Association of Private Airport Operators (APAO)

Response to AERA's Consultation Paper No. 22/2012-13 dated 11 October 2012 on determination of Aeronautical Tariff and Development Fee in respect of Chhatrapati Shivaji International Airport, Mumbai for 1st Regulatory Period (01.04.2009 – 31.03.2014)

November 2012

Table of Contents

1	Executive Summary	4
2	Cost of Equity	7
3	Non Aeronautical Revenue	17
4	Refundable Security Deposit	18
5	Cargo Revenue	21
6	Hypothetical Regulatory Asset Base	22
7	DF Collection Charges	23
8	Retirement Compensation	24
9	Adjustment to RAB on account of DF	26
10	Fuel Throughput Charges and CUTE Counter Charges	28
11	AAI Upfront Fee	29
12	Development Fee	30
13	User Development Fee	31
14	Conclusion	32

List of Abbreviations

Term	Description
AAI	Airports Authority of India
ACI	Airports Council International
AERA	Airports Economic Regulatory Authority of India
AS	Accounting Standard
ATM	Air Traffic Movements
Capex	Capital Expenditure
CAPM	Capital Asset Pricing Model
CAA, UK	Civil Aviation Authority of the United Kingdom
CGD	City Gas Distribution
Consultation Paper	Consultation paper issued by AERA on Determination of Aeronautical Tariff in respect of Chhatrapati Shivaji International Airport for the 1st Regulatory period
CSIA	Chhatrapati Shivaji International Airport
CWIP	Construction Work in Progress
DF	Development Fee
DIAL	Delhi International Airport Private Limited
DGCA	Directorate General of Civil Aviation
HRAB	Hypothetical Regulatory Asset Base
ICAI	Institute of Chartered Accountants of India
IDC	Interest during construction
IGI Airport / IGIA	Indira Gandhi International Airport
MIAL	Mumbai International Airport Private Limited
MoCA	Ministry of Civil Aviation
Mppa	million passengers per annum
MYTP	Multi Year Tariff Proposal
NIPFP	National Institute of Public Finance and Policy
NPV	Net Present Value
NTA	Non Transfer Asset
O&M	Operation and Maintenance
OMDA	Operation, Management and Development Agreement
PNGRB	Petroleum and Natural Gas Regulatory
RAB	Regulatory Asset Base
RC	Retirement Compensation
RoCE	Return on Capital Employed
ROE	Return on Equity
RSD	Refundable Security Deposit
SSA	State Support Agreement
Tariff Guidelines	Terms and Conditions for Determination of Tariff for Airport Operators Guidelines, 2011
TAMP	Tariff Authority of Major Ports
The Act	The Airports Economic Regulatory Authority of India Act, 2008
UDF	User Development Fee
WACC	Weighted Average Cost of Capital
X Factor	Tariff escalation factor

1 Executive Summary

1.1 Airports Economic Regulatory Authority of India (AERA/ the Authority) has issued a Consultation Paper No. 22/2012-13 dated 11 October 2012 on Determination of Aeronautical Tariff in respect of CSIA, Mumbai for the 1st Regulatory Period (01.04.2009 – 31.03.2014).

1.2 AERA has sought feedback, comments and suggestions on the Consultation Paper from stakeholders.

1.3 **Cost of Equity:** The cost of equity of 16% as proposed by the Authority for determination of aeronautical tariff at CSIA underestimates the riskiness of the CSIA. The aviation sector in India competes with other sectors in India as well as global airport projects around the world for investments. Further, there are certain risks unique to CSIA which will need to be duly considered by the Authority while determining the cost of equity for MIAL.

APAO would request the Authority to ensure that the returns available to investors suitably cover the riskiness of the assets and provides a strong incentive for attracting new investments in the sector, consistent with the principles of tariff fixation in Schedule 1 of the SSA. Further, APAO would like to appeal to the Authority to consider the cost of equity estimated by KPMG, Leigh-Fisher and SBI Capital Markets for airport investments in India, which is in the range of 18.5% - 25%.

1.4 **Non Aeronautical Revenue:** The Authority tentatively decided to true-up the non-aeronautical revenue at the time of tariff determination for the next control period subject to the projections made by MIAL in respect of non-aeronautical revenue being treated as minimum / floor for the current control period. APAO is of the view that no true-up of non-aeronautical revenue should be done subject to realistic forecasts of non-aeronautical revenue being made by the airport operator / Authority. This approach will help provide the right incentive for investors in airport assets.

1.5 **Refundable Security Deposits (RSD):** The Authority has proposed to provide zero returns on aeronautical assets funded through RSD. However, it is evident that there is an opportunity cost associated with RSD in terms of the foregone lease rentals. Professor Aswath Damodaran, a Professor at New York University and one of the leading corporate finance experts in the world, defines cost of capital as "opportunity cost of all the capital invested in an enterprise". As per Principle 1 of Schedule 1 of the SSA, Authority is required to follow an 'incentive-based' approach for tariff determination. A zero return on RSD does not provide any incentive to investors to utilize RSD as a means of finance going forward. This is significant considering that RSD will be raised from lessees of the Non-Transfer Assets and is outside the purview of any cross-subsidy for the aeronautical users as per the terms of the SSA. At the least, RSD should earn return equivalent to the benchmark returns available on long-term fixed deposits, which would continue to incentivize the operator to utilize such funds for financing aeronautical assets, as opposed to employing debt or equity at a higher cost, in a capital constrained scenario. There are also examples from other infrastructure sectors where the regulator provides return on the capital employed by the

Concessionaire without considering the source or cost of funding while calculating tariff.

1.6 **Cargo Revenue:** AERA's stand of treating cargo revenue of MIAL as non-aeronautical irrespective of whether the services are provided by the airport operator itself or concessioned out to the third parties is a correct stand and is in accordance with the provisions of the Concession Agreement. Further, the Authority's view of treating cargo services as aeronautical services and regulating the same is consistent with the provisions of the AERA Act. We appreciate the view taken by the Authority in this regard.

1.7 **Hypothetical Regulatory Asset Base:** The Authority tentatively decided to include Rs. 54 crs. (extraordinary expenses in relation to AAI Operation Support cost) in operating expenses in calculation of Hypothetical RAB. Extraordinary expense of Rs. 54 cr., only Rs. 24.13 cr. pertains to FY09. After applying the ratio of aeronautical expenses to non-aeronautical expenses on the Rs. 24.13 cr. amount, the amount attributable to aeronautical activities can only be considered for determination of HRAB.

1.8 **DF Collection Charges:** The Authority has disallowed collection charges with respect to DF as a pass through cost. MIAL has been allowed to collect DF to part fund the capital expenditure. Collection charges with respect to DF are similar in nature to the collection charges being allowed by the Authority on collection of PSF / UDF. Therefore, the same should be allowed as part of O&M expenditure. Moreover, DF collection charge is mandated by the Government. APAO would like to request the Authority to allow DF collection charges as pass-through operational expenses.

