AIRLINES FOR AUSTRALIA & NEW ZEALAND

Commerce Commission New Zealand
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3 September 2024

RE: Review of Auckland Airport's 2022-2027 Price Setting Event

Airlines for Australia & New Zealand (A4ANZ) welcomes the opportunity to respond to the Commerce Commission's draft conclusions on Auckland International Airport Limited's (AIAL) pricing decisions for the period 1 July 2022 to 30 June 2027 (PSE4).

As the Commission is aware, A4ANZ is an industry group representing airlines based in both Australia and New Zealand; including international, domestic, regional, full service and low-cost carriers. Established in 2017, A4ANZ's members include Air New Zealand, Qantas, Virgin Australia, Regional Express (Rex), and Jetstar.

As the industry body representing airlines in both Australia and New Zealand, A4ANZ has a strong interest in ensuring that airport infrastructure on both sides of the Tasman is efficient and fit-for-purpose, supported by an appropriate regulatory regime. As such, A4ANZ's comments on the Commission's draft conclusions will focus on AIAL's pricing and profitability, the Commission's draft conclusions on the appropriateness of AIAL's proposed investment, and the limitations of the current regulatory regime in meeting the objectives in Part 4 of the Commerce Act (1986).

A4ANZ member airlines will also be making their own submissions in response to the Commission's draft conclusions.

Aeronautical Pricing and Profitability

The Commission notes that airlines have raised concerns about the forecast increases in aeronautical charges. This is understandable given that from FY23 to FY27, domestic jet prices at Auckland Airport will more than double, and pricing for regional and international services will almost double.

As such, we welcome the Commission's findings that AIAL is targeting excess profits of between $193.4 million and $226.5 million in setting its prices. Given the historical behaviour of Auckland Airport in targeting excess returns, this finding is unsurprising to the airline industry. What has changed, however, is that the quantum of excess profits being targeted is now far greater. During PSE3, the Commission found that AIAL had initially set prices that would result in customers paying an extra $65 million in airport charges over the five-year pricing period, compared to what they would pay if the airport was targeting the mid-point WACC estimate.[i] In this current price setting event, AIAL is targeting excess profits more than three times that amount.

The cumulative impact of this behaviour on users of Auckland Airport and the New Zealand economy more broadly, is large. In evidence submitted to the Commission in 2018, A4ANZ shared economic analysis suggesting that, between 1998 and 2017, the value of excess returns to AIAL was more than $3.6 billion (in 2017 dollars).[ii]

What this current and historic behaviour by AIAL in targeting excess profits demonstrates, is that the regulatory regime for airports is ineffective, and does not achieve the objectives Part 4 of the Commerce Act (1986) – specifically, 52A(d) of the Act which aims to *"promote the long-term benefit of consumers by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services [are limited in their ability to extract excessive profits]".* We discuss this issue in more detail, later in this submission.

Use of Australia's Unregulated Monopoly Airports as Comparators

A4ANZ was concerned by the Commission's commentary on, and comparison of, AIAL's pricing in the context of prices set by Australian airports – which are all natural monopolies, subject only to a monitoring regime which offers no effective constraint against excessive profits. The Commission states that "*Auckland Airport's international charge is low in comparison with other Australasian international airports*" and that "*international charges [at AIAL] by FY2027 also appear comparable with peer Australian international airports' FY2024 prices*" – noting charges from Sydney, Melbourne, and Brisbane airports.

We are concerned by the Commission's decision to compare the pricing of Auckland Airport with other monopoly airports under very light-handed regulatory regimes, as if they in any way reflect "reasonable" pricing and profitability, for a robust point of comparison. Noting also these are the published prices, rather than actual charges most airlines pay – therefore comparing to an elevated base.

