NZ AIRPORTS

CROSS-SUBMISSION ON THE COMMERCE COMMISSION'S WELLINGTON AIRPORT CONFERENCE HELD ON 7 AUGUST 2012

1. This is the New Zealand Airports Association ("**NZ Airports**") cross-submission on the Commerce Commission's ("**Commission**") Wellington Airport Conference held on 7 August 2012, as part of the Review of the ID Regime ("**Review**"). The cross-submission is made on behalf of the three Airports that are subject to the Information Disclosure Regime ("**ID Regime**") under Part 4 of the Commerce Act - namely, Auckland International Airport Limited, Wellington International Airport Limited and Christchurch International Airport Limited ("together, **Airports**"). It should be read in conjunction with the cross-submissions from the Airports.

2. This submission focuses on issues of scope and process that arose during the conference and that are of interest to all Airports. Each Airport will submit on matters of specific relevance or interest to them.

3. The NZ Airports contact for matters regarding this cross-submission is:

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EXECUTIVE SUMMARY

4. The conference provided helpful clarification of various scope issues that had been raised in submissions prior to the conference. The Commission correctly highlighted the need to firmly establish the correct lawful scope of assessing the effectiveness of the ID Regime.

5. In particular, the Commission helpfully acknowledged that the Review has been carefully framed by Parliament, so that it does not require the Commission to consider matters such as other potential forms of regulation. Instead it must be confined to reporting to the relevant Ministers on whether the ID regime established under Part 4 is effectively promoting the Part 4 purpose statement.

6. However some issues remain outstanding. Notably, in light of discussion regarding the relevance of the input methodologies ("**IMs**"), the Commission invited cross-submissions on how it might properly make its assessment of effectiveness if it is correct that it should not consider whether the IMs have been applied in pricing.

7. NZ Airports believes that the legal position is clear. IMs are set for the purpose of prescribing how certain information must be disclosed under the ID regime, and need not be applied by airports in their pricing decisions. It would therefore be improper for the effectiveness of the ID Regime to be measured by whether the Airports have adopted the IMs in pricing. In short, this would amount to asking whether the ID regime has been effective at exceeding its proper legal boundaries in the Commerce Act, which cannot be what Parliament intended the Review to assess.

8. However, NZ Airports accepts that as a matter of practice, the IMs are relevant to pricing decisions in consultation under the Airport Authorities Act (**"AAA"**), and the Review. Indeed, the Airports have been placed under severe pressure to apply the IMs for pricing, and they have now been established as the starting point building blocks for pricing.

9. A balance therefore needs to be struck in considering IMs under the Review:

   (a) The Commission must guard against concluding that in order for the ID Regime to be effective at promoting the purpose of Part 4, the application of the IMs *must* be used as building blocks for setting prices. If the Commission concludes that the IMs are a determinative basis for assessing effectiveness of the ID Regime, then it will be imposing the very type of *de facto* price control that it denied would occur when the IMs were determined and the ID Regime was established.

   (b) On the other hand, the process and reasoning around an Airports' decision to apply or depart from an IM when setting prices could provide valuable evidence that the ID Regime has been effective at encouraging Airports to be cognisant of whether their decisions will promote the Part 4 purpose statement, and to justify their approaches in that respect. This seems a sensible balance between the fact that the IMs are not legally binding for pricing but are relevant to the operation of the ID Regime. Such information should be readily available in the price setting disclosures and/or other publicly available information.

10. We also think that such an approach recognises that the IMs are an important part of the ID regime and that considerable time and effort was spent in developing them, but equally recognises the limitations of considering their applicability to pricing and investment decisions. Further, it also recognises the proper relationship between the ID Regime and the AAA. In that context, NZ Airports strongly endorses the comments made by WIAL and AIAL during the conference (in response to the Commission's suggestion that Airports might believe the two are in conflict) that the AAA and ID Regimes can and do work effectively together.

