



**SUBMISSION ON COMMERCE COMMISSION'S REVIEW OF
CHRISTCHURCH INTERNATIONAL AIRPORT'S PRICING
DECISIONS AND EXPECTED PERFORMANCE
(JULY 2017 – JUNE 2022)
- DRAFT REPORT**

16 August 2018

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PART A: INTRODUCTION

- 1 This submission responds to the Commerce Commission's (**Commission**) review of Christchurch International Airport's (**CIAL**) pricing decisions and expected performance (July 2017 – June 2022) – draft report (**Draft Report**). The Draft Report comprises the Commission's draft summary and analysis required by section 53B(2) of the Commerce Act 1986 (the **Act**).

Context for readers

- 2 For context, the Commission's Draft Report follows a thorough price setting and information disclosure process:
 - 2.1 CIAL set prices for its "airport activities" on 19 June 2017 following seven months of extensive consultation with CIAL's substantial customers, in accordance with section 4B of the Airport Authorities Act 1966. Those prices apply for CIAL's third pricing period (**PSE3**), from 1 July 2017 to 30 June 2022 and relate to CIAL's "**Priced Services**".
 - 2.2 On 14 August 2017 CIAL disclosed information to the public triggered by its 19 June price setting event in accordance with the Airport Services Information Disclosure Determination 2010 (the **ID** regime).
 - 2.3 The Commission's Draft Report relates to CIAL's 14 August information disclosure. The Commission was also kept informed throughout CIAL's PSE3 consultation.

Distinction between priced and other services

- 3 There is a key distinction between the types of services regulated and considered by the Commission, which the Commission has clearly identified in its Draft Report and those interested in this process should keep in mind. That is:
 - 3.1 CIAL is required by the Airport Authorities Act to consult with substantial customers in respect of charges for "identified airport activities".¹ The de facto rule is that prices must be set, and therefore consultation occur, at least once every five years.
 - 3.2 However, the Airport Authorities Act also allows for prices for identified airport activities to be set directly by agreement between the relevant parties – airports are not required to reset prices and consult to the extent that a charge has been agreed in writing by the relevant customer (i.e. through a contract).
 - 3.3 This framework draws out two different types of services:
 - (a) CIAL's PSE3 prices set via consultation to run for a five year period are typically referred to as "**priced**" services. Priced services include airport landing services and passenger use of the terminal. They apply to all airlines.
 - (b) CIAL also provides a set of services subject to terms negotiated and agreed directly with the relevant customers, which were not the subject of CIAL's PSE3 price consultation and reset. These services are typically called "non-priced" or "**other regulated services**".

¹ "Identified airport activities" include "airfield activities", "aircraft and freight activities" and "specified passenger terminal activities".

3.4 ID requirements are triggered by an airport's reset of priced services, but information must be disclosed for all specified airport activities,² including priced and other regulated services.

4 The result is the Commission's assessment considers two very different sets of services:

4.1 priced services set for PSE3 via consultation for five year periods; and

4.2 other regulated services agreed by competitive negotiation and set for periods determined through that process and relevant to the service (usually involving a lease).

Background and other materials

5 For additional context, we direct interested parties to:

5.1 CIAL's extensive consultation pack, which includes all substantial correspondence between CIAL and its substantial customers during consultation on CIAL's prices for the period from 1 July 2017 to 30 June 2022 (**PSE3**), the price setting event now being considered by the Commission – available on the Commission's website [here](#);

5.2 CIAL's 14 August 2017 disclosure of information to the public relating to PSE3, to which the Draft Report refers. That information is available on CIAL's website: www.christchurchairport.co.nz;

5.3 CIAL's previous submissions on the Commission's process and issues paper on the review of Auckland and Christchurch Airports' third price setting events for airport services – available on the Commission's website [here](#).

6 We refer also to the New Zealand Airports Association's submission on the Commission's Draft Report.

Questions

7 If there are any questions in relation to this submission please contact:

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² The Commerce Act uses the term "specified airport services" and the Airport Authorities Act uses the term "identified airport activities". The two cover essentially the same services.

PART B: EXECUTIVE SUMMARY

- 8 The Draft Report is a positive and helpful aid to understanding CIAL's efficiency and expected profitability. In it the Commission makes several important findings, in particular noting that CIAL:
- 8.1 is targeting reasonable returns on its priced services;
 - 8.2 is acting in an efficient manner, including in relation to its new price structure; and
 - 8.3 used appropriate forecasts, including in relation to demand, operating expenditure and capital expenditure.
- Further emphasis is needed**
- 9 There are several topics where CIAL believes the Commission should add further emphasis or re-prioritise its analysis.
- 10 CIAL made a number of decisions for PSE3 that are worth highlighting as, despite not being controversial, they demonstrate that CIAL is acting in the long term interests of consumers. They reflect on CIAL's transparent and efficiency focused approach driven by the ID regime. In particular:
- 10.1 CIAL made several changes in response to feedback received during the previous price setting event (PSE2), including:
 - (a) moving to a tilted annuity approach to depreciation, chosen with expert input from Incenta Economic Consulting (**Incenta**) and supported by airlines. This change was made to increase transparency compared to the 20 year levelised approach used in PSE2; and
 - (b) aligning CIAL's pricing asset base where possible with its regulated (disclosure) asset base, in order to increase transparency and align CIAL's price setting exercise with the process the Commission is now undertaking in assessing CIAL's returns.
 - 10.2 CIAL changed its price structure to per-passenger airfield and terminal prices. This approach simplified CIAL's prices and improved transparency, as well as being efficient (which the Commission has identified and focused on). The majority of substantial customers were strongly supportive of CIAL's change in price structure.
 - 10.3 CIAL was transparent through its PSE3 consultation and price setting process, and in information disclosure. The quality of information and explanation to substantial customers, the Commission, and others through the process was good. Through the Board of Airline Representatives New Zealand (**BARNZ**), the majority of airlines agreed.
- 11 The Commission's prioritisation of topics is also important and plays a key role in informing interested parties. CIAL would like to see a number of topics at the back of the Draft Report brought forward, covered in the Commission's executive summary, and identified in media statements. In particular, the Commission's appendices contain important analysis on CIAL's WACC calculation, forecasts, and transparent approach. That analysis is important – it demonstrates that CIAL is acting in the long term interests of consumers and highlights CIAL's approach to the ID regime; it is worth placing greater emphasis on.
- 12 Conversely, the message that the Commission is "not satisfied" regarding CIAL's profits for other regulated services is one of the first messages in the Draft Report and is vulnerable to misinterpretation by interested persons either directly when reading the Draft Report or

indirectly via media coverage. The Commission later identifies that other regulated services are complex and need a different, flexible and proportionate approach. CIAL agrees. The Draft Report may give the impression that the Commission has made a finding on these services, rather than that it's seeking feedback on possible approaches and intending to answer the question in a separate process. Some of the coverage of the Draft Report by media appears to illustrate this point.