1.9 **Retirement Compensation**: The Authority has proposed to expense out the Retirement Compensation (RC) paid to AAI by MIAL with respect to AAI staff instead of amortizing it over the life of the asset. As per Accounting Standard 10, cost related to bringing an asset to its working condition can be treated as part of capital expenditure. In the current scenario, MIAL could not have obtained the concession rights for CSIA without accepting the obligation of RC. Hence such payments may be treated as cost related to bringing an asset to its working condition. APAO would like to request the Authority to consider capitalizing the RC payments as part of RAB in the year of capitalization done by MIAL and allow amortizing these expenses over the life of the asset. However, if the Authority decides to expense out the RC, amount paid as interest on the loan taken should be allowed as a pass-through O&M expense.

1.10 **Adjustment to RAB on account of DF:** The Authority has tentatively decided to consider DF funding of RAB such that RAB to be capitalized in any tariff year would be reduced to the extent of the total DF amounts billed / securitized. DF collected during a year can only be deployed towards assets that are under construction. While a part of DF funds may be deployed towards assets that get capitalized in the same year as that of DF billing / securitization, the remaining portion of the DF funds would go towards capital work-in-progress (CWIP). APAO would also request the Authority to take into account the provisions under The Airports Authority of India (Major Airports) Development Fees Rules, 2011, which does not provide any guideline on adjustment of DF against capitalized assets, in the manner proposed by AERA. APAO would request

the Authority to take into account the extent to which DF billed / securitized in a given year is actually capitalized for the purpose of adjustment of the RAB.

1.11 **Fuel Throughput and CUTE Counter Charges:** The Authority has proposed that fuel throughput and CUTE counter charges are charges in respect of provision of aeronautical services and thus should be treated as aeronautical revenue. The fuel throughput charges is received against the concession given to the oil companies for their fuelling services. In the case of CUTE counters, MIAL only provides space to airlines on a rental basis. In both cases, revenue earned by MIAL should be treated as non-aeronautical revenue. Treating such revenue as aeronautical is inconsistent with the Authority's own view in determining the nature of revenues from cargo, ground handling and in-to-plane services. APAO would request the Authority to adopt a consistent approach with respect to classification of non aeronautical services and consider revenues from fuel throughput charges and CUTE counter charges as non aeronautical revenues. However, in case AERA decides to consider CUTE counter charges as aeronautical revenues, the same treatment should be extended for the determination of HRAB where revenue from CUTE counter charges should be considered as aeronautical revenue.

1.12 **AAI Upfront Fee:** Authority has tentatively decided to not consider Upfront Fee of Rs 153.85 cr. paid to AAI towards Equity. APAO would request the Authority to not exclude the Upfront Fee of Rs. 153.85 cr. paid to AAI towards Equity. The Authority's proposed methodology results in an unfair reduction in the true cost of capital for the project.

1.13 **Development Fee:** We agree with the Authority's position to allow project funding of Rs. 3,400 cr. through Development Fee as a means of last resort. We agree with the Authority's views that the duration of DF levy should be co-terminus with project completion. The period of DF levy is expected to conclude in December 2015 if rates of Rs. 200 per departing domestic passenger and Rs. 1,300 per departing international passenger are adopted. APAO requests the Authority to allow the following rates of levy to avoid the additional interest burden on passengers:

a. Rs. 200 from each departing domestic passenger

b. Rs. 1,300 from each departing international passenger

1.14 **Levy of User Development Fee:** APAO requests the Authority to allow MIAL to levy UDF effective from 1 January 2013 and 100% truing-up for any shortfall in UDF collection, since gate collection of UDF at airport is practically impossible whether the Authority provides a period of 3 or 6 months for implementation of tariff order.

2 Cost of Equity

2.1 ***The Authority tentatively decided to adopt Return on Equity (post tax Cost of Equity) as 16% in the WACC calculation.***

2.2 In its review of the cost of equity for CSIA, the Authority had requested National Institute of Public Finance and Policy (NIPFP) to estimate the expected cost of equity for the private airports at Delhi, Mumbai, Hyderabad, Bangalore and Cochin (NIPFP Report). The Authority has also analyzed return on equity (RoE) as provided by regulatory authorities in other infrastructure sectors such as electricity, ports & road and has observed that the RoE in these sectors ranges from 15.5% to 18%. In view of the above, the Authority in its Consultation Paper has proposed 16% as RoE for Mumbai Airport.

2.3 The methodology adopted by NIPFP underestimates the risks inherent to an emerging market such as India and more specifically to an evolving sector like aviation. The key concerns with the NIPFP report have been listed below.

2.4 The NIPFP report included a number of companies ***which are not directly related to or limited to airport operations***. The diverse operations of these companies affect the overall business risk of the company and thus, using their beta estimates as comparables provides an incorrect assessment of risk. These incomparable companies have been included by NIPFP as 'comparable firms' in its determination of cost of equity for Indian Airports. The details of diverse non airport business operations of these incomparable companies are mentioned below:

S No.	Airport	Country	Details of Business
1.	Beijing Airport High-Tech Park	China	Principally engaged in the architectural construction, real estate sale, leasing and land development.
2.	Derichebourg SA	France	Offers: i) Environmental services: Provides recycling and conversion of end of life consumer goods, management of industrial and household waste, and urban cleansing, among others. ii) Airport services: Specializes in the airport passenger services, services to airport infrastructures, fuel management, and maintenance of runway equipment, among others. iii) Service to businesses: Offers cleaning,

S No.	Airport	Country	Details of Business
			security and electrical services, temporary staff recruitment, aircraft maintenance and others.
3.	Infratil Ltd	New Zealand	Owner and operator of businesses in the i) Energy (mainly renewable) ii) Airport iii) Public transport sectors. Its energy operations are predominantly in New Zealand and Australia. The Company owns Wellington Airport in New Zealand and airports in Glasgow and Kent. Infratil's public transport services are in Auckland and Wellington, New Zealand.

2.5 ***Comparable Airports:*** NIPFP has included airports from developed as well as emerging markets as comparable airports while determining comparable beta for CSIA. Beta is a measure of systemic risk of an asset as compared to the market as a whole. Inclusion of airports from developed markets implies that airport assets in these markets have risks similar to Indian Airports. The rationale provided by NIPFP for including airports from developed as well as emerging markets is:

*"In terms of **traffic volume**, all the private airports in India have grown very fast and they are now mostly comparable with airports in developed countries. This is substantiated by the surveys of Airports Council International (ACI) (www.aci.aero), the representative body of the airports, which has rated the **Hyderabad airport as the best in the world** in the category of airports in the 5-15 million category for the year 2010. Similarly Mumbai airport and Delhi airport have been rated the 2nd best and 4th **best in their respective categories** (Mumbai -15 to 25 million and Delhi -25 to 40 million)."*

2.6 India, as a result of its large population, has traffic volumes comparable to some airports in the developed countries. However, traffic volatility and underlying factors of traffic growth (such as per capita income, GDP growth rate, and income and price elasticity) in these developed countries are different from those in India, which is an emerging market. Thus, riskiness of airport assets in India is higher than those in developed markets.

2.7 ACI rankings primarily reflect service quality of airports and are not a measure of riskiness of an airport asset. On the contrary, the stringent quality norms for Indian Airports as specified under OMDA and Authority's Tariff Guidelines have necessitated capital expenditure to maintain minimum service quality levels and thus increase riskiness of the assets because of higher operating leverage.

