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To.

Shri Alok Shekhar
Secretary, Airports Economic Regulatory Authority of India
AERA Building, Administrative Complex,
Safdarjung Airport, New Delhi- 110003
Tel: 011-24695040
Fax: 011-24695039

Sub: Comments/observations to the Consultation Paper No. 22/ 2013-14 - Addendum to Consultation Paper No. 14/ 2013-14 dt. 26th June 2013 concerning BIAL

Dear Sir,

On behalf of citizens of Bangalore, truly in perspective of the passengers using KIA, WE, **Bangalore Political Action Committee (BPAC)** would like to submit the following observations and comments on the consultation paper referred above for your knowledge and kind consideration while determining the User Development Fees (UDF) against the claims submitted by BIAL and under consideration by AERA.

<u>Proposal No 1. Regarding Pre-control period shortfall claim and</u>
<u>Proposal No 2. Regarding Asset and Expenditure Allocation (Aeronautical / Non Aeronautical)</u>

a. Overall cost bifurcation between aero and non-aero (91%-9%) is not in comparison with any of the international airports of similar capacity, worldwide. Need to be benchmark with other airports and compared with the cost allocation principles followed in aviation sector elsewhere. Proper justification for a dissimilar allocation to be sought.
b. The allocation of expenses on aero and non-aero operations must be based on activity based costing.
c. Employee costing need to be properly bifurcated between aero and non-aero. The engagement of common employees for various projects within BIAL and projects elsewhere need to be identified and proper cost bifurcation to be ensured.
d. Why the passengers have to bear the lease cost of land lying idle, when BIAL failed to utilize it for commercial development?
e. There appears to be a discrepancy in utility cost allocation. The rate paid by BIAL to the utility suppliers and the rate recovered from the consumers seems different, the second being around 50% higher side after incorporating capital investment costing and overhead charges. This leads to double recovery of capital cost, from passengers and form utility consumers, and also converting a portion of it as non-aero revenue. Also the allocation of the capital cost on utilities under aero and non-aero in line with the revenue allocation need to be ensured.

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f. In terminal expansion project accounting, the allocation of expenditure between aero and non-aero is apparent not in line with the real scenario. The real footprint of non-aero commercial activities (as listed in the document) looks three times higher than what is projected. There seems to be misinterpretation of area allocation, for example the unenclosed areas allocated to concessionaries, seating area of restaurants etc, bringing under aero.

g. Overall concerns about accounting practices can be alleviated with more transparent reporting of the aero and non-aero financials.

Proposal No 2. Regarding Asset and Expenditure Allocation (Aeronautical / Non Aeronautical) and Proposal No 3. Regarding Future Capital Expenditure

a. T1 expansion cost of **1545 Cr** looks extremely inflated and would add unsolicited burden to passengers. In this regard the following points need to be scrutinized, investigated and audited by third party appointed by the Authority keeping public interest in consideration:
    1. Expansion cost of T1 to be thoroughly audited and benchmarked in comparison with the similar airport expansion projects recently completed in Chennai and Kolkata.
    2. Cost per sq. ft. of **Rs. 11744** is too high. It also raises doubts about the method adopted for the area of footprint calculation. The bifurcation of area and costing between the actual building (covered, facilitated and effectively used) and the roofed structure (open and only covered with canopy/roofing/facia) need to be properly evaluated and bench marked in comparison with the cost of similar projects.
    3. The service levels in consideration for designing and execution of the terminal need to be verified for its appropriateness. It appears that building is designed keeping in a higher standards of service level compared to what level is being assured to AERA vide the document under reference. This results in higher (undesired) capital cost, but not adding desired value to the travellers.
    4. In view of the use of common contractors, consultants, employees and suppliers by the promoters having multiple airport projects and non-airport projects across the country and abroad, the cost allocation need a thorough auditing to confirm the works/supplies billed for T1 project is actually used here or elsewhere.