Future engagement

- 13 We look forward to engaging with the Commission further on a number of topics in related processes and future pricing periods.
- 14 CIAL agrees with the Commission that other regulated services are different in nature to priced services, and is happy to engage in a process to understand and analyse those services and their associated revenue.
- 15 The Commission and airports are still working through how and when airports are justified in differing from the Commission's benchmark WACC inputs. We have not focused on this issue in this submission given that ongoing work and because the Commission's key finding is that CIAL is targeting reasonable returns in PSE3 based on the Commission's WACC with one adjustment for CIAL's credit rating. However we look forward to engaging with the Commission in the future and in the lead up to PSE4.
- 16 In this submission we do raise two further areas where the Commission can usefully clarify its expectations in relation to asset beta for airports' understanding for future price resets (starting at paragraph 48), and identify how the Commission might provide more contextual analysis to assist preparation for PSE4.

PART C: COMMISSION'S APPROACH

- 17 Overall the Commission has taken a positive approach in its analysis and Draft Report. CIAL supports the Commission's appropriate focus on expected profitability and pricing efficiency against the backdrop of the purpose of Part 4 of the Commerce Act.
- 18 The Draft Report highlights the effectiveness of the Information Disclosure (**ID**) regime. The ID regime has encouraged CIAL to be transparent about its prices and price setting approach, and cognisant of the Commission's WACC estimates and expectations around efficiency. Consequentially, as the Commission's Draft Report identifies, CIAL has set efficient prices targeted at earning reasonable profits, and is acting in the long term interests of consumers.
- 19 The Commission has taken a reasonable approach to assessing profitability. The Commission has:
- 19.1 rightly focused on CIAL's expected returns rather than its estimated cost of capital, ensuring a true understanding of forecast profitability in its full context. CIAL's forecast returns take account of incentives offered to airlines. In PSE2 CIAL's incentives offering resulted in actual earnings below the Commission's benchmark; and
 - 19.2 assessed profitability in the context of CIAL's true credit rating, not the standard rating used to calculate the Commission's WACC.
- 20 The Commission has also taken a reasonable approach to assessing pricing efficiency. The Commission agrees with the majority of airlines that CIAL's price structure is simple, transparent and likely to reduce airlines' exposure to demand risk. The Commission also identified that CIAL's price structure is conducive to important efficiency principles. Indeed, this was CIAL's intention; the price structure is efficient and matches CIAL's long term commercial objectives.
- 21 CIAL also supports the Commission's prioritisation of focus on CIAL's priced services as set through consultation with airlines. This approach is in line with the intention of the ID regime. 85% of CIAL's revenue is forecast to come from CIAL's priced airport services. Other regulated services are different in their nature, and better assessed in a considered and flexible manner.
- 22 There are several parts of the ID regime still being worked through and understood by the Commission, airports and other interested parties. In the following sections we discuss several of the outstanding topics covered in the Draft Report. Of particular note:
- 22.1 the Commission is rightly considering how to assess profitability over non-priced/other regulated services (discussed from paragraph 28);
 - 22.2 the Commission has provided a clearer indication of what it requires for any future departures from the Commission's standard asset beta. There are consequential details to work through and understand (discussed from paragraph 45); and
 - 22.3 the Commission has important feedback on the nature of pricing disclosure. CIAL wants to ensure it's clear exactly what is expected going forward (discussed from paragraph 67).

PART D: COMMENTS ON SPECIFIC ISSUES RAISED

Price structure

- 23 CIAL changed its price structure from 1 July 2017 to implement per passenger prices for airfield and terminal services, aimed at increasing the productive and efficient use of CIAL's terminal without incurring substantial additional capital expenditure. CIAL set:
- 23.1 one per passenger landing charge for use of the airfield; and
 - 23.2 different per passenger prices for use of the terminal, split by:
 - (a) international and domestic (non-regional), coming together gradually over PSE3. By FY22 CIAL's international and domestic (non-regional) prices will be the same, as CIAL intends for the long term; and
 - (b) regional, which represents a top up for services used in conjunction with the Regional Lounge but not covered by CIAL and Air New Zealand's Regional Lounge arrangements.
- 24 The Commission determined:³
- "Overall, Christchurch Airport's new charging structure does not raise significant efficiency concerns. Per-passenger charges are simple to understand, transparent and are likely to reduce airlines exposure to demand risk."
- 25 The Commission also noted that CIAL's prices were likely to encourage efficient changes in usage patterns, moving passengers "from the more congested regional terminal to the less congested integrated terminal", and were unlikely to result in cross-subsidisation.
- 26 The majority of airlines shared similar views during consultation, with BARNZ (for the majority of airlines) and Qantas Group strongly supporting CIAL's approach and noting its transparency and simplicity.
- 27 The Commission noted that airports should have regard to price stability over the long-term. This discussion resonates with CIAL; in general, CIAL agrees that long term stability (both in pricing and the regime) is important. CIAL took a principled and efficiency-driven approach to developing its price structure, as the Commission has acknowledged. As indicated throughout consultation, CIAL's price structure reflects its long term commercial strategy. The Commission's focus on stability and sending a consistent signal to airlines aligns with CIAL's commercial approach.
- ### **Approach to other regulated services**
- 28 The Commission is rightly considering how to approach other regulated services, and CIAL welcomes the invitation to engage on this issue.
- 29 Other regulated services make up approximately 15.5% of CIAL's Regulated Asset Base (**RAB**). The Commission identified that CIAL's returns over other regulated services were higher than those for priced services and higher than the Commission's WACC estimates. However, the Commission also acknowledged that:
- 29.1 other regulated services are set in a different manner and over different periods than the five-year period relevant to priced services and the Commission's WACC; and

³ Draft Report at paragraph 133.

29.2 many factors affect the appropriateness of returns on other regulated services.

30 The Commission has highlighted that:⁴

“[T]he approach we take, including any information and evidence we require to apply our approach, should be proportionate to the size of the risk presented by those other regulated services. An airport’s ability to earn excessive profits on these services is moderated by the fact that these services represent a relatively small proportion of the RAB at any one time; any excessive profits on priced services are likely to represent greater harm to consumers over the long-term.”