2.8 Unlike experienced airport operators in developed markets, private Indian airport operators are still at a nascent stage and are confronted with various business risks and uncertainties specific to India over and above the risks common to all airport operators. These aggravating factors and additional risks are highlighted below:

a. **Revenue sharing with the Government**: Unlike most of the airports globally, airports operated by MIAL and DIAL involve significant revenue-sharing with the Government. Cash flows available to capital providers are highly susceptible to changes in air traffic volumes due to the high degree of operating leverage. The revenue share at Delhi and Mumbai airports makes them more susceptible to risks than other airports in emerging markets.

   MIAL is liable to pay 38.7% revenue share to AAI on all its revenues including return on equity and therefore in effect 16% return on equity proposed by AERA results in a return of only 9.8% to the shareholders which is significantly lower than the reasonable return expectation of any investor.

b. UDF cannot be treated as a risk mitigation measure as it is essentially a component of target revenue just like landing, parking or PSF charges.

c. **Financing risk:** Authority has acknowledged a gap in the means of finance of Rs. 819 cr. and is unable to identify means of finance to cover such gap. The Authority further noted that even after considering Development Fee and Internal Resource Generation, there would be a gap in the means of finance with respect to the project cost. For no other regulated Indian airport has a gap in funding been left unmet by Authority. In this scenario, MIAL may be forced to draw additional debt to meet this funding gap, increasing the degree of financial leverage. Higher financial leverage will also increase risk of equity investments, requiring higher rate of return. Alternatively, if MIAL is unable to raise debt to meet the funding gap it would aggravate the risk profile of the airport and jeopardize the completion of the project.

d. **Riskiness of Indian airports:** The risk profile of Indian airports is comparable to those in emerging markets than in developed markets. Inclusion of airports from developed markets while determining beta of CSIA tends to underestimate the beta (risk). Some of the characteristic factors affecting aviation industry in emerging economies (vis-à-vis developed economies) include:

   i. Low per capita air trips (< 0.5); India – < 0.04 (as per Planning Commission)
   ii. Volatility in air traffic growth rates
   iii. Political risks, absence of a robust legal framework

   Therefore, it is not appropriate to club emerging and developed economies in the same basket to determine an estimate of beta. As shown below, CSIA faces high volatility in pax traffic as compared to some airports in developed economies.

Airport	Volatility[1]
CSIA	15%
Atlanta	3%
Frankfurt	3%
Singapore	7%

2.9 The asset beta for comparable airports, in line with the above is shown below:

S. No	Airport	Country	Asset Beta (NIPFP Estimates)	Asset Beta (KPMG estimates)[2]
1.	Airports of Thailand Public Co Ltd	Thailand	0.72	0.54
2.	Beijing Capital International Co Ltd	China	0.63	0.61
3.	Grupo Aeroportuario Del Sureste SA de CV	Mexico	0.51	0.87
4.	Guangzhou Baiyun International	China	0.81	0.80
5.	Malaysian Airport	Malaysia	0.53	0.79
6.	Shanghai International Airport	China	0.92	0.87
7.	Xiamen International Airport Co	China	0.79	0.91
	Mean		**0.70**	**0.77**
	Median		**0.72**	**0.80**

From the above table, it can be seen that the average and median asset betas of airports in emerging economies are higher than the asset beta recommended by NIPFP for CSIA (0.54). This difference is also due to the fact that the risks being faced the aviation industry are closely linked to general state of the economy. Hence, despite CSIA being comparable to airports in the developed economies in terms of traffic volumes and service levels, their betas are not comparable as they operate under very different economic conditions.

[1] Measured as standard deviation in annual passenger traffic growth rates for the period 2002-12
[2] As on 31 March 2010

2.10 NIPFP, in one of the variants, has estimated the cost of equity where equity beta is re-levered using market value of equity. As per financial literature, determination of market value of an unlisted company using off-market transaction is not appropriate. In such cases, book value of equity may be used for the purpose of re-levering.

2.11 ***Equity Risk Premium:*** NIPFP has suggested the following approach for calculating the equity risk premium for determination of cost of equity –

"One approach proposed by Aswath Damodaran, a Professor at New York University and one of the leading corporate finance experts in the world, is to take equity risk premium of a mature equity market like United States and add the country risk premium (or the default spread implied in the country risk rating). For the United States market, taking the time horizon of 1928-2010, we get the historical equity risk premium of 4.31 %, which is the geometric average of premium for stocks over treasury bonds'. We take this as the equity risk premium for a mature market', to this, we add the default risk spread for India (given the local currency sovereign rating of Ba1), which is 2.4%. So, adding the United States equity risk premium (1928-2010) to this default spread, we get an equity risk premium of 6.71 %."

The equity risk premium was later revised by NIPFP to 6.1%.

2.12 The approach suggested by NIPFP underestimates the equity risk premium of the project. Aswath Damodaran mentions three approaches for calculating equity risk premium, when using developed market historical data –

a. Country Bond Default Spread (as used by NIPFP)

b. Relative Equity Market Standard deviations

c. Melded Approach (Bond Default Spread and Relative Standard Deviation)

Aswath Damodaran recommends using the third approach for calculation of equity risk premium and says[3],

"The country default spreads provide an important first step in measuring country equity risk, but still only measure the premium for default risk. Intuitively, ***we would expect the country equity risk premium to be larger than the country default risk spread****. To address the issue of how much higher, we look at the volatility of the equity market in a country relative to the volatility of the bond market used to estimate the spread."*

"We believe that the larger ***country risk premiums that emerge from the last approach are the most realistic for the immediate future****…"*

2.13 Aswath Damodaran also regularly calculates equity risk premium for different countries. Damodaran's current estimation of Equity Risk Premium for India is 9.0%[4],

[3] Source: Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2011 Edition, Aswath Damodaran, Stern School of Business, New York University

[4] Country Default Spreads and Risk Premiums, January 2012, Aswath Damodaran, available at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html

which could have been directly taken by NIPFP as ERP instead of trying to calculate it indirectly by using benchmark of US market which is not relevant in present case.

2.14 ***Risk Free Return:*** NIPFP in its methodology for calculating of equity risk premium has taken an arithmetic average of daily yield on 10-year Government of India bonds resulting in a risk free return of 7.25%. This risk free return is lower than the current 10 year bond yield of 8.428%[5].

Aswath Damodaran suggests taking the current risk free rate rather than a 'normal' risk free rate during valuations and says[6],

"Interest rates generally change over time because of changes in the underlying fundamentals. ***Using a normal risk free rate, which is different from today's rate, without also adjusting the fundamentals that caused the current rate will result in inconsistent valuation.*** *For example, assume that the risk free rate is low currently, because inflation has been unusually low and the economy is moribund. If risk free rates bounce back to normal levels, it will be either because inflation reverts back to historical norms or the economy strengthens. Analysts who use normal interest rates will then have to also use higher inflation and/or real growth numbers when valuing companies."*

"'Normal' is in the eyes of the beholder, with different analysts making different judgments on what comprises that number. To provide a simple contrast, analysts who started working in the late 1980s in the United States, use higher normal rates than analysts who joined in 2002 or 2003, reflecting their different experiences."

2.15 MIAL has used the latest available (at the time of filing MYTP) 10-year bond yield, which as mentioned above is more appropriate for calculating equity risk premium. This approach of MIAL is in conformity with the approach of Prof. Aswath Damodaran as well as mentioned above and should have been considered by Authority.

