11 April 2019

INTRODUCTION

1. This is the New Zealand Airports Association (**NZ Airports**) submission on the Commerce Commission's (**Commission**) draft decision "Airport Services Information Disclosure (Backward Looking Profitability) Amendments Determination 2019" (**Draft Decision**).

2. The affected airports – Auckland International Airport Limited (**AIAL**), Wellington International Airport Limited (**WIAL**) and Christchurch International Airport Limited (**CIAL**), and together (**Airports**) – have been involved in the preparation of this submission.

3. The NZ Airports contact for this submission is:

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4. NZ Airports appreciates the opportunity to attend the workshop, held on 22 February, and to make this submission.

EXECUTIVE SUMMARY

5. The Airports recognise, and accept, that the Commission is seeking to enable a better understanding of airport performance.

6. We understand the intent of the Commission's approach to achieve the desired outcomes in the annual information disclosures, but we have some concerns over the level of detail that will be required.

7. We are concerned that the proposed level of information is more likely to hinder rather than help interested persons, while also requiring a considerable increase in resource to prepare the disclosures, and then for subsequent review by auditors and management/ directors of the Airports.

8. We have two particular concerns.

   (a) The substantial increase in the level of detail required which includes potential duplication of explanations between schedules and confusion between annual and period variances.

   (b) The change in the guidance on materiality, where airports will be required to provide "reasonable" explanations, is not consistent with the quantum of variances that the Commission is proposing will require explanation throughout the schedules.

9. To resolve these issues NZ Airports proposes that:

(a) Variance analysis is required for schedule 1 only. The financial items contained in the supporting schedules 2, 4 and 6 are all inputs to the IRR calculation and consequently containing the variance explanations to one schedule will address all financial items while also enabling cohesion in the commentary focussed at explaining any differences from expected returns.

(b) Variance explanations should only be required for pricing period to date outcomes, but with a reasonable expectation that unexpected major events or diversions from forecast in any particular year, will form part of the period to date commentary.

PROPOSED AMENDMENTS TO ANNUAL DISCLOSURE REQUIREMENTS

Overall Objective

10. NZ Airports appreciates that the Commission's objective is to develop changes to the annual information disclosure templates which will enable comparison of actual financial outcomes to the forecast information published following airport price setting events.

11. This is intended to improve the opportunity for the Commission and other interested parties to understand and analyse airport performance.

12. We understand the intent of the Commission's approach to achieve the desired outcomes in the annual information disclosures, but we have some concerns over the level of detail that will be required.

Profitability Assessment

13. The Airports agree that it is appropriate to replace the previous Return on Investment **(ROI)** calculations with an internal rate of return (**IRR**) approach consistent with the forecast approach published in price setting disclosures. The Commission are now proposing to extend the annual disclosures to require annual and pricing period IRR's to be considered.

14. NZ Airports remains concerned that the way the changes have been proposed in not only schedule 1, but also the supporting schedules 2,4 and 6, results in an inappropriate level of focus being given to annual outcomes which is not consistent with the pricing period approach taken by the airports.

RAB and Pricing Asset Base Profitability Assessments

15. NZ Airports appreciates that the Commission has recognised the additional layer of complexity that would be required if separate information disclosures were required for the pricing asset base in addition to the total RAB.

16. NZ Airports also recognises that this approach may require the Commission to seek further information from the airports when it undertakes its intended review of financial outcomes from non pricing assets.

Comparison to Forward Looking Profitability Assessment

17. The Airports recognise that the Commission is seeking to enable a better understanding of airport performance. However, in our view the quantum and level of detail required in the Commission's amended annual information disclosure templates is excessive.

18. It is not evident from the Reasons Paper as to how the Commission considers this level of detail is necessary to contribute to the achievement of the Commerce Act part 4 objectives, and to ensure airports are limited in their ability to earn excessive profits. In an information disclosure context where the Commission undertakes extensive review of the price setting process, including the consultation forecast approaches and outcomes, subsequent ex post review should be a follow up to the price setting review rather than establishing a substantial stand-alone process.