31 Other factors the Commission is seeking feedback on include whether greater flexibility is appropriate, how the Commission can ensure a consistent approach over time, and how to ensure the approach doesn’t set up harmful incentives applying to when parties use negotiated contracts.⁵

32 In the Appendix to this submission we provide some more information on CIAL’s current portfolio of contracts for the provision of other regulated services. This illustrates the complexity of the subject matter and the difficulty of drawing quick conclusions. Some key points covered include:

32.1 the variety of services supplied under these contracts;

32.2 the variety of counterparties to those contracts. Some are significant, well-resourced corporates, and some are smaller operators. Many are not consumers of priced services;

32.3 the differing degrees to which the services are competitive or easily marked to market;

32.4 there is a wide variety in the duration of the contracts, and how far into the terms of those contracts CIAL and its counterparties are; and

32.5 the nature of differences above and otherwise may well vary from airport to airport.

33 In short: CIAL agrees with the Commission’s suggested approach to considering profitability across other regulated services. A flexible and proportionate approach is appropriate.

Relevance of market rentals and rental reviews

34 With the exception of the Regional Lounge, the prices for the vast majority of other regulated services are set at “market rentals”, meaning that the price for the service in question is set having regard to the prevailing rent level in the broader commercial real estate market that is most relevant to the tenancy in question (i.e. office or industrial, and then reflecting the compatible grade of the facilities).

35 The rentals are also reviewed and where necessary re-determined at intervals, with reference to the prevailing market rent and, in some instances, with predetermined escalators (such as CPI) applying for the intervening period. The relevant review period will be agreed between the parties to reflect their own circumstances.

36 The Commission has asked what it can take from this reference to market rentals when considering the appropriate benchmark WACC against which to assess these contracts.

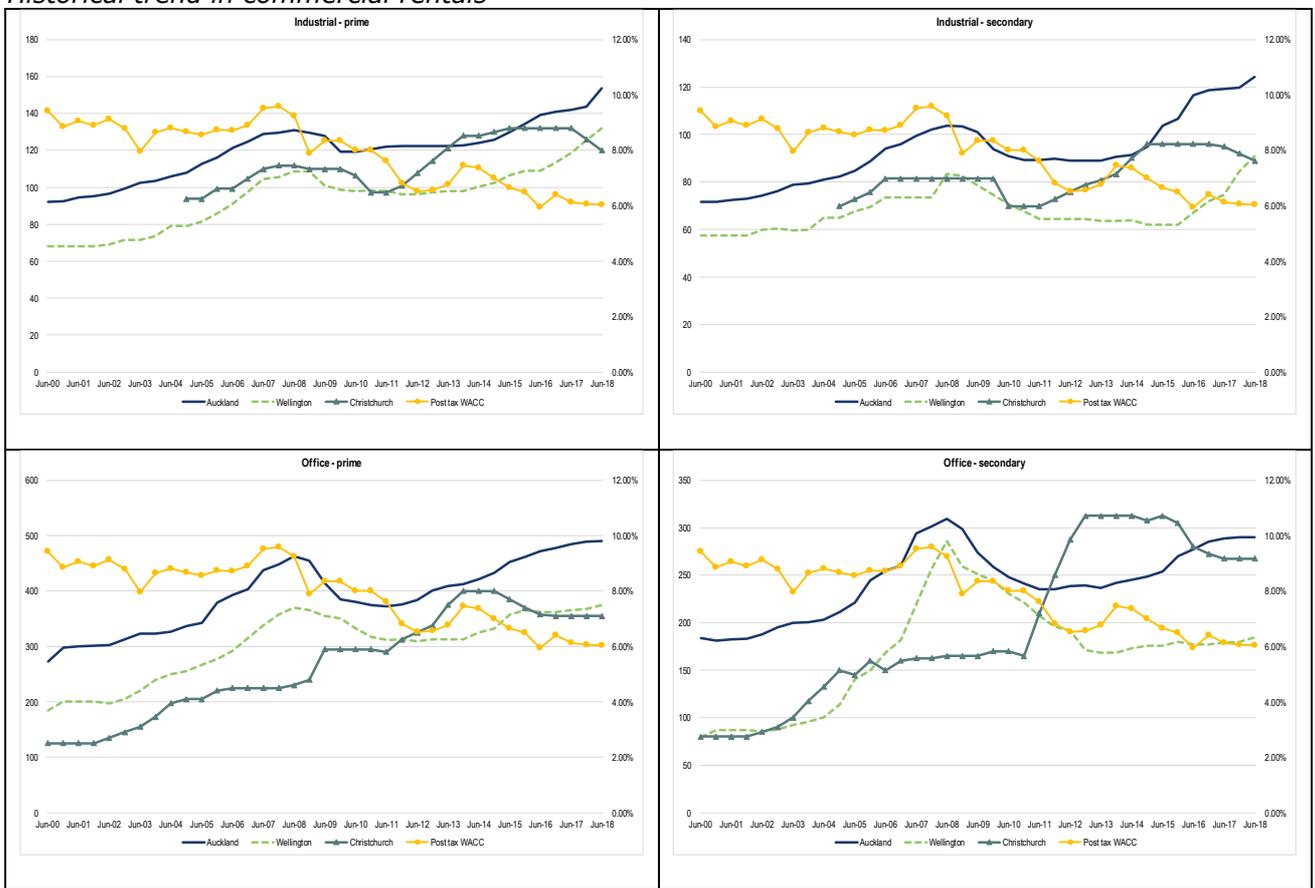
⁴ Draft Report at paragraph 128.

⁵ Draft Report at paragraph 126.

37 CIAL noted in earlier correspondence that its non-priced agreements are (on average) long term (weighted average term of between 6 and 26 years, depending on how options are treated), and many were entered into some time ago. The Commission observed that the resetting of rentals to the then prevailing market rental *may* have the effect of aligning rentals to be consistent with prevailing interest rates – and so justify using current interest rates when testing the returns under non-priced agreements.

38 However, an initial scan of available data suggests that the situation is more complex. In order to provide further insight into the behaviour of the commercial property market, we have sourced information on the historical trend in rentals.⁶ The data that we were able to obtain is for the industrial and office markets (and further subdivided into prime and secondary standards), being the properties that are most relevant to CIAL’s non-priced services. The data set that we were able to obtain extends back to June 2000, with two observations available per year (end June and end December). In addition, we have estimated the post-tax WACC prevailing at the same time (the Commission’s current parameters have been applied).⁷ The historical trend in the observed commercial rentals, as well as the post-tax WACC, are shown in the figures below.

Historical trend in commercial rentals



⁶ This information was sourced from JLL New Zealand. The figures on the left-hand vertical axis are the rentals expressed in terms of dollars per square metre per annum. The figures are not adjusted to reflect incentives provided as part of a lease.

