

Airport Services – s 56G Reports

Process and Issues

Release Date:

31 May 2012

Chapter 1: Introduction

What we have been asked to do

1. Section 56G(1) of the Commerce Act 1986 (Act) requires the Commission to report to the Ministers of Commerce and Transport as to how effectively information disclosure (ID) regulation is promoting the purpose in s 52A(1)¹ of the Act in respect of specified airport services² regulated under Part 4. These specified airport services are supplied by Auckland International Airport Limited (AIAL), Wellington Airport Limited (WIAL) and Christchurch International Airport Limited (CIAL) (the airports).
2. The process the Commission must follow is also set out in s 56G(1) of the Act. It requires us to:
 - review the information that has been disclosed by the airports under the ID regulation determined by the Commission under subpart 4 of the Act
 - consult with interested parties
 - report to the Ministers.
3. We are required to carry out our review and report to the Ministers as soon as practicable after any new price for a specified airport service is set in or after 2012.³
4. This paper sets out our intended process, which includes some steps that go beyond what is required by the Act.

Scope of this paper

5. This paper sets out our proposed:
 - process and timings for reporting to the Ministers (indicative only at this stage for AIAL and CIAL) (chapter 2)
 - scope and approach to assessing the effectiveness of Part 4 ID regulation (chapter 3).

¹ The purpose of Part 4 is to promote the long-term benefit of consumers in markets where there is little or no competition and little or no likelihood of a substantial increase in competition. How this is to be done is by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and (d) are limited in their ability to extract excessive profits.

² Refer s 56A.

³ Refer s 56G(1).

6. We seek interested persons' responses to all questions in this paper, including questions on WIAL's disclosures (refer Attachment 1). Submitters are also welcome to comment on any aspect of this paper and to provide any other information that they consider we should have regard to in carrying out the review of each airport's disclosed information. We ask that submitters clearly indicate the source of their information, and why we can and should have regard to that information.

Process for submissions

7. All submissions must be received by the Commission no later than 5pm on 22 June 2012. Cross submissions are due no later than 5pm on 2 July 2012.
8. To foster an informed and transparent process, we intend to publish all submissions and cross submissions on our website. Accordingly, we request an electronic copy of each submission, and ask that interested persons not provide hard copies of submissions (unless an electronic copy is not available). Electronic copies should be provided in an accessible form (ie. they are 'unlocked' and text can easily be transferred). If the submission contains confidential information, or if the submitter wishes that the published version be 'locked', an additional document labelled "public version" should be provided.
9. We discourage requests for non-disclosure of submissions, as it is desirable to test all information in a fully public way. However, we recognise that there may be cases where parties may wish to provide confidential information to us. If it is necessary to do so, the information should be clearly marked, with reasons why that information is confidential. The responsibility for ensuring that confidential information is not included in the public version of a submission rests entirely with the party making the submission.

CHAPTER 2: Process and timings

Why we are commencing the review now

10. Section 56G(1) requires the Commission to report to the Ministers 'as soon as practicable' after any new price is set in or after 2012 by a supplier of specified airport services. Section 56(1)(c) indicates that we must report "as soon as any new price is set in 2012".
11. We consider that it is practicable to commence this review now, for the following reasons:
 - the trigger for reporting to the Ministers has been met – the airports are resetting their prices (WIAL has done so; AIAL and CIAL intend to do so later this year)
 - we have price-setting event⁴ information disclosed under Part 4 from WIAL and expect to receive price-setting event information from AIAL and CIAL later this year
 - we anticipate that given the timing of this review, the likely impact of ID regulation would be seen predominantly in the behaviour of the airports and airlines in price setting rounds, and in the forecast returns based on the prices set
 - we have historical and forecast information disclosed under Part 4 for each of the three airports
 - if we delayed the review in order to obtain more information from annual disclosures, it is likely that it would be delayed until the end of the pricing period that follows each airport's 2012 price changes. We do not consider such a delay is consistent with reporting 'as soon as practicable' given the information available. However, we appreciate this will mean that any conclusions we draw about historical performance will be limited.
12. We have considered whether we should proceed with the review in light of the appeals against our input methodologies for specified airport services, due to be heard later this year. We consider that we should proceed given that IMs stand until any appeal against them is finally determined,⁵ and that there is the potential for delays if there are further appeals. We appreciate that given the IM appeals, and refinements of ID requirements over time, ID regulation may impact differently in future.
13. We are interested in your views on the timing of the review.

