known only if such an event occurs. In addition, impact on cargo volumes due to operationalisation of Cargo Hub at new Greenfield Airport at Jewar (Noida) may only be estimated only after operations have normalised after recovering from the impact of Covid-19, as past trends during abnormal times of Covid-19 may not show similar trends in the future.

Thus, Authority may please kindly note the following factors:

- The possibility of loss of cargo volume due to entire domestic cargo operations of Air Asia and Vistara shifting to the terminal owned and operated by Air India can be known only if such an event occurs, as there is no official communications or proposal from to appropriate authority to shift its domestic cargo handling from DCSC to Air India facility and hence loss of cargo volumes from 1st Jan'2023 appears to be pre-mature by DCSC.

- The assumption of erosion of cargo volumes of DCSC due to new AFS appears to be excessive. As, there is no historical data or trend to arrive at the loss of volumes as proposed, such loss may not be able to be assessed realistically at this point of time.

- The loss of cargo volumes on the basis of development of Greenfield Airport at Jewar (Noida) and the assumption that cargo volumes will be bifurcated, may not be able to be realistically predicted. At this juncture it may be premature to estimate the actual loss of volumes. We may be able to gauge the impact only once the Greenfield airport is ready, estimated somewhere around the last stages of the 3rd Control Period.

Thus, is submitted that at this point in time, it may not be realistic to assess the impact of the aforementioned factors on the cargo volumes and therefore it is requested that Authority may rationalize the volumes significantly upwards while considering only a minimal impact from the above mentioned uncertain factors. Authority may thereafter true up the actual volumes during the 4th Control Period, when a clearer picture emerges.

3. Deferment of Capital Expenditure - Regulatory Asset Base

Stoppage of non-safety/security related capital expenditure (Refer 4.1.3, 4.4.3 & 4.4.12 and Table 7, 8, 9 & 12 of CP)

As mentioned above, it may take up to three years for the operations to reach to its pre COVID-19 peak levels. In this situation, as DCSC has itself projected that it would not be able to reach the volume levels of pre-Covid by the end of the 3rd Control Period (2025-26), it is unlikely that additional capex equipment would be required in addition to the existing inventory, unless as a replacement for damaged/worn-out equipment. In order to support the airlines to continue and sustain its operations, all non-essential CAPEX proposed by DCSC should be put on hold/deferred to the Fourth Control Period, unless deemed critical from a safety or security compliance perspective.

Without prejudice to the above, in case DCSC wants to make capital expenditure, then it should be at no additional expense to the airlines until the project is completed and put to use. Similarly, if any proposed Capex projects can be deferred from the Third Control Period to the Fourth Control Period, same should be considered by AERA.

It is humbly submitted that it may be possible to gauge only in the last year of 3rd Control Period (2025-26) whether significant work has progressed in development of infrastructure, procurement of latest equipment and repairs / renovation, as proposed in the CP.

While we appreciate AERA's proposal to extend Tariff Rates prevailing as on 31.03.2021 to continue up to the end of FY 2024-25, at the same time is suggested that since the subsequent control period (4th Control Period) would commence shortly thereafter from FY 2026-27, and as tariff determination process is a detailed and time consuming procedure, and as the actual impact would only be evident in the last year of 3rd control period (2025-26), it is humbly suggested that it may be more practical to extend the Tariff Rates prevailing as on 31.03.2021 to continue up to the end of FY 2025-26, and that a fresh analysis be done for the 4th control period, including the timing of the capex for the proposed new cargo warehouse additions proposed at Rs. 300.02 Crores, based on ground realities at that time.

4. Abolishment of Royalty Charges/ Concession Fee

Operating & Maintenance Expenditure (Refer 5.1.12, 5.2.3 & Table 15 of CP)

Any attempt to award the contracts by the airport operator on highest revenue share basis should be discouraged as it breeds inefficiencies and tends to disproportionately increase the cost.

It is a general perception that service providers have no incentive to reduce its expenses, as any such increase would be passed on to the airlines/stakeholders through the tariff determination mechanism process, and indirectly airlines would be forced to bear most of these additional costs. There needs to be a mechanism for incentivizing the parties for increasing efficiencies and cost savings and not for increasing the royalty for the airport operator.

As you are aware, royalty is in the nature of market access fee, charged (by any name or description) by the airport operator under various headings without any underlying services. These charges are mostly passed on to the airlines by the airport operator or other services providers.