⁷ That is, an asset beta of 0.60, tax-adjusted market risk premium of 7 per cent, leverage assumption of 19 per cent, 5 year term for the risk free rate and a 5 year term for the debt risk premium and A- credit rating have been applied. The risk-free rate and debt risk premium reflect averages over the month ending with 30 June or 31 December. The Commission’s published estimates of the airport debt risk premium have been applied from June 2011 (with values interpolated to generate end December values) and the Bloomberg fair value curve for A rated debt has been used for the period prior to this (C2615Y).

- 39 Some of the preliminary observations that we think can be drawn from these trends are as follows.
- 39.1 First, market rents have been observed to vary materially over time, reflecting (it would appear) aggregate demand and supply for commercial rents as well as other factors, like cost. This supports the proposition that “cost recovery” under a commercial rental arrangement is not uniform over time and also that pricing for services based on the market rent entails the acceptance of a degree of risk.
- 39.2 Secondly, the material increase in rents over the period (which exceeded CPI growth by some margin) appears to be consistent with the profile of cost recovery over time for commercial property being considerably “back-ended”.⁸
- 39.3 Thirdly, it is not obvious from the figures that market rentals are strongly linked to the prevailing WACC, as the Commission’s discussion surmised. For example, while the WACC has declined considerably over the period (by more than one third), market rentals have increased considerably overall, as noted above. In addition, while there was a general reduction in rentals after June 2008 (coinciding with the period immediately after the collapse of the Lehman Brothers bank and the worst of the Global Financial Crisis), the recovery in rentals occurred well before the rebound in interest rates. Moreover, the more recent fall in interest rates (i.e., since December 2013) has coincided with a strong general growth in rentals in most markets (the Christchurch commercial property markets being an exception).
- 40 As noted above, however, the observations above are only preliminary in nature, reflecting as they do an initial analysis of the data that we have obtained. Moreover, a proper test of the nature of the link between changes in the WACC and rentals would require a more sophisticated analytical exercise. To the extent they remain relevant, CIAL would be happy to engage with the Commission over these matters further, as further consideration is given to the appropriate means of testing the appropriateness of prices for non-priced services.

Next steps: assessment of other regulated services

- 41 The Commission is right to consult on and carefully consider how best to assess returns on other regulated services. As set out in the section above, these services are bespoke and commercially negotiated, and occur in a different context to airports’ five year pricing periods. A nuanced approach is required.
- 42 The Commission doesn’t need to determine its final approach to other regulated services now. These services run over multiple pricing periods and require different analysis to the priced services. As the Commission has identified, other regulated services are also small components of airports’ overall income. Other regulated services represent less than 16% of CIAL’s RAB and approximately 12.7% of CIAL’s total revenue.⁹

⁸ As the commercial property markets in question are competitive, it is reasonable to assume that a higher expected growth in rentals will result in a lower starting rent (although, being a competitive market, higher or lower returns than originally anticipated may result). A stream of payments that (within the constraint of generating an expected NPV=0) starts low and grows faster than CPI over time will imply back-ended cash flow / cost recovery.

⁹ The Commission has identified that approximately 15.5% of CIAL’s RAB is allocated to other regulated services. There are various ways to measure the relative significance of priced and other regulated services. For example:

- An alternative is to use the relative RIV (i.e. the value that includes any carry-forward adjustments), under which CIAL’s non-priced services are forecast to account for approximately 15% of the total.
- From a customer’s perspective, total revenue may be the preferred measure of significance (reflecting as it does the relative importance to customers’ bills). Non-priced services are forecast to account for approximately 12.7 per cent of CIAL’s total revenue.

- 43 One option for further discussion may be flexible oversight involving two stages. The Commission could:
- 43.1 run a filter over airports' returns on other regulated services (which could involve ex post review based on annual disclosure as well as analysis in response to pricing event disclosures such as in this process); and
 - 43.2 enquire further only if red flags are raised by the filter process, ensuring the Commission's time and resources are well spent, and recognising that other regulated services are an ongoing and changing revenue stream different to five year pricing periods.
- 44 CIAL welcomes further discussion on possible approaches open to the Commission.

Asset beta

- 45 The Commission has concluded that it has not been persuaded by the evidence presented by CIAL that a higher asset beta should be applied for CIAL (0.65) than the Commission's benchmark asset beta of 0.60.
- 46 CIAL appreciates the further guidance the Commission has given about the evidence that CIAL provided in its proposal and on the further matters the Commission would like to see addressed. CIAL will consider and reflect on this guidance when considering its pricing for PSE4.¹⁰
- 47 There are two matters upon which CIAL would appreciate further guidance from the Commission. We address each in turn below.

Points for further guidance

Clarification of the Commission's in-principle view

- 48 First, as the Commission will appreciate, outside of simple aggregate financial information a substantial effort is required to draw reliable comparisons between the characteristics of any of the New Zealand airports and those reflected in the Commission's asset beta sample, given that this sample spans 26 entities from 17 countries that currently operate 50 airports of material size.¹¹
- 49 Moreover, even after such an exercise, comparisons would most likely be subject to limitations and caveats. Thus, while CIAL is prepared to undertake the required work in the future if it would assist the Commission, we would also appreciate a clear confirmation from the Commission that the Commission is open to applying a different asset beta to the benchmark and that it does not have an in-principle view that a single asset beta should apply across the regulated New Zealand airports. The Commission has previously expressed a contrary opinion, which is replicated in the Draft Report, and for that reason CIAL would appreciate clarity that the Commission's views have evolved.

Factors most significant

- 50 Second, the Commission has also emphasised the importance of consistency across the New Zealand airports. We read this as implying that the Commission would require any case for an

¹⁰ We acknowledge the Commission's comment that Incenta's quantitative analysis (through an error) picked up an incorrect data series, and agree with the re-worked results the Commission derived. We observe that the Commission's correction left materially unchanged the results that Incenta advocated as the most informative (i.e., a simple comparison of CIAL's passenger beta measured over the longest period, against the passenger beta for the asset beta sample for the longest period for which data for that sample was available), but did deliver quite different results for the shortened period (2007 to 2016). This shortened period contained a number of unusual events for CIAL (including the earthquake, as well as 2008 which was an unusual year for the sector across all of New Zealand), and so we would caution against drawing too much from these results.

¹¹ This includes airports with more than 500,000 passengers per annum.

airport's asset beta to differ to the benchmark asset beta to reflect a consideration of all of the factors that may cause a difference in systematic risk. The concern here is to discourage each airport from just focussing on the factor(s) that are most advantageous to it.

- 51 While CIAL acknowledges this concern, it is also the case that a very large number of factors have the *potential* to cause a difference in systematic risk. Noting the previous comment about the extent of the task to draw reliable comparisons with the entities in the benchmark asset beta sample, it would be of substantial assistance for the Commission to be forthcoming about the factors that it considers to be most significant in terms of their potential to cause a difference in systematic risk. This will assist in focussing our efforts and consultation, as well as avoiding possible surprises during the Commission's process.

