

COMMERCE COMMISSION SECTION 56G REVIEW
FEEDBACK ON PROCESS

24 APRIL 2014

INTRODUCTION

1. The Commission has requested feedback on its review of the effectiveness of information disclosure regulation under section 56G of the Commerce Act 1986. In our view, the section 56G process provided valuable insight for all parties into the operation of information disclosure regulation, as well as forming the start of an ongoing analysis process that will build a higher level of understanding about airport performance (and how to assess that performance) for all interested parties.
2. We have canvassed feedback from the Auckland Airport team involved in the section 56G project. Overall, we consider that the Commission's project management of a complex and extensive process was professional and appropriate.
3. In terms of high level observations, Auckland Airport considers that:
 - (a) The section 56G review has demonstrated that information disclosure regulation, including the Commission's analysis, is most useful when it provides meaningful and accessible information about the decisions that airports have made. This may require recognising that prescriptive approaches to disclosure templates and analytical models can have limitations in some areas.
 - (b) In particular, it is positive that the section 56G review has provided feedback to each of the airports on how the Commission measures airport performance against the purpose of information disclosure regulation. In our view, the ongoing analysis process will continue to provide information and guidance that will help to shape future airport decision-making. Auckland Airport will continue to seek to implement further improvements in its business practice for the benefit of consumers, informed by this additional guidance.
4. Auckland Airport remains committed to the new information disclosure process and to working constructively with the Commission to develop and implement the regulatory framework. In this submission, we address the specific areas of feedback the Commission is interested in, and provide more detail on these high level reflections where relevant.
5. We have focussed on what worked well and what could be improved, as well as providing our initial comments on how improvements can be made in the future (relating to both the information disclosure regime and to the way performance is assessed).
6. If you have any queries in relation to any of the matters raised in this submission, please contact Simon Robertson (Chief Financial Officer) on 09 255 9174, or Adrienne Darling (Regulatory Affairs Manager) on 09 255 9090.

SECTION ONE: SPECIFIC AREAS FOR FEEDBACK

7. As we reflect on the almost 22 months of consultation under the section 56G review for the three airports, it is fair to say that for the most part the process was clear, comprehensive, and very well run. Overall, the process allowed time for all parties involved to build and test their understanding of the disclosure regime and the information disclosed to date.
8. We respond below to the specific aspects highlighted by the Commission in its request for feedback.
 - (a) **Commission conferences:** In Auckland Airport's view, these were well organised and appeared to serve their purpose.

As these conferences were predominantly led by the Commission asking questions of the parties, we consider that it may be useful for the distributed agenda to provide greater clarity in advance about the items the Commission wishes to discuss. This would allow the participants to ensure they are able to address key issues on the Commission's mind during the conference. Of course, there would still be scope for further questions and more expansive discussion during the conference

We continue to encourage the Commission to consider holding conferences in different locations. In our view, a tour of the relevant airport would provide valuable context to Commissioners and staff, and would assist in bringing the realities of airport performance to life. In turn, this would help build a better picture of the airport-specific matters under discussion, particularly in some areas where numbers and calculations are just part of the story.

- (b) **Profitability analytical models:** As the Commission is aware, there are many different ways to assess profitability, particularly forecast profitability. In practice, Auckland Airport was not aware of how the Commission would approach this analysis, although we anticipated that its analysis would focus on the ROI measure in line with the information disclosure templates. This was not the case, and the Commission instead developed its IRR approach to assessing profitability over the course of the section 56G process.

We understand that this model was designed to provide a longer-term view and address concerns that the ROI measure may be overly susceptible to yearly fluctuations in actual/expected performance. We accept that it is useful for the Commission to explore ways to sensibly assess performance (including profitability) over time, and that this will be part of the long-term journey to improve the regulatory and analytical framework. Considering ways to address the very real concerns about short-term variances in profitability measures is a responsible step.

Overall, we consider the Commission's analytical approach in this case was fair, but continue to encourage the Commission to recognise that trends over an appropriate time-series of data are required to draw conclusions about performance over the medium to longer term.

We also note that the five year IRR approach used by the Commission was heavily influenced by assumptions about the closing asset values in the model. This created a difficult situation where the outcome of a profitability assessment for a five year period was significantly determined by assumptions regarding decisions that have not yet been made (ie, decisions about an opening asset value in five years' time). We continue to have concerns about assessment approaches that rely on such assumptions.