19. We are also concerned that the proposed level of information is more likely to hinder rather than help interested persons, while requiring a considerable increase in resource to prepare the disclosures, and then for subsequent review by auditors and management/ directors of the Airports.

20. The Commission is proposing a substantial increase in the quantum of explanations required to explain variances in actual outcomes from forecasts.

21. This is being proposed through the addition of variance analysis requirements to schedules 1, 2 and 4, in addition to the analysis already required in schedule 6.

22. The Commission's greatly expanded approach to variance analysis will result in an overwhelming amount of information that could confuse interested persons due to:

    (a) The level of duplication required. All the items where forecast variances are to be explained are in at least one of the schedules and some more. Consider:

        - Explanations in respect of revenues will be required in schedules 1 and 2.
        - Explanations in respect of operating costs will be required in schedules 1, 2 and 6.
        - Explanations in respect of the RAB will be required in schedules 1 and 4.
        - Explanations in respect of assets commissioned will be required in schedules 1 and 4, while explanations concerning capital expenditure will be required in schedule 6.

    (b) Confusion between annual and period to date variance explanations. Schedules 1 and 6 require comment on annual and period variances, while explanations are only being sought for annual variances in schedules 2 and 4.

    (c) The implicit requirement that comment must be provided for every line item disclosed in the schedules when in fact not all the variances may be significant to the difference in profitability. This could be due to:

        - Materiality;
        - Compensating or offsetting variances between sub items. For instance, an airport may receive total revenue that is consistent with forecast but there may be ups and downs in contributing line items; or to
        - Transfers between items or to changes in services between activities.

Materiality

23. The Commission commented in the Reasons Paper that it proposes to remove the guidance on materiality, from the current schedule 6. This guidance provides a threshold of 10% to determine whether explanations for differences from forecast are required.

24. While not referred to by the Commission in the Reasons Paper we note that the proposed changes to the Determination now offer guidance on materiality in clause 2.3(9):

> *In completing the Report on Profitability set out in Schedule 1, the Report on Regulatory Asset Base Roll Forward set out in Schedule 4, and the Report on Actual to Forecast Performance set out in Schedule 6, for variances specified, airports must provide reasonable explanatory comments on the variance between actual and targeted revenue and forecast expenditure to allow interested persons to understand actual returns relative to forecast returns.*

25. NZ Airports supports the approach from the Commission to seek “reasonable” explanations from the airports. We note however that “reasonable” may in fact mean no comment at all if a variance is not material or significant to the change in profitability. The proposed level of detailed disclosure by the Commission is not conducive to a reasonableness approach as it implies all variances need to be explained.

26. For the record, we note that clause 2.3(9) refers to explaining variances related to revenue and expenditure but it does not refer to the explanations that may also be required relating to changes in the forecast asset base.

Proposed Solution

27. NZ Airports considers that the disclosure requirements can be substantially reduced while achieving more cohesive and transparent commentary on the airport performance outcomes.

28. NZ Airports proposes that:

    (a) Variance analysis is required for schedule 1 only. The financial items contained in the supporting schedules 2, 4 and 6 are all supporting detail for the inputs to the IRR calculation and consequently containing the variance explanations to one schedule will address all financial items included in the profitability calculation, while also enabling cohesion in the commentary focussed at explaining any differences from expected returns.

    (b) In preparing the required commentary the airports will be expected to have regard to the supporting schedules (2, 4 and 6) and to ensure that any material variations from forecast for large line items be they revenue, operating expenditure or capital projects, or differences in financial outcomes due to changes to services or business, are appropriately explained.

    (c) Variance explanations should only be required for pricing period to date outcomes, but with a reasonable expectation that unexpected major events or diversions from forecast in any particular year, will form part of the period to date commentary. Early in the pricing period the commentary will reflect annual outcomes in any event, while later in the pricing period it is the achievements in the period to date that become more relevant.