Other considerations

- 52 CIAL notes that during its preparations for PSE3, the Commission was open to discussing at an early stage the challenges of transitioning from CIAL's previous "long term price path" approach to pricing and CIAL's proposed response of an approach that preserved the key objective (i.e., a more efficient spreading of cost recovery over time) whilst improving the transparency. As noted elsewhere in this submission, the limited treatment of this matter in the Draft Report is testament in part to the success of those constructive discussions.
- 53 CIAL would be available for, and very much welcome, a similar level of constructive engagement with the Commission at an early stage during preparations for the PSE4 price review on matters that are expected to be significant for the Airport, of which the data and analysis required for asset beta is expected to be one.
- 54 The Commission also noted in its Draft Report that the systematic risk caused by leisure based inbound international passengers may be much lower than that associated with leisure based domestic and outbound international passengers. This was not an issue that was raised during consultation, including by the experts (Incenta did not address this issue because its accounting beta exercise was intended to estimate directly the effect of all passengers on systematic risk).
- 55 CIAL notes, however, that whether the systematic risk associated with inbound international passengers is low will depend upon the countries from which those passengers originate and, specifically, the extent to which the share markets of the countries of origin move in line with the New Zealand share market, which is something that will differ across countries (and potentially also across airports). CIAL notes that around two thirds of inbound international passengers into New Zealand originate from Australia, China, the UK or the USA, and that the share markets of which have (at least in recent times) moved closely with the New Zealand share market. Noting the Commission's interest, this is a matter that CIAL would expect to undertake more work on in preparation for PSE4.

Demand

- 56 CIAL forecast PSE3 demand with expert assistance from Three Consulting. The Commission has accepted CIAL's demand forecasts, raising no concerns with the forecasts underpinning CIAL's expected returns.

Prices and demand responsiveness

- 57 The Commission raised no concerns with CIAL's expectation that the new price structure would not materially affect overall demand. However, the Commission did query this position in the context of CIAL's transitional path to gradually introduce changes in terminal prices by the end of PSE3.

- 58 The Commission quoted CIAL’s additional information provided, noting the Commission read it as indifference to consumers’ demand responsiveness:¹²
- “Importantly, [our] price structure is set on a per passenger basis and ensures that [we] remain[n] indifferent to the type of demand – which types of aircraft airlines use, load factors and numbers of aircraft, **and whether passengers are travelling to/from international or domestic locations.**” (emphasis added by Commission)
- 59 CIAL is not indifferent to the number of final passengers (which now drives CIAL’s revenue more directly than the previous per-aircraft pricing approach).
- 60 Conceptually, there are two different demand responses:
- 60.1 the response of airlines regarding their decisions over type and quantity of aircraft capacity; and
- 60.2 the response of passengers to changes in the final ticket prices as a result of changes to aeronautical prices paid by airlines.
- 61 The statement quoted clearly focuses on the first of these – CIAL’s indifference to **airlines’ choices** about types of aircraft, load factors, and routes.¹³ CIAL set a price structure that avoided providing airlines with an incentive to alter behaviour where it was not related to CIAL’s forward-looking costs (as well as being compatible with the most efficient use of the terminal). The Commission approved of this approach.
- 62 Indifference as to airlines’ commercial decisions is not equivalent to indifference to the final number of passengers. In fact, CIAL’s per passenger price structure means passengers directly drive its revenue.
- 63 CIAL has acknowledged difficulty determining how different groups of passengers will respond to changes in airport prices. In particular, this difficulty arises because:
- 63.1 CIAL has no control over the extent to which airlines pass through aeronautical charges to final customers; and
- 63.2 regardless, CIAL isn’t in a position to judge the impact of small changes in airline-ticket prices to demand.
- 64 As a result, CIAL did not attempt to differentiate prices depending on the nature of the passenger (i.e. point of origin or destination) except in relation to true regional passengers, who use the Regional Lounge facility subject to CIAL and Air New Zealand’s Regional Lounge arrangements.
- 65 CIAL was nonetheless mindful of how changes to price structure may promote demand growth or the interests of passengers more generally. For example, CIAL’s price structure encourages:
- 65.1 airlines to introduce new capacity earlier than otherwise – a consequence of charging only on the basis of passengers actually travelling;

¹² Draft Report at paragraph 206.

¹³ The reference to “whether passengers are travelling to/from international or domestic locations” is a reference to airlines’ route decisions, not to the number of passengers. It shows indifference on where passengers come to/from – an airline route decision facilitated by CIAL’s price structure – not on whether any passengers come to/from the Airport at all.

- 65.2 new entry – and hopefully stimulation of greater competition – via a simpler tariff structure and one that places less risk on the airline; and
- 65.3 direct international flights in preference to hubbing through another New Zealand airport to avoid higher international landing fees, offering passengers greater convenience.
- 66 During consultation CIAL added a transitional price path in response to concerns from Air New Zealand and a statement it might withdraw capacity from regional destinations. For example, Air New Zealand noted during consultation and before CIAL proposed the transitional path that CIAL’s price structure, endorsed by all other airlines, would “inevitably result in review and reconsideration of the level of service offered by Air NZ across its network.”¹⁴ The transition does not reflect an assessment by CIAL that passenger demand itself would respond differently with or without the transition.

¹⁴ Air New Zealand submission to CIAL of 5 May 2017 at paragraph 42.

PART E: RELEVANCE OF THE INFORMATION DISCLOSURE REGIME

- 67 CIAL aligned its PSE3 pricing approach with the Input Methodologies/Information Disclosure regime, and on 14 August disclosed information in compliance with the Commission's ID templates, as set out and explained in the Airport Services Information Determination 2010 (as periodically updated).
- 68 The ID regime is an important driver of CIAL's behaviour. CIAL calculated its allowable revenue in accordance with the Input Methodologies and placed a strong emphasis on transparency and simplicity in consulting on, setting and disclosing its PSE3 prices. In particular, concerning transparency:
- 68.1 As the Commission notes, CIAL engaged with its substantial customers in a thorough and transparent manner while setting its PSE3 prices:¹⁵
- "BARNZ acknowledged that the airport consults with its substantial customers and provides a detailed model showing how the prices are derived from input costs and other assumptions."
- 68.2 CIAL's key change – the new price structure – was made in order to increase transparency and was consulted on in a transparent manner, as the Commission and the majority of airlines agreed:¹⁶
- "Based on the information provided and stakeholders' views, Christchurch Airport appears to have engaged considerably with its customers regarding its significant changes to its pricing structure. In particular, the simplicity of per-passenger prices helps provide transparency to airlines about their respective charges."
- 68.3 CIAL kept other key stakeholders informed throughout its PSE3 consultation process, providing consultation material to its other customers (e.g. freight companies) and the Commission.
- 68.4 CIAL completed its 14 August 2017 pricing event disclosures in accordance with the Commission's template, along with an explanatory note. CIAL staff were made available to the Commission to answer any questions as the Commission undertook its analysis and prepared its Draft Report.
- 69 Section 53B(2)(b) of the Commerce Act is the provision requiring the Commission to publish a summary and analysis of pricing disclosure information "for the purpose of promoting greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time." CIAL believes the information disclosure regime has been effective, prompting CIAL to disclose information and engage fulsomely with the Commission.