⁴ A price setting event occurs when an airport fixes or alters the price it charges for its regulated services following consultation. Airports are required to consult on their prices at least once every five years. Following the price setting event, Airports are required to publicly disclose information on their forecast expenditures, assets, expected return and associated required revenues for the pricing period, as well as a ten year demand forecast. Airports are also required to provide information on their pricing methodology and the quality of service provided.

⁵ Refer s 53(2) of the Act.

We will review the effectiveness of ID for each airport

14. We propose to prepare a separate report for each of the three airports.⁶ This is appropriate given that ID regulation may be having a different impact across the three airports. It will also allow the Ministers to receive the reports in a timely manner following each airport's new prices being set.

Proposed process

15. We propose to:
- review the information disclosed under Part 4 and the price-setting consultation documentation as it becomes available for each airport
 - review the information disclosed in consultation during this review process and in response to any requests for information under our information-gathering powers under the Act
 - hold a conference prior to preparing draft reports to ensure that we have all the relevant information, and to test the views and ensure we understand any differences of opinion
 - consult with parties on our draft reports. Once we receive submissions on each draft report, we will also consider whether a further conference is necessary before finalising our report to the Ministers
 - prepare a final report on each of the airports.
16. The timing of the AIAL and CIAL reports depends on the timing of their price setting decisions. We will confirm timeframes and seek information specific to each of AIAL and CIAL once they set new prices.

⁶ This is consistent with the requirement in section 56G which provides:
 “As soon as practicable after **any new price** for a specified **service** is set in or after 2012 by a **supplier** of the service, the Commission must...

The use of singular when referring to “a specified service” “by a supplier”, and reference to “any new price” distinguishes this section from the other wording in subpart 11 which refers to “specified services” and “suppliers” in plural. The use of singular and the word “any” indicates that the Commission has an obligation to report on how effectively the information disclosure regulation is promoting the purpose set out in section 52A, as soon as practicable once each new price is set by each individual supplier.

17. The following table sets out our proposed process and timings for reporting to the Ministers in relation to WIAL.

Process	Indicative timeframes
Process and Issues paper	31 May 2012
Submissions	Due 22 June 2012
Cross-submissions	Due 2 July 2012
Preliminary issues paper for conference	9 July 2012
Conference	17 July 2012
Draft report	28 August 2012
Submissions	Due 24 September 2012
Cross-submissions	Due 1 October 2012
Final report to Ministers	November 2012

CHAPTER 3: Scope and approach for all airports

18. This chapter sets out our proposed approach and scope for each of the three airports. We seek your views on the scope and approach; in particular, whether there are differences between the three airports that mean the approach should differ between them.

How we have interpreted the task

19. The reports to the Ministers require an assessment of:
- airports' performance (historical and projected) under s 52A(1) to identify whether the objectives in (a) to (d) are occurring
 - the extent to which ID regulation under Part 4 has had an impact on the airport's performance and conduct.

What the reviews will not consider

20. We are not required to, and we do not propose to, assess how effectively ID is promoting the purpose of Part 4 relative to other types of regulation provided for under Part 4, or relative to no regulation.
21. We do not propose to recommend what, if any, alternative type of regulation should apply.

