

26 November 2013

Regulation Branch
Commerce Commission
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Attention: Ruth Nichols

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Draft Section 56G Report on Christchurch Airport

The Commission received submissions on its draft report on Christchurch Airport from:

- Christchurch Airport
- Auckland Airport
- New Zealand Airports Association (NZAA)
- BARNZ

In addition, Wellington Airport indicated its support for the NZAA submission and Air New Zealand indicated its support of the BARNZ submission.

Air New Zealand notes that it has contributed to the cross-submission from BARNZ and supports that cross-submission in its entirety. The following comments are intended to be read in conjunction with the BARNZ cross-submission.

The NZAA and Auckland Airport submissions essentially stated that:

- The Commission should limit its assessment to the PSE2 return, rather than the 20 year period of Christchurch Airport's modelled levelised price path;
- Information disclosure has been effective if the airports make changes to their pricing conduct as a result of Commission's conclusions from these section 56G reviews; and
- The Commission is creating further uncertainty and potentially discouraging airports from adopting appropriate commercial approaches to pricing reflecting their particular circumstances.

Air New Zealand rejects all three of these claims:

- Christchurch Airport's levelised price path over the 20 year period means prices in each period are inextricably linked to prices set in previous periods, with the target return over the 20 year period being the sum of all the periods. Christchurch Airport

has been very clear that its perceived under-recovery in PSE2 will be recouped through future prices reflecting the entire period price path. Throughout consultation Christchurch Airport went to great pains to explain this approach as a response to the step-change in pricing required as a result of the commissioning of the ITP. NZAA's comment that the Commission must base its assessment of the effectiveness of information disclosure on the information disclosed highlights the ineffectiveness of Christchurch Airport's disclosure given it failed to provide sufficient transparency for NZAA to understand the basis on which Christchurch Airport established its prices.

- NZAA and Auckland Airport are misstating the purpose of the section 56G reviews. These reviews are intended to assess how effectively information disclosure is promoting the purpose of Part 4 of the Commerce Act. The inescapable conclusion after assessing Christchurch Airport's disclosure is that information disclosure has been ineffective as the Airport is seeking to extract excessive returns over both the initial PSE2 pricing period and over the 20 year period of its levelised pricing model. Simply because an airport may propose changes to its approach in the future – when there will be no section 56G detailed assessment of its conduct – does not change the fact that information disclosure has to date been ineffective.
- NZAA and Auckland Airport claim that the Commission's conclusion that Christchurch Airport's conduct was influenced more by demand considerations than by information disclosure creates "increased uncertainty and regulatory risk" for the airports. Air New Zealand considers such statements to be unnecessarily provocative. The Commission has rightly identified that Christchurch Airport's pricing approach has been influenced more by the specific circumstances it is facing rather than any incentives created by information disclosure. As the Commission notes, "there is a risk that those [other] incentives might not apply in the future, and that information disclosure might not have a greater influence at that time." Air New Zealand considers that Christchurch Airport's selective approach to complying with the IMs highlights the very real risk that airports will adopt whatever approach they want in the future, regardless of information disclosure.

Christchurch Airport's submission focussed on a number of issues:

- Its "surprise" and "disappointment" that the Commission concluded that information disclosure had a "minimal influence" on Christchurch Airport's approach to pricing;
- Its intention to make changes, as identified by the Commission, to its approach in PSE3 and subsequently;
- Its intention to change the way in which it discloses information in the future, particularly in relation to depreciation;

- The appropriate risk free rate to use when assessing returns over the 20 year pricing period;
- The seeming inconsistency in the Commission's assessment of Christchurch Airport's performance in terms of innovation, service quality and pricing efficiency with the assessments of Wellington and Auckland airports.

