

24 April 2014

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Commerce Commission
Wellington

Dear Ruth

Feedback on Commerce Commission section 56G review process

1. This letter responds to the Commission's request for feedback on the process it followed to satisfy the requirements of section 56G of the Commerce Act 1986. We appreciate the opportunity to provide comments, and we hope that our views will assist the Commission to reflect on how it might enhance constructive engagement with stakeholders on Part 4 regulatory matters more generally.
2. We understand that each airport will have its own views on aspects of this process, which will be provided directly to the Commission. In this letter, we provide some high level comments from NZ Airports, focussing on:
 - (a) The process taken by the Commission to satisfy the requirements of section 56G of the Commerce Act. In general, NZ Airports considers that the Commission's process provided all parties the opportunity to better understand information disclosure and airport performance, but (as was expressed throughout the section 56G review) we have some concerns with particular aspects of the process that was followed.
 - (b) The Commission's preliminary observations about future changes to information disclosure. Overall, NZ Airports is happy to explore ways to enhance the information disclosure regime so that clear information is available to interested parties about the decisions that airports have made. There will however be a need to carefully consider the design and implementation of any changes, to ensure that the intent of the regulatory regime is promoted in the best way possible.
3. Should you wish to discuss these comments further, please contact me on (04) 384 3217, or at kevin.ward@nzairports.co.nz.

The process taken to satisfy the requirements of section 56G of the Act

The requirements of section 56G

4. As a starting point, it is useful to step back and consider the requirements of section 56G. This provision imposed a statutory obligation on the Commission to review the information that had been disclosed by suppliers at a certain point in time (ie following the setting of prices by airports in or after 2012), consult with interested parties, and report to Ministers on the effectiveness of information disclosure regulation.

5. We think the Commission shares our view that Parliament perhaps did not appreciate just how demanding a task it had set, bearing in mind that information disclosure had barely been put in place, and was still subject to considerable uncertainty (merits review) at the time prices were set and the section 56G reviews carried out.
6. In those circumstances, our view is that heightened care was needed to ensure a fair, pragmatic and balanced approach was taken to the regulatory process.
7. NZ Airports appreciates that the Commission ran a comprehensive consultation process designed to give interested parties the opportunity to provide views throughout. The Commission faced the challenge of considering a number of different views from airports, airlines and other interested parties, and presenting a report to Ministers in a situation where the infancy of the regime meant that there were material limitations in some of the conclusions that could be drawn.
8. In general, the Commission did reasonably well to address that challenge, although NZ Airports continues to consider that, given the factors discussed above, greater explanation of the limitations in the Commission's analysis and conclusions was needed in order to present the most complete picture of the current performance of the information disclosure regime for interested parties.
9. However, we consider that some aspects of the process could have been improved, and that these lessons can inform future engagement processes. For example, the Commission set out its proposed process in a relatively definitive manner in the Wellington Airport process paper in May 2012. Key aspects of this process (the timing of the review, producing separate reports for each airport, the requesting of further information, and the types of questions asked by the Commission about airport performance) were not deviated from throughout the remainder of the process. In our view, ultimately there was little opportunity for stakeholders to influence these key aspects of the 56G process.
10. In this case, we consider that this contributed to a process that seemed, in part, to be different than contemplated by section 56G of the Act. The Commission itself noted in its first process paper that its intended process included some steps that went beyond what was required by the Act.
11. In the future, NZ Airports considers it may be beneficial for the Commission to consider how it can better include stakeholders in decisions on process points (including in an informal way) before it forms a clear view that is then published in a formal process paper. This could allow for better and more constructive engagement between the Commission and interested parties on process questions.

The analytical models

12. The Commission has noted that its profitability analysis needed to be significantly tailored to the different airports' approaches (although, in our view, core aspects of the Commission's analytical model were broadly similar for its analysis of each airport).
13. NZ Airports agrees that a "one size fits all" approach may not always provide the most useful information about airport performance. We appreciate that the Commission made an effort to reflect the pricing approaches taken by airports in its modelling, including considering whether airports' departures from the input methodologies were appropriate in some cases (although we consider it could have been explained more clearly why the Commission considered departures to be relevant in some cases, but not others).

14. On this basis, NZ Airports is happy to continue to explore the best way of assessing returns on an ongoing basis (including the best ways to reflect the differences between the pricing approaches taken by each airport in future summary and analysis). However, we continue to consider that it is important for any intended assessment approach to be made clear and transparent in advance, so airports are aware of the basis on which returns are assessed when they are making the relevant decisions.