Learnings for future pricing periods

- 70 The Commission has suggested that CIAL "could have been more transparent about its intentions behind its charging structure, and the relevant impacts on different customer groups, in its PSE3 disclosure... [The Commission's] understanding and views on Christchurch Airport's charging structure was shaped by material provided by the airport after consultation closed."

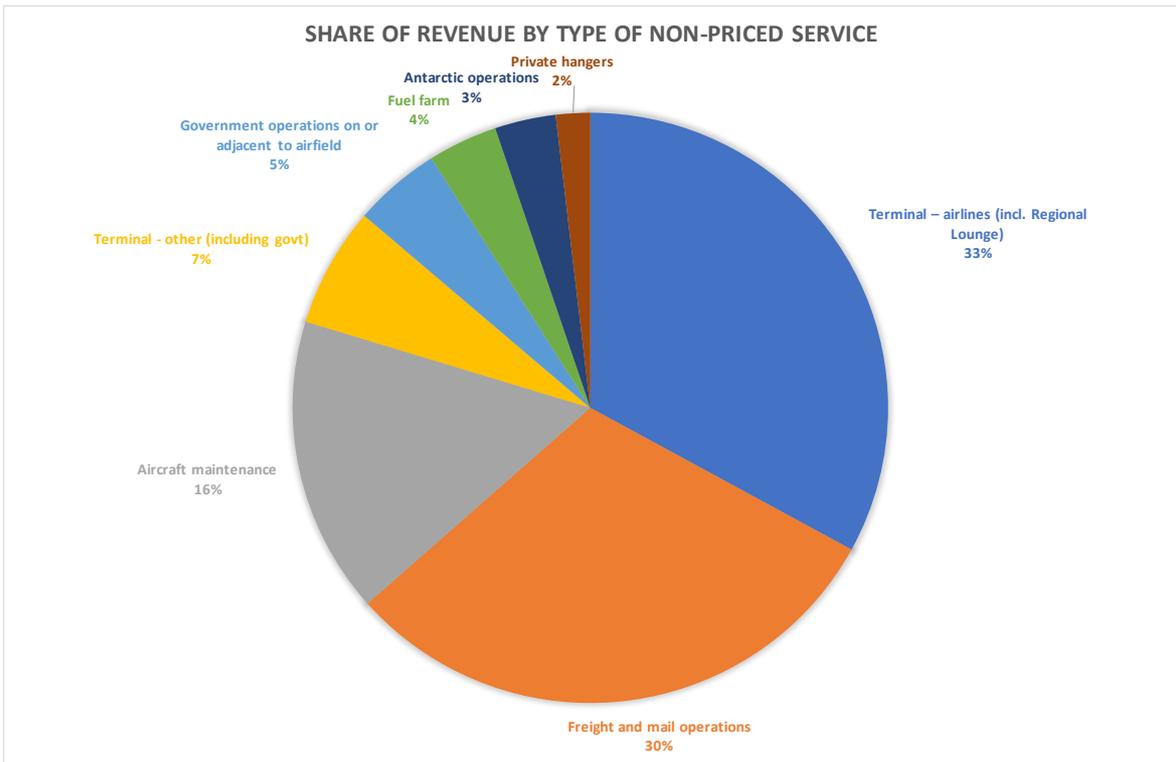
¹⁵ Draft Report at paragraph 222.

¹⁶ Draft Report at paragraph 223.

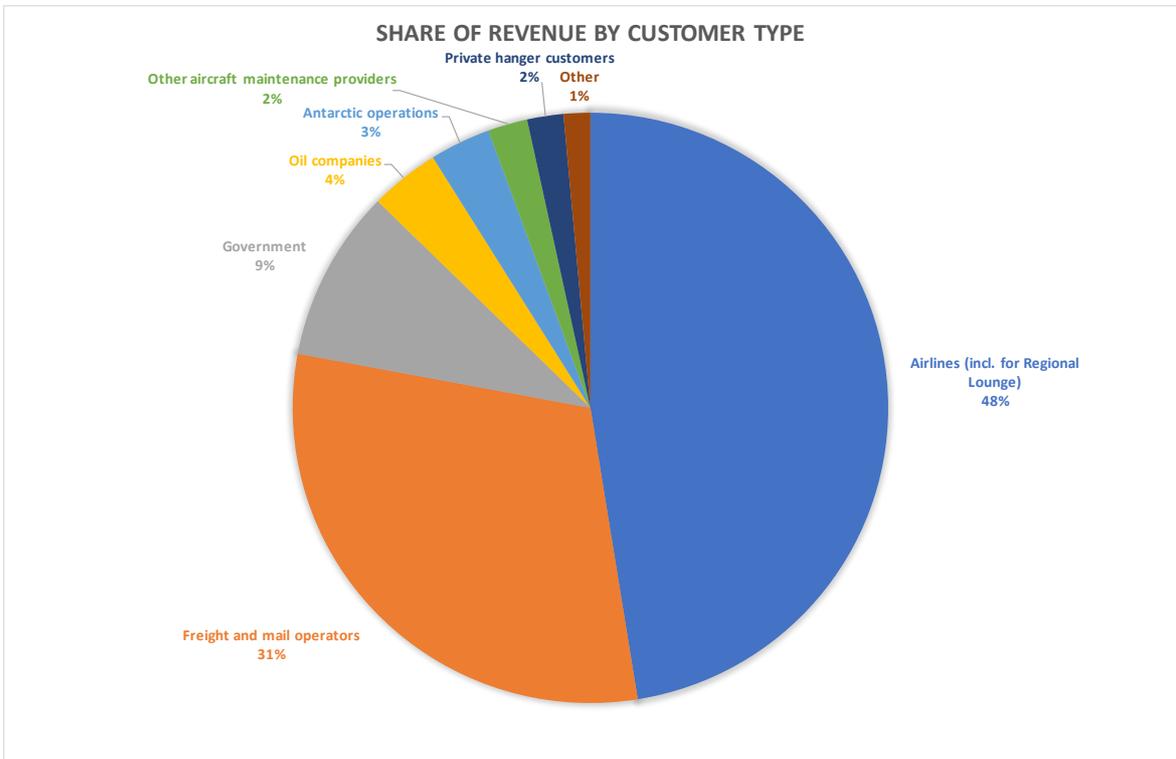
- 71 CIAL will take this feedback into account in future disclosures, and in particular will reassess how CIAL uses the prescribed information disclosure templates. However, we don't agree there's a transparency concern per se. In particular:
- 71.1 as above, CIAL's substantial customers were consulted with and understood CIAL's price structure. The Commission and other stakeholders were given the same information throughout. CIAL provided all formal consultation material with its November 2017 response to the Commission's PSE3 process and issues paper, for publication on the Commission's public website;
 - 71.2 CIAL's price structure is simple and transparent in and of itself, as identified by the Commission and the majority of airlines; and
 - 71.3 CIAL completed the information disclosure templates in full, as well as providing an additional explanatory note not required by the ID regime. Further information was provided in response to the Commission's questions to further assist the Commission in analysing CIAL's performance.
- 72 Transparency matters to CIAL. If the Commission's position is that airports need to explain decisions differently in or outside the disclosure templates, or explain the impact on a wider set of potentially interested parties, CIAL would like to understand that position going forward. In setting out its position, the Commission should be mindful not to create a perverse incentive for airports to cease engagement after pricing disclosure. The Commission's role in promoting greater understanding of airport performance is an important one, and helped by ongoing airport engagement.
- 73 CIAL believes that the quality of information and explanation to various audiences during consultation, disclosure and engagement with the Commission was good, and would like to see that recognised.
- 74 CIAL was available to answer questions at all times and made its consultation material public at the beginning of the Commission's s53B process, reflecting a transparent approach. CIAL's pricing decision was the outcome of seven months of extensive consultation with substantial customers, and the majority through BARNZ considered that consultation was extensive. CIAL will keep working with airlines during PSE3, responding to any queries and dealing with customers' operations teams at the Airport on a day-to-day basis.
- 75 We will take on board the Commission's preferences about when and in which format information is provided for future pricing decisions and disclosures. The ID regime appears to be driving the right incentives and as the Commission and airports continue to learn it will promote increasingly greater understanding for users of airport services.