2.16 Renowned Prof Jayant Varma from IIM Ahmedabad is also of the view that the long term rate is the risk free cost of capital today and it is the rate that would have to be paid today to finance a risk free project. 10 year GOI bond yields in Q1 FY13 have ranged between 8.05% to 8.79% which is much higher than NIPFP's historical estimates.

2.17 ***Estimates by other consultants:*** KPMG, Leigh-Fisher and SBI Capital Markets are renowned global consultants with experience in airports including valuation of airports.

2.18 Both SBI Capital Markets (Report on fair rate of return on equity for Indian airport sector) and KPMG (Cost of Equity Estimates of Indian Airport Industry) have estimated a higher cost of equity than NIPFP. Comparison between cost of equity estimates of NIPFP, Authority , KPMG,SBI Capital Markets and Leigh-Fisher are shown below:

[5] As on 30 September 2011 – Risk free rate quoted by MIAL in its MYTP

[6] Source: What is the riskfree rate? A Search for the Basic Building Block,, Dec 2008 Aswath Damodaran, Stern School of Business, New York University

S No.	Consultant	Cost of Equity Estimates
1.	NIPFP	11.64% - 13.84%
2.	Authority	16%
3.	KPMG[7]	20% - 23%
4.	SBI Capital Markets	18.5% - 20.5%
5.	Leigh-Fisher	25.1%

2.19 ***Benchmarking of returns with other regulated sectors**:* The Authority has analyzed the returns on equity with other regulated sectors –

"Central Electricity Regulatory Commission (CERC), in its Terms and Conditions of Tariff Regulations for 2009-14 issued on 20.01.2009, vide regulation 15, computes the RoE at the base rate of 15.5% in the manner indicated therein. The Authority, has noted that in its regulatory framework the Corporate Tax is being allowed as a cost pass through and the RoE on CAPM.

It is understood that State Electricity Regulatory Commissions normally consider 16% as cost of equity in respect of distribution companies.

In the Port sector, the Tariff Authority of Major Ports (TAMP) is understood to be using 16% as return on equity. However, the model of tariff determination of TAMP is different – TAMP finalizes and announces the tariff and escalation factor upfront and then bids out with revenue share as the decision or selection parameter.

In case of National Highways, the NHAI also determines the tolls and escalation factor upfront. In a recent report, a Committee headed by Shri B.K. Chaturvedi, Member, Planning Commission has stated that Equity IRR of upto 18% may be acceptable for certain types of projects."

[7] As on 31 March 2010

Illustration on return to equity investors in Power Sector

As per CERC guidelines, tariff for supply of electrici**ty comprises of capacity charge** for recovery of Annual Fixed Cost and energy charge. Relevant extract is as below:

> *"The tariff for supply of electricity from a thermal generating station shall comprise two parts, namely, capacity charge (for recovery of annual fixed cost consisting of the components specified to in regulation 14) and energy charge (for recovery of primary fuel cost and limestone cost where applicable)."*

Following comprises Annual Fixed Cost of a generating or a transmission system:

a. ***Return on equity;***
b. ***Interest on loan capital;***
c. ***Depreciation;***
d. ***Interest on working capital;***
e. Operation and maintenance expenses;
f. Cost of secondary fuel oil (for coal-based and lignite fired generating stations)
g. Special allowance in lieu of R&M or separate compensation allowance,

Return on Equity is calculated on the equity considered as part of the Capital Employed. As a result, even though CERC guidelines provide a return on equity equivalent to 16%, actual returns available to the equity investor is higher than 16%. An illustration comparing the returns to equity investors in airport companies to those in electricity companies is shown in Appendix 1. In comparison, return to equity investors of airport companies is based on ***Regulated Asset Base which depreciates over the life of the assets***. The diminishing returns for investors in Airport Company are thus lower than those for investors in electricity generating or transmitting companies.

2.20 There are key differences, some of which have been detailed by the Authority, between aviation sector and the infrastructure sectors mentioned above.

a. The ***volatility of revenue drivers*** such as units of electricity consumed is lower than the volatility of revenue drivers in airport viz. traffic.

b. In the airport sector return (i.e. WACC) is provided on the Regulated Asset Base which is depreciated each year. However, this is not the case in the power sector. Here, return is available on the equity brought in by the investor and is not subject to depreciation. In effect this means that 16% return proposed by AERA will be decreasing every year as RAB depreciates every year and for a concession period of 30 years 16% return on equity proposed by AERA would translate to a much lower return which is grossly inadequate and will discourage any further investment in the sector by the prospective investors.

c. The ***concessioning terms for the highway and port sector***s are different from Aviation sector with a ***pre determined tariff/ toll charge***. There is ***no regulation on***

the revenue or profits earned on a project[8]. More importantly, the return to the equity investors is based on project assumptions which may be significantly different from actual growth of revenue drivers. For example, the equity IRR of 16 - 18% in NHAI projects is used to determine the minimum revenue share or maximum viability gap funding for the project for a toll project assuming a traffic growth of 5% or alternatively the maximum annuity payments required to meet the benchmark equity IRR of 18%. The actual traffic growth may be significantly different for a project as is evident from the average return of 20%-23% earned by the investors in road projects[9].

2.21 ***UDF as risk mitigating tool:*** NIPFP has recommended downward adjustment of asset beta to 0.54 from its calculated value of 0.59, since in its view UDF acts as a risk mitigant for airport, although, with the following caveat –

"....we are given to understand that it is only over the past 3-4 years that this instrument has been extensively used. Therefore, sufficient historical data is not available to estimate how well UDF would work as a risk mitigating tool to reduce the beta for the respective airports. So, we have to estimate the impart as beta, based on a priori understanding of how this might work, and then revisit the estimate once we have data on its effectiveness during the coming years."

The Authority in its analysis in the consultation paper has suggested that,

"Similarly it proposes to use the legislative instrument of user development Fee as a revenue enhancing measure to enable the Airport Operator earn the Target Revenue (which, in turn, depends on Fair Rate of Return on equity as well as other means of finance like debt, internal resource generation, refundable security deposits etc)."

2.22 As per Authority Tariff Guidelines,

"The User Development Fee (UDF) and other aeronautical charges cover the same range of services, and therefore ***UDF shall be considered as a revenue enhancing measure*** *to ensure economic viability of the airport operations and shall be allowed only in specific cases upon due consideration."*

As indicated above, UDF is only a substitute for tariffs not realizable for aeronautical services and covers the same range of services as under other aeronautical revenue heads. It does not act as a risk mitigating revenue source for the airport as the levying of UDF would imply reduction in other aeronautical tariffs levied by the airport for specified target revenue. Further, the levying of UDF, which is a passenger traffic related charge, instead of increase in Air Traffic Movement (ATM) related charges such as landing and parking charge increases the volatility in revenues of the airport as the volatility of passenger traffic is higher than volatility in ATMs.

2.23 **Conclusion*:*** The cost of equity of 16% as proposed by the Authority for determination of aeronautical tariffs at CSIA underestimates the riskiness of the CSIA. Further, the aviation sector in India competes with other sectors in India as well as global airport

[8] Except in cases where concession period is reduced when the actual traffic exceeds target traffic for a specified year. However, the concession period is only reduced by a maximum of 10% of the original period in such cases.

