



16 March 2016

Keston Ruxton

Manager IM Review

Commerce Commission New Zealand

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Dear Keston,

**SUBJECT: COMMENTS ON IM REVIEW – PROFESSOR YARROW REPORT AND
EMERGING VIEWS ON THE AIRPORT WACC PERCENTILE**

The International Air Transport Association (IATA) represents some 260 airlines comprising 83% of total air traffic. The major scheduled airlines operating to the three major international airports in New Zealand are members of IATA. We appreciate the opportunity to provide our views for consideration by the Commerce Commission.

Firstly, we are aware that BARNZ commissioned an independent report from COVEC to comment on Professor Yarrow's analysis and the Commission's emerging views. IATA supports the findings of this report as well as the BARNZ submission to the Commission. This submission should be seen as supplementing BARNZ's comments with views drawn from its international experience and research on economic regulation.

IATA supports the Commission's proposal to use the mid-point as the baseline for assessing an airport's profitability. The mid-point is the value with the highest probability of occurrence. As such, it would be overly conservative to assess the existence of excessive returns from a starting point higher than that of the mid-point. Put simply, starting from a percentile higher than a mid-point would provide the airports with an upside of any possible WACC deviations but not give them any of the potential downsides. Such an approach is not in the benefit of consumers as it fails to achieve a proper balance of outcomes in line with the purpose of Part 4 of the Commerce Act.

In fact, even using a mid-point may be overly generous for assessing excessive profits. An airport should be seen as a single business entity and any assessment of returns should be seen in the same manner. In other words, returns should be assessed on the airport's business as a whole and not just on the regulated activities. If airports were in real competition, it can be expected that the default pricing mechanism would resemble that of the single till approach. That is, airports would maintain aeronautical charges at as low a level as possible in order to attract airlines (and their passengers) and hence drive increasing complementary revenue streams. Professor Yarrow



discusses this "platform" nature of the airports sector in some detail. Due to this feature of the airports business structure, allowing a mid-point WACC for the regulated activities, while allowing the airport to gain excess profits on non-regulated activities is not the most appropriate way to prevent an airport from abusing from its dominant position.

We have not seen elsewhere the way in which Commission builds and treats ranges around WACC. When regulators have used ranges (i.e. the Commission for Aviation Regulation in Ireland and the UK CAA), these were on the basis of the fact that there was different types of evidence which would help to build the range for the WACC estimate itself (i.e. for the ERP there might be statistical data, survey data, decisions from other regulators, etc.). After having built this range, then the regulators have used their best judgement as to where in the range, given the evidence and market circumstances, the point estimate for the WACC would lie. Once a point estimate is defined, the regulators have not made a further adjustment to this point estimate.

Finally, actual returns could be different from a defined ex-ante WACC, and this could be related to changes in expected demand, out or under performance, reductions in levels of service, changes in the level of investments, etc. and this needs to be properly explained. More generally, any deviations from the initial forecasts (not just WACC, but also all the components against which prices were determined) need to be appropriately justified.

With regards to the specific questions posed by the Commission in paragraph 29 of its paper:

- We do not see why on an ex-ante basis, an airport should be automatically allowed to target a WACC above the mid-point level. On the contrary, and as highlighted previously, the utilization of a dual till approach suggest that the WACC could be targeted to a value lower than the mid-point. In any case, any proposals by the airports to deviate from the mid-point should be properly justified, open to consultation with users and subject to the Commission's approval.
- Since we do not see merit from allowing a return higher than that of the mid-point, we do not see the need for developing a quantitative framework for percentiles.

We remain at your disposal to answer any of the points raised in this submission.

Yours sincerely,

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