11. Accordingly, the Commission's focus for the Review should be on assessing the information disclosed under the ID Regime – which is the purpose for which IMs were determined. This information will include (limited) actual outputs compiled using the IMs, and the actual outputs forecasted under the most recent pricing setting event. This will provide an initial basis to evaluate the price setting event forecast using the IMs, but as the Commission has acknowledged, there is insufficient time series data to reliably identify any trends, and actual outcomes may differ from forecasts in the final result for good reason.

12. Of course, annual financial disclosures are compiled using the IMs. Focussing on what that information tells interested parties about airport performance is not only the most appropriate approach to the Review (bearing in mind the limited time series of data), but is also the key way to give full effect to the IMs.

13. In light of the above, NZ Airports strongly disagrees with Air New Zealand and BARNZ (together "**the Airlines**") view that information disclosure has been completely ineffective in promoting the four limbs of the Part 4 purpose statement due to the Airports' disregard for ID regulation and the underlying IMs. NZ Airports is confident that the individual Airport submissions throughout the Review processes will provide evidence to demonstrate that:

   (a) the Airports have dedicated significant resources to considering the IMs and have carefully explained any departures from them in pricing;

(b) ID has provided greater transparency of (forecast) outcomes, which enable evaluation of with the achievement of the Part 4 purpose statement; and

(c) efficiencies have been targeted and shared, and an ongoing change programme has been implemented.

14. NZ Airports' specific responses to the questions that emerged from the Conference are set out in further detail in this cross-submission.

15. Additionally, attached to this submission is a report NZ Airports has commissioned from AIRBIZ. The report provides a peer review of the airport charge benchmarking information provided by BARNZ to the Commission and then provides further analysis of the benchmarking of New Zealand airport domestic charges.

16. AIRBIZ concludes that:

- *"The BARNZ analysis shows that New Zealand international airport charges are below the average of a sample of international airports. The analysis was consistent with other recent analysis undertaken for Auckland and Wellington airports.*

- *The comparision that AIRBIZ undertakes of the New Zealand airport domestic charges demonstrates that average domestic New Zealand airport charges are between half and a quarter of average Australian domestic charges.[1]"*

CLARIFICATIONS OF SCOPE

17. During the course of the conference, the Commission provided some helpful clarification regarding its views on the proper scope of the Review. The Commission's questioning of the Airlines requests for the scope to be broadened also failed to elicit valid grounds for such views. In particular:

(a) the extension of ID to services outside of the current specified services in accordance with section 53D is outside of the proper scope of the Review; and

(b) that the Review is not focussed on whether ID is the right form of regulation or whether other forms of regulation would be better, but is focussed on how effectively the ID Regime under Part 4 is promoting the Part 4 purpose statement.

INTERRELATIONSHIP BETWEEN INFORMATION DISCLOSURE, SECTION 56G REPORTS AND THE INPUT METHODOLOGIES

18. During the Conference, the Commission asked for participants' views on the interrelationship between ID, section 56G Reports and the IMs**,** by inviting cross-submissions on how the Commission might go about making its assessment of effectiveness under the Review if it accepts that it cannot legally consider the IMs.

19. To be clear, NZ Airport's recognises that IMs have an important role to play and are relevant to the Review. Our position regarding the consideration of IMs is more specific than suggested by the Commission's question 16 following the conference.[2] That is, our position is that whether or not IMs have been applied in pricing decisions is not a valid basis on which to assess the effectiveness of the ID Regime.

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[1] AIRBIZ Peer Review, BARNZ Analysis of New Zealand Airport Domestic Charges 15 August 2012, page 1.

[2] Question 16 provides: Interrelationship between ID, s 56G reports and CC's IMs? How can the Commission carry out its task under s 56G if it cannot consider input methodologies?

20. As outlined in detail in earlier submissions, NZ Airports believes that the proper scope of the Review does not include an assessment of whether the Airports have adopted the IMs for the purposes of pricing. Rather, the correct focus of the Review must be on:

    (a) reviewing the information disclosed in accordance with the ID Determination as directed by section 56G(1)(a);

    (b) assessing the "effectiveness" of the ID Regime interpreted in light of the purpose of the ID Regime and the specific requirements under subpart 4; and

    (c) assessing the mechanics of the regime and, if the disclosed information reveals that performance might not be consistent with the Part 4 purpose statement, assessing whether there is evidence that this will not be addressed under the ID Regime.

