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Dane Gunnell
Head of Price-Quality Regulation – Infrastructure Branch
Commerce Commission

Email im.review@comcom.govt.nz

Consultation on Process and Issues and Decision-Making Framework for the Part 4 Input Methodologies Review

Air New Zealand welcomes the opportunity to make this submission on the Commerce Commission's (the Commission) Part 4 Input Methodologies Review. This review comes at an important time for the aviation sector as we seek to recover from the impact of COVID-19 over the past two years and look forward to progressing the Goverment's decarbonisation goals for New Zealand.

The Commission has published two consultation documents – one relating to the proposed framework for progressing, and the other setting out the key topics for review.

The proposed framework is essentially unchanged from that adopted during the 2016 Review which Air New Zealand participated in. The Commission is proposing three overarching objectives for the IM Review:

- promoting the Part 4 purpose in section 52A more effectively
- promoting the IM purpose in section 52R more effectively
- significantly reducing compliance costs, other regulatory costs, or complexity

The Commission considers the first objective - promoting the Part 4 purpose – should take precedence. Air New Zealand agrees with these objectives and this approach.

A key update to the framework adopted in 2016 is recognition of the increased importance of emissions reduction initiatives and the ability for the Commission to take into account the 2050 target and emissions budgets where these are relevant to its deliberations, and where doing so is consistent with promoting the section 52A purpose of Part 4. Again, Air New Zealand supports the Commission's proposed approach.

The Commission has also set out the three key economic principles it believes underpin the overarching objectives:

- ex-ante FCM
- allocation of risk

- asymmetric consequences of over-/under-investment

These principles have been a consistent feature of the Commission's approach since the IM regime was first developed. Air New Zealand believes it is important the Commission maintains a principles-based approach and considers this consistency is vital to the credibility of the regime.

The Process and Issues paper identifies 5 main topics for consideration:

- Risk allocation and incentives under price-quality regulation
- Issues relating to the cost of capital
- CPPs and in-period adjustments to price-quality paths
- Transpower investment
- Effectiveness of the IMs for each sector

BARNZ, on behalf of its member airlines, commissioned TDB Advisory Limited to provide some commentary on the Commission's papers, focusing on the issues relating to the cost of capital. BARNZ will be providing the Commission with this report as part of its submission.

While supporting the report in its entirety Air New Zealand would like to draw the Commission's attention to the following comments from TDB Advisory:

Adjustments in beta-.

> Risk episodes, when they actually happen, are almost by definition a shock and surprise. That has also been the case with Covid-19. But whether or not any specific risk eventuates, airports' cost of capital determinations implicitly reflect their possibility. These risks, among many other factors, are built into the airports' beta. To pursue further *ex-post* adjustments in equity or asset betas to compensate for risk events (like Covid) that have actually arisen would in effect be double counting the risk assessment elements in the cost of capital methodology.

Adjustment of the TAMRP-

> We do not consider that rounding the TAMRP estimate is necessary or appropriate. This approach has artificially inflated an actual estimated TAMRP change of 0.2 (from the previous median of 7.1 to the new estimate of 7.3), to an actual change of 0.5 (7.0 to 7.5). As was noted at the time, this further adjustment in the TAMRP led to the WACC estimate increasing by 0.3 percentage points, despite the median TAMRP estimate only changing by enough to justify a 0.12 percentage point increase in the WACC.
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> With a RAB of around $2b in the case of Auckland International Airport, each 0.1 point increase in the TAMRP implies an increase in "regulatory" revenues of over $1m per year. This would mean a revenue increase of nearly $6m associated with a TAMRP move from 7.0 to 7.5, whereas the increase implied by the median change from 7.1 to 7.3 would be more of the order of $2.4m. This is a not inconsequential difference, with the consequences growing over time as the asset base rises.
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> …

> In our view, the median estimate from the range of methodologies deployed should be the TAMRP used by the Commission. Although not perfect, the median is nevertheless a logically coherent way of smoothing out the potential weaknesses in the individual estimation methodologies and hence the best point estimate that is available. The approach of then rounding this median to the nearest 0.5 percent adds an unnecessary further layer of approximation and artificiality to the TAMRP estimate.

TDB has also noted, in respect of the Commission's Airports comparator sample, that its preferred approach would be to use a smaller but more comparable sample of firms rather than including firms which may operate in significantly different functional and regulatory circumstances. Air New Zealand agrees that this should be the preferred approach.

Finally, Air New Zealand wishes to emphasise the importance of ensuring the IM regime supports industry aspirations for pursuing decarbonisation strategies. Sustainable aviation fuel, hydrogen and electric technologies are all part of the suite of measures that Air New Zealand will be leveraging to achieve our sustainability objectives. This cannot be done in isolation and our airport partners will play a key role in providing appropriate facilities to support the roll-out of all these initiatives. It is also important to note that this will require investment and innovation across the entire network, not just at the three airports currently subject to information disclosure requirements under the Commerce Act.

For example, looking globally, airports are moving to incentivise the use of SAF with London Heathrow and Swedavia (Swedish Airports) both having incentive schemes where the airports contribute to reducing the premium between conventional fuels and SAF. It is vital that the IM regime supports innovative initiatives that allow for unconventional approaches to achieving our climate change goals.

Air New Zealand looks forward to further engagement with the Commission throughout this review process.

Please contact me if you have any queries relating to any of the above.

Yours sincerely

Sean Ford
Manager Aeronautical Suppliers