(d) The Commission, and other interested persons, will still have visibility of all forecast and actual outcomes in the supporting schedules to enable them to ensure that the variance commentary provided by the airports is appropriate.

Inclusion of Monthly Assets Commissioned in IRR Calculation

29. While this issue is not a major concern there are two issues that we wish to comment on for the Commission's consideration.

Requirement for Monthly Cash Flows

30. The Commission has commented that while the recognition of monthly cash flows for commissioned assets is not consistent with pricing assumptions it will allow interested persons to make more accurate assessments of backward-looking profitability.[1]

31. The Commission has not commented on why the more detailed disclosure is necessary to evaluate whether airports are earning excessive profits. We question whether this level of disclosure is needed because:

(a) Different disclosure requirements in forward and backward-looking disclosures, while creating timing differences in cash flows and returns, will not provide any indication of changes in airport's planning assumptions or behaviours. Consequently, this does not provide any help in considering the excess profits issue.

(b) Changes in airport planning or achievement of capital expenditure projects will be evident if a consistent annual mid point assumption is used for assets commissioned cash flows, in forward and backward disclosures, and the value of projects or timing of project delivery is changed. That is, monthly cash flows are not required to identify these issues.

(c) The airports will be required to explain variances from planning assumptions in their commentary on differences from forecast, rather than explaining why there may be a variance in the IRR that arises from the different timing of asset cash flows.

Consistency of Cash Flow Assumptions if Monthly Cash Flows Retained

32. The Commission's backward looking IRR template base assumption is that capital projects are commissioned at the end of each month, with capitalised interest also included until each month's end.

33. In the pricing (forward-looking templates), the Commission's default is that capital expenditure occurs at the mid-point of each year. This is approximately equivalent to assuming that capex occurs at the midpoint of each month, and is then evenly spread over the months.

34. In our view there should be consistency in the cash flow assumptions for the forecast and backward looking IRR calculations.

[1] Commerce Commission, Airports backward-looking profitability information disclosure amendments, Draft reasons paper, 28 March 2019, paragraph 67

Comments on Determination and Template Amendments

35. There are several other more minor comments or observations we have on the wording in the Draft Decision.

36. These are provided in the Appendix to this submission.

CORRECTION TO OTHER DEFINITION

37. A technical error has been identified in the definition of interruption included in the ID Determination. We are requesting that the Commission use the opportunity provided by this consultation to correct this definition.

38. We consider that the correction is not controversial and that the airlines and BARNZ will be able to confirm this in their cross submissions.

39. The relevant Determination definition is as follows:

interruption	*means, in relation to any **specified airport service** provided by an **airport**, the withdrawal by the **airport** of that service for 15 minutes or longer, at a time when the service was required by a **scheduled** aircraft (or to process the **passengers** on a **scheduled** aircraft), but does not include:* *(a) **planned withdrawals**; or* *(b) the withdrawal of **runway services** [OUR EMPHASIS] necessitated by weather conditions; or* *(c) withdrawals of any services operated and managed by a third party and that are not being provided on behalf of, or under contract with, the **airport***

40. A correction is needed to recognise that weather related interruptions affect more than just runway services and consequently weather related interruptions that result in the withdrawal of any specified airport services should be excluded. Other services than can be impacted are:

(a) Taxiway (for example, can be fog constrained in the same manner as the runway);

(b) Remote stands requiring bus embarkation (for example, can be by impacted by fog, lightening or high winds); and

(c) Contact stands (for example, can be impacted by high winds).

41. We request that the Commission takes the opportunity to correct this definition by changing sub paragraph (b) above by either:

(a) Removing the word “runway” from the definition; or

(b) Changing the wording “runway services” to “any specified airport services”.