What information we need

22. Our primary source of information for this review is the information disclosed under Part 4 ID regulation (including any follow ups and clarifications we may have on the disclosures) and, in particular, information in relation to the setting of new prices. However, we do not consider that we can only rely only on the information disclosed under Part 4. Other information may assist our review by providing insights into an airport's performance in terms of the purpose of Part 4 and/or an airport's conduct, in particular in relation to the recent price-setting event. This information will therefore provide insights into how effectively ID regulation is promoting the purpose of Part 4.
23. We therefore consider that in assessing the effectiveness of ID regulation we may have regard to:
- information received from parties during the review process
 - information requested under our information-gathering powers
 - consultation material from price-setting events
 - the airport's pricing decision and announcements
 - information disclosed under the Airports Authorities Act 1966
 - other company information, eg annual reports

- benchmarking data (domestic and international)
 - reports (national and international) on evaluation of the effectiveness of regulation
 - academic literature
 - industry reports.
24. We are particularly interested in your views on what information other than that disclosed under ID regulation we should have regard to, why is it relevant to this review, and how should we use it in forming our conclusions. We also seek your views on whether the information sources listed above are appropriate, and what specific information is relevant and why.

Assessment approach

25. The assessment of how effectively ID regulation is promoting the Part 4 purpose will be informed by:
- the recent and expected performance of each airport since information disclosure was implemented and as a result of the recent price setting round
 - whether ID has had an impact on the airports' conduct (behaviour) in relation to this recent price setting round. For example, were some matters 'off the table', were others less contentious?
 - changes in each airport's conduct and systems to comply with ID regulation.
26. As implied by the purpose of Part 4, the performance of regulated airports may be assessed by considering whether:
- the airports are earning excessive profits
 - the airports are operating and investing in their assets efficiently and effectively
 - the airports are innovating where this innovation would lead to higher profits, or maintenance of position in the market
 - the airports are providing services at a quality that reflects consumer demands
 - the prices set by the airports reflect efficiency gains and are consistent, to the extent feasible, with efficient pricing principles.
27. We propose to ask interested persons for their views on the impact of ID regulation, if any, on the airports' conduct/behaviour since ID regulation came into force.⁷ We will also review the price-setting consultation documentation.

⁷ Part 4 information disclosure regulation for specified airport services came into force on 14 October 2008. The ID requirements under Part 4 came into force on 1 January 2011.

28. We will also consider the airports' recent and expected performance based on annual disclosures under Part 4 against the relevant IMs, where possible.⁸ We consider that IMs are likely to be most relevant to the profitability assessment aspect of our review. We will look at any variations by each airport from our IMs, and the reasons why the airport has departed from them (if this is the case). IMs do not cover all aspects of performance under s 52A(1) (for example, pricing efficiency) and we will assess these aspects of performance based on the processes, outputs and outcomes that we might expect to find in a workably competitive market.
29. We seek your views on the matters raised in this paper and welcome any other questions/issues that you consider are relevant to our task. (Please indicate why you consider them to be relevant). If you suggest changes to the scope and approach, please indicate what difference that would make for any of the questions we have asked in Attachment 1.
30. Given that WIAL has reset its prices for the next five years and has disclosed its price-setting information, we have included some questions specific to WIAL in Attachment 1. We seek your response to those questions. We also welcome any other information in relation to WIAL relevant to this review – please indicate why you consider the information is relevant.
31. We appreciate that submissions on our proposed approach may result in an amended approach such that there may need to be some follow-up questions on WIAL's information. However, we consider that providing questions now will better inform submissions than simply providing our proposed approach in the abstract.
32. Further, given that s 56G(1) requires us to undertake the review and report to the Ministers as soon as practicable after any new price is set in or after 2012, setting out these questions as part of this paper means that we can proceed with our task in a timely manner.

⁸

Commerce Act Specified Airport Services Input Methodologies Determination December 2010.

ATTACHMENT 1

Questions relating to WIAL

In chapter 3 we outlined our views on the scope and approach for the s 56G reviews. Based on those views, we are interested in hearing from you on the following questions relating to WIAL's disclosures and consultation process. These questions are intended to elicit information necessary to understand airport performance and therefore how effectively ID regulation is promoting the purpose of Part 4. We appreciate that WIAL has already provided much of this information in their disclosures. However, this paper provides all interested persons an opportunity to give their views.

