

CROSS SUBMISSION

REVIEW OF AUCKLAND INTERNATIONAL AIRPORT'S PRICING DECISIONS & EXPECTED PERFORMANCE (JULY 2017 – JUNE 2022)

OVERVIEW

Airlines for Australia and New Zealand (A4ANZ) welcomes the opportunity to provide a cross-submission to the Commerce Commission's *Review of Auckland International Airport's Pricing Decisions & Expected Performance (July 2017 – June 2022)*.

A4ANZ has considered each of the submissions received by the Commission and is pleased to note shared positions among a number of stakeholders – particularly regarding areas such as the expected profitability of Auckland International Airport, the proposed Runway Land Charge and the need for the Commerce Commission to consider quality, efficiency and innovation.

ABOUT AIRLINES FOR AUSTRALIA & NEW ZEALAND

Airlines for Australia and New Zealand (A4ANZ) is an industry group, established in 2017 to represent airlines based in Australia and New Zealand. Member-funded and representing international, domestic, regional, full service and low-cost carriers, A4ANZ advocates on key public policy issues relevant to airline operations, including efficient access to domestic airport infrastructure.

The A4ANZ Board identified at the time of the organisation's formation that one of its highest priority issues was the regulatory frameworks for Australia and New Zealand's monopoly airports.

PERFORMANCE OF AUCKLAND AIRPORT

Profitability

As noted in our original submission, A4ANZ believes that Auckland International Airport appears to be targeting excessive profits in setting a target weighted average cost of capital (WACC) of between 6.99% and 7.06%.

A4ANZ notes that Auckland International Airport has submitted its case for proposing a WACC higher than the Commission's mid-point estimate. However, these points do not change A4ANZ's view that Auckland International Airport is targeting excessive profits and has set prices that are not in the long-term interest of consumers.

In submissions received by the Commerce Commission there has been significant commentary regarding both the methodology used by the Commission in calculating a WACC range, and the importance of contextualising this methodology for Auckland International Airport.

The NZ Airports Association's submission notes that *"It appears to NZ Airports that the Commission's concerns on target returns mostly arise from the Commission's technical assessment approach being different to the way Auckland Airport approached price setting, and not a deliberate decision by Auckland Airport to operate outside the Part 4 purpose statement. NZ Airports emphasises that all*

airports seek to ensure that their performance promotes the long-term benefit of consumers. NZ Airports believes that looking at the broader picture and airport-specific context as set out in airport pricing disclosures should provide interested parties with comfort that airports are doing so, including because they are limited in their ability to extract excessive profits.”¹

A4ANZ recognises that there are many factors which influence target returns, and indeed that differences in methodology will ultimately have different results in calculating an appropriate WACC – however, Auckland International Airport’s reliance on a methodology which is no doubt similar to that used in previous price setting events will undoubtedly deliver the airport the same excessive profits which have been delivered previously.²

A4ANZ supports the methodology used by the Commerce Commission. The Commission’s methodology informed the independent analysis undertaken by Frontier Economics (which was referenced in A4ANZ’s initial submission to the Commission). The results from Frontier’s analysis of both Australian and New Zealand airports have been validated by other analysis of profit including returns on capital employed or assets, and comparative margins.

Another metric used to corroborate the principal results was benchmarking against the performance of similarly-situated airports that are either regulated, or subject to effective competition. Indeed, margin data (EBIT & EBITDA) support and validate the central findings that NZ airports are earning far higher margins than comparable international airports.

A4ANZ finds it unsurprising that other New Zealand Airports and the NZ Airports Association provided submissions supporting Auckland Airport’s proposed target returns – as noted in A4ANZ’s original submission, Wellington Airport has the fifth highest EBITDA margin of all international airports analysed, only outperformed by Auckland Airport and other Australian airports which also operate under a light-handed monitoring regime.³ Indeed, the only groups who appear to be defending the current regulatory model are those who are reaping all the benefits: the highly profitable, private monopoly airport operators.

A4ANZ acknowledges the supporting evidence provided by Auckland Airport in Appendices E, F and G, regarding methodology and assessment of systematic risk. However, as it stands A4ANZ remains unconvinced that the risk to Auckland International Airport is inherently greater than, or even the same as the level of risk currently present in the market – given the recent financial performance of Auckland International Airport, historic average profit margins (as noted in A4ANZ’s original submission), and the outlook provided by financial analysts.⁴

Runway Land Charge

As noted by the Commission, Auckland Airport is proposing to build a second runway in 2028 with a view to accommodate future growth. In our initial submission, A4ANZ recognized that a second runway may become necessary – but questioned the appropriateness of the proposed runway land charge (RLC).

¹ NZ Airports. Submission on draft report for review of Auckland International Airport’s pricing decisions and expected performance (July 2017 – June 2022) – 29 May 2018 At: <http://www.comcom.govt.nz/dmsdocument/16291>

² See A4ANZ’s submission at: http://www.a4anz.com/documents/A4ANZ_Submission_to_AIAL_PSE3_Review.pdf

³ See A4ANZ’s submission at: http://www.a4anz.com/documents/A4ANZ_Submission_to_AIAL_PSE3_Review.pdf

⁴ Morgan Stanley. 2018. Airports: Ample Runway for Growth.