This IRR model meant that we faced challenges (particularly at the Auckland Airport conference) in providing information about what we would do in five years' time, when these decisions (appropriately) had not yet been made, and in circumstances where we had not consulted with the airlines or sought feedback from investors, our board or our management team. In the end, we were able to provide assurances to the Commission and interested parties about the broad principles of the approach we would take, and give examples of different potential options that we considered to be consistent with these principles, and which may form part of the basis for consultation in 2017.

From a process perspective, Auckland Airport was satisfied with the Commission's explanation of the analytical profitability models and the question and answer sections of these sessions. In addition, Auckland Airport

appreciates that the Commission recognised how we understood our decisions were likely to be assessed at the time pricing decisions were made, and factored this into its assessment of Auckland Airport's conduct and intentions when setting prices.

- (c) **Process updates:** Auckland Airport welcomed the time and effort that went into the process updates provided by the Commission. Regular communication about timeframes was useful to assist with internal planning and resources.
- (d) **Analyst briefings:** Auckland Airport considers the format and timing of the analyst briefings met their intended goal of providing financial analysts and industry participants an early overview of the Commission's conclusions and a chance to ask questions.

From Auckland Airport's perspective as a listed company, the release of the Commission's reports at 8.00 am (when the New Zealand and Australian stock exchanges are closed) was very important, and we appreciate the Commission's approach. This allowed sufficient time for Auckland Airport to review the relevant material and prepare the necessary market releases to comply with its continuous disclosure obligations, and we continue to support this timing approach going forward.

- (e) **Other areas of interest:** In general, the Commission was available to answer queries or concerns throughout the review process, which was appreciated.

Overall, we consider that the Commission did a reasonably good job of explaining its final conclusions, although it is difficult to make an all-encompassing statement in respect of all documentation and the rationale for the Commission's final conclusions. Auckland Airport reinforces the importance of reaching an understanding of the detail of why the Commission does not agree with a particular submission as this assists with building understanding in an often complex and nuanced area.

Auckland Airport appreciates that the Commission made the effort to seek to set reasonable timelines. To the extent possible, we consider it is best if neither the Commission, nor regulated entities, are required to work through the first weeks of the calendar year as it is difficult to ensure a full complement of staff is available for analysis. That was a small challenge Auckland Airport faced at the beginning of calendar year 2013, as a range of information requests were received in December 2012.

9. In addition, in our experience:

- (a) As part of the section 56G process, the Commission's valuation advisors prepared a report on whether Auckland Airport's MVAU valuations were compliant with Schedule A of the IM Determination. Auckland Airport appreciated the opportunity to provide comments on the advisor's draft report (and acknowledges that this issue may have been handled by a different Commission team to that running the section 56G review), but considers that aspects of this process could have been improved.

Auckland Airport and its external experts spent a considerable amount of time seeking to understand and respond to the report of the Commission's advisors. In our view, the process resulted in experts who wrote past each other, rather than an attempt by all parties to build true understanding. In any event, from Auckland Airport's perspective the issue related to the correct legal interpretation of the input methodology, rather than being a matter for valuation

experts. Auckland Airport continues to consider that its interpretation of the IM is correct, and that its expert valuers have correctly followed Schedule A, but the process did not allow greater understanding as our requests for meetings were not accepted.

- (b) Some aspects of submissions were not addressed by the Commission where it did not consider that these affected its overall conclusions (for example, issues in relation to superior performance and contextual factors that may influence the Commission's view of the appropriate range for assessing profitability). Although we anticipate that these issues will be explored over time, there is still a large degree of uncertainty about when and how the Commission may choose to factor these issues into its analysis of historic and forecast performance.
- (c) We also note that the Commission's rationale for concepts such as the WACC range and appropriate treatment of asymmetric risks were relatively consistently expressed throughout the section 56G review, but have varied with other documents issued by the Commission.