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5. It is understood from reliable sources that employees in BIAL payroll is executing projects elsewhere and also the employees actually working for the project elsewhere are charged to BIAL projects, resulting misrepresentation of the BIAL revenue. Hence it is felt necessary to undertake a thorough audit of payroll of top 20% category of employees and if found them shared resources in multiple projects, care should be taken to allocate only relevant costs to BIAL.
6. It is also understood that there is huge variation of completion cost (around 300 Cr) from the original scope. This need proper justifications if those expenditures were actually necessary to be executed as the burden of this straight away falls on the users.
7. There was no public consultation involving the pretentious stakeholders – passengers. Why the citizen forums and industry bodies were not involved for consultation? Also, it is unclear from the consultation paper, if BIAL had made available the cost estimation of the project during the stakeholders' consultation. Any consultation without revealing the projected expenditure and its impact on stakeholders is incongruous and would allow the airport operator free to draw and deviate the lines wherever they desire during execution and by the end of the project.
8. Threats of conflict of interest and its probable impact in inflated project cost:
    1. We see that one of the shareholder having multiple interests in allied businesses such as airport hotel, construction contracts within BIAL, projects at another airport and elsewhere has engaged a common contractor for all these works, raising concerns over the misrepresentation of cost over the transaction through this common conduit.
    2. The contractor for T1 expansion is an ex-stakeholder of BIAL, having sold their 17% of their stake to the present major stakeholder who in turn awarded the contract back to the ex – stakeholder.
    3. Since the same contractor is involved in handling many projects of the major stakeholder of BIAL and also in the sale of Airport hotel, there is a possibility that the fund allocation for various activities and the source of funding could have undergone adjustments to match the final 'give and take'. If the dues of the project elsewhere got adjusted in the project cost of BIAL, this would result in high capital expenditure, and hardship to the passengers.
    4. The method of award of contract, the criteria adopted, transparency in dealing public money, approval process etc. need to be thoroughly investigated and audited.

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b. It is necessary to ensure that the capital expenditure on aero operations is not overstated and non-aero operations are not understated. Need detailed scrutiny to overcome this risk.

c. The projections for immediate future capital expenditure **(over 10,000 Cr)** for second terminal, second runway and allied facilities looks too much inflated. The projected cost must be based on reliable and systematically fit to ***India costing*** and not based on ***dollar conversion*** of the similar projects in US or Europe as projected by a foreign consultant.

d. The cost of site preparation work for the second runway amounting to **1000 Cr** is unjustifiable and raises the doubts about the suitability of site for building a runway. There are many airports (with complete infrastructure and facilities) in India which were built with a total cost much lesser the site preparation cost alone for a runway in BIAL. May please seek clarification from AAI in this regard.

e. It is felt necessary that the operator discloses the details of design, service levels in offer and cost along with the probable impact of UDF at the initial stage with the representatives of major stakeholders – passengers. Before freezing the scope and costing of the project, an independent detailed scrutiny of proposal to be made mandatory and the projected cost to be disclosed to the public.

f. Regarding expenditure of strengthening of existing airfield pavements, the existing warrantee for such infrastructure need to be taken in to consideration. It is learned that the flexible pavements built in first phase enjoy a warrantee of 12 years and the rigid pavements, 20 years. The passengers need to be safeguarded from the burdens of such inappropriate cost doubling.

g. Capital expenditure for those facilities which are made available to the users only to be considered for determination of UDF. The expenditure for a facility which will be offered to the user during next control period should not be considered for evaluating UDF of this control period. Why the passengers should pay for a facility which is not made available to them?

<u>Proposal No 4. Regarding Regulatory Asset block and Depreciation</u>

a. For non-development of committed assets like hotel etc. on time, why not a penalty be imposed?

b. Regarding consideration of depreciation on 100% of the asset values (without considering any salvage value), we have concerns as it would lead to higher expenditure and lesser profitability. May please reconsider.

c. We understand that the arbitration process on hotel is over now and hence the current status including the change of ownership if any need to be considered. Or else, the amount of security deposit to be transferred to an ESCROW account.

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d. Commitment on commercial exploitation of land may be made time bound and appropriate penalty be imposed on failure to adhere to such commitments.

Proposal No 5. Regarding Traffic Projections

a. Traffic projections once frozen for deciding investments should not be reworked or manipulated to justify the variations in investment without undergoing an approval process and consultation process.

Proposal No 6. Regarding Cost of Debt,

a. Regarding ceiling in respect of the cost of debt for rupee term loan availed by BIAL at 12.50% and considering interest for Foreign Currency loan at 10.15%, it may be explored if a Government guarantee will reduce the cost of debt.
b. Regarding the proposed increase of 1% in the rate of interest of rupee term loan, a benchmark could be established and if the interest rates stay above that benchmark then 1% hike could be agreed.
c. Regarding weighted average Cost of debt, flexibility may be provided by pegging to a benchmark interest rate index.

Proposal No 7. Regarding Cost of Equity and
Proposal No 8. Regarding Weighted Average Cost of Capital

a. We have the following concerns with regards to the Computation of cost of capital:
   1. While the Equity risk premium could be computed in many ways, we would like to suggest that the computation methodology used should be forward looking, for the benefit of passengers.
   2. Is the rate obtained from the Indian term structure of interest rate and ratified by SBI?
   3. Cost of Debt could be brought lower if GoK or GOI can give counter guarantee.
   4. Cost of Debt should be accurately reflected in the financial projection in each control period.
   5. Cost of capital must transparently reflect the interest cost deducted from the income statement in the business plan.
   6. Cost of equity must reflect forward looking equity risk premium and not historical risk premium.