The final reports and the reasons for the Commission's conclusions

15. NZ Airports appreciates the effort put in by the Commission to publishing reports that attempted to strike a balance between providing a range of technical and detailed information while remaining easy to read and follow for interested parties. In general, we think this balance was about right. However, we consider that there are some aspects of the Commission's approach to explaining its conclusions that could be improved in the future. In NZ Airports' view:
- (a) Some aspects of the Commission's analysis included general statements that the Commission had considered a particular issue. For example, the Commission appropriately noted that the performance areas under assessment (which translated to the elements of the Part 4 purpose statement) were interrelated, and that it was appropriate to consider relevant outcomes in other areas in order to assess the effectiveness of information disclosure in promoting particular outcomes. Its reports noted that it had done this. However, beyond this statement, it was never precisely clear how the Commission had considered the interaction between different performance areas or the trade-offs that may be involved. In our view, greater explanation would have assisted in explaining the reasoning for the Commission's conclusions in this respect.
 - (b) At times, the Commission had a tendency to make assumptions that may not be borne out in reality. For example, the Commission had a tendency to make assumptions about the "natural incentives" faced by regulated entities in particular areas, without evidence as to whether these incentives existed in reality, and/or were affecting airport performance. This applied to assumptions about both the presence of incentives in some areas (eg that airports have natural incentives to invest), and the lack of incentives in others (eg that, without regulation, there are minimal incentives on airports to limit profitability). We are somewhat surprised that the Commission was prepared to use these assumptions as part of its reasoning process, without testing or cross-checking whether they had a sound evidential basis.
 - (c) Although we acknowledge the Commission was prepared to make changes between its draft and final reports, these were generally at the margins of its analytical model, and resulted in small changes to the quantum of expected returns. It was not always clear that the Commission's final reports reflected the weight of detailed and careful submissions that had been provided on the draft reports.
16. Our intention in raising these points is not to provide further views on the substantive content of the Commission's reports. Rather, it is to suggest that, from a process perspective:
- (a) greater explanation about how the Commission has taken a particular issue into account, and how it has balanced and weighed interactions and competing trade-offs may be more helpful in explaining the Commission's reasoning to interested parties; and

- (b) assumptions about the conduct and incentives of regulated entities should generally be avoided in explaining the rationale for the Commission's conclusions, unless appropriately supported by evidence.

Potential changes to information disclosure

17. The Commission has indicated that:

- (a) refinements to information disclosure requirements could make disclosures more transparent, assist future summary and analysis, and provide stronger incentives to limit excessive profits;
- (b) 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; and
- (c) summary and analysis after future pricing reviews should include a more in-depth analysis.

18. Consistent with these comments, the Commission has previously suggested that refining or enhancing information disclosure may involve requiring airports to disclose an indicator of expected returns comparable to its cost of capital (ie an IRR calculation), which would in turn require further information to be disclosed. The Commission's indications suggest this information may include an opening asset base that reflects departures from IMs in pricing, and the expected asset base to be used to set prices on an ongoing basis. The Commission has also suggested that greater alignment between pricing and information disclosure values may be considered.

19. In response, we note that:

- (a) NZ Airports is happy to explore ways to enhance information disclosure to make disclosures more transparent and to assist future summary and analysis, to ultimately ensure that information disclosure is providing meaningful information to all interested parties about decisions that have been made. However, we note that:
 - (i) It is important to remember (as we have noted previously) that information disclosure regulation was intended to support outcomes that reflected the circumstances of individual airports, taking into account efficiency, productivity, investment and other issues, while providing clear guidance to assist commercial pricing consultations. It was not intended to dictate one-size-fits all approaches to airport pricing.
 - (ii) In our view, striking the appropriate balance may involve exploring enhancements by way of appropriately focussed principles, rather than seeking to introduce more prescriptive requirements. In NZ Airports' experience to date, although detail is useful and necessary in some areas, some of the more prescriptive aspects of the current disclosure requirements can reduce the ability for airports to describe their performance, and for interested parties to understand that performance in a meaningful way.
 - (iii) NZ Airports still has some concerns about how the Commission's more specific suggestions may be implemented, and what they may require in terms of committing to future pricing decisions. In particular, we reiterate the concerns that NZ Airports expressed throughout the section 56G process about the limitations of analysis based on assumptions about future

conduct, rather than decisions that have actually been made. However, NZ Airports is not opposed to exploring options that help to promote transparency and are consistent with airports' obligations under the AAA. Again, we suggest that principles, rather than prescription, may be the best approach when thinking about the most productive way forward under information disclosure.

- (b) We have some concerns with the Commission's view that 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. In particular:
 - (i) We understand that the Commission's comments were raised in the context of Christchurch Airport's decision to adopt a 20-year pricing model, rather than the 5-year building block approach used by Wellington and Auckland Airports.
 - (ii) We disagree with the Commission's view that information disclosure "contemplates" any particular pricing approach, whether implicitly or explicitly. Information disclosure is about providing information about the approaches taken by airports (including the choice of pricing methodology, as well as the inputs into that methodology).
 - (iii) Rather, the key is ensuring that information disclosure allows airports to fully and transparently disclose the choices they have made. This may require the Commission, airports and airlines to engage constructively on the best way to analyse those choices. As above, we are happy to explore ways to improve the effectiveness of information disclosure in this way.
- (c) A more in-depth summary and analysis report after future price-setting disclosures may be an appropriate way to maintain accountability, guidance and discipline (including a credible regulatory threat) following the one-off section 56G reviews.

Yours sincerely

Kevin Ward
Chief Executive