SECTION TWO: COMMISSION'S OBSERVATIONS

Refinements to analysis and information disclosure requirements

- 10. The Commission has specifically welcomed feedback on its views that:
 - (a) The profitability analysis needed to be significantly tailored to the different airports' approaches.
 - (b) Refinements to information disclosure requirements could make disclosures more transparent and assist future summary and analysis.
 - (c) There may be a limit to the effectiveness of information disclosure where airports take a pricing approach that is not explicitly contemplated by the regime.
- 11. In Auckland Airport's view, these observations are related, and can usefully be considered together. In our view:
 - (a) When Part 4 was introduced, the aim of the strengthened information disclosure regime for airports was to improve the value and relevance of the information disclosed. It was contemplated that this would, among other things, provide for better information to guide consultation between airlines and airports and provide for ongoing analysis by the Commission of trends and performance.
 - (b) The ability for each airport to develop tailored and innovative pricing approaches that reflect their unique challenges and the needs of their consumers (including reflecting the views of their substantial customers through the consultation process) is an important and valuable part of the provision of airport services in New Zealand. This allows flexible and appropriate pricing approaches to be developed that will continue to promote the long-term benefit of consumers over time.
 - (c) Throughout the process to develop the IM and ID requirements, Auckland Airport expressed concerns that there were dangers with developing an overly prescriptive ID regime, including that prescription may not be the best approach to promote understanding of the unique pricing and investment

complexities in the airport sector (including airport-specific circumstances, decisions and pricing approaches).

- (d) The Commission considered that its ID Determination was designed to make transparent to interested persons the pricing and investment decisions airports make as part of operating an international airport, and the subsequent performance resulting from those decisions.¹ It identified a number of principles intended to guide its decision-making in implementing effective ID requirements, which included the following considerations:²
 - (i) Relying, where possible, on existing information gathering practices to promote a cost-effective information disclosure regime.
 - (ii) Ensuring consistency of data, both between airports and over time, to promote comparability of performance and therefore more meaningful assessment.
 - (iii) Providing for a degree of flexibility, so that airports can present as realistic a picture as possible of their actual performance for interested persons to assess.
 - (iv) Ensuring the airports make any underlying assumptions or rationale explicit, so that interested persons can make an informed assessment of whether the purpose of Part 4 is being met.
 - (e) These principles remain very relevant, and provide a useful starting point for building on the lessons from the section 56G experience.
 - (f) The cycle of annual reviews will build on the section 56G experience, providing an opportunity for ongoing dialogue about information disclosure regulation. This will sensibly inform the pathway to making future disclosures more transparent, and assisting with future summary and analysis.
12. In these circumstances, we consider that asking whether there is a limit to the effectiveness of ID regulation where airports take a pricing approach not contemplated by the regime is looking at the issue from the wrong perspective. In our view, the question for discussion going forward will be: how can the information disclosure requirements best provide meaningful transparency about the decisions (including pricing approaches) taken by airports?
13. Answering this question may involve:
- (a) recognising that analysis (including profitability analysis) may need to be tailored where this provides the most useful and accurate information; and
 - (b) thinking about whether refinements to information disclosure requirements can make disclosures more transparent and assist future summary and analysis.
14. Going forward, if refinements to the information disclosure requirements are considered, we consider it will be useful to carefully evaluate whether prescription or the establishment of principles will best support continuous improvement in the quality and usefulness of disclosure (taking into account the nature of the relevant disclosure) and in encouraging positive airport performance. For example, useful questions for discussion might be (consistent with the Commission's principles listed above):

¹ ID Reasons paper, paragraph 2.20.

² ID Reasons paper, paragraph 2.36-2.37.