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7. Beta Calculation seems right but it must be levered for the changing debt ratio each year of the project life and average gearing must be avoided.

Proposal No 9. Regarding Taxation

a. BIAL must enjoy the tax holiday and maximum marginal rate of tax and not effective rate to be considered.

Proposal No 11. Regarding Operating and Maintenance Expenditure

a. Maintenance Capex over the life of the project must be monitored since it reduces cash flow over the project life if left unmonitored.
b. Break up for the maintenance capital expenditure must be obtained and it must corroborate with what's being presented in the business plan.
c. Maintenance cost need to be bench marked with reference to the service levels in offer and the similar capacity airports.

Proposal No 12. Regarding Revenue from Services Other than Aeronautical Services

a. We understand that UDF driven revenues is expected to contribute about 90% of the total estimated revenues for the FY 2014-2015 & 2015 – 2016. Obviously there are many other sources of aeronautical revenue. Why is UDF forming the bulk of the source of revenue generation? It must be residual. The distribution and source of aeronautical revenue should be proactively made available to the public.
b. We feel the necessity for the revenue sources that are currently classified into aero and non-aero to be reclassified keeping in view of prudential accounting norms. For instance, Advertising revenue, commercial activities happening in the terminal etc. are purely the earning due to travelling public and therefore need to be considered Aero.
c. The activities of flight catering, landside traffic, terminal entry, retail, F&B, advertisement etc. are purely traffic driven revenues based on the principle of ***'zero traffic, zero revenue'*** and hence illogical to be classified under non-aero.
d. ICT investment is classified under aero or non-aero? Need clarity.
e. Interest income: 60% to be considered under aero and 40% under non-aero.
f. Revenue break up from various sources earned till date must be obtained to know if the forecasts are too optimistic.

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g. Today the non-aero revenue is too small compared to aero revenue due to the fact that the land allocated to BIAL by GoK for development of non-aero business is laying idle earning no revenue, even after 6 years. We would like to bring forward the following submissions for the review of AERA in this regard:
    a. State government extended the patronage, purely for the benefit of the passengers and public interest, in the form of:
        i. Rs. 350 Crore Cash
        ii. 4008 acres valued at 175 in 1999 with a 3% annual lease rental. If the lease rental value is revised as per the capital gains indexation valuing today, the land would cost at 353 crores. (175 x 785 / 389)
    b. The chunk of GoK land, just other side of the KIA wall, has already been developed by the GoK for Aerospace Industries and SEZ. Many business units have already started functioning there. Therefore, the inability of BIAL to develop around 1000 acres of land meant purely for non-aero business development is beyond the logic and hence looks deliberate.
    c. If BIAL fails to develop the land and the revenue thereof generated is not contributing for the benefit of travelling public, GoK should take over the surplus land with BIAL to develop Airport City, SEZ, Aero Space Park, MRO etc. in line with the state government's activities and business plans happening at next plot of KIA and the revenue thus generated from those activities should be used for cross-subsidizing the User Fees.
    d. Since BIAL enjoys all concessions from GoK to develop various sources of non-aero revenue, intending for the sole benefit of passengers, there is no reason why the non-traffic revenue to be treated separately by the promoters. Hence we are of the opinion and conclusion that **single till** is the only option to be considered for tariff determination for BIAL.
    e. The views of GoK on this issue, considering the larger interest of people of Karnataka and to safeguard the public investment from being misused and misinterpreted by the promoters, to be sought before finalizing the method of tariff determination.

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Proposal No 13. Regarding Treatment of Cargo, Ground Handling and Fuel Revenues

a. While noticing with great appreciation, the decision of Authority to reallocate the revenue from Fuel farm, cargo, GHA and into place services, we would also like to request Authority to apply same logic and accounting principles for the sources of revenues from flight catering, landside traffic, terminal entry, retail, F&B, advertisement etc. since all these revenues are purely *passenger driven*.

Proposal No 14. Regarding Inflation

a. May please ensure that RBI data at what Inflation risk premium bonds of duration matching the remaining length of the concession period are yielding is compared.

Proposal No 17. Regarding Quality of Service:

a. It is noted with great concern that while making investment decisions BIAL promises quality of services at par with best of the airports internationally whereas during actual delivery of service and evaluation process, the commitments in concession agreement are brought in. Authority may please note that the volume of capital investment largely depends on the service level for which the facilities are designed. In case of BIAL insisting to stick only to the concession agreement clauses, all future investments and projects also need to be designed and delivered in line with the commitments of service quality in concession agreement only. This will largely bring down the project cost and thereby the burden of travelling public.

b. The declared service levels to be shared and displayed for the knowledge of users for assessing their travel experience.

c. The UDF charged from the passengers to be reimbursed in case of reduction in declared service levels, such as failure of air-conditioning, delayed delivery of baggage etc. are experienced.