

06 September 2018

Jo Perry  
Chief Advisor, Compliance and Performance Analysis  
Regulation Branch  
Commerce Commission

Be email: [Regulation.branch@comcom.govt.nz](mailto:Regulation.branch@comcom.govt.nz)

Dear Jo,

Air New Zealand is pleased to offer a cross-submission to submissions received on the Commerce Commission's review of Christchurch International Airport's (CIAL's) price setting event three.

Submissions to the process were received from airports and airlines, and notably from an interested individual, Patrick Wilson, who made some observations of the effect on consumers of CIALs price structure.

**CIAL is targeting excess profits with prices set using target returns of 6.82%**

Air New Zealand stands by comments made in its submission on CIAL's price setting event; CIAL has targeted excessive profits by adjusting the inputs to its target cost of capital, such that resulting prices for airlines were higher than they would otherwise have been following price consultation.

The Commission appears to have allowed CIAL to declare target returns which are lower than those with which prices were set, principally by allowing CIAL to use target incentives to offset target returns. Such incentives are not transparent, and are likely to be unevenly applied across substantial customers.

Target incentive payments were explicitly declared by CIAL during price consultation to be excluded from the building blocks model and the PSE3 information disclosures. Given they were so excluded, Air New Zealand does not see how they may be taken into account by the Commission in reviewing target returns.

Air New Zealand also notes with interest Auckland International Airport's (AIAL's) further attempt to justify its excessive profits in its most recent submission on AIAL WACC delivered to the Commission in August.<sup>1</sup> Despite the plea from all airport submitters that the mid-point WACC should not be treated as a bright line test, AIAL capably demonstrates how they too can apply modelling to artificially lower their WACC used in price consultation to such a 'bright line'.

---

<sup>1</sup> Section 53B review of Auckland Airport's pricing decision and expected performance for PSE3: cross-submission on WACC in light of Christchurch Airport's Draft Report, AIAL, 23 August 2018

Air New Zealand would encourage the Commission to include guidance for airports in their final report that target returns used in price modelling are those used in both information disclosure and in the Commission's subsequent review of services and returns.

### **CIAL's asset beta uplift is unjustified**

In CIAL's submission on the draft report, it notes that the Commission finds its asset beta uplift unjustified. CIAL comments that it appreciates guidance given by the Commission, and notes it will consider this carefully when price setting for PSE4.<sup>2</sup>

Air New Zealand encourages the Commission to note in its final report that a response such as this is insufficient – and that it expects more from airport companies than a promise to do better in future, while keeping excess profits earned in the current regulatory period. Such behaviour in fact demonstrates that information disclosure and Commission led reviews of price setting deliver insufficient regulatory threat to stop airports retaining excess profits.

### **CIAL price structure is harmful to most consumers**

Air New Zealand submitted that CIAL's restructure of prices penalizes operators of turbo-prop aircraft, in favour of larger jet aircraft. Air New Zealand agrees with submitter Patrick Wilson this is neither fair nor reasonable, and harms most consumers, contrary to the purpose of Part 4.<sup>3</sup> We note with interest the citations raised by Wilson from the First Circuit and the Supreme Court of the United States.

CIAL submits that the majority of airlines supported CIAL's price structure via BARNZ. While this may be true, it is also true that the price structure is constructed in favour of the majority of airlines arriving into CIAL – and that these beneficiaries are international airlines. Routes most affected by increased prices for turbo prop aircraft are regional routes. The increased charges are detrimental to existing route traffic and discourage new entrants from growing tier three carriers.

WIAL submits that the Commissions support of CIAL's use of its own debt premium and the change in price structure represent the ability of airlines and airports to have robust commercial discussions.<sup>4</sup> Air New Zealand considers that this in fact represents the opposite scenario – that Air New Zealand, despite representing the airline operating the largest turbo prop fleet, was not able to influence a price structure which penalizes the use of that aircraft.

### **Other regulated services**

Air New Zealand is supportive of further discussion on how other regulated services may be regulated by the Commission. The data submitted by CIAL on these services is of interest, and Air New Zealand would be supportive of information requests made of airport companies to

---

<sup>2</sup> Submission on Commerce Commission's review of Christchurch International Airport's pricing decision and expected performance (July 2017 – June 2022) – Draft report, CIAL, 16 August 2018, para: 46 – 47.

<sup>3</sup> Submission of Commerce Commission's review of Christchurch International Airport's pricing decision and expected performance, Patrick Wilson, page one.

<sup>4</sup> WIAL response to the Draft Report on CIAL PSE3 pricing, 16 August 2018, page 1.

understand better the type of services offered as other regulated service, the tenure of such services, and the terms under which they are offered relative to terms in the competitive market.

AIAL submits *that customers of non-priced services generally have greater countervailing power relative to priced services.*<sup>5</sup> Air New Zealand does not consider this to be the case. Other regulated services such as engineering space, lounges, or other operational space cannot be provided off-airport. Air New Zealand is not free to seek market rents or terms elsewhere.

Air New Zealand does not consider it has countervailing power in relation to other regulated services, in the same way is it does not for other aeronautical services. The fact that target returns for both AIAL and CIAL are higher for other regulated services indicates airport companies do hold market power in negotiations over these services.

### **Final report**

Air New Zealand looks forward to the final reports from the Commission. We would be pleased to discuss with the Commission and with airport companies an appropriate process, should any airport company be found to have targeted excess profits. In the event of any findings regarding excess profits, we encourage the Commission to set expectations with airport companies that some form of response is necessary in the current price period.

In the event that no response is forthcoming, Air New Zealand considers tighter regulatory controls should be applied, to ensure best outcomes for price and service for consumers of New Zealand.

Regards,



Cath O'Brien  
Manager Regulatory Affairs  
**Air New Zealand**

---

<sup>5</sup> Section 53B review of airport pricing decisions and expected performance for PSE3: submission on the draft report for Christchurch Airport, 16 August 2018, AIAL. (clause 11)