APPENDIX – DETAILED COMMENT ON DRAFT DETERMINATION AMENDMENTS

Note

Determination reference in table is to “[DRAFT] Airport Services Information Disclosure (Backward-looking Profitability) Amendments Determination 2019”

Annual Templates Reference in table is to “Specified Airport Services Information Disclosure Requirements Information Templates for Schedules 1-17, 25”

Pricing Templates Reference in table is to “Specified Airport Services Information Disclosure Requirements Information Templates for Schedules 18-20”

Document	Reference	Comment
Determination	Table of Contents, page 3	Title to be amended to “Report on Profitability” not Report on Return on Profitability
Determination	Definitions of “actual for current disclosure year” and “actual for period to date”	The amendments restrict these definitions to apply to revenue, opex and IRR only, while the templates in schedules 1 and 6 also indicate values are required for a range of other items. Suggest these definitions are amended to refer more generically to financial information for the current or period to date as indicated in the Schedules.
Determination	Definitions of “forecast for current disclosure year” and “forecast for period to date”	The amendments restrict these definitions to apply to revenue, opex and IRR only, while the templates in schedules 1 and 6 also indicate values are required a range of other items. Suggest these definitions are amended to refer more generically to financial information for the current or period to date as indicated in the Schedules.
Determination	Definition of “opening carry forward adjustment”	This definition has been amended to accommodate the new schedule 1. However, the definition is now not correct within the context of schedule 18. This could be rectified by the term in cell G41 of schedule 18 being amended to “forecast opening carry forward adjustments” and the previous definition of “opening carry forward adjustment” being reinstated for the new term.
Determination	Definition of “other carry forward adjustment – not forecast”	We are unclear as to the rationale as to why this item is required. We cannot contemplate a situation where an unforecast item of this nature would be required. Could the Commission provide further comment on the requirement for this item?
Determination	Assets Held for Future Use Definitions	There are several issues with the definitions utilised for AHFU that could be considered further: 1) All the distinct definitions for terms used in the forecast and actual variants of AHFU have not been proposed; *E.g. the only definition for the AHFU forecast movements is for revaluations whereas there are several other forecast movements not defined.*

Document	Reference	Comment
		and 2) Some of the existing definitions require amendment to recognise the changes in the Schedule 4 annual disclosure. *E.g. existing definition for "opening base value" and "opening tracking revaluations" refer to values at the start of a pricing period whereas these terms are also used in the revised annual disclosure template which require these values to be at the commencement of the disclosure year.*
Determination	Paragraph 2.3(1)(a)(i)	Title is to be amended to "Report on Profitability" not "Report on Return on Profitability"
Determination	Paragraph 2.3(7)(a) & (b)	This requires part year disclosure outcomes to be treated consistently with the price setting disclosures that relate to the part years. The intention of this clause is appropriate but the wording in sub clause (a) and (b) should be altered to read "include information for the period" rather than "disclose information for the period". If part year outcomes were to be separately disclosed the airports would have to be provide two separate disclosures for the relevant years rather than one which reflects the total outcome for the disclosure year, with explanation then provided in accordance with sub paragraph (c) ensuring transparency of the impact of the new pricing on the disclosure year.
Determination	Paragraph 2.3(9)	This clause comments that the intent of the commentary on variances is to provide a reasonable explanation of to enable an understanding of actual returns relative to forecast returns. Requiring commentary to be provided in multiple schedules will create the opportunity for confusion. This clause should relate to Schedule 1 only. (Refer to the further detailed comments in the body of this submission).
Determination	Paragraph 2.3(9)	The clause wording as it stands is also a bit more constrained than we presume the Commission intends. The clause requires comment on actual and target revenue and forecast expenditure which does not include variances on other items such as the RAB or asset movements. We suggest the requirement should be to provide comment on variances between actual and forecast outcomes.
Determination, Annual and Pricing Templates	Sign of Carry Forward Adjustment	The definitions of Investment Value in the Determination note that this is the sum of; *RAB – Carry Forward Adjustment* which means that if the carry forward adjustment is negative the Investment Value increases from the RAB.

