

13 February 2014

Hon Gerry Brownlee
Minister of Transport
Parliament Buildings
Wellington

Dear Minister

Final s56G Commerce Act report – Christchurch Airport

1. Please find enclosed our final report on how effectively information disclosure regulation is promoting the purpose of Part 4 of the Commerce Act 1986 (Act) in relation to the airport services regulated under Part 4. This final report is in relation to Christchurch International Airport Limited. It will be published on our website today. A copy of the report has been provided to the Minister of Commerce.
2. Overall, we found that information disclosure regulation appears to have had little influence on Christchurch Airport's conduct or performance.
3. We acknowledge that in some areas of performance Christchurch Airport is performing consistently with their customers' expectations and the purpose of Part 4 - eg, innovation and quality.
4. Our primary concern though relates to profitability. Given the charges that Christchurch Airport has set, which were based on a 20 year pricing approach, our conclusion at this point is that information disclosure regulation is not limiting excessive profits. Further, we have significant concerns with the transparency of Christchurch Airport's approach to pricing, and therefore the ability of interested parties to properly assess what the airport is intending.
5. A summary of the key findings of our section 56G reviews for each of the three airports can be found at Attachment A to this letter.

Consistency across the section 56G reviews

6. Given we prepared our section 56G reports as soon as practicable after each airport set its new prices, this resulted in you receiving our reports in sequence. We have therefore reviewed our reports provided to you on Wellington and Auckland International Airports to check whether there is anything we would wish to revise in light of our final report on Christchurch Airport. We confirm that there is not.

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Implications of the IM judgment

7. As indicated in the enclosed report, we have considered the implications on all of our section 56G reports of the 12 December 2013 High Court decision in the input methodology merits appeals.¹ The Court in substance confirmed our input methodologies for the regulated airport services. However, there was one specific change relating to the date land valuations for the purposes of establishing the initial regulatory asset base should be undertaken (ie, 1 July 2010, rather than 1 July 2009). Consultation with interested parties confirmed that the Court's ruling on this matter does not affect our analysis or conclusions for our section 56G reports for Wellington or Christchurch Airports.
8. In the case of Auckland Airport, we would expect that the change to the valuation date, once given effect, would affect the analysis presented in our final section 56G report. The change would likely bring the Commission's estimate of Auckland Airport's target returns further within the range of acceptable returns. Consequently, it would not alter our conclusion that information disclosure has been effective in limiting the ability of Auckland Airport to earn excessive profits. Interested parties agreed with our proposal not to update our analysis for Auckland Airport.

Developments in light of our section 56G reports

9. There have been some positive developments in light of our reports that I would like to alert you to. Wellington Airport has advised us that it is consulting on resetting prices in March 2014. Christchurch Airport has advised us that it is shortly to consult on how to improve transparency of its pricing methodology. It appears that these developments are a direct result of the section 56G review process and conclusions. They are welcome news, and we will monitor their progress.
10. The Commerce Act does not provide for another round of section 56G reviews. The section 56G process has highlighted the strengths and weaknesses of information disclosure regulation, and the review process itself has resulted in the airports modifying their behaviour consistent with better achieving the purpose of Part 4 of the Act. In future, we expect to provide an extended summary and analysis after prices are reset in the hope this will achieve similar benefits to the section 56G process.

Limitations of information disclosure regulation

11. Information disclosure regulation does not deal easily with the significantly different approaches each airport took to pricing. It is difficult to design a reporting regime that is flexible enough to accurately reflect performance under any kind of price setting approach.
12. The airports' use of different pricing approaches may continue to create some difficulties in assessing airport performance in future. More prescription in the

¹ *Wellington International Airport Ltd and others v Commerce Commission* [2013] NZHC 3289

information required to be disclosed may only go so far in addressing this problem. The approaches airports use in their future pricing decisions will likely have a far greater impact.

13. Nevertheless, we have identified a number of areas where we consider the information disclosure regime for airports can be enhanced through changes to some of the disclosure requirements. We intend to begin work this year on possible changes, with a view to consulting on them in 2015.
14. We highlight that any changes to the existing disclosure requirements could result in a different assessment of performance from that presented in our section 56G reports. Nonetheless, such changes would not affect the conclusions in those reports, because our conclusions are based on the airports' conduct when they set prices for the current pricing period, in light of the disclosure requirements in force at that time.

Yours faithfully



Dr Mark Berry
Chairman

Encl.

