BARNZ RESPONSES TO COMMERCE COMMISSION SECTION 56G ISSUES PAPER RELATING TO AUCKLAND AIRPORT

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This submission, in its entirety, is made on behalf of the 'international-only airlines'[1] which BARNZ has written authority under s2A of the Airport Authorities Act 1966 to represent during consultation over charges with Auckland Airport.

This submission is also made on behalf of the Air NZ Group with the exception of responses to questions regarding the reasonableness of Auckland Airport's revenue forecasts or profitability.[2] In relation to such revenue related topics the Air NZ Group will respond separately to the Commerce Commission.[3]

The Qantas Group will respond separately to the Commerce Commission in relation to all questions.

1.0 OVER ARCHING QUESTIONS ON ALL ASPECTS OF PERFORMANCE[4]

Overall the 'international-only airlines' represented by BARNZ consider that the charges set by Auckland Airport in the second PSE will result in airlines paying $147m too much in charges over the five years of the pricing period and in the Airport earning excess returns, in NPV terms, of $85m at the mid-point 6.49% WACC estimate identified as appropriate by the Commerce Commission.

The international passenger charge contributes the vast majority of this over-recovery. It has been set significantly too high and, at its current level, will result in substantial excess profits being extracted by the Airport, at the cost of international airlines and their passengers. At the Commission's mid-point WACC estimate of 6.49% a reduction of $3.66 or 24% per passenger (which equates to approximately $7 on a round trip) from Auckland Airport's initial international passenger charge of $15.16 is required to produce a forecast combined NPV = 0 outcome over terminal and airfield pricing activities

[1] These are the airlines which had authorised BARNZ under section 2A of the AAA to represent them in consultations with airports under section 4B and 4C of the AAA. As at the 7th of June when AIAL set its charges these airlines were Air Calin, Air Pacific, Airwork, Air Tahiti Nui, Air Vanuatu, Cathay Pacific Airlines, China Southern Airlines, Emirates, EVA Airlines, Fieldair Holdings/Air Freight, Korean Air, LAN Airlines, Malaysia Airlines, Virgin Australia, Singapore Airlines, Tasman Cargo Airlines and Thai Airways International.
[2] This is primarily the over-arching comments in section 1 and the response to question 3.5.
[3] For the avoidance of doubt Air NZ may also respond on other matters as well.
[4] This comment is made on behalf of the international-only airlines BARNZ has authority under s2A of the AAA to represent in consultations.

1.1	Has information disclosure had any impact on AIAL's performance and in understanding AIAL's performance relative to the first price setting event (PSE) and why?

The price setting disclosure made in 2011 in relation to the first PSE (which occurred in 2007) undoubtedly improved the availability of information in the public domain with respect to the first PSE. Prior to these disclosures the publicly available information was only of a very general descriptive nature in the form of media releases by Auckland Airport at the time it set charges in 2007. The subsequent annual information disclosure for FY11 then assisted in providing a better understanding of AIAL's performance in FY11 relative to the first PSE. The forthcoming FY12 disclosure due at the beginning of December will further improve that understanding.

Overall, BARNZ's view is that information disclosure has resulted in an improvement in understanding AIAL's performance in relation to the first PSE.

However, BARNZ notes that there remains a disconnection between the price setting events and the form information disclosure occurs in. Information disclosure relates to a wider asset base than the pricing asset base in the case of all three airports. In addition asset values, which differ from the disclosure asset values, have been adopted by Auckland and Wellington Airports for the purposes of setting charges. In the case of Wellington Airport it used a higher MVEU valuation. In the case of Auckland Airport, it set charges using its 2006 MVAU valuation with no forecast revaluations due to the 10 year moratorium on asset revaluations which it committed to as it set charges in 2007.

1.2	Has information disclosure had any impact on the effectiveness and scope of consultation as part of AIAL's second PSE relative to the first PSE, and why?

<u>Information disclosure</u> (in the sense of the annual release of historical information) did not have any impact on the effectiveness and scope of AIAL's second PSE. This is because, as with WIAL, AIAL's second PSE occurred during the 'vacuum' between the previous AAA information disclosure regime and the new disclosure requirements under the Commerce Act. The last information disclosure under the AAA occurred on 30 November 2010 for FY10. Disclosure for FY11 under Part 4 was not due until 31 May 2012. Consultation for the second PSE occurred from August 2011 until the beginning of June 2012 – hence it was coming to an end at the same time that the first annual information disclosure was released under Part 4.

In previous consultations BARNZ made considerable use of the AAA Information Disclosure to discern trends over matters such as operating costs and depreciation. The AAA information was also referred to during the second PSE, but was less up to date than before. BARNZ envisages that the Part 4 Disclosures would similarly be useful in future consultations.

<u>The input methodologies</u> developed by the Commission under Part 4 as part of information disclosure regulation were however available to airlines and the Airport during consultation for the second PSE. They had a mixed impact on the effectiveness and scope of consultation with Auckland Airport. It cannot be said that the input methodologies were ignored or dismissed as irrelevant by Auckland Airport. However, neither can it be said that they were applied consistently by the Airport.

The clearest instance of the input methodologies impacting decisions taken during consultation is with respect to the allocation of arterial roads, which were previously allocated virtually entirely to aeronautical activities using an ACAM cost allocation methodology. As a result of the input methodologies, the Airport revised its allocation methodology to treat these arterial roads as a common cost.

On the other hand, the Airport continued to apply its own adviser's views in relation to WACC, not applying many of the components of the Commission's input methodology regarding the methodology for estimating an appropriate WACC.

With respect to asset valuation, the Airport is in the middle of a 10 year moratorium on asset revaluations which it had publicly committed to as it set charges in 2007. As such, the asset valuation input methodologies and treatment of revaluations were less relevant to Auckland Airport's second PSE. However, this is likely to be the key issue facing the Airport and airlines in the third PSE.

The forthcoming s56G Review did have some impact on the effectiveness of the second PSE consultation. In BARNZ's view, it was the presence of this Review which resulted in Auckland Airport, while not acknowledging the validity of the Commission's WACC input methodology, or the Commission's lower WACC estimates which hovered around the 7% to 8% range during consultation, not pricing up to the 9.16% WACC it was targeting across all activities, instead setting charges at a level which it described as resulting in an overall 8.5% return[5] (albeit still significantly above the Commission's estimate of a reasonable range of 5.51% to 7.48% and therefore still incorporating excessive profits in breach of section 52A).

BARNZ notes that airport regulation in Australia has evolved to include regular five yearly reviews by the Productivity Commission of the effectiveness of airport regulation, with these reviews becoming an integral component of the regulatory regime for airports in that country.

1.3	What aspects of performance and conduct should we focus our efforts on for this review for AIAL?

The key decision by Auckland Airport in relation to its second PSE which needs to be focused on during the Commission's section 56G review is *the pricing decision for international terminal charges*, and whether the Airport has been limited in its ability to extract excessive profits, or whether it has used its market power and right to set charges as it thinks fit under section 4A of the AAA to extract excessive profits from international airlines.