Air New Zealand wishes to comment on these issues as follows:

- It should come as no surprise that the Commission should conclude that information disclosure has had only a "minimal influence". Christchurch Airport wilfully adopted approaches to WACC and tax which were fundamentally different to the IMs and which resulted in a significant divergence from the level of returns which would have resulted from application of the IMs. Christchurch Airport's insistence on adopting a WACC equivalent to approximately 9.8% over the course of the consultation highlights the ineffectiveness of information disclosure at modifying airport behaviour. While adoption of these different approaches is not in itself an issue the simple fact that they created a major gulf between the returns expected under the alternative approaches is. Christchurch Airport did adopt other approaches consistent with the IMs but Air New Zealand submits that this was not due to information disclosure but simply because these were standard approaches the airport had previously applied.
- In its submission, Christchurch Airport has indicated its intention to make changes to its future modelling to address a number of issues raised by the Commission in the draft report. As the Commission noted, many of these issues potentially resulted in an understatement of the returns being targeted. Air New Zealand refers the Commission to the BARNZ submission on the draft report which identified the Commission was indeed significantly under-estimating the returns being sought by Christchurch Airport. As highlighted in both the BARNZ submission and cross-submission the Commission needs to update its analysis to reflect the adjustments identified.
- Christchurch Airport has proposed an approach to applying non-standard depreciation and has sought views on this approach. In common with BARNZ, Air New Zealand does not consider it appropriate to enter into discussion of those proposals via this section 56G review process and would welcome further in-depth discussion with Christchurch Airport on this issue. As noted by BARNZ, these are complex and technical issues which will require detailed analysis of the modelling to properly understand the implications. For example it is not clear that the proposed approach to dealing with the over-recovery of tax in the initial years of the levelised pricing path does result in an equitable outcome. Similarly it is not clear why Christchurch Airport is proposing to calculate two inconsistent depreciation paths for the purpose of its modelling when it could simply use an economic depreciation calculation.

- Christchurch Airport continues to believe its adoption of a 10 year historic average risk free rate is appropriate, given the “historically anomalously low” levels in 2012. Air New Zealand provided the following comment to Christchurch Airport in the course of the consultation:

We disagree with this approach and strongly believe the prevailing risk-free rate should be used in the WACC calculation given it reflects the current market information and expectations. By definition, the risk-free rate is the rate that investors can expect to earn on a risk-free (or as close to risk-free as possible) security in the market today. New Zealand investors can not currently earn 6% on ten year government bonds or other risk free securities.

It is not reasonable to assume the average rate from the last ten years is representative of the current risk-free rate. Neither CIAL or PwC hold any more information than the market to assess where the rate is headed in the next five to ten years or what it ‘should be’. Whilst current government bond rates are low compared to historical levels, it is presumptuous to assume rates will increase to average historical levels during the term of the next pricing period. In absence of better information, actual current market rates are the best representation today of returns over the next five years.

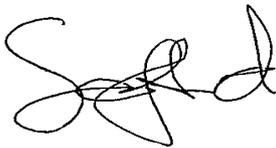
Air New Zealand continues to hold this view.

- Christchurch Airport has also expressed its concern that the Commission is using the October 2012 risk free rate as the basis for assessing returns over twenty years. Air New Zealand agrees with the Commission’s approach. As noted in the BARNZ submission, Christchurch Airport indicated its intention to update its WACC at the commencement of each pricing period, resulting in a recalculation of the levelised price path. These adjustments will likely offset one another. Also as noted by BARNZ, the future risk free rates postulated by Christchurch Airport are significantly over-stated.
- Christchurch Airport appears aggrieved that the Commission has adopted a seemingly different approach to its assessment of the impact on innovation, service quality and pricing efficiency than it did with Wellington and Auckland airports. Air New Zealand supports the Commission’s conclusions on these matters insofar as they relate to Christchurch Airport. While not questioning Christchurch Airport’s facilitation of innovation and desire to improve service quality, Air New Zealand considers that information disclosure has had no discernible impact on Christchurch Airport’s conduct. Improvements in these areas have been the result of drivers external to information disclosure, e.g. airline initiatives and commissioning of the new Integrated Terminal. Air New Zealand is not able to identify any instance where information disclosure is actively promoting a particular approach by Christchurch Airport.

In conclusion, Air New Zealand notes that the task before the Commission is to assess whether the information disclosed by Christchurch Airport indicates that the Airport has been incentivised to act in a manner consistent with achieving the purpose of Part 4 of the Commerce Act. It is clear, given the returns being targeted by Christchurch Airport as well as the continuing lack of clarity as to the approach adopted by the Airport that this is not the case.

Please contact me if you have any questions regarding this cross-submission.

Yours sincerely



Sean Ford
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