ATTACHMENT A

Summary of our key conclusions about the effectiveness of information disclosure for each of the three airports regulated under Part 4 of the Commerce Act

Key performance question	Wellington	Auckland	Christchurch
<p>Is the airport earning an appropriate return over time?</p>	<p>Information disclosure at this time has not been effective at limiting Wellington Airport's ability to extract excessive profits.</p> <p>Wellington Airport set prices for its current five-year pricing period ('PSE2') knowing that its estimate of return (8.9%) would exceed the Commission's estimate of an acceptable range of returns for PSE2 (7.1% to 8.0%). Further, our estimate of returns for Wellington Airport, which took into account Wellington Airport's revaluation of its assets, was even higher (12.3% to 15.2%).</p>	<p>Information disclosure at this time has been effective at limiting Auckland Airport's ability to extract excessive profits.</p> <p>Auckland Airport set prices such that its expected return over PSE2 is equivalent to 8.0% when the information disclosure framework is applied. This is just within the Commission's estimate of an acceptable range of returns for PSE2 (7.1% to 8.0%).</p> <p>Our analysis takes into account Auckland Airport's moratorium on asset revaluations.</p> <p>We would expect that the change to the valuation date required by the High Court in the merits appeal, once given effect, would affect the analysis summarised above. The change would likely bring our estimate of Auckland Airport's target returns further within the range of acceptable returns.</p>	<p>Information disclosure at this time has not been effective at limiting Christchurch Airport's ability to extract excessive profits.</p> <p>When it set its prices for PSE2, Christchurch Airport targeted its returns over the 20 year economic lifetime of its investment in its new integrated terminal, rather than just over PSE2.</p> <p>Christchurch Airport set prices such that its expected returns over the 20 year period from 2012 to 2032 are equivalent to 8.9% when the information disclosure framework is applied. This is above the Commission's estimate of an acceptable range of returns over that entire 20 year period (7.6% to 8.5%).</p> <p>Christchurch Airport's target return for PSE2 (6.8%) falls within the acceptable range of returns for that initial five-year period. However, its price setting behaviour for PSE2 has primarily been influenced by demand-related considerations (such as the impact of the Canterbury earthquakes), rather than information disclosure.</p> <p>Christchurch Airport's expected profitability performance is not transparent for interested persons.</p>

Key performance question	Wellington	Auckland	Christchurch
Do the prices set by the airport promote efficiency?	<p>ID regulation is effectively promoting pricing efficiency at Wellington and Auckland Airport.</p> <p>The airports appear to have given greater consideration to pricing efficiency in PSE2 relative to the previous pricing period ('PSE1'). Consequently, prices based on the pricing methodology for PSE2 are more likely to improve pricing efficiency than those previously in place.</p> <p>The airports have indicated that information disclosure led to changes in their pricing methodology.</p>		<p>Christchurch Airport's pricing methodology for PSE2 is likely to promote efficiency, and it did seek to improve the efficiency of its pricing to some extent for PSE2.</p> <p>We do not consider that information disclosure is as effective as we would have expected it to be at this time. This is because airlines have raised some concerns about the extent to which the development of Christchurch Airport's pricing methodology for PSE2 was transparent.</p>
Is the airport innovating where appropriate?	<p>Information disclosure regulation under Part 4 is effectively promoting the purpose of Part 4 in relation to innovation.</p> <p>The airports facilitate airline-led innovation, and the level of innovation at each of the airport appears to be appropriate.</p> <p>At this time, information disclosure does not appear to have an additional impact on incentives to innovate; however, where a supplier is already innovating appropriately, we would not expect information disclosure to have any material impact on innovation.</p>		
Is the airport providing services at a quality that reflects consumers demand?	<p>Information disclosure is effectively promoting the provision of quality at a level that reflects consumers' demands.</p> <p>Airlines are generally satisfied with the quality of service and the quality experienced by passengers is comparable across the airports.</p> <p>While ID regulation may not have had an additional impact on incentives in this area, it has not negatively affected existing incentives.</p>		
Is the airport operating and investing in its assets efficiently?	<p>It is too early to tell whether information disclosure is effectively promoting improvements in operating efficiency or efficient investment.</p> <p>We are unable to conclude whether information disclosure regulation is effectively promoting improvements in opex efficiency because we do not have a sufficiently long time series on actual operating expenditure to assess meaningful trends in opex since information disclosure regulation was implemented.</p> <p>We cannot conclude whether information disclosure regulation is effectively promoting efficient investment at this stage as we do not have actual investment information for PSE2.</p>		
Is the airport sharing the benefits of efficiency gains with consumers, including through lower prices?	<p>We are unable to conclude whether information disclosure is effectively promoting the sharing of efficiency gains with consumers.</p> <p>This is because it is unclear to what extent the airports have achieved efficiency gains historically that could be shared with consumers when setting prices for PSE2.</p>		