The key matter requiring particular attention is the *cost of capital*, where Auckland Airport not only applied a WACC of 9.16% when modelling international terminal charges, it actually set its international terminal charge at a level which is forecast to result in a positive NPV outcome of $50m

[5] Refer Auckland Airport Investor Pricing Presentation, 7 June 2012, slide 6. Note charges were set so that returns from airfield charges are forecast to be below this level while returns from international terminal charges are forecast to be materially higher.

for terminal activities at even that over-stated WACC. This represents a forecast return of 11%[6] on terminal activities. By contrast, the charges set for airfield activities represent a return of approximately 6.8%[7]. The Commerce Commission mid-point WACC of 6.49% suggests that the charges set by Auckland Airport will result in forecast excess returns with a positive NPV of $85m across all pricing activities.

The reasonableness of the 2009 and 2011 MVAU land valuations adopted by Auckland Airport also require consideration by the Commission. The 2006 opportunity cost value of airfield land undertaken by Auckland Airport by Seagars was $600 000 per ha. The per ha MVAU value adopted by Auckland Airport in FY11 on the basis of the Collier valuation is less clear:

- The Collier valuation concludes by noting a $675 000 per ha value over the RAB and future development land (excluding seabed, coastal margin and commercial land).[8]
- Auckland Airport's FY12 Annual Report records that the rate per ha for airfield land prior to the addition of holding costs is $1 020 000 per ha.[9]
- BARNZ's reading of the valuation rates adopted by Colliers is that the MVAU rates average $797 000 per ha for RAB land and $448 000 per ha for land held for future use.

The alternative land use plan underlying Auckland Airport's adopted land value contains an extraordinarily high level of retail and commercial use. The planning advice received by BARNZ questions the plausibility of this aspect of the alternative land use plan. Given that the asset valuations adopted by Airports directly affect the perceived level of return achieved by the Airports, this is a key matter the Commission needs to focus on in its s56G deliberations. As BARNZ submitted in its post-conference submissions in relation to Wellington Airport, BARNZ strongly considers that the Commission needs to engage its own independent valuation advisers, as the Commission did during the Airport Price Inquiry, to determine an appropriate land valuation. Without independent verification of the appropriate MVAU value, the Commission will not be able to clearly assess the level of profitability of the Airport.

Looking forward to the third PSE, an additional key issue, able to be side-stepped in the second PSE as a result of the Moratorium on asset revaluations, will be whether Auckland Airport will continue to apply the Moratorium on asset revaluations, or whether it will switch to revaluing its assets? If assets are revalued, then issues will arise such as:

- The valuation methodologies – in particular whether MVEU or MVAU will be applied to valuing land and whether specialised asset valuations will be indexed forward by CPI or whether updated ODRC valuations will be adopted?[10]

[6] Note this is calculated from AIAL's financial model, with all other inputs unaltered. BARNZ has other issues of a less material nature such as volume forecasts and allocation of space on the second floor of the ITB which would slightly alter the level of return if also corrected.
[7] Note this is also calculated from AIAL's financial model, with all other inputs unaltered. There is an unresolved issue around the inclusion of approach land which would slightly alter the level of return if corrected.
[8] Colliers International MVAU Auckland Airport Valuation Report, June 2011 at page 33.
[9] Auckland Airport Annual Report for the year ended 30 June 2012, page 72, note 11 to the financial statements.

- The reasonableness of the adopted valuations. Revaluations included in Auckland Airport's annual accounts amounted to $519m in FY11, made up of $403m for land, $56m for infrastructure and $60m for runway, taxiway and apron revaluations.
- The treatment of asset revaluations and whether AIAL will treat all revaluations – both forecast and actual – as income for the purposes of setting charges as per the Commerce Commission input methodologies.[11] The amounts are not immaterial. Revaluations included in Auckland Airport's annual financial accounts amounted to $519m in FY11, made up of $403m for land, $56m for infrastructure and $60m for runway, taxiway and apron revaluations.[12]

Auckland Airport and the airlines have been able to side-step these issues in the second PSE by virtue of the pre-existing Moratorium on asset revaluations. However, in the absence of Auckland Airport treating the 2006 revaluations as its deemed historic cost with no further revaluations being applied, these issues will need to be addressed in the third PSE. BARNZ therefore considers that it is essential that the regulation of airports under Part 4 of the Commerce Act include on-going, regular, 5 yearly reviews of the effectiveness of regulation under Part 4 in achieving the purpose contained in section 52A.

2. ANY ADDITIONAL ISSUES INCLUDING EXPLANATION OF WHY THEY ARE IMPORTANT

BARNZ does not have any additional matters to raise that are not addressed elsewhere in the responses to the questions asked by the Commission in its Issues Paper.

[10] At the commencement of consultation in 2011 Auckland Airport advised that its preliminary views on asset valuation for pricing purposes was to apply new 2011 valuations of land using MVEU and of specialised assets using ODRC. Refer letter to substantial customers dated 14 September 2011.

[11] In that same letter Auckland Airport advised that its preliminary view was that it would treat forecast revaluations as income on a prospective basis.

[12] Auckland Airport Annual Report for the year ended 30 June 2012, page 70, note 11 to the financial statements.

3. IS AIAL EARNING AN APPROPRIATE ECONOMIC RETURN OVER TIME?

3.1 What is an appropriate level of target return for AIAL, and why is this level appropriate?

BARNZ considers that the Commerce Commission's mid-point estimate (currently 6.49%) is the appropriate level to set charges so as to anticipate a return reflecting a normal performance, noting however that some of the inputs used by the Commission when estimating its WACC range are generous towards suppliers[13].

Comment on WACC Inputs

During consultation BARNZ sought advice from Futures Consultants Ltd (FCL) on AIAL's Weighted Average Cost of Capital and the differences in WACC inputs between Auckland Airport and the Commerce Commission Determination, and specifically on whether there is any valid reason for departing from the Commission's cost of capital methodology developed for the purposes of information disclosure, when setting charges. The FCL Report dated 31 October 2011 is attached as **Attachment 1**. In this report FCL concluded:

> *… there is no justification for AIAL, when it is setting charges, adopting parameter estimates using a different approach from what the Commission has set for AIAL for information disclosure purposes. Should AIAL use Uniservices' WACC estimates in order to set charges for its regulated services, without making offsetting adjustments in one or more of the other components it uses for this purpose, it will be seeking very significant excess returns compared with the level the Commission considers to be appropriate.*

A comparison of the inputs being used by Auckland Airport and the Commerce Commission in its latest Cost of Capital Determination for Airports are set out below:

	AIAL June 2012 Uniservices WACC	**ComCom Airports July 2012 Mid-point**
Risk-free Rate before Tax	3.48%	2.78%
Debt Premium	1.72%	2.18%
Debt Issue Costs	0.35%	0.35%
Market Risk Premium	7.5%	7.0%
Leverage	30.0%	17.0%
Beta (Asset)	0.65	0.60
Investor Tax Rate	28%	28%
Cost of Debt		
RFRBT+DebtP+DebtI	5.55%	5.31%

[13] In particular, the asset beta and debt issuance costs

Cost of Equity		
Beta (Equity) = BetaA/(1-Lev)	0.93	0.72
RFRBT*(1-Ti)+BetaE*TAMRP	9.5%	7.0%
Mid-point Post Tax Weighted Average Cost of Capital	**7.8%**	**6.5%**
Point estimate adopted for pricing purposes	**9.2%**	

The core differences are:

- AIAL has used a 7 year cost of debt, which is approximately 0.7% higher than the current five year cost of debt, which is considered the appropriate length of debt by the Commerce Commission. However, partially offsetting this, the Airport has used a debt premium approximately 0.5% lower than the debt premium calculated by the Commission. Overall, the cost of debt adopted by Auckland Airport is 0.24% higher than that calculated by the Commission.
- AIAL has used a PTMRP of 7.5% rather than the 7% identified as reasonable by the Commission for all regulated industries, claiming that the sovereign debt crisis makes it appropriate to extend the one year temporary uplift of PTMRP to 7.5%, which the Commission applied at the end of 2010.
- AIAL has used an asset beta of 0.65 rather than the asset beta of 0.60 identified as reasonable by the Commission for the airport sector.