Pre-COVID, the profit margins of Australian airports were the highest in the world – with Sydney, Melbourne, and Brisbane airports being the 1st, 3rd, and 4th most profitable airports.[iii] A study by the Grattan Institute found that these airports earned "super profits" three times larger than even the major banks, to the detriment of consumers.[iv] In the same period, Auckland Airport and Wellington Airport rounded out the top five highest profit margins globally, at 2nd and 5th place respectively.[v]

What this demonstrates is that, while the profit margins of the major Australian and New Zealand airports may be comparable, this should not be relied upon as a source of reassurance to the Commission; rather it should be a cause for concern – that airport users, including passengers, on both sides of the Tasman are being charged too much by monopoly infrastructure operators. The Commission need only look at the repeated calls for reform expressed by its equivalent organisation in Australia, the Australian Competition and Consumer Commission (ACCC), which has found that the current light-handed regime is not working well enough to prevent the airports exercising their market power, and that this is to the detriment of both airlines and consumers.[vi] In other words, the exact opposite of what is set out in the objectives of Part 4 of the Commerce Act is observed in Australia. Accordingly, Australia's airports are hardly a suitable model for the Commission to use as a benchmark for New Zealand.

Assessing the Appropriateness of the Total Investment in PSE4 and PSE5

A4ANZ and our member airlines were disappointed to read the Commission's assertion that AIAL's forecast capital expenditure appears to be reasonable – and are concerned by their reliance on information from the airport company to reach this conclusion. While all airlines agree on the need for investment in Auckland Airport's infrastructure, the current proposal from AIAL is not supported – for valid reasons including the fact that, at a significant cost, it will not deliver additional capacity for the longer term. In fact, when assessed

against appropriate metrics from IATA's Level of Service framework, the current proposal has been assessed as being oversized, overdesigned, and overdeveloped – with the current proposal more akin to that of a high-end international terminal, than that of an appropriately sized domestic terminal. Additionally, in the short-term (through to 2026) it will reduce access to gates, significantly inconveniencing passengers.

The even more concerning issue, however, is that the constraints placed on the Commission to assess only the pricing proposed for PSE4 (and not PSE5) leads to an artificial assessment of whether the proposed expenditure and pricing are reasonable, because it only covers part of the period of the massive capital project. The Commission notes that any analysis of PSE5 would be speculative, however, this is unhelpful, given that what has been proposed by AIAL is actually a 15-year construction plan. A4ANZ understands that, as part of its recent consultations with airlines, the Airport shared a range of price estimates for per passenger prices out to 2032. This of course informs airlines' future planning, and an assessment of the viability (or otherwise) of certain routes. It doesn't, however, fit neatly inside the 5-year assessment timeframe for the Commerce Commission to consider airport prices.

This is a problem because, as the Commission itself notes, investment decisions made in PSE4 will also affect pricing – and the ability to make changes to pricing – in PSE5. Both AIAL and its customers would be able to provide the Commission with insight into expected pricing in PSE5, and it ought to be taken into account because otherwise there is a risk that the decision on PSE4 effectively "bakes in" the further increases in PSE5, once construction is well underway.

If the Commission remains of the view that, under their current remit for making a decision on PSE4, they are unable to have regard to Auckland Airport's full project and investment proposal – and potential PSE5 pricing – there is a strong case for the Commission to take a course of action which *would* enable this work to be undertaken properly: making a recommendation to the Minister for a S56G Inquiry into the airports.

Effectiveness of Regulatory Regime

Given what we have outlined above, the Commission's draft conclusions on AIAL's pricing highlight some of the limitations of the current regulatory regime.

A4ANZ recognises that under the Information Disclosure regime, the role of the Commerce Commission is limited to the publication of guidance in relation to the inputs, and the review and assessment of the airports' financial information against such guidance. The experience with AIAL demonstrates how this clearly isn't sufficient to either constrain their ability to extract excess profits, nor to incentivise appropriate investment. As Greg Foran, Air New Zealand's Chief Executive noted, "a*t the end of the day, the airport can effectively do what it wants to do. And they do, and we live with the cost, which invariably ends up in a ticket price.*"[vii] This has flow-on effects on demand and then into tourism, impacting the New Zealand economy.

