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Dear Jo,

## **Cross-submission on the Review of Auckland and Christchurch Airport's third price setting events – Process & Issues paper – process, timing and scope**

### **Introduction**

1. BARNZ welcomes the opportunity to provide this cross-submission on the Commission's consultation paper *Have your say on the review of Auckland and Christchurch Airport's third price setting events (July 2017 – June 2022)*, dated 20 October 2017. We respond to the submissions of Auckland Airport, Christchurch Airport and the New Zealand Airports' Association (NZAA).
2. This cross-submission covers process, timing and scope considerations. A separate cross-submission is provided on the issues raised and questions asked in the review. No part of this submission is confidential.
3. This cross-submission is made on behalf of the airlines<sup>1</sup> which BARNZ has written authority under s2A of the Airport Authorities Act 1966 to represent during consultation over charges with Auckland and Christchurch Airports.

### **Process and Scope**

**There appears to be consensus that the Part 4 Purpose and the long-term interest of consumers should be the focus of the review**

4. Submissions from BARNZ and airlines considered that the review should assess whether the Part 4 Purpose and the long-term interest of consumers is being met by the pricing decisions. We are pleased to see that airports appear to agree that this test should be applied. For example, NZAA considers that the review could "provide further confidence to consumers that airports are achieving the objectives of the Part 4 purpose statement"; and AIAL state that they consider their WACC and runway land charge decisions are in the long-term interest of consumers.<sup>2</sup>

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<sup>1</sup> Air Calin, Air China, Air Tahiti Nui, Air Vanuatu, Airwork, American Airlines, Cathay Pacific Airlines, China Airlines, China Eastern, China Southern, Emirates, Fiji Airways, Hong Kong Airlines, Korean Air, LATAM Airlines, Malaysia Airlines, Philippine Airlines, Singapore Airlines, Tasman Cargo Airlines, Tianjin Airlines, Thai Airways International, United Airlines, Virgin Australia. This submission is also supported by the Qantas Group.

<sup>2</sup> NZAA submission, paragraph 7(a); Auckland Airport, pages 11 and 16.

5. The only way the Commission could be in a position to agree or disagree with these views is for its review to assess the pricing decisions against the Part 4 Purpose. BARNZ considers the focus of the review should be on whether the decisions are consistent with the Part 4 Purpose.

#### **There is consensus support for including quality, innovation and efficiency in the review**

6. Submissions from BARNZ and the airlines supported including airport service quality, innovation and expenditure efficiency in the review of the PSE3 pricing decisions.
7. NZAA argued that the Commission should not expand the topics for consideration set out in the consultation paper. However, NZAA also considered that information about quality, innovation and efficiencies provide important rationale and context for the airport pricing decisions; and should inform the Commission's analysis, to provide a balanced view of airport performance.<sup>3</sup> NZAA also noted that performance trends and developments need to be considered over time and some decisions need to be considered in their historical context.<sup>4</sup>
8. We believe that these positions are not very far apart. Whether quality, for example, is reviewed as a focus area in itself or as a means of providing context to other parts of the review, the practical outcome is likely to be the same – the Commission will consider the quality of service provided by the airport and this will include an assessment of the balance between price and quality.
9. As there is effectively consensus between airlines and airports that the Commission should take quality, innovation and expenditure efficiency into account in its review, we submit that the Commission should consider these items and reach a view on whether the airports' performance in these areas is delivering the outcomes intended by the Part 4 Purpose.

#### **The Commission's scope should not be limited in the way the airports propose**

10. The Airport submissions, particularly those of NZAA and Auckland Airport, go to some lengths to identify restrictions that should be imposed on the Commission's review. Our reading of the submissions has identified 28 restrictions that the airports would like to impose; these are listed below to illustrate the scale of restrictions being proposed.
11. NZAA states that the Commission should:
  - a. Assess the pricing decisions based on the information that was available to airports at the time prices were set (paragraph 5(d))
  - b. Not criticise airport decisions if airports could not have reasonably anticipated the reason or basis for that criticism when prices were set (paragraph 5(e))
  - c. Not speculate about future decision making by the airports (paragraph 5(g))
  - d. Not provide a forum for consultation participants to raise new concerns or put forward new evidence or arguments (paragraph 5(h))
  - e. Not repeat or extend the pricing consultation (paragraph 5(h))
  - f. Not estimate each airport's return based on the Commission's understanding of the airport's forecasts (paragraphs 27-30)
  - g. Not consider different views on forecasts and projections that the airport has developed (paragraph 31)
  - h. Not carry out scenario analysis (paragraph 31)

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<sup>3</sup> NZAA submission, paragraphs 5(b) and 14. Much the same point was made in paragraph 14 of Christchurch Airport's submission.