Comment on WACC Range

BARNZ notes that, while the Commission observed that the mid-point estimate of the WACC should be the starting point for assessing the profitability of airports in its Information Disclosure Determination for Specified Airports, subsequently in its WACC Determinations, the Commission has observed that ‘75th percentile estimates of the WACC are used [by the Commission] when considering default and customised price paths’ for electricity and gas distribution business.

BARNZ considers it is appropriate to apply a mid-point estimate WACC as the target return, based on what an efficient debt structure and costs would be for the industry. A higher level of WACC (such as the 75th or 80th percentile estimates) just increases the likelihood of the asset owner earning excessive returns.

Moreover, airports fundamentally differ from other regulated businesses such as gas pipelines and electricity lines businesses. Airports are able to leverage off their aeronautical activities to create extremely lucrative retail and car-parking businesses whose customers are the passengers carried by airlines. Any internal consideration by airports of the business case for adding additional aeronautical capacity (such as additional contact gates, hard stands or passenger processing capacity), will not only take into account the forecast aeronautical revenue to be earned from such investment, it will also consider the likely increase in retail and car-parking revenue from the additional passenger volumes. The complementary nature of the retail and car-parking activities occurring at airports has led many countries to treat airports as single till businesses, with aeronautical charges set after taking into account the non-aeronautical revenue earned by the Airport. Heathrow Airport is one of the most well-known examples. Regulation of New Zealand Airports is currently implicitly based on a dual till approach, whereby assets, costs and revenues are split between the different activities, with charges for aeronautical activities set in isolation from the tens (even hundreds) of millions of dollars able to be earned from the provision of car-parking and retail activities to airline passengers. The fact that such a lucrative complementary revenue stream exists, means that it is not necessary for Airports to set charges at the 75th percentile WACC estimate in order to be incentivised to innovate and invest – the presence of the ability to earn additional revenue from provision of these complementary services already provides additional incentive on Airports to invest in maintaining or adding aeronautical capacity.

Passenger volumes are the main driver of a substantial portion of Auckland Airport's commercial revenue. In FY12 Auckland Airport earned $120.9m from retail activities, and $36.6m from car parking activities. As a whole, retail activities earned $152.2m or 39% of revenue earned by the Airport. Only 14% of airport costs are attributed to retail activities. Overall the retail segment contributed 42% ($142m) of Auckland Airport's after tax profit.[14]

The market for car-parking services and duty-free concessions and other terminal retail activities only exists because of the presence of airline passengers. As the volume of passengers moving through the airport increases, so too does the Airport's car-parking and retail concession revenue. The Airport itself describes international passenger volumes as 'our biggest value driver'[15] and 'a key driver for our company performance'[16]. The Airport discloses that the average retail income earned from each international passenger is $16.15. In addition, each passenger (domestic and international) on average contributes $2.73 in car-parking revenue to the airport.[17]

BARNZ therefore considers that the mid-point WACC estimate represents an appropriate level of target return for Airports and is more than sufficient to provide incentives to innovate and invest.

Feedback provided to Auckland Airport during consultation

Given the Commission's indication that it intended to use the 75th percentile estimate when setting default and customised price paths for gas pipeline and electricity lines businesses, during consultation BARNZ undertook its Assessment of the Pricing Proposals prepared by Auckland Airport using a WACC range from the 50th percentile to the 75th percentile, thus allowing airlines to judge the reasonableness of the proposed charges under both a mid-point WACC and a higher WACC estimate.

The Qantas Group and the Air NZ Group each made their own submissions to Auckland Airport during consultation. BARNZ is not aware of what WACC these airlines considered appropriate.

The international-only airlines which BARNZ represented during consultation considered that the mid-point WACC was the appropriate point to set charges, however elected to apply the updated

[14] Refer Auckland Airport Annual Report for year ended 30 June 2012, at page 56.
[15] Refer Auckland Airport Annual Report for year ended 30 June 2011, at pages 11 and 16.
[16] Refer Auckland Airport Interim Results for six months ended 31 December 2011 at page 8.
[17] Refer Auckland Airport Annual Report for year ended 30 June 2012, at page 26.

Commerce Commission's 75th percentile WACC estimate as a commercial concession in order to endeavour to reach an outcome which both the airlines and the Airport considered reasonable. The May 2012 submission on behalf of these airlines stated:[18]

> With respect to the appropriate WACC range, the BARNZ Represented Airlines confirm that they continue to consider that the mid-point WACC is the appropriate estimate to use to determine charges. However, the Commerce Commission has indicated it will use a WACC estimate at the 75th percentile when determining default or customised pricing paths for gas pipeline and electricity lines businesses. ***As a pragmatic commercial concession in order to endeavour to reach an outcome which both the airlines and the Airport consider to be reasonable, the BARNZ Represented Airlines have elected to apply the Commerce Commission's 75th percentile WACC estimate of 8.04% when considering the charges proposed by Auckland Airport.***

In response Auckland Airport adjusted its WACC range down 5% from the 85th percentile to the 80th percentile. This was slightly disappointing, and not the commercial outcome which the international-only airlines had been endeavouring to achieve. In its pricing determination Auckland Airport set prices effectively resulting in a forecast overall return of approximately 8.5% on its pricing activities.[19] However, this was not evenly spread across all activities, with the Airport's financial model highlighting that returns of more than 11% are being targeted on terminal activities.

The international-only airlines BARNZ represented during consultation consider that charges have been set at a level which will result in Auckland Airport earning excessive returns on international terminal activities over the next five years, at the cost of international airlines and their passengers.

Given that a commercial outcome was not able to be achieved, the international-only airlines confirm their underlying view, as expressed to Auckland Airport during consultation, that the mid-point WACC estimate represents an appropriate level of target return for Airports. A mid-point WACC estimate is more than sufficient to provide incentives for airports to innovate and invest, particularly in light of the significant complementary revenues able to be earned by the airport from the provision of retail and car-parking services to passengers carried by airlines.

3.2 What is an appropriate level to reflect normal performance, and why?

BARNZ considers that the Commerce Commission's mid-point estimate (currently 6.49%) reflects normal performance, noting however that some of the inputs used by the Commission when estimating its WACC range are generous towards suppliers. Below average returns, albeit still within a normal range, could be expected within the range down to the 25th percentile. The 25th percentile is just as relevant as the 75th percentile.