[9] Source: Crisil database & secondary research

projects around the world for investments and if reasonable return on investment is not allowed, it will certainly affect future investment in the sector adversely.

2.24 Authority has not considered MIAL's submission that during the bidding process AAI had clarified to the bidders that it has considered a WACC of 11.6% based upon cost of equity and debt of 22.8% and 6% respectively for the purpose of bid comparison and advised bidders to submit bids accordingly. Authority has disregarded the above submission mentioning that it was only indicative for comparison purposes and cannot be construed as assured return by any stretch of imagination. However, Authority must appreciate that bidders had prepared their bids on the specific cost of equity and debt indicated by AAI and quoted the revenue share percentage accordingly. If AAI had indicated a lower cost of equity (say, 16%), the revenue share percentage quoted by bidders would have certainly been lower. It is unfair to change the critical assumption on cost of equity which was indicated during the bid stage, as it affects the viability of the airport adversely.

2.25 It is important to note that the Authority has a responsibility to ensure economic and viable operations of the airport, both under the AERA Act and State Support Agreement entered into by MIAL with the Government of India. The relevant extracts are reproduced below:

Section 13(1)(a) of the AERA Act required the Authority to determine tariff for the aeronautical services taking into consideration :" economic and viable operations of major airports."

Schedule 1 of SSA provides that "….. *in undertaking is role, AERA will observe the following principles:" 2. Commercial – In setting the price cap, AERA will have regard to the need for the JVC to generate sufficient revenue to cover efficient operating costs, obtain the return of capital over its economic life and achieve a reasonable return on investment commensurate the risk involved."*

2.26 From the above it is evident that AERA needs to provide reasonable return on the investment so that airport is able to generate sufficient revenues which after meeting cost of operation are able to provide reasonable return to the investors. AERA has taken a position in the case of tariff determination for Delhi airport that while ensuring viability of the airport, it will not consider Annual Fee (revenue share) payable to AAI since the same is not a pass through cost as per SSA. While it is fact that Annual Fee is not a pass through cost in accordance with SSA and has accordingly not been included by the Authority while calculating Target Revenue, it cannot be ignored while considering viability of the airport as Annual Fee is a contractual and legal obligation which airport has to meet. Therefore to ensure viability of the airport, Authority should have considered this fact also and provided commensurate return on equity. We request the Authority to duly consider these submissions while determining the cost of equity. We firmly believe that Authority should provide a minimum return on equity of 24% for CSIA to remain viable.

3 Non Aeronautical Revenue

3.1 ***The Authority also tentatively decided to true-up the actual non aeronautical revenue at the time of tariff determination for the next control period subject to the projections by MIAL in respect of non-aeronautical revenue being treated as minimum / floor for the current control period.***

3.2 APAO is of the view that no true-up of non-aeronautical revenue should be done provided realistic forecasts of non-aeronautical revenue are made by the airport operator / Authority. This approach will help provide the right incentive for investors in airport assets.

4 Refundable Security Deposit

4.1 ***The Authority has proposed not to provide any returns on aeronautical assets funded through refundable security deposits collected by MIAL from real estate monetization.***

4.2 **Definition of Equity as per OMDA:** OMDA defines Equity only for the limited purpose of defining Equity Capital to be considered in OMDA. The definition does not define Equity as used in common business parlance which is shareholders net worth.

4.3 **Foregone Lease Rentals[10]:** Refundable Security Deposit (RSD) of Rs. 1000 cr. from lease of land is proposed to be used by MIAL to part fund the capital expenditure. In lieu of upfront deposit received by MIAL in the form of RSD, it is expected that MIAL would have to forego a part of the lease rentals. Additionally, MIAL had the option to invest RSD in the non aeronautical business or other related businesses which could have earned a higher return.

4.4 **WACC is determined based on opportunity cost of capital[11]:** Professor Aswath Damodaran, defines cost of capital as "opportunity cost of all the capital invested in an enterprise[12]". "Opportunity cost is what you give up as a consequence of your decision to use a scarce resource in a particular way". By this definition, the opportunity cost of RSD, in MIAL's case, may need to be measured by returns from RSD in the next best use, and NOT by the associated cost or source of funds.

4.5 **Interest foregone:** Even if MIAL were to invest the RSD in a bank fixed deposit (FD), it would earn interest between 8-9 % depending on the prevailing FD interest rates. It is evident that there is a cost associated with RSD. Since the RSD will be raised from lessees of the Non-Transfer Assets, it is also outside the purview of any cross-subsidy for the aeronautical users as per the terms of the SSA. The RSD amount would show as liability in the books of MIAL and MIAL's investment in the aeronautical business is not expected to dilute MIAL's liability towards lessees of the land. In event of early termination of lease agreement, MIAL would be required to repay such RSD, subject to the conditions of the agreement.

4.6 Principle 1 of Schedule 1 of the SSA states that:

"Incentives Based: The JVC will be provided with appropriate incentives to operate in an efficient manner, optimising operating cost, maximising revenue and undertaking investment in an efficient, effective and timely manner and to this end will utilise a price cap methodology as per this Agreement."

Providing zero return on RSD would not be in line with the Principle 1 of the SSA.

4.7 Zero return on RSD at this stage may not set the right precedent for any future investment by a private player in airport sector in India. Importantly, it contradicts Principle 1 of Schedule 1 of the SSA by not providing any incentive for investment of RSD or equivalent sources of funds in the aeronautical business.

[10] Source: Secondary research
[11] Source: http://pages.stern.nyu.edu/~igiddy/articles/wacc_tutorial.pdf
[12] Source: http://pages.stern.nyu.edu/~igiddy/articles/wacc_tutorial.pdf

4.8 A zero return on RSD does not provide any incentive to investors to utilize RSD as a means of finance. This is significant considering that RSD will be raised from lessees of the Non-Transfer Assets and is outside the purview of any cross-subsidy for the aeronautical users as per the terms of the SSA. At the least, RSD should earn return equivalent to the benchmark returns available on long-term fixed deposits, which would continue to incentivize the operator to utilize such funds for financing aeronautical assets, as opposed to employing debt or equity at a higher cost, in a capital constrained scenario.

4.9 SBI Caps in its report to the government for cost of RSD has mentioned as under*: "On the quasi-equity for the airport sector, the study has concluded that the rate of return would depend on the type and feature of the instrument being used for such form of finance. The report further states that in quasi-equity, the risk / return profile lies above that of debt and below that of Equity"*. It is worth noting that RSD has all the characteristics of Equity such as no associated fixed costs, nature of funds being very long term and are subordinate to long term debt. Therefore RSD can be regarded as quasi-Equity.