21. Core to this approach is that the focus should be on what the information disclosed under the ID Regime tells interested parties about airport performance and its consistency with the Part 4 purpose statement. This is where the IMs are of most relevance, as information must be disclosed using the IMs, and therefore the IMs will directly influence the assessment of performance. The difficulty facing the Commission is that the time series of data compiled using the IMs is insufficient to allow robust conclusions to be drawn - that is, the Review comes too early. However, that difficulty does not make it lawful to base an assessment on the effectiveness of the ID Regime by considering whether or not IMs have been applied in pricing.

22. NZ Airports acknowledges that the IMs could have broader relevance to the Review. For example, the process and reasoning around an Airport's decision to apply or depart from an IM in pricing could provide good evidence of the influence that the ID Regime is having in practice. For example, the evidence would show that Airports are being rigorous and careful in explaining and justifying their approaches and assessing whether they are consistent with the Part 4 purpose statement. An important countervailing consideration is that the Commission must be open to considering expert advice as to why approaches adopted by Airports that are different to the IMs have been taken, and why those different approaches are appropriate in light of the Part 4 purpose statement.

23. This approach would appear to strike a good balance to ensure consideration of the IMs under the Review, and is consistent with the proper application of the ID Regime and the AAA. It is also consistent with the legal interpretation set out above (whereas effectively requiring IMs to be applied in pricing is not). Specifically:

    (a) the requirement under the AAA that prices are set "as an Airport sees fit" necessarily includes consulting with an open mind and therefore considering a range of factors, which includes commercial factors and the Commission's IMs;

    (b) ultimately, however, the focus for assessing the effectiveness of the ID Regime should be on outcomes from airport decisions, not inputs; and

    (c) in that context, the IMs have an important but confined role to play in determining whether the ID Regime is effective in promoting outcomes consistent with the four limbs of the Part 4 purpose statement.

24. What the Commission cannot do is conclude that any deviation from the IMs means that information disclosure is ineffective. This would require the Commission to have undue focus on *inputs*, and would disregard the complexities of pricing and the fact that a range of outcomes is consistent with Part 4.

25. NZ Airports' position is that the assessment of the effectiveness of the ID Regime must be focused on the *outputs* (and therefore the information disclosed in accordance with

the ID Determination). This is because what is important to an effective ID Regime is ensuring *transparency* so that the outcomes produced by Airports are fully scrutinised. Airports must also be transparent about the inputs they have in fact used.

26. This approach best aligns with the purpose of the ID Regime, to ensure transparency of Airports' decisions and decision-making processes, together with the potential threat of further regulation. As noted above, NZ Airports believes that there is evidence that the ID Regime is influencing Airport conduct in that respect.

27. NZ Airports is concerned that the correct scope of the Review will be compromised if the Commission places too much weight on the IMs. If the Commission concludes that in order for the ID Regime to be effective the IMs must be adopted in pricing, then it is difficult to understand how this does not amount to the *de facto* price control that the Commission is on record as stating would not apply following the establishment of IMs:[3]

> While some incentive effects will flow from any information disclosure regime, the Commission's information disclosure framework has been developed to ensure that sufficient information is readily available to interested persons to assess whether the purpose of Part 4 is being met. **Some submitters have argued that the Commission is setting *de facto* price control of airport services. This is incorrect. The Commission appreciates that Airports are able to charge as they see fit.** The information required by the Commission's ID Determination is based on the information listed in s 53(2) (which is not an exhaustive list) and is considered necessary to assess whether the purpose of Part 4 is being met. However, as discussed above, the new regime may, among other things, help to create incentives for Airports to ensure that the returns they generate are not excessive.
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> *[Emphasis Added].*

28. Such an outcome would also be inconsistent with Cabinet's clear intention regarding the correct lawful scope of the ID Regime as follows:[4]

> We (Ministers of Commerce and Transport) consider that there is sufficient evidence that the regulatory regime needs to be strengthened, particularly with respect to the current information disclosure regime. A further study on this particular issue would be unlikely to yield materially new information and would simply postpone a decision on a well-traversed and pressing issue (particularly in the light of overseas interest in acquiring AIAL).
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> [...]
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> The advantages of this option are that it significantly improves the value and relevance of information disclosed, and provides guidelines that would be taken into account by airports in their consultations. Furthermore, by providing more useful regulatory information on airport pricing, and an explicit monitoring role for the Commerce Commission, it improves the credibility of the threat of regulation if prices are excessive.