As noted earlier, pre-COVID analysis found that the total value of excess returns to the airport (across all operations) since privatisation had amounted to more than $3.6 billion.[viii] At the same time, the airport company failed to invest appropriately in ensuring that its infrastructure was fit-for-purpose, leaving the airport and travellers vulnerable during recent extreme weather events[ix], despite airlines agreeing to a master plan including capital upgrades more than a decade prior.

In the absence of any regulatory change, we are seeing this pattern of behaviour repeated – Auckland Airport initially targeting excess returns, the Commission finding that they have targeted excess returns, and then the Airport likely adjusting their proposed WACC after the Commission indicates an acceptable range. Rather than this being evidence that the regulatory regime works, we would instead contend that this is evidence of a regulatory failure. Furthermore, with the scale of the investment, the amount of money involved this time is far greater; and the negative impact – on both domestic and international travel – is likely to be significant for some years to come.

This outcome is not in keeping with the objectives of Part 4, which seeks to promote the long-term benefits of consumers. There are also a range of issues that need to be addressed but are outside the scope of the Commission's assessment, such as: unclear rules of engagement, a lack of information or detail on which to enable inputs to be challenged, confidentiality provisions preventing such challenges being put to the regulator early in the process of price-setting, and decisions being made after capex has already commenced.

As indicated earlier, the ACCC has consistently recommended reforms to airport regulation, with a focus on retaining a light-handed approach, whilst allowing access to independent arbitration in the case of intractable disputes – over issues such as capex plans and pricing. In its response to the recent consultation on the Australian Government's Aviation White Paper, the ACCC urged the Australian Government to introduce provisions to enable binding commercial arbitration to occur should negotiations between airports and airlines breakdown (i.e. a negotiate/arbitrate regime).[x] The ACCC noted that, "*a negotiate/arbitrate framework is a light-handed and flexible regulatory solution, given the limited need for intervention, and could protect either airlines or airports in the event they had weaker negotiating power than their counterpart*".[xi]

This accords with previous commentary from the ACCC during the 2018-19 Productivity Commission Inquiry into the Economic Regulation of Airports, which noted that *"A commercial arbitration regime would be a pragmatic and flexible solution under which both airports and airlines can seek arbitration if negotiation between the two parties break down due to the exercise of market power. It is likely that having recourse to arbitration will be enough of an incentive to come to an agreement in negotiations, meaning that in practice few parties will seek to initiate arbitration."*[xii]

Unlike in Australia, there is already scope within the existing regime in New Zealand to enable airport regulation to be moved into a negotiate-arbitrate setting, without requiring legislative change. While A4ANZ acknowledges that reforms to the regulatory settings in New Zealand are not part of this review, we believe that it is important context, particularly given the Commission has sought to make comparisons between airports of the two jurisdictions. Just as it does in Australia, the current regulation of New Zealand's monopoly airports comes at a cost to the community, both financially and through lost opportunities for improving the quality and efficiency of airport services.[xiii]

Conversely, enabling agreements between airports and airlines on inputs and pricing to be reached in an efficient and timely manner, with appropriate avenues for challenge and resolution of disputes, assists in providing certainty to the sector and investors – allowing airports to move forward quickly with fit-for-purpose infrastructure for New Zealanders and international travellers.

A4ANZ again encourages the Commission to consider a rapid Inquiry, which would enable the benefits of such a change to be assessed against the status quo.

Concluding Comments

As the aviation sector, and the New Zealand visitor economy more broadly, continues to recover from the impact of the COVID-19 pandemic, it is essential that the regulatory settings for airports are fit-for-purpose, supporting the achievement of Part 4 objectives.

While we welcome the Commission's findings regarding AIAL seeking to recover excess returns, we remain concerned that the current regulatory regime is not fit-for-purpose. Due consideration must be given to creating a policy and regulatory environment that encourages innovation and efficiency, to ensure that both the community needs of New Zealand and those of the broader economy are met.

We thank the Commission for the opportunity to make a submission in response to this consultation and would be pleased to discuss any part of this submission with the Commission.

Sincerely,

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