4.10 **Case Study:** Other infrastructure sectors, where tariff is also regulated, allow a return on the capital employed. Regulators in these sectors do not provide return on the basis of source and associated cost of funds. Case studies from the relevant sectors are presented below:

a. City Gas Distribution (CGD): Petroleum and Natural Gas Regulatory Board (PNGRB) allows return to concessionaires on the basis of the capital employed. It even recognizes that the security deposits received by the concessionaire would exist as liability and these should not be reduced from the total capital employed while determining tariff. Relevant extracts from the guidelines issued by PNGRB for determination of network tariff for city or local natural gas distribution network and compression charge for CNG have been reproduced below:

"Entity [13]may collect refundable interest free security deposit as specified under the Petroleum and Natural Gas Regulatory Board (Authorizing Entities for Laying, Building, Operating or Expanding City or Local Natural Gas Distribution Networks) Regulations, 2008. Such deposit is towards the safe-keeping of the meter and is to be refunded in full to the domestic PNG customer in case of a dis-connection. ***Further, since the amount collected as interest-free refundable security deposit shall exist as a liability in the books of accounts of the entity, the same shall not be reduced from the total capital employed while determining the network tariff****.*

The reasonable rate of return shall be the rate of return ***on capital employed*** *equal to* ***fourteen percent*** *post-tax considering the rate of return on long-term risk-free Government securities and the need to incentivize investments in creation of CGD infrastructure"*

[13] Source: Petroleum and Natural Gas Regulatory Board (Determination of Network Tariff for City or Local Natural Gas Distribution Networks and Compression Charge for CNG) Regulations, 2008, point 2, Attachment 3 to Schedule A

b. Other factors to be considered from the CGD guidelines:

i) PNGRB guidelines regulates tariff for CGD networks, which **applies directly to end-users.** PNGRB allows the security deposits provided by end users to be invested in the business and earn return on such investments, whereas in case of MIAL, security deposits have been availed from lessees of land.

ii) **Demand risks are less for a CGD network** as compared with traffic risk at an airport. Additionally, tariffs for CGD networks are for an essential commodity.

iii) Guidelines issued by PNGRB are one of the **most recent** guidelines in the Infrastructure sector in India and could be considered as learning from other regulated sectors.

c. Port Sector: In port sector, Tariff Authority for Major Ports (TAMP) sets tariff for Major Ports based on cost plus Return on Capital Employed (ROCE) approach. Capital Employed is calculated as a summation of net fixed assets and working capital. Relevant extracts from the regulation have been reproduced below:

"Return will be allowed on Capital Employed (ROCE), both for Major Port Trusts and Private Terminal Operators, at the same pre-tax rate, fixed in accordance with the Capital Asset Pricing Model (CAPM)."

"Capital Employed will comprise Net Fixed Assets (Gross Block minus Depreciation minus Works in Progress) plus Working Capital (Current Assets minus Current Liabilities)"

4.11 **Conclusion***:* The Authority has proposed to provide zero returns on aeronautical assets funded through RSD. However, it is evident that there is an opportunity cost associated with RSD in terms of the foregone lease rentals. Professor Aswath Damodaran, a Professor at New York University and one of the leading corporate finance experts in the world, defines cost of capital as "opportunity cost of all the capital invested in an enterprise". As per Principle 1 of Schedule 1 of the SSA, Authority is required to follow an 'incentive-based' approach for tariff determination. A zero return on RSD does not provide any incentive to investors to utilize RSD as a means of finance going forward. This is significant considering that RSD will be raised from lessees of the Non-Transfer Assets and is outside the purview of any cross-subsidy for the aeronautical users as per the terms of the SSA. At the least, RSD should earn return equivalent to the benchmark returns available on long-term fixed deposits, which would continue to incentivize the operator to utilize such funds for financing aeronautical assets, as opposed to employing debt or equity at a higher cost, in a capital constrained scenario. There are also examples from other infrastructure sectors where the regulator provides return on the capital employed by the Concessionaire without considering the source or cost of funding while calculating tariff.

5 Cargo Revenue

5.1 ***The Authority has noted the Government's confirmation that the revenue from services of cargo and ground handling in Delhi and Mumbai be regarded as non-aeronautical revenue in the hands of the respective Airport Operators, irrespective of whether these services are provided by the Airport Operator itself or concessioned out to third parties.***

5.2 We agree with the Authority's position to consider revenue from cargo as non-aeronautical revenue, 30% of which shall go towards cross-subsidizing the target revenue requirement. This is as per the OMDA and has been confirmed by the Government.

5.3 The Authority has pointed out that as per section 2 (a) (vi) of the AERA Act, the services provided for cargo facility at an airport is an "aeronautical service". As per the guidelines issued by the Authority the tariffs for cargo facility service being provided by MIAL at CSI Airport, Mumbai merits to be determined under "Light Touch Approach", as the service is "Material but Competitive".

5.4 We appreciate the position taken by the Authority in this regard.

6 Hypothetical Regulatory Asset Base

6.1 ***The Authority tentatively decided to include Rs. 54 crs. (extraordinary expenses in relation to AAI Operation Support cost) in operating expenses in calculation of Hypothetical RAB.***

6.2 Extraordinary expense of Rs. 54 cr. – MIAL has submitted to the Authority that it has reimbursed AAI towards pay revision of AAI employees for the period 1 January 2007 to 2 May 2009. Thus, the expense of Rs. 54 cr. corresponds to a period of 28 months. For the determination of HRAB, O&M expenses corresponding to only FY09 is admissible. Expenses pertaining to other periods (January 2007 to March 2008 and 1 April 2009 to 2 May 2009) should be excluded.

6.3 Rs. 54 cr. may be apportioned equally to the said 28 months. Thus, only Rs. 24.13 cr. may be included as part of O&M cost for FY09. Further, this amount of Rs. 24.13 cr. should be adjusted for the ratio of aeronautical to non-aeronautical expenses to determine the amount attributable to aeronautical activities. The HRAB may be determined accordingly.

6.4 **Conclusion:** Extraordinary expense of Rs. 54 cr, only Rs. 24.13 cr. pertains to FY09. After applying the ratio of aeronautical expenses to non-aeronautical expenses on the Rs. 24.13 cr. amount, the amount attributable to aeronautical activities alone may be considered for determination of HRAB.

7 DF Collection Charges

7.1 ***<u>The Authority has disallowed collection charges with respect to DF as a pass through cost.</u>***

7.2 AERA has not accepted the proposal of MIAL to defray the collection charges paid by them to airlines in respect of DF as operational expense. The Authority has quoted:

"… as per the provisions of Section 13 (1) (b) of the Act read with Section 22A of the AAI Act, 1994, the Authority's function in respect of DF is confined to determination of the rate/amount thereof. Further, the issue of collection, deposit etc., of DF is not within the purview of the Authority."

7.3 **DF as part of means of finance:** MIAL has been allowed to collect DF to part fund the capital expenditure. Collection charges with respect to DF are similar to the collection charges being allowed by the Authority on collection of PSF / UDF. Since the nature of the charges are identical both for UDF / PSF and DF, the same should be allowed as part of O&M cost.

7.4 **Mandated by the Government:** DF collection charge is mandated by the Government. MIAL is therefore obligated to pay such collection charge to the airlines.

7.5 **<u>Conclusion:</u>** APAO requests the Authority to allow collection charges with respect to DF collection as part of operational expenses.

8 Retirement Compensation

8.1 ***The Authority has proposed to expense the Retirement Compensation paid by MIAL with respect to AAI staff instead of amortising it over the life of the asset.***

8.2 AERA has taken a view to expense the Retirement Compensation (RC) payments made by MIAL, in line with its decision for DIAL. The Authority has mentioned:

"The Authority, in line with its Tariff Order in respect of IGI Airport, Delhi, has tentatively decided to expense out the actual amount that is paid or will be paid by MIAL during the control period instead of capitalizing the same."