29. On the other hand, the approach suggested by NZ Airports would be consistent with both the Commission's and Cabinet's views on the scope of influence that the ID Regime could have on pricing.

30. In summary, the Commission must review the information disclosed and assess the "effectiveness" of the ID Regime in light of the purpose of the ID Regime and the specific requirements under subpart 4. IMs are relevant to that assessment because information has been compiled using the IMs for information disclosure, but whether or

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[3] Commerce Commission, Information Disclosure (Airport Services) Reasons Paper, 22 December 2010, paragraphs 2.29 to 231.
[4] Cabinet Paper, Commerce Act Review - Airports, 2007, paragraphs 36 and 39.

not they have been applied in pricing cannot legally form the basis of a determination regarding the effectiveness of the ID Regime.

Relationship between AAA and the ID Regime

31. NZ Airports notes that Airlines continue to advocate that the information disclosure regime is incapable of providing the sort of incentives and outcomes that Parliament intended. As previously submitted, their real concern appears to be with the AAA rather than the ID Regime itself.

32. Of relevance, the Commission queried whether the Airports believed that the AAA and ID Regime were in conflict. NZ Airports strongly endorses WIALs and AIALs comments during the conference that the two regimes can and do work well together. As NZ Airports consistently submitted throughout the IM development process, and above, if the legal scope of each regime is properly observed, then they can form an effective whole.

CONTENT OF THE COMMISSION'S SECTION 53B(2) SUMMARY AND ANALYSIS REPORTS

33. The Commission has invited cross-submissions on Airports' expectations regarding the content of the Commission's section 53B summary and analysis reports.

34. NZ Airports' appreciates that there is no prescribed format for the Commission's summary and analysis reports in the Act. The only guidance available in the Act is that the purpose of these reports is to promote greater understanding of the performance of regulated suppliers, their relative performance, and the changes in performance over time.

35. Given the context in which the summary and analysis reports are to be prepared, and consistent with the statutory purpose of the reports, NZ Airports would expect the Commission's section 53B(2) summary and analysis reports to:

    (a) summarise key "highlights" of performance in a way that facilitates comparison between airports and which make it easier to identify trends over time;

    (b) identify any concerns the Commission has regarding the way in which disclosure is being made, with reasons; and

    (c) make any observations it may have around particular aspects of performance.

36. As with the section 56G process, the section 53B(2) summaries form an important part of the ID Regime, which encourages outcomes consistent with the Part 4 purpose statement.

37. We expect the content of the summary and analysis reports to be informative regarding the issues that may need further consideration by Airports, either immediately if the Airports consider this appropriate, or as part of the next scheduled price consultation, consistent with the fact that the ID regime should influence outcomes over time.

38. We also expect that the Commission's summary and analysis reports will evolve over time, including because of the current lack to time series data which may lead the Commission to feel empowered to reach more definitive conclusions after it has produced a number of summary and analysis reports over a number of years.

39. NZ Airports believes that the commentary that the Commission provides at the end of each year will also greatly assist interested parties to use the information disclosure report for the purposes intended under the Act. In this way, it will be an essential

ingredient in promoting and shaping a three-way conversation between Airlines, Airports and the Commission.

BROADENING THE ID REGIME: CONSOLIDATED STATEMENTS

40. The Commission has helpfully acknowledged that the extension of information disclosure outside of aeronautical services is technically outside of the current section 56G Review.

41. However, in submissions, cross-submissions and during the "other issues" session of the Conference, the Airlines advocated for the Commission to broaden the ID Regime and require Airports to disclose information regarding non-regulated activities, on the basis of section 53D of the Act. Accordingly, we make some brief high level points by way of response.