<sup>4</sup> NZAA submission, paragraph 16(a)(iii).

- i. Not consider hypothetical scenarios (paragraph 33)
- j. Not criticise airports if the Commission ultimately decides their target return has been set too high (paragraph 38)
- k. Not review the airports' expert reports in isolation (paragraph 39)
- l. Not allow airlines to propose new risk allocation adjustments that were not raised during consultation (paragraph 41)
- m. Not reopen forecasts used by airports when they have been developed and consulted on (paragraph 45)
- n. Not challenge an airport for using the assets held for future use disclosure mechanism (paragraph 52)
- o. Not make conclusions about whether airports should have used a different charging structure (paragraph 54(b))
- p. Not consider what decisions the airports could have made but chose not to (paragraph 54(c))
- q. Not expect or assume that a large capital investment programme requires risk allocation adjustments (paragraph 58).

12. Auckland Airport states that the Commission should:

- a. Only consider information that the airports had in front of them at the time of decision making (page 5)
- b. Recognise it is not possible to provide an exact answer about the optimal level of return (page 7)
- c. Recognise the potential for estimation error when dealing with WACC estimates (page 7)
- d. Not generate a different estimate of the expected return for PSE3 or make adjustments to the airport's disclosed returns (page 7)
- e. Not assess what might have been the case had different inputs or calculation method for target return been used (page 7)
- f. Not second guess pricing inputs (page 7)
- g. Not assess the pricing based on theoretical incentives (page 8)
- h. Summarise and analyse the decisions we have made, rather than question whether the airport should have taken a different approach (page 20)
- i. On capex, focus on robustness of consultation process rather than re-litigate consultation outcomes (page 24).

13. Christchurch Airport states that the Commission should:

- a. Not consider target profitability for non-priced services (paragraphs 20-22)
- b. Consider an airport's expected return rather than its target WACC (paragraphs 24-26).

14. We will comment below on some of these items. But when reviewing the list as a whole, it becomes clear the set of proposed restrictions is too large to be useful. If the Commission accepted all of the items listed above, there would be little point in the review progressing any further. This is because, if the review was limited in all of the ways specified above, we do not see how the Commission could possibly determine whether the pricing decisions were in the long-term interest of consumers. BARNZ encourages the Commission to reject these proposed restrictions on its scope and maintain its ability to consider the pricing decisions properly.

### **This review should consider the decisions themselves, not just the process that was followed**

15. Auckland Airport in particular appears to be pushing the Commission to review the consultation process (and not the decisions) and to accept decisions where the consultation process has been robust<sup>5</sup>. This would not be acceptable to BARNZ or the airlines which we represent. Just because a sound consultation process was followed, does not mean that the concerns of submitters were addressed or that the decisions were in the long-term interest of consumers. BARNZ encourages the Commission to review the decisions themselves – if the Commission only reviews the process, we do not believe the Commission could conclude whether or not the pricing decisions are consistent with the Part 4 Purpose.

### **This review should not be limited to items that were before airports when prices were set**

16. NZAA and Auckland Airport both argue that the Commission’s review should not consider any information that was not in front of the airports at the time their pricing decisions were made.<sup>6</sup> BARNZ disagrees.
17. In essence, NZAA and Auckland Airport are arguing in favour of a closed record. We think that limiting the review to information available at the time prices were set would reduce the Commission’s ability to review the decisions and also create substantial procedural and practical difficulties.
18. For a ‘closed record’ arrangement to be applied, all parties need to know about it in advance. If the Commission had declared at the time the airports started their pricing consultations with airlines that its review of the decisions would be based solely on information available at the time of the final decision, then all parties could have tailored their consultation and submission material accordingly. An example is the closed record for the input methodologies merits appeal, which all parties knew about in advance and where some submitters therefore provided material to the Commission in submissions that was mainly intended to be useful for potential future court hearings.
19. For the pricing consultations, the parties were not aware of any closed record restrictions and thus prepared submissions that were intended to be persuasive to airports as part of the consultation process. It is not very surprising that other information may be emphasised when preparing submissions for the Commission. To take one example: the airlines’ submissions on the Process and Issues paper raised concerns about the differing reasons being used by Auckland and Christchurch Airports to support their proposed WACCs. This is likely to be an issue the Commission will want to consider as it is an issue relating to how airport regulation is applied nationally. However, when airlines were preparing submissions to Christchurch Airport, the fact that Auckland Airport was using a different rationale for its WACC uplift was unlikely to be such a compelling argument to persuade Christchurch Airport individually to change its approach. Also, importantly, airlines could not have made this case to Christchurch Airport at that time as they were subject to confidentiality restrictions imposed by Auckland Airport and could not disclose to Christchurch Airport or anyone else what Auckland Airport’s WACC proposal was.
20. As submissions have already been made on the Process and Issues paper without any knowledge of a closed record, the Commission already has material before it that was not known at the time prices were set (see next paragraph for some examples). To now seek to identify and then require the Commission to somehow ‘forget’ all of this information, is not very practicable.
21. The airports themselves have demonstrated how difficult it is to adhere to a position where no new information is considered. Christchurch Airport’s statement (in the table after paragraph 18 of its submission) that its expected WACC for PSE3 is 6.44% provides information that was not known by

