

Briefing on final s 56G report on the effectiveness of information disclosure regulation at Christchurch Airport

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Overview



Report to Ministers on how effectively information disclosure is promoting the purpose of Part 4 for Christchurch Airport

We did not consider whether other types of regulation should apply to Christchurch Airport

This presentation summarises:

- our task under s 56G of the Commerce Act
- the analytical framework we have used
- our conclusions



Our task under s 56G



Report to Ministers on how effectively information disclosure (ID) regulation is promoting the purpose of Part 4 of the Commerce Act

Report must be made 'as soon as practicable' after prices set in or after 2012

Report considers effectiveness of ID regulation of Christchurch Airport

We have considered the implications the High Court Merits Appeal decision for this report

- the decision has not resulted in any changes to our analysis for this final report



Summary of conclusions

Christchurch Airport has made a number of positive changes in its latest pricing round, but ID regulation appears to have had little effect:

- ID is effective in promoting innovation and quality
- ID is not effective at limiting excessive profits over Christchurch Airport's 20-year pricing horizon, but returns fall within an acceptable range in the current pricing period, primarily due to the influence of demand-related considerations
- ID is not as effective as we expected it to be at this time in promoting pricing efficiency
- We cannot conclude on other areas (operating expenditure efficiency, investment efficiency, sharing of efficiency gains)



Regulated services under Part 4



ID regulation applies to specified airport services:

- aircraft and freight activities
- airfield activities
- some passenger terminal activities

Car-parking and retail activities are not regulated under Part 4



Analytical framework

We assessed performance (historical and projected) and conduct in each performance area

We considered whether performance had moved closer to outcomes found in workably competitive markets as a result of incentives provided by ID regulation

- We use the cost of capital IM as a benchmark in assessing target returns
- For other areas, we compared performance and conduct before and after Part 4 ID was implemented

Our approach is consistent with that taken for Wellington and Auckland Airports



Conclusion – limiting excessive profits (I)

ID regulation is not effective in limiting Christchurch Airport's ability to extract excessive profits over time

- ID is not effective at limiting excessive profits over Christchurch Airport's 20-year pricing horizon, but returns fall within an acceptable range in the current pricing period
- Christchurch Airport's price-setting behaviour for PSE2 appears to have been primarily influenced by the demand-related considerations that are affecting the airport, rather than by information disclosure regulation
- Christchurch Airport's expected profitability performance is not transparent for interested persons because its price setting disclosure does not fully or transparently reflect its pricing approach.



Conclusion – limiting excessive profits (II)



Christchurch Airport has adopted a ‘levelised constant real price’ model to target returns over 20 years to reflect the expected utilisation of its new integrated terminal over its lifetime

- Straightforward in concept but difficult to follow in practice

It treated revaluation gains as a discount that reduced prices

It made a commercial decision to only gradually increase prices to the levelised price path during current pricing period, given short-term demand uncertainty due to the Canterbury earthquakes



Conclusion – limiting excessive profits (III)



Our estimate of an acceptable range of returns over the 20 year period for which Christchurch Airport set its levelised price is 7.6% to 8.5%

Christchurch Airport's target return over the 20 year period is 8.9%, which is above that acceptable range

Christchurch Airport's target return of 6.8% during PSE2 falls within an acceptable range of returns for PSE2 (6.6% to 7.6%), based on an IM-compliant RAB and straight-line depreciation



CIAL's proposed changes for the future



Christchurch Airport has proposed a number of methodological changes to its disclosures and future pricing to improve the transparency of its pricing approach. These include:

- using a non-standard depreciation approach to allow customers to better track the recovery of its investment and asset base each year
- changing the pricing model to use a post-tax WACC and to include forecasts of the regulatory tax allowance (calculated using the tax input methodology) in each year

Christchurch Airport has also stated that it intended (and still intends) setting prices as the outcome of a series of rolling 20 year periods

- this does not appear to be consistent with airlines' understanding at the time that prices were set for PSE2

We welcome Christchurch Airport's commitment to improve the transparency of its pricing approach



Conclusion - innovation

ID regulation under Part 4 is effectively promoting innovation at Christchurch Airport:

- the level of innovation appears to be appropriate
- airlines generally consider that Christchurch Airport is receptive to airline-led innovation
- while ID regulation has not had an additional impact on incentives to innovate, it has not negatively affected existing incentives



Conclusion - quality

ID regulation is effectively promoting the provision of quality at a level that reflects consumer demands:

- quality at Christchurch Airport has improved since ID and compares well to other airports, as measured by passenger surveys
- airlines are generally satisfied with the quality of service
- Christchurch Airport generally seeks to ensure quality reflects consumer demands
- Christchurch Airport facilitates improvements in quality or efficiency for services provided by its consumers (eg, airlines)
- New integrated terminal has led to quality improvements
- ID regulation does not appear to have an additional impact on quality, however, it has not negatively affected existing incentives



Conclusion – pricing efficiency

Christchurch Airport's pricing methodology for PSE2 is likely to promote efficiency in most areas

Christchurch Airport did seek to improve the efficiency of its pricing to some extent for PSE2

- for example, it made changes to its pricing methodology to address previous concerns about cross-subsidisation

However, ID is not as effective as we would have expected it to be at this time

- the development of Christchurch Airport's pricing methodology has not been fully transparent



Conclusion – operating expenditure efficiency



We are unable to conclude whether ID regulation is effectively promoting improvements in operating efficiency (opex):

- we do not have a sufficiently long time series on actual opex under ID regulation
- unit opex has increased since the implementation of ID regulation and Christchurch Airport forecasts this to continue until 2014
- the Canterbury earthquakes of 2010 and 2011 and the new terminal building are affecting operating expenditure
- Christchurch Airport has sought to improve its opex efficiency (eg, features to improve efficiency while building the new terminal)
- there is little or no evidence that ID regulation has had an impact



Conclusion – efficient investment

We are unable to conclude whether ID regulation is effectively promoting incentives to invest efficiently:

- we do not have a sufficiently long time series on actual capital expenditure (capex) under ID regulation

Airlines are generally satisfied with Christchurch Airport forecast investment in PSE2

- there is little or no evidence that ID regulation had any impact



Conclusion – sharing of efficiency gains



We cannot conclude whether ID regulation is effectively promoting sharing of efficiency gains:

- like Wellington and Auckland Airports, there is limited evidence of historic efficiency gains that could be shared



Thanks to stakeholders



This final report completes our reviews under s56G of the Commerce Act.

We thank everyone who has participated in the review process. We sincerely appreciate the professional and helpful manner in which the three airports have conducted themselves throughout the review process and for their comprehensive submissions on our draft reports.

We want to also thank Air NZ and BARNZ for their valuable input into our review process and for the effort they went to in their submissions to us.



Questions?



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