42. NZ Airports strongly disagrees that detailed information on non-regulated activities should be disclosed pursuant to section 53D:

    (a) Subpart 11 of the Act states that only "specified airport services" are subject to Part 4 information disclosure regulation. Therefore the Commission cannot require information to be disclosed in respect of activities not defined in section 56A as "specified airport services".

    (b) Although section 53C(2)(k) allows the Commission to require disclosure of consolidated information, it is subject to section 53D.

    (c) Section 53D of the Act only provides for limited circumstances where the disclosure of consolidated financial and other information, including non-regulated activities, is permitted. It is a narrow exception to the rule above.

    (d) The purpose of section 53D is clear; to enable *the Commission* to monitor compliance with information disclosure regulation applying to regulated goods or services. It is not a mechanism to allow disclosure of commercial information for the benefit of interested parties in general.

    (e) Accordingly, the airlines (or the Commission) would need to demonstrate that further disclosure of information regarding airports' unregulated business is required to allow the Commission to monitor compliance with information disclosure regulation. No such case has or can be established.

43. More generally, we also note that the dual till regime that NZ Airports has been operating under since the establishment of commercial airports in New Zealand has delivered successful levels of airport infrastructure, internationally recognised as providing a high level of service to consumers and in contrast to the infrastructure failure of Airports overseas and in relation to other (now) regulated industries in New Zealand.

TREATMENT OF AIRPORTS' COSTS OF LITIGATION

44. The Commission has queried how Airports should treat the cost of litigation generally, and the costs of Part 4 judicial review and merits review appeals litigation specifically.

45. In our view, it is appropriate for Airports to recover the costs of any expected litigation that is associated with regulation of aeronautical services as a cost of running an airport business in New Zealand under the current regulatory settings. Indeed, the outcome of the merits review proceedings could mean that the ID Regime impacts differently in the future, so is directly relevant to regulation of aeronautical services.

46. The approach adopted by Airports is also supported by the fact that the Commission's regulatory functions were intended to be paid for by consumers who will benefit from the regulation (by way of levies payable by regulated entities to the Crown). We also note that the cost to consumers is also capped within this pricing period to the figures included in the forecast.

47. Furthermore regulatory changes or litigation arises that cannot be forecast by airports during price setting. Airports are therefore exposed to this cost risk. The consultation process and subsequent development of the ID Regime is a case in point all of the Airports have incurred historical costs that were not forecast, and consequently cannot be recovered by airports.

48. Accordingly, BARNZ is incorrect in stating that because Airports are forecasting the cost of litigation in their operating expenditure, they have no incentive to conduct litigation efficiently. The position would be different if litigation costs were treated as pass through costs.

COMMISSION'S EVALUATION OF EXPERT OPINIONS

49. At the conference, BARNZ advocated that the Commission should arbitrate between two conflicting expert views in relation to the MVAU valuations. The Commission helpfully acknowledged that the ID Regime does not include a negotiate/arbitrate form of regulation in which it is incumbent on the Commission to arbitrate between two expert views. Although it is open to the Commission to more tightly specify the IMs to narrow differences between experts, in our view there are some instances in which the particular difference of opinion between experts is not amenable to further specification of the IMs. The MVAU valuations fall into this category.

50. In our view, the Commission's role under the Act is not to seek to broker a resolution between differing expert opinions, but to monitor and oversee compliance with the requirements in the Act, ID Determination and relevant IM. Relevantly, the Board of each airport is required to certify that the airport has complied with the ID Determination, which includes the proper application of IMs. In practice this requires careful due diligence and audit procedures to provide the Board comfort that certification is warranted.

51. Put another way, the Commission's evaluation role should be focused on ensuring that:

    (a) the airport has followed a proper process in obtaining a valuation; and

    (b) that the valuation has been undertaken in accordance with the IMs and in a transparent manner.

52. Only where the Commission can find fault with this process should it form a contrary view or consider whether other actions, such as amending the IM’s, are required.