- (a) Do the current disclosure requirements provide a sufficient degree of flexibility to allow the airports to present as realistic a picture as possible of their actual performance?
 - (b) Do the current requirements allow airports to make any underlying assumptions or rationale clear?
- 15. For both of these questions, the section 56G experience suggests that, at times, complex input methodologies and detailed spreadsheets may not necessarily be the best way to achieve transparency and understanding of airport performance and decision-making.
- 16. For example, the current information disclosure requirements provide for a large amount of detailed information to be disclosed. However, all parties would recognise that perhaps not all of this information has been useful in practice, and that some of this information is perhaps not presented in the most useful way.
- 17. Airports have a very strong incentive to ensure their decisions and intentions are well understood, but there are some situations where filling in a prescribed template does not necessarily provide the best opportunity to do so. In our view, transferring complex real life decisions to a spreadsheet template has, in some cases, increased complexity and reduced transparency, where this was not intended (by either the Commission or airports). We are accordingly pleased that the Commission has recognised that more prescription in the information required to be disclosed may only go so far.
- 18. In Auckland Airport's view, the focus for ongoing discussion should be on making sure information disclosure regulation assists in establishing a clear understanding of what each airport is doing, and ensuring that all information is disclosed in a meaningful and transparent way.
- 19. For example, the trade-off between prescription and principles for disclosure purposes has been dealt with by a number of other governance bodies (such as Accounting Standards Boards), which have identified methods of promoting clarity and transparency through principles, objectives and standards rather than a prescribed format of output. This approach also promotes continuous improvement as companies look for industry best practice and continue to improve disclosures over time.
- 20. We recognise that not all lessons from such bodies will translate into an information disclosure context, and accept that the Commission will be keen to ensure a reasonable degree of specificity to promote consistency of analysis between airports and over time. However, going forward, Auckland Airport would be keen to work constructively with the Commission, the other airports and the airlines to identify:
 - (a) areas where a detailed and prescriptive approach is helpful, including where additional prescription may be useful going forward; and
 - (b) areas where a more principles and commentary based approach to disclosure may promote better and more meaningful information and analysis.

Summary and analysis after future pricing reviews

- 21. The Commission has observed that summary and analysis after future pricing reviews should include a more in-depth analysis (compared to other years) of an airport's performance in relation to targeted profitability.
- 22. It is difficult for any party to definitively respond to this view, given that we have no experience of the annual reviews as yet. However, our preliminary views are that:

- (a) The section 56G process has been a largely constructive process. A more detailed annual review following future pricing events, using some aspects of the section 56G framework, may be an appropriate way to promote transparency and understanding for all parties. The precise way this more detailed analysis should be constructed can be explored further as part of the ongoing development of the information disclosure regime.
- (b) The primary focus of the section 56G review was on profitability, with high level analysis only on the other aspects of airport performance. Auckland Airport would anticipate that the annual reviews would therefore seek to take a broader approach, such that at the time of the next price setting event, a broader understanding of airport performance (and the assessment of that performance) has developed together with an understanding of how different performance aspects can relate to each other (for instance quality, price and investment).

SECTION THREE: SPECIFIC REFINEMENTS TO INFORMATION DISCLOSURE

- 23. The Commission has indicated some specific areas where information disclosure regulation could be refined (for example, disclosure of information about the airports' expected returns for the relevant pricing period), and proposes to consult in 2015 on possible amendments to both information disclosure requirements and input methodologies applicable to the regulated airports.
- 24. In our view, given the age and stage of the regulation, it is doing a good job of promoting understanding and dialogue about how airport performance can best promote the long-term interests of consumers. At the same time, Auckland Airport acknowledges that the information disclosure regime is still in its infancy, and that it is important for all parties to be open to ways the information disclosure requirements can be improved over time to promote meaningful and lasting transparency.
- 25. Auckland Airport is committed to continuous improvement of our disclosure statements, as we are to all other aspects of our business. As discussed above, Auckland Airport is therefore open to constructive discussions with the Commission and interested parties about ways to improve the information disclosure regime over time. In our view, beneficial areas for discussion may involve:
 - (a) Recognising that prescriptive spreadsheets may not always tell the full story about complex businesses such as airports.
 - (b) Identifying areas where more free-form disclosure requirements and principles could better capture the underlying substance of pricing, investment, and operational decisions.
 - (c) Increasing the quantum and location of areas to provide commentary so that we are able to better describe the results contained within each section.
 - (d) Engaging with the Commission to develop monitoring and analysis mechanisms for the Commission's annual reviews that transparently reflect performance.
- 26. We note that the learning cycle for Auckland Airport has been slower for disclosure reporting than for financial reporting because there are only three airports from which to gauge best practice. However we expect the Commission will indicate where understanding needs to be built as part of its annual reviews and/or engagement processes.

27. As we move to the next phase of exploring specific areas where targeted changes may improve disclosure reporting, it is important to keep in mind that this represents the normal course of continuous improvement inherent in any successful reporting regime. As above, Auckland Airport is happy to engage in this process.