3 May 2019

Introduction

1. This is the New Zealand Airports Association (**NZ Airports**) Cross Submission on the Commerce Commission's (**Commission**) draft decision "Airport Services Information Disclosure (Backward Looking Profitability) Amendments Determination 2019" (**Draft Decision**).

2. The affected airports – Auckland International Airport Limited (**AIAL**), Wellington International Airport Limited (**WIAL**) and Christchurch International Airport Limited (**CIAL**), and together (**Airports**) – have been involved in the preparation of this submission.

3. The NZ Airports contact for this submission is:

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Overview

4. NZ Airports notes that there is consensus between NZ Airports and BARNZ, and therefore the contributing airports and airlines, on several high level Draft Decision issues proposed by the Commission. These are:

   (a) Inclusion of an internal rate of return (**IRR**) backward profitability calculation in Schedule 1 to replace the existing return on investment calculation;

   (b) The Commission's reasonableness approach for airport preparation of variance explanations;

   (c) The inclusion of variance explanations in one disclosure schedule, with repetition in more than one schedule unnecessary; and

   (d) Separate disclosures for total regulated assets and pricing assets are not required.

5. These views are consistent with the Commission's Draft Decision except for item (c), and consequently no further comment on the other issues is required.

6. We comment further on the requirement for variance explanations and a further detail issue below.

Variance Analysis

7. The Commission's Draft Decision proposes that detailed variance analysis is provided in schedules 1,2 and 4, in addition to the current analysis provided in schedule 6 for operating and capital expenditure.

8. It appears that NZ Airports and BARNZ agree that this approach will lead to unnecessary duplication and that the provision of variance explanations in one schedule only is appropriate.

9. BARNZ however go one step further and suggest that the variances from forecast in other schedules could be referenced to the commentary that is provided.

10. NZ Airports is concerned that this requirement will lead to a situation where all variances would need to be explained because of any requirement, or indication, that each difference from forecast should be referenced to commentary. If this were to occur the reasonableness approach proposed by the Commission, which would include consideration of materiality of variances, would become ineffective.

11. Commenting on every variance could well lead to confusion and in fact obscure a reasonable explanation of changes in airport performance or behaviour during the pricing period.

12. Consider the following example for assets commissioned/ capital expenditure:

Schedule	**Variance Commentary Required**	**Comment**
1 (Profitability)	Cumulative assets commissioned for period to date	Variances may result from a change in project timing between disclosure years, or a change in completed project costs.
1 (Profitability)	Cumulative assets commissioned for disclosure year	Variances may also be due to changes in timing or cost but for a discrete period which may be neutral in the period to date and may have little impact on overall profitability.
1 (Profitability)	Monthly assets commissioned	Are not forecast, so there are no variances, but the prospective timing difference impact on the IRR to be evaluated for the disclosure year and period to date.
4 (Asset Roll Forward)	Cumulative assets commissioned for period to date	Duplicate of variance explanation required for period to date assets commissioned in schedule 1, and hence direct referencing would be possible.
6 (Expenditure)	Capital expenditure <u>by project</u> for period to date and disclosure year.	A requirement for far more detailed commentary: • Which cannot be referenced to other explanations as capital

Schedule	Variance Commentary Required	Comment
		expenditure is not the same as assets commissioned. • Will require comment on variances that appear to be significant but do not have any measurable impact on the IRR.

13. In NZ Airports view this table demonstrates the high level of detail that is currently proposed, the level of repetition that would also be required, and the confusion that could be caused by explanations provided for different contexts of disclosed information (i.e. assets commissioned versus capital expenditure).

14. NZ Airports is not proposing that there should be any reduction in transparency, but that discretion is provided to the airports to provide one set of explanations in respect of variances from forecast returns.

15. NZ Airports proposes that the annual disclosure schedules:

    (a) Would require variance commentary to be provided in Schedule 1 only.

    (b) Would continue to show variances from forecast in Schedules 2, 4 and 6.

    [Note: upon further review we note that the disclosed variances in Schedules 1, 2, and 4 are shown in dollars, while the variances in Schedule 6 are shown in percentage terms. We propose that the Schedule 6 variances are also disclosed in dollar terms for consistency and to ensure that small value variances are not given undue prominence if they are shown as large percentage changes.]

    (c) Would require airports to have regard to the variances in the supporting schedules and to ensure that all substantial variances that impacted returns were addressed.

16. The Commission, airlines and other interested parties could then review airport commentaries and seek enhancements if these are necessary.

17. The airports have shown in their historical annual disclosures that the disclosures have been further developed over time, where they routinely now provide comprehensive and meaningful commentary on the airport annual achievements.

18. This same approach will extend to the new profitability disclosure requirements.

Transition

19. NZ Airports considers that BARNZ's comments on the transition for WIAL indicates some confusion on how a wash up arrangement is treated in the information disclosures.

20. NZ Airports cannot comment on the arrangements for WIAL's next pricing period, however in NZ Airports view the disclosure requirements are intended to explain airport pricing decisions, and outcomes, not determine them.

21. Therefore, the applicability of the new disclosures to WIAL would need to consider:

(a) The commencement and end of the pricing periods established by WIAL in consultation with their substantial customers; and

(b) The arrangements for any carry forward or risk share adjustment both in respect of its calculation and how any adjustment would be shared with customers.

22. A wash up adjustment that is calculated by reference to a historical point in time (e.g. retrospective start of a year) cannot be calculated until after the wash up period and therefore cannot be returned historically.

23. It is when the adjustment will be shared with consumers that will determine the disclosure requirements for the adjustment. For example:

(a) If a price setting period commences retrospectively, that is new prices are set after the commencement of a price setting period but before the end of the first year, and any pricing adjustment is applied in the first year, then outcomes for disclosure year will simply be net of any over or under recovery that is returned to customers; and

(b) If the over or under recovery were to be returned to customers over the remainder of the pricing period, or some portion thereof, this would be reflected in the gradual amortisation of a carry forward adjustment over the pricing period.

24. It is only when WIAL publishes new price setting disclosure forecasts, in the form now required by schedules 18 and 19, that forecast information will be available to enable them to meet the new annual disclosure requirements.

25. It is the commencement date for these new forecasts that should determine the appropriate timing for WIAL to respond to the new disclosure requirements.

Prices Set Part Way Through a Year

26. A similar issue exists where prices are set part way through the year, as contemplated in the new clause 2.3(7) proposed by the Commission.

27. A wash up may apply from a historical point in time to enable the value of the adjustment to be calculated.

28. How that wash up would then be shared with customers is more likely to be an issue for the new pricing period and shown in the disclosure of forecast carry forward adjustments, rather than being able to be applied as retrospective adjustments.

29. The most important issue is that the airports are transparent about the approach they have taken and how this is reflected in the forecast information contained in price setting disclosures.

30. In our view, this is the disclosure requirement that should be required by the Commission, with the airports left to prepare the detailed disclosure forecasts in the manner that reflects their pricing decisions.