



16 August 2018

Jo Perry
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Commerce Commission
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Dear Jo

RESPONSE TO DRAFT REPORT ON CHRISTCHURCH INTERNATIONAL AIRPORT'S PSE3 PRICING

This is Wellington International Airport Limited's (WIAL) submission on the Commerce Commission's (Commission) draft report "Review of Christchurch International Airport's pricing decisions and expected performance (July 2017 – June 2022)" (Draft Report).

WIAL has been involved in the preparation of the New Zealand Airports Association (NZ Airports) submission and supports it. In this submission we highlight some key points and themes that we consider are important and warrant further consideration by the Commission.

General comments

WIAL welcomes the Commission's positive findings regarding CIAL's pricing approach, in particular, its views of an airport performing within the Part 4 purpose. This also provides further evidence of the effectiveness of the Information Disclosure (ID) Regime.

WIAL considers that it remains important to allow airports flexibility in their pricing approach and support an environment where airports and airlines can continue to have robust commercial discussions. The Commission appears to be open and accepting of this flexibility and recognising of airport specific characteristics, such as supporting CIAL to use its own debt premium and change in price structure.

WIAL has previously submitted to the Commission on its "Review of Auckland Airport's pricing decisions and expected performance (July 2017 – June 2022)" (AIAL PSE3 Review) and reiterates the points made in that submission on 29 May 2018. These points are not repeated in full in this submission, but we note that we remain concerned that New Zealanders and interested persons must be provided with a full contextual assessment of airport performance. This includes ensuring airport performance is assessed against all limbs of Part 4, without an undue focus on profitability, and importantly the relationship between the limbs such as service quality, investment, efficiency and profitability. These are obviously all interconnected to deliver customer service and value for money.

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Non-priced services

WIAL emphasises NZ Airports' submission on the regulation of non-priced services. WIAL strongly supports the submission that it is appropriate for the Commission to assess non-priced services on a more flexible basis. WIAL notes that such services are priced under contracts of varying duration, specific to individual customers, reflecting a competitive market process. The context of these contracts provide customers with the full ability to negotiate commercial terms that suit their requirements. Such agreements therefore ensure mutual benefits for the parties, and are not unduly affected by the terms of the contract. WIAL supports the Commission's observation that it ought not to discourage such commercial agreements.¹

WIAL supports the Commission's suggestion that it assess non-priced assets over a longer period of time. As noted in the NZ Airports submission, there is no defined pricing cycle for non-priced services in the same way as there is for the five-year pricing cycle for common use airfield and terminal activities; and the effective returns on non-priced services will not align with building block concepts like a five-year estimation of WACC and target return. It would therefore be unhelpful to assess returns on a five-year cycle that does not reflect the reality of how such services are contracted. A longer term assessment would ensure greater commercial and regulatory certainty, and importantly, would better inform stakeholders and be consistent with the Part 4 purpose of promoting the long-term benefit of consumers.

Asset beta

WIAL is concerned with the Commission's finding that CIAL has not provided legitimate reasons to depart from the Commission's benchmark asset beta and from its benchmark cost of capital. The Commission's approach in the Draft Report makes it very difficult for airports to justify adjustments based on airport specific data, with little or no accommodation for standard error and the necessary exercise of judgment. In short, WIAL considers that the Commission is proposing an unreasonably high burden of proof.

For example, the use of overseas airports to derive the Commission's sample mean is a problematic approach, which assumes that CIAL can properly be regarded as "from the same population" as those overseas airports. By way of example, many (equity) beta estimate are not capable of withstanding a statistical test against the null hypothesis that an individual firm's beta is the same as the market average. WIAL therefore supports NZ Airports' submission that estimation uncertainty and error must still be accommodated in the determination of an airport-specific asset beta, and that it is not possible to empirically justify departures from a sample set for which there is little empirical evidence.

WIAL echoes the submissions made in the NZ Airports submission that false precision risks obscuring the full context, with the Commission's approach in the Draft Report requiring CIAL to carefully justify a WACC estimate at the 52nd percentile. This is inconsistent with the Commission's acceptance that such measurement is prone to estimation error. As WIAL noted in its submission on the AIAL PSE3 Review, Professor Yarrow has previously advised that the performance of an airport should be assessed in context, including the commercial context of the airport at the time it makes a pricing decision. He observed:²

...too much weight is being placed on one set of numbers, deriving from exercises to estimate the cost of capital, and too little weight is being placed on the contextual factors that can influence the interpretation of disclosed information. Put another way, there is an implicit assumption that the cost of

¹ Draft Report at [122].

² Yarrow Report, page 20.

capital to be published should be itself be based on judgments that, in effect, reflect views on how the information should be interpreted.

Debt premium

WIAL supports the Commission's recognition that CIAL has justified using its own debt premium reflective of its credit rating of BBB+. WIAL submits that the Commission should also consider accepting the use of a forward-looking cost of debt estimate, along with an airport's actual credit rating. WIAL considers this is the most reasonable approach for the purpose of setting the debt premium for a forward looking pricing period.

If you have any questions in relation to this submission please contact me at martin@wlg.aero.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'pp. mf.', is located below the 'Yours sincerely' text.

Martin Harrington
Chief Financial Officer