[18] Submission on Behalf of BARNZ Represented Airlines, 7 May 2012, page 5, note the WACC estimate differs from the applicable rate at the time Auckland Airport set charges in June.
[19] Refer Auckland Airport Investor Pricing Presentation, 7 June 2012, slide 6.

3.3	What is an appropriate level to reflect superior performance, and why?

BARNZ considers that superior performance could be expected within the range up to the 75th percentile, which the Commission has estimated at 7.48%, however prices should not be set using a WACC estimate reflecting superior performance. Superior returns should have to be earned through superior performance – not simply granted through use of a WACC at the upper bounds of an appropriate range. The 9.16% WACC targeted by AIAL would represent excessive returns.

3.4	Have there been any wash-ups, discounts or other discretionary adjustments to the forecast revenue requirements. If so, how should these be dealt with for assessing profitability?

In the first PSE covering the period 1 July 2007 to 30 June 2012 there were five known wash-ups, discounts or discretionary adjustments:

- There was an $7.5m credit[20] applied to reflect the 'over-payment' of the international departure charge which occurred from 2005 until 30 June 2007 after the departure charge paid by international passengers to the Airport remained unchanged at $25, despite airlines assuming responsibility for meeting Aviation Security (Avsec) costs and CAA levies, which had previously been paid by the Airports out of the revenue collected from international passengers in the departure charge. The then Avsec and CAA charges amounted to $5 per departing international passenger. At that time, all international airports were undertaking unexpected modifications to their terminal buildings to allow hold stow baggage screening equipment to be installed. Auckland Airport and airlines agreed that the international departure charge should remain at its current level of $25 until charges were reset in mid-2007, with the Airport retaining the $5 previously paid to Avsec and CAA, with this amount used to meet the capital expenditure associated with the previously un-forecast security requirements, and any remaining monies treated as a credit when charges were reset as at 1 July 2007.[21]

- There was a $99m credit applied to reflect approximately half of the un-forecast land revaluations. There was not any equivalent credit aimed at reflecting un-forecast building or civil works revaluations. [22]

- The Terminal Services Charge (TSC) was the subject of annual wash-ups to reflect actual costs for the space and services within the ambit of the TSC Agreement (primarily air-side international terminal space and services). These annual wash-ups were generally less than $0.5m pa positive or negative.

[20] Refer page 14 Auckland Airport FY08 to FY12 Price Setting Disclosure.

[21] This was the same agreement and resulting wash-up as was the case at Wellington Airport. Christchurch Airport also reached the same agreement but has reflected it differently in the charge setting process, making the adjustments via asset inclusion rather than as a wash-up.

[22] Refer page 15 Auckland Airport FY08 to FY12 Price Setting Disclosure, and Auckland Airport Media Release dated 2 July 2007 entitled *'Auckland Airport adopts 10 year asset revaluation moratorium'*.

- The capital charge for the connector between Pier A and Pier B was discounted by 50%, in reflection of the fact that when first constructed, it would only be serving two contact gates (out of the ultimate total of ten contact gates when Pier B is fully constructed). This discount was intended to be repaid from the earlier of the start of the FY18 to FY22 pricing period (1 July 2017) or when six contact gates were operational on Pier B.

BARNZ cannot think of any other wash-ups, discounts or discretionary adjustments in the second price setting period which would require adjustment from one pricing period to another, as the TSC Agreement has been terminated and the Pier B connector is now being fully charged for in this pricing period.

BARNZ addressed the issue of how such 'adjustments' should be dealt with for assessing profitability at page 7 of its Post Conference Submission on Wellington Airport dated 17 August 2012. BARNZ noted that *while in general revenue should be treated as income in the period in which it is received, where there is a firm commitment by an Airport to treat a particular class of revenue as income in the next pricing period, then that revenue amount represents an over-payment by the airlines and a liability to the Airport at the end of the first pricing period, and should be treated as reducing the profitability of the first pricing period, and should treated as income in the second pricing period. On the other hand, if there is not a firm commitment by the Airport to treat the revenue in question as income in the next pricing period, then the general rule should apply and it should be considered to be income earned in the first period, increasing profitability in that period.*

Applying this principle suggests that the:

- Departure tax wash-up should be treated as income in the first PSE as there was a pre-existing commitment to treat this as a credit in the first PSE.
- Revaluation credit of $99m does not need to be treated as income in the first PSE as there was no pre-existing commitment to treat this as a credit.
- Strictly speaking, any TSC wash-up needs to be carried forward, however the amounts involved are not as material, and the wash-ups tend to work both ways, so the complexity of this adjustment might be best avoided.
- The repayment of the under-recovery of capital costs of the connector should be treated as income in the first PSE, and not in the third PSE because there is a pre-existing commitment for airlines to make good the discount which was allowed over the first three to four years of the life of Pier B.

3.5 How reasonable is AIAL's revenue forecast for the second PSE compared to the first PSE forecasts, and why?[23]

Overall the assessment by BARNZ on behalf of the international-only airlines is that the charges set by Auckland Airport in the second PSE will result in airlines paying $147m too much in charges over the five years of the pricing period at the mid-point 6.49% WACC estimate identified as appropriate

[23] The response to this question is on behalf of the international-only airlines BARNZ has authority under s2A of the AAA to represent in consultations.

by the Commission. At current forecasts, this would result in the Airport earning excess returns with a positive NPV of $85m.

Level of Airfield and Terminal Required Revenue and NPV Outcomes

Building Block Inputs	WACC Point Estimate	Required Revenue	Forecast Revenue	Under/Over Recovery from charges	NPV Outcome (Post Tax) at AIAL Proposed Charges
AIAL decision	9.16%	$1194m	$1155m	($39m)	($25m)
BARNZ inputs with Com Com 75th percentile Airport WACC	7.48%	$1078m	$1160m	$82m	$45m
BARNZ inputs with Com Com mid-point Airport WACC	6.49%	$1013m	$1160m	$147m	$85m

The analysis supporting this assessment is attached as **Attachment 2.** BARNZ has updated its alternative revenue model to reflect the changes made by Auckland Airport to the various inputs as the Airport set charges in its final financial model and to reflect the most recent WACC Determination of the Commission in relation to specified airports.

The performance of the airfield and terminal cost centres is not equal. The international passenger charge contributes the vast majority of this over-recovery, hence the international-only airlines BARNZ represented during consultation consider that the terminal charges levied by Auckland Airport on international airlines with respect to international passengers are significantly too high, and need to be reduced by 24% or $3.66 per international passenger, from the current initial charge of $15.16 to $11.50 per international passenger (which represents a reduction of approximately $7 per round trip) in order to produce an NPV = 0 result at the Commerce Commission mid-point WACC.

With respect to the other charges set by Auckland Airport, the BARNZ Represented Airlines considered that the airfield MCTOW charges, airfield parking charges, international transit and transfer passenger charge and international check-in counter charges were all reasonable. The domestic passenger charge was considered to be set approximately 10% too low, as while the charge will meet all direct costs associated with domestic terminal activities, its contribution towards joint and common terminal costs is very low.