APPENDIX: ADDITIONAL INFORMATION ON CIAL'S OTHER REGULATED SERVICES

- 76 CIAL's other regulated services are those services provided (mostly leases) inside CIAL's RAB but subject to agreed commercial terms. They can be grouped into the following categories:
- 76.1 *Terminal activities (Regional Lounge)* – which is the long term, non-exclusive lease by Air New Zealand for the Regional Lounge;
 - 76.2 *Terminal activities (airlines)* – which are office areas in the terminal leased by the airlines for their own operational activities as well as airline lounges;
 - 76.3 *Terminal activities (other)* – which are office areas in the terminal leased by other parties, comprising providers of services and government agencies (including customs and immigration);
 - 76.4 *Freight and mail operations* – which are leases for land and buildings that are used for freight forwarding activities. Lessees include NZ Post and CourierPost;
 - 76.5 *Aircraft maintenance* – which are leases for land and buildings that are used for aircraft maintenance activities;
 - 76.6 *Government operations on or adjacent to the airfield* – which are leases for land and buildings for government operations such as AVSEC, customs inspection facilities and Airways' radar sites;
 - 76.7 *Antarctic operator* – which are leases for the land and buildings that are used for Antarctic operations;
 - 76.8 *Fuel farm* – which are the common facilities that are used by the oil companies for the delivery of aircraft fuel;
 - 76.9 *Private hangers* – which are hangers used by smaller commercial operators, the Canterbury aero club and private individuals.
- 77 The relative contribution of each of these categories of service to CIAL's actual other regulated services revenue for FY18 is shown below.