It may be pertinent to note that market access fee by any name or description is not practiced in most of the global economies, including European Union, Australia etc. Sometimes it is argued by the airport operators that 'Royalty' on 'Aero Revenues' helps in subsidizing the aero charges for the airlines, however royalty in 'Non-Aero Revenues' hits the airlines directly without any benefit.

In view of the above, we urge AERA to abolish such royalty which may be included in any of the cost items.

5. Operational Expenditure – Drastic Cost Cutting
Operating & Maintenance Expenditure (Refer 5.1, 5.2.7 and Table 14, 15 & 16 of CP)

It may be noted that across various industries, instead of cost escalations, all the costs have been renegotiated downwards substantially. It may also be noted that cost incurred by DCSC impacts the airlines, as such cost is passed through or borne mostly by the airlines. In order to ensure that there is no adverse impact/increase in the tariff, we request AERA to kindly put on hold any increase in operational expenditure by DCSC not related to safety or security.

Further, we submit that:

i) Payroll Costs: The Y-o-Y increase may please not be more than approx. 6%, in line with recent proposals of AERA in other consultation papers, rather than the proposed CAGR of 15%.

(ii) Administrative & General Expenses, R & M Expenditure, Utility Expenses: The Y-o-Y increase may please not be more than approx. 5%, in line with recent proposals of AERA in other consultation papers, rather than the proposed CAGR of between 11% to 15%.

(iii) It may also please be clarified that although it is projected that the Concession Fee (and revenues) would keep continually falling drastically at CAGR of -15%, but still the Opex items like Payroll, Administration & General Expenses, R&M Expenditure and Utility Expenses are projected to continually increase at a CAGR between 11% to 15%. This is in contrast to claims of cargo volume loss by DCSC in 2024-25 due to greenfield Jewar Airport, loss due to shifting of Vistara & Air Asia to Air India facility in 2023 and new loss due to AFS facility.

In order to ensure that there is no adverse impact/increase in the tariff, we request AERA to kindly put on hold any increase in operational expenditure by DCSC not related to safety or security, without any escalations in payroll and other costs.

6. Aggregate Revenue Return

Return on Revenue (Refer 7.2 and Table 18 & 22 of CP)

It is submitted that only a reasonable Fair Rate of Return (FRoR) to the service provider may be provided. It is observed that AERA has considered FRoR of 14%, which is the net of income tax return to the service provider, for the Third Control Period. However, while such fixed/ assured return favours the service provider, but it creates an imbalance against the airlines, which are already suffering from huge losses and are bearing the adverse financial impact through higher tariffs.

Due to fixed/assured returns, service providers have no incentive to look for productivity improvement or ways of increasing efficiencies, take steps to reduce costs as they are fully covered for all costs plus their hefty returns. Such a scenario breeds inefficiencies and higher costs, which are ultimately borne mostly by airlines.
In the present scenario any assured return on investment to any services providers like DCSC, in excess of three (3) % (including those on past orders), i.e. being at par with bank fixed deposits (i.e., return on investment after the income tax), will be onerous for the airlines.

In view of the above, AERA is requested to kindly review the proposed return on RAB to the service providers like DCSC and requested to revise all the Tariff Orders (including past orders) by capping the returns to a maximum of three (3) %.

7. Aggregate Revenue Requirement

Tariff (Refer 7.3.2 and 7.3.3 of CP)

We humbly request AERA to kindly consider our submission as mentioned above, and review the proposed tariffs in light of the same. It is in the interest of all the stakeholders not to implement unnecessary Capex and reduce Opex for efficiencies where possible. We request the Authority to extend the current tariffs end of FY 2025-26, and evaluate the situation in the consultation paper for the 4th control period, such that the ARR is reduced, thereby keeping the tariff low and thus encouraging middle class people to travel by air, which will help in sharp post COVID-19 recovery.

We hope that your good self will positively consider the above recommendations/ comments as it will help in achieving the affordability and sustainability of the aviation sector including airlines, which is also outlined as a key objective in the National Civil Aviation Policy, 2016.

We look forward to your continued support in these challenging times.

Thanking you in advance,

Yours Truly,

For SpiceJet Limited

Suryavir Singh Bisht
Sr. General Manager – Regulatory Affairs

Copy to:

Director (P&S Tariff), Airports Economic Regulatory Authority of India