Summary of BARNZ Airfield Assessment

BARNZ's analysis has identified that the following adjustments should be made to the Airport's financial model calculating the allowable revenue for airfield activities in order to align with the Commerce Commission's framework (but continuing to apply the agreed asset valuation moratorium):

- Reduce the WACC from 9.16% to the updated Commerce Commission range of 6.49% to 7.48%.
- Remove the Southern Airfield Restricted land from the asset base[24] as this land is not required to be owned by the Airport (a $2.7m reduction in the asset base). This land is shown on the plan contained in **Attachment 3.**

Making these adjustments significantly affects the outcome, as shown in the table below.

Level of Airfield Required Revenue and NPV Outcomes

Building Block Inputs	WACC Point Estimate	Required Revenue	Forecast Revenue	(Under)/Over Recovery from charges	NPV Outcome at AIAL Proposed Charges
AIAL decision	9.16%	$543m	$452m	($91m)	($52m)
BARNZ inputs with Com Com 75th percentile Airport WACC	7.48%	$475m	$452m	($23m)	($15m)
BARNZ inputs with Com Com mid-point Airport WACC	6.49%	$436m	$452m	$16m	$8m

This Analysis indicates that, at the Commerce Commission mid-point WACC of 6.49% the airfield charges set by AIAL are forecast to result in it earning a positive NPV of $8m over the five year pricing period. The international-only airlines BARNZ represented consider the airfield charges set by Auckland Airport are largely reasonable, albeit that they believe the justification for the differential MCTOW rates for aircraft below 40 tonnes needs reviewing prior to charges being reset in 2017.

Summary of BARNZ Terminal Assessment

BARNZ's analysis has identified that the following adjustments need to be made to the Airport's financial model calculating the allowable revenue for terminal activities:

[24] This land is part of what was formerly known as the Eastern Approach land which the Commerce Commission in the Airport Price Inquiry held was not required to be owned by the Airport in order to provide airfield activities. Subsequently some overseas regulators (particularly in the UK and the USA) have recommended that major airports take what steps are practicable to ensure Runway End Protection Areas and Public Safety Zones at the end of runways are not intensively used. Auckland Airport allocates an area of some 38 ha which it calls 'Southern Airfield REPA/PSZ'. It included this in the asset base on which it set charges in 2007 and 2012 and BARNZ considers this appropriate and does not object – despite the fact it was previously wholly optimised out by the Commission in the API. However, Auckland Airport also includes a further 27ha of land that it describes as 'Southern Airfield Restricted Use'. BARNZ does not consider that this land is required to be owned by the Airport, nor that the land is used for the purposes of providing specified airport services. Aircraft could continue to use Auckland Airport in the absence of the Airport owning this land, with planning provisions being more than adequate to protect the airspace.

- Reduce the WACC from 9.16% to the updated Commerce Commission range of 6.49% to 7.48%
- Reallocate the circulation and common space on the second floor of the international terminal building so that commercial activities meet a portion of the cost of this space. The adjustment to the opening asset base ranges from $1.25m to $2.5m depending upon whether it is applied to all circulation and common space on the second floor, or just the portion up to where commercial activities cease. This area is shown on the floor plan of the second floor of the ITB in **Attachment 4.**
- Remove the merits review costs as pursuing this case is a decision taken by the Airport which should not be funded by the airlines. This is forecast by the Airport as $3.9m over the pricing period.[25]
- Increase the forecast arriving and departing international passenger growth in FY13 from 1.8% forecast growth to 2.7% forecast growth

Making these adjustments significantly affects the outcome over the five year pricing period, as shown in the table below.

Level of Terminal Required Revenue and NPV Outcomes

Building Block Inputs	WACC Point Estimate	Required Revenue	Forecast Revenue	Under/Over Recovery from charges	NPV Outcome at AIAL Proposed Charges
AIAL decision	9.16%	$652m	$702m	$50m	$27m
BARNZ inputs with updated Com Com 75th percentile Airport WACC	7.48%	$603m	$708m	$105m	$60m
BARNZ inputs with updated Com Com mid-point Airport WACC	6.49%	$577m	$708m	$131m	$77m

This analysis indicates that, at the Commerce Commission mid-point WACC estimate, the terminal charges set by AIAL will result in airlines paying some $131m too much and the Airport earning a positive NPV outcome of $77m on the terminal activities. At the Commission's 75th WACC percentile the terminal charges proposed by AIAL will result in airlines paying some $105m more in charges than is justified which will result in the Airport earning an NPV surplus of $60m on the terminal activities.

Clearly, it is the international terminal charges set by Auckland Airport which will result in it earning significant excess returns on its terminal assets over the pricing period. Applying the Commission's current estimate of the mid-point WACC, the international passenger charge should commence from

[25] Refer Appendix H Auckland Airport Revised Pricing Proposal, 5 April 2012.

$11.50 per passenger, which is $3.66 or 24% per passenger less than the $15.16 initial charge set by Auckland Airport.

As noted above, the international-only airlines BARNZ represented applied the 75th percentile WACC estimate as a commercial compromise during consultation in an endeavour to reach agreement with the Airport. Applying the Commission's current estimate of the 75th percentile WACC suggests that the international passenger charge should commence from $13.20 per passenger, which is around $2 per passenger less than the $15.16 initial charge set by Auckland Airport.

However, a commercial outcome was not able to be achieved, therefore international-only airlines confirm their underlying view, as expressed to Auckland Airport during consultation, that the mid-point WACC estimate represents an appropriate level of target return for Airports

The First PSE

In September 2007, several months after Auckland Airport had reset its charges in the first PSE, BARNZ wrote to the Minister of Finance responding to a series of questions asked by the Minister on the level of perceived excess returns. In this letter BARNZ advised that it considered that at Auckland Airport, each arriving and departing international passenger would be paying approximately $2.30 more than is reasonably required (ie $4.60 per round trip). Overall, this was forecast to equate to $26m pa in excess returns, which would amount to $130m over the five year pricing period. The summaries from that letter are set out below:

AIAL Airfield Charges

	Annual average	Total 2008 – 2012
Airfield revenue which will be earned by AIAL	$80.4m	$402.1m
BARNZ Assessment of reasonable charges	$63.6m	$317.9m
Difference	$16.8m	$84.2m
AIAL airfield revenue per arriving and departing passenger	$5.80	
BARNZ Assessment of reasonable charge per arriving and departing passenger	$4.60	
Difference per arriving and departing passenger	$1.20	

AIAL International Terminal Charges

	Annual average	Total 2008 – 2012
Terminal Charges Revenue which will be earned by AIAL	$111.6m	$558.1m
BARNZ Assessment[26] of reasonable charges	$102.4m	$512.0m
Difference	$9.2m	$45.8m

[26] BARNZ set out its Assessment of the reasonableness of terminal charges on two different bases. The first approach removed the effect of 'the TSC top-up' under which AIAL set terminal charges so as to make up the shortfall it perceived in revenue relating to TSC areas due to the TSC charge being based on commercial rental rates of approximately $300 per sqm (rather than on WACC times the ODRC asset value which produced a required revenue of over $600 per sqm). The second approach did not adjust for 'the TSC top-up'. The figures in this table are from the second approach as the TSC was terminated by Auckland Airport in the second PSE.