8.3 **Mandatory requirement as per OMDA:** Payment of RC with respect to AAI staff was a mandatory condition as per OMDA. Concession rights were granted to MIAL subject to their acceptance of all the obligations under OMDA. Relevant section from OMDA is stated below:

"The JVC shall be the new employer for these employees on terms and conditions mutually agreed between the JVC and such employees. Provided however that if less than 60.00 % of the General Employees (as reduced for retirements, transfers, resignations and death and any fractions to be rounded off to the nearest whole number) accept the offers of employment made by the JVC, then the JVC shall pay to AAI ***Retirement Compensation*** *for such number of General Employees as represent the difference between 60.00 % of the General Employees (as reduced for retirements, transfers, death and any fractions to be rounded off to the nearest whole number) and the number of General Employees accepting offers of employment made by JVC, including cumulatively the offers made and accepted during the Operational Support Period.*

"*Retirement Compensation"* *shall mean the average 'voluntary retirement scheme' ("VRS") cost for all the General Employees other than those General Employees who have accepted offers of employment made by the JVC under the provisions of Article 6 hereof, as per the latest VRS of the AAI, if any, or, in the absence of an AAI specific VRS, the highest VRS as applicable for the then available profitable schedule A public sector undertakings"*

8.4 **Accounting Standard (AS) 10**: As per AS10, cost related to bring an asset to its working condition would be treated as part of capital expenditure. Since, in the current scenario, MIAL could not have obtained the concession rights for CSIA without accepting the obligation of RC, such payments may be treated as cost related to bringing an asset to its working condition, subject to the conditions imposed under accounting standard issued by Institute of Chartered Accountants of India (ICAI). Hence, payments made towards RC could be capitalized. Relevant section from AS 10 is presented below:

"The cost of an item of fixed asset comprises its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use";

8.5 **Staggered Payments:** The Authority has proposed that since RC amount are not being paid on a one time basis, treatment of amortization would be incorrect. It would not be appropriate to consider it as part of operational expense only because the payments are staggered. It may be noted that interest during construction (IDC) is also paid to the lenders every quarter (or as based on the agreement between the lenders and the party) and is not a one-time expense. However, IDC is capitalized and amortized along with fixed asset.

8.6 The approach adopted by the Authority is also inconsistent with the principles of accrual based accounting mandated under Accounting Standards. Even if Authority decides to expense out this expenditure it should be done based upon the total liability to MIAL and not based upon payment made / to be made in future. It is incorrect to treat one particular item of asset / expenditure on cash basis while the entire accounting and tariff determination is being done on the basis of accrual accounting.

8.7 Alternatively, if the Authority decides to expense out the RC amount, it should be the total amount capitalized (not just the amount paid), including the interest on the loan taken to pay this amount which needs to be expensed out.

8.8 **Conclusion:** The Authority has proposed to expense out the Retirement Compensation paid to AAI by MIAL with respect to AAI staff instead of amortizing it over the life of the asset. As per Accounting Standard 10, cost related to bringing an asset to its working condition can be treated as part of capital expenditure. In the current scenario, MIAL could not have obtained the concession rights for CSIA without accepting the obligation of RC. Hence such payments may be treated as cost related to bringing an asset to its working condition. On the basis of above arguments, APAO requests the Authority to consider capitalizing the RC payments as part of RAB in the year of actual payments made by MIAL and allow amortizing these expenses over the life of the asset. Alternatively, if the Authority decides to expense out the RC amount, it should be the total amount capitalized (not just the amount paid), including the interest on the loan taken to pay this amount which needs to be expensed out.

9 Adjustment to RAB on account of DF

9.1 ***<u>The Authority tentatively decided to consider DF funding of RAB such that RAB to be capitalised in any tariff year would be first reduced to the extent of DF amounts billed / securitised and not already reduced from RAB.</u>***

9.2 AERA has proposed that the RAB capitalized in any tariff year be reduced to the extent of the total DF amount billed/ securitized in that year. DF is collected to fund construction and development of identified Aeronautical Transfer Assets, which typically take more than a year to build. While some of the DF funds may be deployed towards assets that get capitalized in the same year as that of DF billing / securitization, the remaining portion of the DF funds would go towards capital work-in-progress (CWIP). It would be inappropriate to reduce the capitalized RAB by the quantum of DF funds tied in CWIP.

9.3 Aeronautical assets of MIAL will be funded through a mix of equity, debt, RSD, IRG and DF. On account of various practical constraints, it is not possible to entirely fund the assets that are to be capitalized in a particular year through DF alone; other means of finance such as equity and debt are also used. If the approach suggested by Authority is considered and the RAB is adjusted entirely for the DF collected, equity and debt providers will be denied return for their contributions.

9.4 DF collected during a year can only be deployed towards assets that are under construction. Some of these assets would be ready for capitalization in the same year; other assets, for which DF funds were also utilized, would still be in WIP stage. In this context, it is erroneous to assume that all DF funds billed /securitized in a year can be capitalized in the same year. The approach of the Authority is also not in accordance with the accrual basis of accounting.

9.5 Actual utilization of DF funds, in respect of assets funded through it, is scrutinized by the Independent Auditor appointed by AAI. Further, monthly reports on collection and utilization of DF have been submitted by MIAL to AAI/MOCA/AERA. The approach suggested by the Authority completely disregards the utilization of DF funds for identified assets, which are clearly verifiable as capitalized and work-in-progress assets.

9.6 It is pertinent to note that the Airports Authority of India (Major Airports) Development Fees Rules, 2011 does not provide any guideline on adjustment of DF against capitalized assets.

9.7 Approach suggested by Authority is impractical, possible only with the advantage of hindsight and at the best could be considered as only theoretical. As explained above, it is incorrect to consider that a particular asset or assets capitalized in a year has been funded entirely through DF considering the fact that:

a) construction cycle of most of the assets is more than a year and for some assets it is as long as five years

b) completion date of some of the projects might change from original estimates due to various reasons and after having made payment from DF it may not be possible to capitalize the asset in that year

c) mismatch in cash-flows between requirement and availability of DF funds

9.8 **Conclusion:** DF collected during a year can only be deployed towards assets that are under construction. While a part of DF funds may be deployed towards assets that get capitalized in the same year as that of DF billing / securitization, the remaining portion of the DF funds would go towards capital work-in-progress (CWIP). APAO would also request the Authority to take into account the provisions under The Airports Authority of India (Major Airports) Development Fees Rules, 2011, which does not provide any guideline on adjustment of DF against capitalized assets, in the manner proposed by AERA. APAO would request the Authority to take into account the extent to which DF billed / securitized in a given year is actually capitalized for the purpose of adjustment of the RAB.

10 Fuel Throughput Charges and CUTE Counter Charges

10.1 ***The Authority tentatively decided that Fuel Throughput Charges are charges in respect of provision of aeronautical service namely, supply of fuel to the aircraft, hence it is an aeronautical charge and is to be determined by the Authority under the Section 13 (1) (a) of the AERA Act..***

The Authority tentatively decided to consider the CUTE counter services as aeronautical service and the payment made by airlines being a direct payment to MIAL as aeronautical revenue.