As it stands, A4ANZ does not believe that the RLC is consistent with a competitive market, and that it instead represents Auckland Airport attempting to pre-fund the runway by passing costs on to current airline customers and their passengers – some of whom may not receive any benefits of the second runway. A4ANZ is not alone in this view, indeed it is shared by Air New Zealand, QANTAS and BARNZ – all of whom have noted concerns in their respective submissions to the Commission.

A4ANZ is also concerned that if Auckland Airport proceeds with the RLC as planned, that a precedent for pre-funding assets may be set for other industries and infrastructure across New Zealand, without considering the unintended consequences of this.

As noted by the International Air Transport Association (IATA), pre-funding through user charges is unnecessary and is generally not applied in other sectors where either public funding through governments or private sector financing is available for sound business cases.⁵

Pre-funding through user charges also challenges the International Civil Aviation Organization ICAO's key charging principle of cost-relatedness⁶, whereby airlines and their passengers are only charged for the cost of services provided.⁷

There are clearly more appropriate and cost-effective financing options, such as loans, institutional lending or subsidies, closely monitored public-private partnerships (PPPs)⁸ or a pre-commitment arrangement with airlines. This would allow a level of funding to be secured by considering the airport's balance sheet together with the forward commitments of the airline customers. This is not dissimilar to the approach used in other industries such as property development, where financing is secured through the inclusion of an agreement for lease from the future tenant. A4ANZ suggests that these financing strategies are far more appropriate than the proposed RLC.

Furthermore, providing an upfront pool of money does not encourage investments to be delivered in a cost effective and timely manner. As such, A4ANZ urges the Commerce Commission to reconsider its view on the proposed RLC.

QUALITY, EFFICIENCY & INNOVATION

A4ANZ is pleased to note the numerous submissions from across the aviation sector, which share A4ANZ's belief that the Commerce Commission should take a broader view of section 53B(2) requirements and consider quality, efficiency and innovation – as these factors are inextricably linked to the economic performance of, and the prices charged by Auckland International Airport.

Under the current light-handed regulatory system, the major airports in New Zealand have clearly been able to exercise their market power to extract excessive profits from airport users. These excessive profits have come at a cost to the New Zealand community, both financially and through lost opportunities for improving the quality and efficiency of airport services. It is a fact that an

⁵ International Air Transport Association. Policy Position – Pre-funding. At: <https://www.iata.org/policy/Documents/pre-funding.pdf>

⁶ International Civil Aviation Organization. 2012. Doc 9082 (9th edition). https://www.icao.int/publications/Documents/9082_9ed_en.pdf

⁷ International Air Transport Association. Policy Position – Pre-funding. At: <https://www.iata.org/policy/Documents/pre-funding.pdf>

⁸ International Civil Aviation Organization. 2013. Doc 9562 (3rd edition). https://www.icao.int/sustainability/Documents/Doc9562_en.pdf

airport or indeed any business with market power has the ability to sustain prices for its services above efficient costs or deliver a poor quality of service.

As per A4ANZ's submission to Government's consultation on the Commerce Amendment Bill 2018, A4ANZ believes that the Commerce Commission must be required to assess whether the current regulation is working. A4ANZ has suggested that the Commission assess the effectiveness of the regulatory regime after each airport price-setting event. We contend, however, that there is ample evidence to allow an assessment to be undertaken immediately.

Perhaps most importantly, a key consideration is the parameters by which the Commission might assess the effectiveness of the regulatory regime (for example terms and conditions of access for users, quality, and efficiency), and the abilities they have – if any – to address any failings. These parameters need to be determined through consultation with the users of the airport infrastructure.

There is no shortage of guidance, with peak bodies for both airlines and airports - IATA and the Airports Council International (ACI) – producing joint resources and services designed to evaluating airport performance, from the perspective of different airport stakeholders and users.⁹

As noted in A4ANZ's original submission, A4ANZ appreciates that the Commerce Commission has recognised the need for further exploration of the issues of quality, efficiency and innovation of airport services and operations. As such, A4ANZ would urge the Commerce Commission to consider this as a future part of the Commission's workplan, as it is urgently needed.

A4ANZ also reiterates the need for the Commission to consult with key aviation sector stakeholders prior to developing criteria for assessing the quality and efficiency of airport services and operations.

CONCLUDING COMMENTS

A4ANZ would again like to thank the Commerce Commission for this opportunity to provide cross-submissions on Commission's review of Auckland International Airport's pricing decisions and would of course be pleased to further discuss both this cross-submission, and A4ANZ's initial submission with the Commission.

CLARIFICATION

To pre-empt commentary regarding A4ANZ's original submission which notes that *"an independent analysis by Frontier Economics found that the value of excess returns to Auckland airport are more than \$3.6 billion (in 2017 dollars)."* A4ANZ wishes to clarify these estimated excess returns pertain to returns earned across all airport operations in the years since privatisation.

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⁹ See <http://www.iata.org/services/consulting/airport-pax-security/Pages/level-of-service.aspx>