AIAL terminal charges per arriving and departing international passenger	$13.66	
BARNZ Assessment of reasonable charge per arriving and departing international passenger	$12.56	
Difference per arriving and departing international passenger	$1.10	

In order of importance, that letter identified the differences as being attributable to:

- Cost of capital
- Treatment of revaluations
- Asset valuation
- Asset inclusion and allocation
- Forecast capex.

Comparison of outcomes in the first and second PSE

The magnitude of the difference between the charges set by Auckland Airport in the first and second PSEs and BARNZ's assessment of what charges would be reasonable looks to be very similar between the two pricing periods with a per passenger difference in the vicinity of $2 to $3 per international passenger.

Comparison of differences in first and second PSE

	First PSE	Second PSE (mid-point WACC)	Second PSE (75th % WACC)
Difference between BARNZ assessment of reasonable charges and price set by Auckland Airport	$130m	$147m	$82m
Difference per arriving and departing international passenger[27]	$2.30	$3.72	$2.08

The topics which were in dispute narrowed, with WACC remaining the only material difference. However, the issues of appropriate valuation methodology and treatment of revaluations have merely been deferred without being fully resolved, with the Airport not committing to what will be the approach for the third PSE when the current 10 year moratorium on asset revaluations will have expired.[28]

In summary therefore, it cannot be said that there has been any noticeable change in the reasonableness of the revenue forecasts between the first and second PSE. All that can be said is

[27] BARNZ forecast of 39.5m arriving and departing international passengers (excluding transit and transfer) applied to calculate the per passenger difference for the second PSE
[28] Refer to the discussion of this issue in response to question 1.3 above.

that the difference has (currently) narrowed to one key input – namely the WACC, and that the level of over-recovery is (currently) confined to one charge – namely the international passenger charge levied on international airlines.

3.6 To what extent did actual results for the first PSE differ from forecasts, and why?

Actual revenue for the first PSE was 5.7% below that forecast, being $12m or 2% less for terminal charges and $39m or 10% less for airfield charges over the pricing period.

Comparison of Forecast Revenue and Actual Revenue for First PSE ($m)

	FY08	FY09	FY10	FY11	FY12[29]	Total
Forecast airfield revenue	69.3	73.8	78.5	83.9	90.8	396.3
Actual airfield revenue	70.1	70.5	66.7	72.5	77.3	357.0
Forecast terminal revenue	88.3	97.6	104.2	111.0	115.4	516.5
Actual terminal revenue	89.8	94.0	101.1	107.1	111.7	504.2

With the exception of domestic passengers, Auckland Airport's activity forecasts as it set charges in 2007 were not achieved.

Comparison of Forecast Activity and Actual Activity for First PSE[30]

	FY08	FY09	FY10	FY11	FY12	Total
Forecast aircraft movements (m)	0.157	0.162	0.169	0.177	0.185	0.849
Actual aircraft movements (m)	0.159	0.157	0.155	0.154	0.156	0.781
Forecast MCTOW (m tonnes)	5.9	6.1	6.3	6.6	6.9	31.8
Actual MCTOW (m tonnes)	5.9	5.8	5.7	5.7	5.9	29.0
Forecast international pax (m)	7.5	7.8	8.1	8.5	8.9	40.8
Actual international pax (m)	7.5	7.4	7.4	7.4	7.8	37.5
Forecast domestic pax (m)	**5.2**	**5.4**	**5.6**	**5.9**	**6.2**	28.3
Actual domestic pax (m)	5.7	7.6	6.0	6.0	6.2	31.5

Actual activity levels being lower than forecast when charges were set (excepting domestic passengers) directly contributed to actual revenue for the first price setting period being lower than forecast when charges were set in 2007. This was due to the impact of the GFC on airline operations worldwide, with airlines needing to down-gauge aircraft, reduce schedules and even withdraw

[29] FY12 actuals taken from AIAL Annual Report for year ended 30 June 2012 as the FY12 annual information disclosure is not due until 30 November 2012.
[30] Forecasts from AIAL Pricing Setting Disclosure FY08 to FY12. Actuals from Five Yearly Summary at page 107 of AIAL Annual Report for the year ended 30 June 2012.

services in order to remain profitable or stem losses. The entire aeronautical industry was hit hard by the GFC which resulted in reduced business travel as well as reduced leisure travel.

In recognition of these difficulties, Auckland Airport deferred the 2.5% increase in airfield charges due to take effect 1 July 2009 for 9 months until 1 March 2010. This Airport has disclosed that this deferral reduced airfield revenue by approximately $2.7m during FY10.[31]

While it has to be acknowledged that over the FY08 to FY12 pricing period Auckland Airport earned $51m less than it forecast it would, it nevertheless still earned $861m, which is $31m more than BARNZ's assessment of appropriate revenue of $830m over the first pricing period.[32] Auckland Airport had set charges using a WACC estimate of 9.9%, as opposed to the 8.2% WACC estimate considered appropriate by BARNZ's advisers.

Moreover, Auckland Airport was also able to defer some of the forecast capital expenditure which was included in its financial model on which charges for the FY08 to FY12 pricing period were set. The FY11 information disclosure indicates that, at that point, four years into the pricing period, some $48m of capital expenditure less than forecast had been spent in relation to the RAB. In addition, the Airport halted construction of the first stage of the Northern Runway some $18m into the forecast $30m budget for Stage One.

3.7	To what extent is the difference between forecast revenue and actual revenue disclosed under ID for 2011 and 2012 different due to changes in demand and what is the dollar value difference in each year due to the changes in demand?

Refer to answer to question 3.6 above.

3.8	How do the asset values used for the second PSE pricing purposes reconcile to the asset values disclosed under ID?

Auckland Airport has applied the moratorium on asset values which it adopted in 2007 for the FY08 to FY12 pricing period and the FY13 to FY17 pricing period. As a result of this moratorium it did not forecast any asset revaluations as it set charges in either the first or second pricing periods.

Auckland Airport has disclosed that the difference between the moratorium asset values as at 30 June <u>2011</u> (based on the 2006 MVAU land value and the 2006 ODRC Opus valuation of specialised assets) and the regulatory investment value as at 30 June <u>2013</u> is some $80m.[33] However, this is not an apples for apples comparison, given the intervening two years of capital expenditure, depreciation and reallocations between FY11 and FY13.

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[31] http://www.aucklandairport.co.nz/Corporate/Investors/~/media/Files/Corporate/Investors/Auckland%20Airport%20Annual%20Results%2030%20June%202010%20Presentation.ashx

[32] Refer BARNZ response to question 3.5 at pages 14 to 15 in relation to the reasonableness of revenue forecasts for the first PSE.

[33] Auckland Airport Price Setting Disclosure for FY13 to FY17, page 22.

While BARNZ can make an informed estimate of the value of this difference, it does not have the information to precisely calculate the difference in asset values used in the second PSE as against the asset values disclosed under ID. This is because the overall assets disclosed in ID is for a wider group of activities than the pricing activities, making it difficult to accurately track the impact of changes in asset allocation and reallocation. In addition, there is a lack of clarity over precisely what MVAU per ha value was adopted by Auckland Airport in FY11:

- The Collier valuation concludes by noting a $675 000 per ha value over the RAB and future development land (excluding seabed, coastal margin and commercial land).[34]
- Auckland Airport's FY12 Annual Report records that the rate per ha for airfield land prior to the addition of holding costs is $1 020 000 per ha.[35]
- BARNZ's reading of the valuation rates adopted by Colliers is that the 2011 MVAU rates average $797 000 per ha for RAB land and $448 000 per ha for land held for future use.