We seek your responses to the following overarching questions for all aspects of performance.

- Has information disclosure had any impact on WIAL's performance and in understanding WIAL performance, and why?
- Has information disclosure had any impact on the effectiveness and scope of consultation as part of WIAL's second price setting event (PSE), and why?
- What aspects of performance and behaviour should we focus our efforts on for this review for WIAL?

We are also seeking your responses to more specific questions provided below. Submissions are not limited to the issues raised in these questions, and we ask that you highlight any additional issues in your response, and explain why they are important.

Is WIAL earning excessive profits?

- What is an appropriate level of target return for WIAL, and why is the level appropriate?
 - What is an appropriate level to reflect normal performance, and why?
 - What is an appropriate level to reflect superior performance, and why?
- How should we assess profitability, given the airports inter-temporal use of wash-ups, discounts and other discretionary mechanisms?
- How reasonable is WIAL's revenue forecast for the second PSE compared to the first PSE forecasts, and why?
- How reasonable are WIAL's asset valuations, and why?
- What role has ID played in discussions in the industry about the target return on investment when setting prices?

Is WIAL operating and investing in their assets efficiently and effectively?

- Where and when do any capacity constraints occur at WIAL, and is additional investment necessary to address these constraints?
- What factors outside WIAL's control have contributed to the capex and opex forecast for the second PSE and to changes in expenditure since the first PSE?
- How reasonable are WIAL's opex and capex forecasts for the second PSE, and how do these compare to the forecasts from the first PSE?
- To what extent does the demand forecast presented by WIAL as part of the second PSE, accurately reflect expectations of future demand, and why?
- How reasonable is WIAL's demand forecast for the second PSE compared to the forecast from the first PSE?
- What role did information disclosure regulation play in negotiations concerning WIAL's expenditure forecasts?

Is WIAL innovating appropriately?

- What research and development (R&D) or innovation activities have been undertaken or are forecast to be undertaken by WIAL and what was the outcome these activities (if they have been undertaken), or the expected outcome?
- How does the level of R&D and innovation activities compare now to activities prior to the introduction of ID in January 2011 ?
- What innovation has occurred in other airports in New Zealand or overseas in recent years?

Is WIAL providing services at a quality that reflects consumer demands?

- What changes in quality have occurred since ID was introduced?
- What, if any, aspects of quality do you think should or could be improved (or potentially lowered) at WIAL?
- What consultation was undertaken on aspects of service quality during WIAL's second PSE? How does this differ from consultation on quality at the first PSE?
- What role did information disclosure play in negotiations concerning service quality during WIAL's second PSE?
- Do the current ID requirements capture the right measures of quality?

Do the prices set by WIAL reflect efficiency gains and comply, to the extent feasible, with efficient pricing principles?

- How do the prices set by WIAL reflect previous and future expectations of efficiency gains?
- To what extent do changes in the pricing structure at WIAL at the second PSE better reflect efficient pricing principles (for example, are prices cost reflective, subsidy-free, do they have regard to service capacity, are they responsive to consumer demands?)
- To what extent have airlines and other consumers of WIAL's services been able to make price-quality trade-offs that best meet their needs?
- How do airlines and other consumers of WIAL's services expect their demand to change in response to the prices set by WIAL in the second PSE, including the introduction of peak pricing?
- What impact will WIAL's proposed prices, pricing structure and associated incentives have on demand and revenues?

Comparator airports

- What airports provide a useful benchmark for assessing the performance of WIAL, and why? Please provide any relevant benchmarking data if possible.

What are the strengths and weaknesses of the current ID requirements?

- What are the additional costs to WIAL of complying with information disclosure?
- How much of the information disclosed during the recent price setting round would have been publicly disclosed, or disclosed to airlines, in the absence of information disclosure regulation?
- What are the benefits to WIAL, airlines and other consumers of WIAL's services of using the information disclosed?
- What additional information (not captured in responses to the questions above) could be added to the current ID requirements that would better help you assess whether the purpose of Part 4 is being met?