10.2 The fuel throughput charges being received are value of the concession given to the oil companies. In case of CUTE counters, only space is given to airlines on a rental basis.

10.3 Authority has considered revenue from concessions such as In-to-plane (ITP) as Non-Aeronautical revenue. Treating revenue from concession to allow supply of fuel as aeronautical is inconsistent with Authority's own views. As in the case of ITP, fuel supply infrastructure is not owned by the Airport Operator and common hydrant infrastructure, pipelines, etc. also belong to the fuel suppliers. Both these cases are identical and non-distinguishable. Further, the Authority has treated other rental income as non aeronautical revenue as well.

10.4 As per ICAO Document No.9082 (Ninth Edition-2012; Appendix 3 - Glossary of Terms) wherein the "revenues from non-aeronautical sources" is defined to include concession granted to oil companies to supply aviation fuel and lubricants and the rental of terminal building space or premises to air carriers. The privilege/concession of grant of access to airport falls under revenue from non-aeronautical sources.

10.5 As per the form used by ICAO Contracting States to report financial data of airports (i.e. Form J), "**Aviation fuel and oil** – Include all concession fees, including any throughput charges, payable by oil companies for the right to sell aviation fuel and lubricants at the airport" is included as a concession (Item 3), i.e. non-aeronautical revenues.

10.6 The airport operators themselves do not provide any aeronautical services under the ambit of section 2(a) of AERA Act, 2008 insofar as FTC is concerned.

10.7 **Conclusion:** The fuel throughput charges is received against the concession given to the oil companies for their fuelling services. In the case of CUTE counters, MIAL only provides space to airlines on a rental basis. In both cases, revenue earned by MIAL should be treated as non-aeronautical revenue. Treating such revenue as aeronautical is inconsistent with the Authority's own view in determining the nature of revenues from cargo, ground handling and in-to-plane services. APAO would request the Authority to adopt a consistent approach with respect to classification of non aeronautical services and consider revenues from fuel throughput charges and CUTE counter charges as non aeronautical revenues. However, in case AERA decides to consider CUTE counter charges as aeronautical revenues, the same treatment should be extended for the determination of HRAB where revenue from CUTE counter charges should be considered as aeronautical revenue.

11 AAI Upfront Fee

11.1 ***Authority has tentatively decided not to consider Upfront Fee of Rs 153.85 cr paid to AAI towards Equity.***

11.2 The SSA precludes Upfront Fee from forming part of the project cost or regulatory asset base or being treated as a pass-through to the airport users. There is no provision in the SSA or OMDA which provides for exclusion of equivalent amount from means of finance for the purpose of WACC calculation. Equity contribution by shareholders in MIAL remains unchanged even after Rs. 153.85 cr is excluded from project cost. There was no such obligation cast upon shareholders under SSA/OMDA that Upfront Fee has to be provided from Equity alone.

11.3 Based upon equity contribution of Rs. 1,200 cr, lenders have agreed to sanction debt of Rs 4,231 cr. to MIAL.

11.4 MIAL is free to use any or all means of finance available at its disposal to meet the payment of Upfront Fee to AAI. Expenditure on account of Upfront Fee cannot be linked to a particular means of finance viz. Equity only because of the reason that when it was paid no other funds were available. As Authority would agree, funds are fungible and therefore it would be wrong to link any specific payment to specific asset / expenditure unless there are such stated restrictions.

11.5 Hence, calculating WACC without recognizing total Equity contribution will be erroneous.

11.6 **Conclusion:** APAO would request the Authority to not exclude the Upfront Fee of Rs. 153.85 cr. paid to AAI towards Equity. The Authority's proposed methodology results in an unfair reduction in the true cost of capital for the project.

12 Development Fee

12.1 ***The Authority has tentatively decided to determine the total amount of DF that could be billed by MIAL at Rs. 3,400 cr.***

12.2 ***The Authority has presented the following options in respect of Development Fee levy rates and solicited stakeholder views on the same.***

S No.	Option	DF rates levied on each departing passenger	Anticipated end date for levy of DF
1	Option I	Domestic – Rs. 100 International – Rs. 600	March 2019
2	Option II	Domestic – Rs. 200 International – Rs. 1300	December 2015

12.3 We support the Authority's position to allow project funding of Rs. 3,400 cr. through Development Fee as a means of last resort. The amount proposed to be sanctioned as DF is comparable to the DF allowed in case of IGI Airport, New Delhi as the two airports are comparable in terms of capital expenditure, passenger and cargo volumes. It will certainly help MIAL to achieve timely completion of the project and at the same time will not result in any undue or unjust benefit to MIAL.

12.4 It must also be noted that DF is used as a pre-funding mechanism to finance capital expenditure. Therefore, the amount sanctioned to be collected through DF by the Authority should be available to MIAL at the earliest for the purpose of project funding. Option II – Rs. 200 per departing domestic passenger and Rs. 1,300 per departing international passenger – may be adopted as the DF rates for CSIA, Mumbai.

12.5 We would also like to point out that in the case of IGI Airport, New Delhi, the Authority has permitted DF rates of Rs. 200 per departing domestic passenger and Rs. 1,300 per departing international passenger (i.e Option II).

12.6 **Conclusion:** In respect of levy of DF, APAO requests the Authority to allow the following rates of levy:

c. Rs. 200 from each departing domestic passenger

d. Rs. 1,300 from each departing international passenger

13 User Development Fee

13.1 ***The Authority has presented the following options in respect of levy of User Development Fee and solicited stakeholder views on the same.***

a. To accept MIAL's request for levy of UDF effective from 1 January 2013 and truing-up any shortfall in UDF billing

b. To levy UDF from 1 April 2013 for domestic passengers and 1 July 2013 for international passengers without any truing-up of shortfall in UDF billing

13.2 The Authority has noted that airlines issue tickets in advance (nearly 12 months for international travel and 3 to 6 months for domestic travel). In case UDF levy is made effective from 1 January 2013 (i.e. option (a)), the Authority has anticipated operational inconvenience at the airport on account of gate collection of UDF for tickets issued in advance.

13.3 Only 15 months remain in the current control period for levy and collection of tariffs approved by the Authority. Reducing the period of UDF levy by another 3 months for domestic passengers and 6 months for international passengers would imply shifting the entire burden of UDF on passengers travelling in this short period rather than distributing it among a broader passenger base.

13.4 To avoid inconvenience to the passengers on account of gate collection of UDF and at the same time not to increase the burden of UDF on passengers due to a shorter collection period it is important that collection of UDF is started immediately from 1 January 2013 along with tariff increase and allow for a 100% true-up for any shortfall in passenger volumes

13.5 **Conclusion:** APAO requests the Authority to allow MIAL to levy UDF effective from 1 January 2013 and 100% truing-up any shortfall in UDF billing.

14 Conclusion

14.1 AERA's initiative in issuing the Consultation Paper and seeking stakeholders' feedback is well appreciated. Stakeholders interaction provides for an open, fair and transparent process in determining an approach to tariff setting which is acceptable by all the stakeholders.

14.2 We request AERA to consider our submissions in right earnest while finalizing the DF and tariff order in respect of MIAL.

--