On a high level the differences can be described as follows:

- The majority of the land, comprising airfield land and land under the terminal buildings is valued for pricing at its 2006 MVAU valuation of $600 000 per ha, as opposed to AIAL's current 2011 disclosed MVAU value of $675 000, $797 000 or $1 020 000 per ha.
- Miscellaneous areas of land were valued for pricing at different rates as per the 2006 MVEU valuation such as:
  - Wiroa Island at $150 000 per ha
  - Landside roads at $300 000 per ha
  - Approach land at $100 000 per ha
  - Land under various infrastructure buildings at $1m per ha.
- Specialised assets such as the terminal building, runways, taxiways and aprons were valued at their 2006 ODRC revaluation for the purposes of pricing, and were not indexed forward at the end of FY10, FY11 or FY12. The pricing value is thus lower than the disclosed values by some three years of CPI indexing.

While BARNZ would be able to make a high level estimate of the total dollar value of these differences, it is better that Auckland Airport accurately quantify the differences for the Commission as at the commencement of the new pricing period.

3.9	What differences (including dollar value effects) are there between cost allocation methodologies and cost categories used for ID disclosure and the second PSE price-setting?

[34] Colliers International MVAU Auckland Airport Valuation Report, June 2011 at page 33.
[35] Auckland Airport Annual Report for the year ended 30 June 2012, page 72, note 11 to the financial statements.

BARNZ will defer to Auckland Airport's response to this question at this stage, and comment in cross-submissions if need be.

3.10	How reasonable are AIAL's asset valuations, and why?

In responding to this question BARNZ will first discuss the 2006 MVAU or opportunity cost land valuations by Seagar which were applied by Auckland Airport in its charge setting in both the first and second PSE. In short, this valuation is considered reasonable by BARNZ.

BARNZ will then outline the advice it has received in relation to the 2009 and 2011 MVAU valuations recently undertaken by Auckland Airport. The advice received to date by BARNZ is that the amount of commercial land included in the alternative land use plan underlying this valuation is significantly overstated and unsustainable.

Finally BARNZ will briefly highlight concerns held with the ODRC revaluation process undertaken by Opus for Auckland Airport in 2006 and 2011. BARNZ considers that ongoing ODRC revaluations of specialised assets are unnecessary and that a historic cost or indexed historic cost approach is preferable.

A The 2006 Seagars MVAU Land Valuation

The opportunity cost or MVAU component of the Seagars 2006 land valuation used by Auckland Airport to set charges in 2007 (and again in 2012 as a result of the moratorium on asset revaluations) contained the following valuation rates for key aeronautical land areas:

	MVEU value (not adopted for pricing)	MVAU value (used for pricing)
Airfield land and airfield roads	$861 000 per ha	$600 000 per ha
Wiroa Island	$150 000 per ha	$150 000 per ha
Southern Airfield REPA, PSZ and restricted use areas	$100 000 per ha	$100 000 per ha
Land under terminal buildings and forecourts[36]	$4 000 000 per ha	$600 000 per ha
Land under public roads	$300 000 per ha	$300 000 per ha

BARNZ commissioned CB Richard Ellis (CBRE) to review the 2006 Seagar land valuation of Auckland Airport. CBRE advised that it considered:[37]

[36] Original MVEU valuation by Seagars was $3.2m per ha for land under the domestic terminal building and $4.9m per ha for land under the international terminal building. Auckland Airport moved to apply the opportunity cost value of $600 000 per ha for pricing purposes.
[37] CBRE Valuation Review Report of AIAL Aeronautical Pricing Proposal July 2006 Asset Valuation, 20 October 2006, section 3.2.

- The value of aeronautical land which AIAL indicated it was optimising out of the pricing asset base and some non-aeronautical land was undervalued.
- The value of the aeronautical land has been in some cases materially overstated.
- The MVAU value of the airfield land is above the reasonable range of value for land outside the Metropolitan Urban Limit.
- The net overall land valuation is broadly in line with its expectation of Fair Value.

The overall conclusion by CBRE was that an average MVEU value across all activities of $59.96 per sqm or $600 000 per ha was appropriate.

Taking this advice into account, when Auckland Airport proposed adopting the Seagars opportunity cost value of $600 000 per ha for airfield land, for both airfield and terminal land, but retaining the lower values of $300 000 per ha for land under public roads and $100 000 per ha for Southern Approach land, BARNZ's assessment was that this was reasonable overall. While CBRE had advised that they considered the $600 000 per ha MVAU value for airfield land to be above a reasonable range, CBRE had also advised that the value adopted by Seagars for land under public roads and the Southern Approaches was below market value. Therefore, taken as a whole, BARNZ considered that the package of land values applied by Auckland Airport as it set charges in 2007 (and again in 2012) were reasonable.

The 2009 and 2011 MVAU Valuations by Colliers

Auckland Airport engaged Colliers to prepare a MVAU valuation of its land as at 30 June 2009 and 30 June 2011.[38] Common Ground Urban Design prepared the alternative land use plan as an input to the Colliers valuation. This alternative land use plan comprised:

- 650.7 ha of residential activity, providing 16 260 dwellings[39] with a predicted population of 40 650 people
- 74.1 ha of commercial land, resulting in a commercial floor-space of 518 841m^2
- 152.6 ha of roads, open space and coastal margin.

As a result of this alternative land use plan Colliers adopted a valuation of:

- $482.8m as at 30 June 2009, which was described by Colliers as representing approximately $580 000 per ha over the RAB and land held for future development.
- $563.1m as at 30 June 2011, which was described by Colliers as representing approximately $675 000 per ha over the RAB and land held for future development.[40]

[38] Only the 2011 valuation was provided to airlines during consultation.
[39] 19% detached houses, 24% urban houses, 27% semi-detached dwellings, 22% terraced dwellings and 8% apartments.

BARNZ has commissioned the following work to review the Colliers valuation and Common Ground alternative land use plan:

- Zomac Planning Solutions (ZPS) was engaged to review the Common Ground assessment of the likely alternative land use in the event the airport closed using the land valuation methodology as set out in Schedule A of the Commission's Input Methodologies Determination dated 22 December 2010.
- Market Economics (ME) was engaged to assess current and future demand for potential alternative uses of Auckland Airport land holdings.
- Property Advisory Ltd (PAL) was engaged to undertake a peer review of the Colliers 2011 MVAU valuation of AIAL's aeronautical land using the land valuation methodology as set out in Schedule A of the Commission's Input Methodologies Determination dated 22 December 2010.

All experts were engaged on an independent basis and all were advised that they would likely be asked by the Commerce Commission to sign the High Court Code of Conduct for expert witnesses.

Some of the work was commissioned during consultation with Auckland Airport prior to the Airport confirming the continued application of the Moratorium on asset revaluations. Other work was commissioned specifically for the section 56G review being undertaken by the Commission.