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<sup>5</sup> For example, Auckland Airport submission, last bullet point on page 7, and 3<sup>rd</sup> paragraph on page 24.

<sup>6</sup> NZAA submission, paragraph 5(b); Auckland Airport, page 5.

airlines during the consultation process. Christchurch Airport's submission (paragraph 43) also states that current FY18 demand has not suggested its demand forecasts were inappropriate. Auckland Airport's submission similarly includes information about flight schedule changes that only came to light after prices were set (page 14); this information seems intended to support its demand forecasts.

22. We therefore submit that the Commission should consider all relevant information provided to it as part of the consultation process.

### **The Commission will need to re-look at issues that were debated during the consultation process**

23. The airport submissions argue that the Commission's review should not repeat the consultation process.<sup>7</sup> We are not sure how this would work in practice. Unsurprisingly, the main items of debate in this review (WACC, runway land charge, etc) were core parts of the consultation debates. The airports' own submissions have repeated much of their reasoning from the consultation process. We question what the Commission would be able to do as part of this review if it were not to re-look at items that were debated during the consultation process.

### **The Commission will need to consider alternatives**

24. The airports' submissions appear to argue that the Commission should not consider different projections or forecasts or generate a different estimate of WACC for an airport or generally consider any alternative approach that an airport could have taken.<sup>8</sup> Once again, we do not see how the Commission could meaningfully carry out this review without considering alternative cost, demand and WACC estimates. By definition, when an airport has decided on a forecast or other input to its WACC determination, it has rejected other options. It is therefore reasonable for the Commission to consider alternatives and the Commission will need to consider them in order to reach a view on whether the final pricing decisions were reasonable and in the long-term interest of consumers.

### **The review should consider priced and non-priced services**

25. Both Auckland and Christchurch Airports report that their expected returns for their non-priced services exceed their expected returns for their priced services. Christchurch Airport argues that the primary focus of the Commission's review should be on priced services.<sup>9</sup> BARNZ recommends the Commission consider both priced and non-priced services as they are both relevant to the review. Part 4 regulation applies to Specified Airport Services and the prices set for all of those services should be reviewed by the Commission.
26. While the charges for non-priced services are determined by negotiation with individual airlines, these negotiations are unbalanced as the airline purchasing the non-priced service is still dealing with a monopoly that is able to price as it sees fit. The effect of this can be seen in the higher rates of return expected for those services. The Commission therefore should include non-priced services in its review.

### **How any concerns identified in the review should be addressed**

27. The NZAA submission suggests that the review could result in identifying "any concerns for airports to address going forward, as each airport is committed to ongoing improvements in performance."<sup>10</sup>

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<sup>7</sup> NZAA submission, paragraph 5(h); Auckland Airport, page 24.

<sup>8</sup> NZAA submission, paragraphs 27, 31, 45; Auckland Airport, pages 7 and 20.

<sup>9</sup> Christchurch Airport submission, paragraphs 20-22.

<sup>10</sup> NZAA submission, paragraph 7(b).

28. This approach will not be appropriate for all findings. The review could plausibly result in findings that take three broad characteristics (and these may vary across topics):

- a. Conclude that an aspect of a pricing decision is consistent with the Part 4 Purpose – in this case, we assume there would be no issues for the airport to address
- b. Conclude that an aspect of a pricing decision is not consistent with the Part 4 Purpose but the impact on consumers is not material – in this circumstance, the approach proposed by NZAA in paragraph 7(b) may be appropriate
- c. Conclude that an aspect of a pricing decision is not consistent with the Part 4 Purpose and the impact on consumers is material – in this circumstance, the approach proposed by NZAA would be inadequate. The Commission’s final report should highlight any of these circumstances. Then, either airports themselves should reopen their pricing decisions to address the identified problems (as Wellington Airport has done previously), or some form of regulatory or legislative intervention would be required.

### Contact details

29. If you have any questions about this submission, please contact me on 09 358 0696 or at [ian@barnz.org.nz](mailto:ian@barnz.org.nz).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ian Ferguson', written in a cursive style.

**Ian Ferguson**  
Regulatory Manager