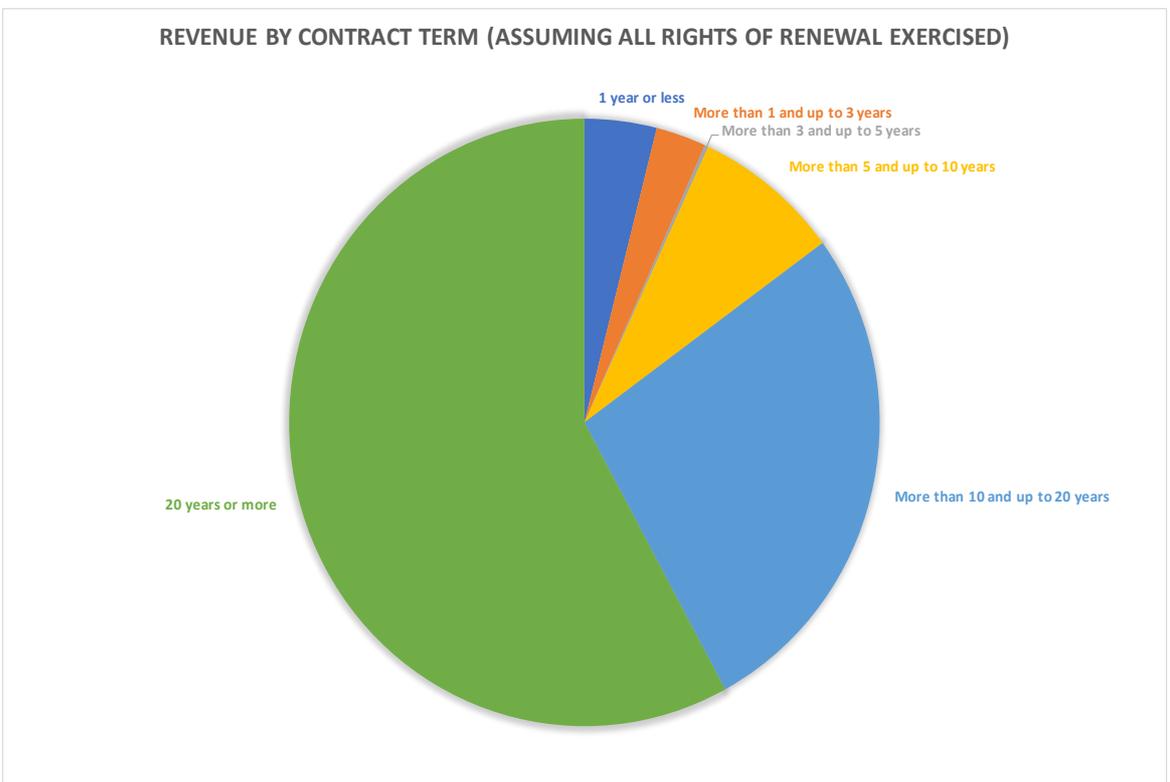
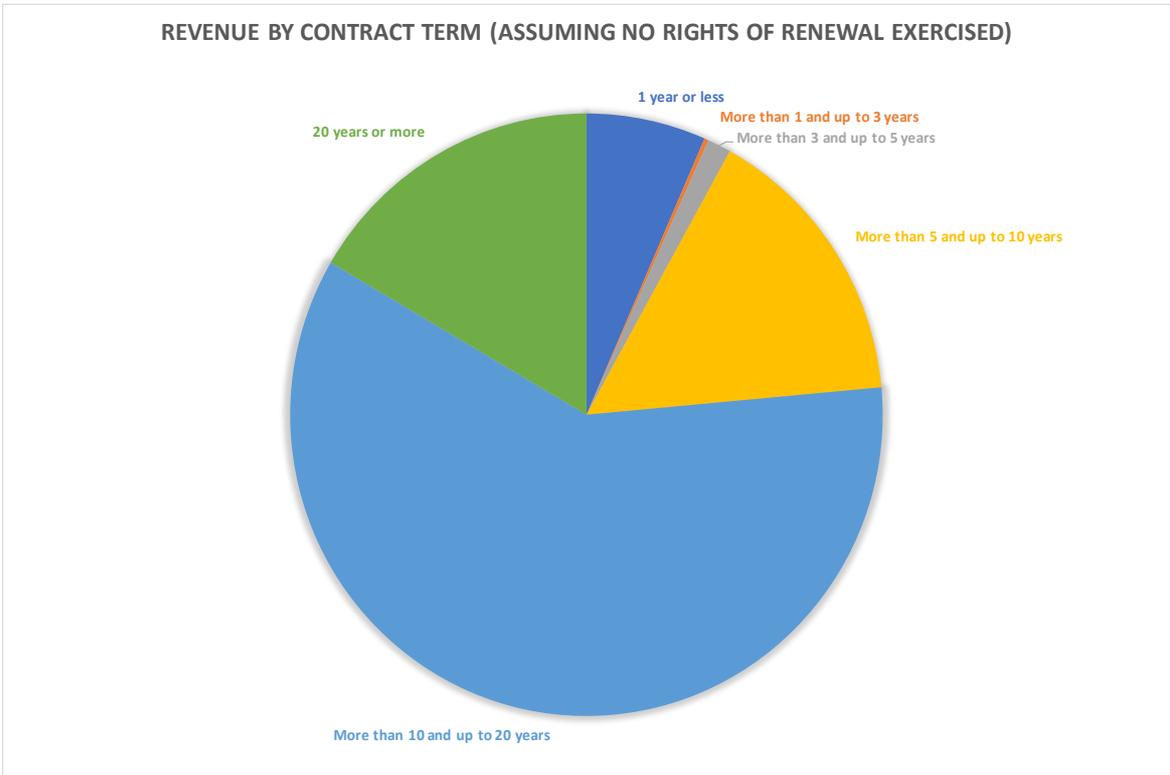


78 As the description of the nature of the services above would suggest, there is a range of different direct customers for the services, which includes the airlines (both as users of the terminal and for aircraft maintenance purposes), freight and mail operators, and oil companies. The relative share of revenue for the 2017/18 financial year across the various groups of customers to whom CIAL provides other regulated services is shown below.¹⁷

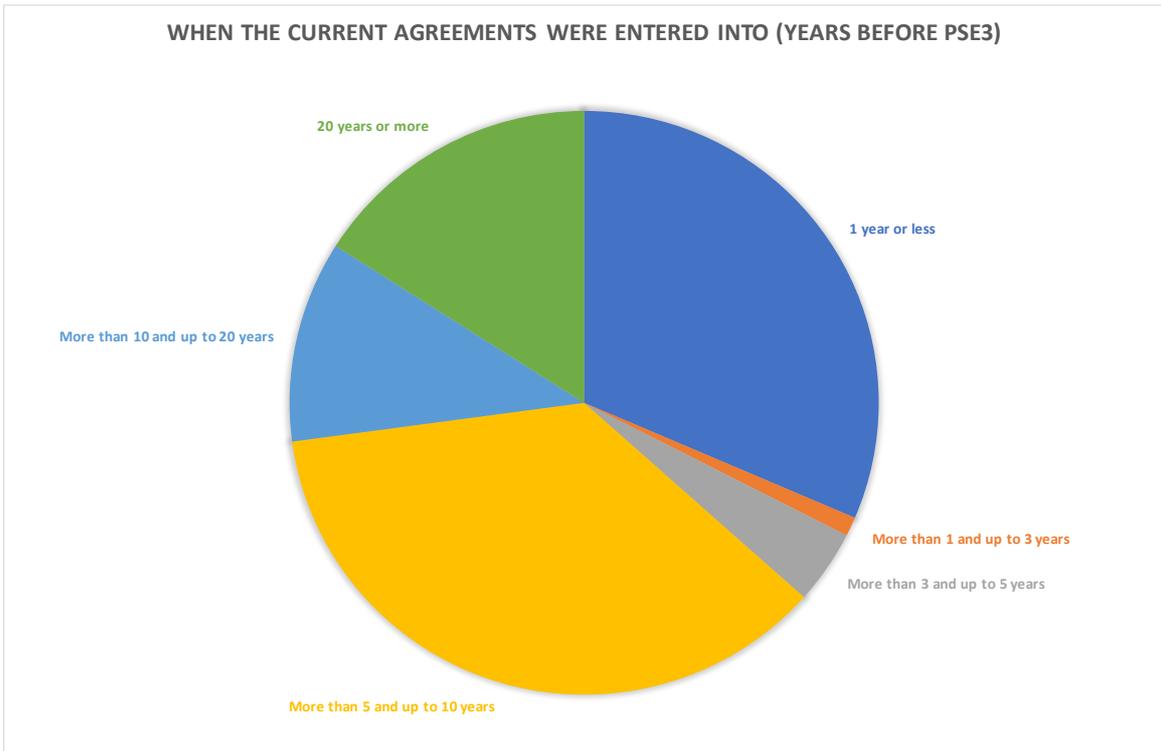


¹⁷ Again, the amounts spent by airlines on the Regional Lounge have been separated out in view of the unique charging basis for those services.

79 Finally, in earlier correspondence, CIAL also observed that many of the agreements with customers are long term in nature. The charts below provide this information pictorially. In calculating the maximum term of the various arrangements, the first chart excludes customers' rights of renewal (i.e. assumes no renewal) and the second chart assumes customers take up all rights of renewal.



80 In addition, many of these agreements were entered into some time ago. The chart below shows amount of revenue that is derived according to the years before the start of PSE3 that the relevant agreements were entered into.





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