Document	Reference	Comment
		The presentation in the templates is therefore counter intuitive. We suggest the disclosures may be clearer to interested persons if the opposite approach is taken and increases in the investment value are depicted by a positive carry forward adjustment, and vice versa.
Annual Templates	Schedule 1	Suggest guiding sentence, as provided in clause 2.3(9) be included after the heading in row 48 to indicate the extent of the variance explanations that are required. For example, *"Airports must provide reasonable explanatory comments on the variances between actual and forecasted outcomes to allow interested persons to understand actual returns relative to forecast returns."*
Annual Templates	Schedule 2	In our view the line by line variances and the requirement for comment should be removed from this schedule. Retaining this variance analysis: 1) Duplicates the requirement to comment on revenue and expenditure variances in Schedule 1; 2) Requires forecast information that is not published in schedules 18 or 19 – forecasts by type of airport charge; and 3) Establishes an implicit requirement the variance for each detail line item will be explained, when this will not be necessary to achieve the reasonable explanations that are required in clause 2.3(9) to explain variations from forecast returns.
Annual Templates	Schedule 4	In our view the line by line variances and the requirement for comment should be removed from this schedule. Retaining this variance analysis: 1) Duplicates the requirement to comment on variances in the RAB value in Schedule 1 [in providing a reasonable explanation for the changes that have occurred to the RAB the airports will have to refer to the change in the asset movement line items that are relevant]; and 2) Establishes an implicit requirement the variance for each detail line item will be explained, when this will not be necessary to achieve the reasonable explanations that are required in clause 2.3(9) to explain variations in the returns.
Annual Templates	Schedule 4b(iii)	In the Reasons Paper the Commission advises they considered whether continued disclosure of non-standard depreciation outcomes was required annually and concluded that this disclosure should be retained.

Document	Reference	Comment
		NZ Airports still maintains this is unnecessary but suggests that retaining Schedule 4b(iii) is inappropriate because this reflects price setting disclosure information. Price setting disclosure information is not repeated in annual disclosures for other pricing items.
Annual Templates	Schedule 4b(iv)	This schedule has not been amended to allow the for the revaluation options the airports can elect in a price setting event. Airports may: 1) Choose to revalue or not revalue assets; and 2) If they do choose to undertake revaluations elect specific assets or groups of assets that will be revalued, while others may not. 3) Furthermore, the schedule still uplifts the value of assets by CPI, while airports can elect to revalue assets at other indexed rates in price setting. Amendments required to this schedule should be made to: 4) Allow airports to indicate whether revaluations are applicable; Then if the answer is yes for specific assets or groups of assets: 5) In rows 35-37 allow airports to advise their indexed revaluation rates from price setting if these are applied to the annual RAB's; and 6) Allow deductions after line 100 for land assets that are not revalued, or other assets that are not revalued.
Annual Templates	Schedule 6	NZ Airports submits that the variance analysis in this schedule is no longer necessary as the information is required in schedule 1 to explain variations in opex cash flows, or in the values of assets commissioned. This schedule has proven to be the most challenging for airports because it has required comment on a high number of detailed items, for both annual and period to date outcomes. The airports have endeavoured to provide meaningful comment however the commentaries provided are very detailed, and perhaps confusing because of this. Limiting the variance analysis to schedule 1 will: 1) Allow airports to provide more direct comment explain variations from forecast operating expenditure without the confusing level of current detail; 2) Allow the airports to focus on variations in assets commissioned in schedule 1, rather than cashflow capital expenditure in schedule 6; and

Document	Reference	Comment
		3) Continued disclosure of the actual and forecast detail variations from forecast in schedule 6 will still provide interested persons with sufficient information to enable them to determine whether the variance explanations in schedule 1 are reasonable.