ZPS – planning advice

Mr Mike Foster of ZPS is a senior planner with over 35 years of experience in some of the most complex urban land developments in New Zealand. There are few planners in New Zealand with more experience in major infrastructure planning and projects than Mr Foster.[41] The advice from ZPS is provided as **Attachment 4.**

ZPS has advised that while it considers that the Common Ground Plan develops a credible and logical approach to the development of a series of residential precincts to cater for up to 40,000 people, the idea that the residential area would need a CBD type of facility is less credible and the proposed provision of 500,000m^2 of commercial floor space is manifestly in excess of what is likely to be realistically sustainable. ZPS concluded:

> Overall while Common Ground's approach to residential precinct development is realistic and rational its approach to the need for commercial floor space is grossly overstated and insufficient regard has been given to the employment and commercial service functions that the existing mixed use development area to the north of the airside land (excluded from the valuation area) may have on the commercial space requirements needed to service a population of 40,000 people. Unfortunately the overstatement by Common Ground of commercial floor space needs by 3 to 5 times casts serious doubt on the balance of their report findings and tends to suggest that the underlying driver behind their report is to maximise the $ value of the alternative land use scenario. In my view such an

[40] Cf Auckland Airport's FY12 Annual Report which notes at pages 71 - 72 that the MVAU land value adopted for airfield land is $1 020 000 per ha.

[41] Details of Mr Foster's experience were set out at page 14 of BARNZ's Post Conference Submission after the Wellington Airport s56G Conference, 17 August 2012 and his CV was provided to the Commission as Attachment 4 to that submission.

approach does not reflect the underlying philosophy of the "Input Methodology Determination" where the emphasis is upon a *"predictable set of alternative uses due to existing and possible zoning and district plan requirements, contour and land area, surrounding land uses, as well as existing linkages and current market supply and demand."*

Market Economics – economic assessment of demand and supply for land uses

When the discrepancy between the views of Common Ground and ZPS regarding the amount of commercial and retail land which was likely to be feasible and permitted to be developed on the Airport site came to light, BARNZ engaged Market Economics to independently assess the current and future demand for potential retail land use on the site, including undertaking an economic assessment to place the resulting likely supply in the context of the future demand environment for the area. BARNZ had previously engaged Market Economics to perform a similar analysis with respect to the Wellington Airport alternative land use plan. However, BARNZ has not otherwise previously engaged Market Economics. Market Economics' report is attached as **Attachment 5.**

Market Economics is one of New Zealand's leading independent consultancies, specialising in both market and economic analysis and environmental and ecological research. [42] With respect to market analysis, it assesses markets and identifies and quantifies their scale, growth and change. Market Economics has a detailed understanding of the expected future growth of residential and business activity (industrial, commercial and retail) and has access to comprehensive datasets and interactive modelling to support its analysis.

Market Economics concluded that:

- The indicative 16,260 dwellings and 40 650 population yield of the Auckland Airport land holding under a MVAU scenario are reasonable given the attributes of the Airport land and the mix of dwelling types presented by Common Ground.
- The 17 year sell-down period adopted by Colliers is the minimum timeframe that should be adopted as the sell-down period as the predicted dwellings represent an average market share of all new residential housing of nearly 10%, which is a very high proportion of growth for the Airport to capture. In reality it may be 20-25 years before 16,260 new dwellings would be sold on the Airport land.
- The 518 841m^2 of commercial floor-space provided for in the Common Ground development plan overstates the sustainable commercial land by a significant amount. Based on how Auckland's centres serve their catchment populations, Market Economics anticipate that an MVAU scenario for the Auckland Airport land would support 111 000m^2 to 147 000m^2 of commercial floor space (retail, services as offices) as follows:
    - 31,000-43,000 m^2 of retail and services floor space
    - 70,000-94,000 m^2 of offices and other commercial land
- In addition 103,000 to 126,000m^2 of non-commercial floor space such as education and other activities would develop. This space should be summarised separately and a different

[42] Details of projects Market Economics has been involved with were set out at page 15 of BARNZ's Post Conference Submission after the Wellington Airport s56G Conference, 17 August 2012.

valuation should be applied to it given that land in this category is mostly non-commercial and will not provide similar returns to office-based on industrial activities.

Overall, Market Economics considered that Common Ground had overstated the sustainable commercial floor space by around 372,000m^2 to 408,000m^2.

BARNZ notes that this same issue regarding the sustainability and plausibility of the amount of commercial land was at the heart of the differences BARNZ's experts identified with the Wellington Airport alternative land use value. Again, as was the case with the Wellington Airport land valuation, there was a lack of economic analysis in the Auckland Airport valuation of the underlying demand for retail and commercial land uses in the catchment around the Airport site, in the event that the Airport were to close.

As was noted by BARNZ in its Post Conference Submission after the s56G Conference on Wellington Airport, an MVAU land valuation is first and foremost an output of the alternative land use plan. Yet there is minimal direction contained in Schedule A, which focuses primarily on providing directions to the valuer, with regard to the development of the alternative land use plan or directions to the planner. BARNZ identified areas where its advisers considered that the Commission could relatively easily improve the specifications provided in Schedule A. BARNZ underlines the importance of the Commission carefully focussing on this issue, which will clearly be a recurring theme in valuations going forward for the foreseeable future, unless greater specification and direction is provided now about obtaining appropriate evidence supporting the sustainability of the proposed land uses and ensuring that the proposed land use is one that is credible and feasible.

Property Advisory Ltd – valuation advice[43]

Mr Dougal Smith of Property Advisory Ltd (PAL) was engaged by BARNZ to undertake a peer review of the land valuation undertaken by Colliers for Auckland Airport applying the Commerce Commission's valuation guidelines set out in Schedule A of its Determination of Input Methodologies for Specified Airport Services. The advice from PAL is provided as **Attachment 7.**

Mr Smith is a Director of Property Advisory Ltd. He is a registered valuer with considerable expertise in valuation of residential and industrial block land, investment property and specialised assets. He holds a Bachelor of Commerce, Valuation and Property Management.

PAL advise that while the valuation steps and methodology adopted by Colliers when assessing the MVAU of the AIAL land as at 30 June 2011 appears to comply with the International Valuation Standards and the requirements of the Commerce Commission specified under Part 4 of the Commerce Act, the alternative use plan for the land promoted by Colliers does not as it is too aggressive in terms of:

[43] Due to unforeseen adverse circumstances, the PAL work was not able to be completed by the valuer prior to the deadline for lodging submissions and the Commission kindly granted an extension of one week. For convenience BARNZ has reissued its submission incorporating the PAL advice and subsequent comment by BARNZ.

- The consent-ability of the Common Ground master plan in terms of the commercial and residential mix,
- The planning and construction timeframe,
- The level of perceived demand for commercial land, and
- The appropriate sell down period for identified residential land.

Mr Smith concludes that in his opinion, the:[44]

> … Colliers MVAU valuation is over stated and it is questionable in terms of Section A10 of Decision 709, as to whether or not the HBAU development is appropriately justifiable, legally permissible, and financially feasible.

Mr Smith goes on to state that:

> From my experience as a valuer if the changes suggested by ME as to the appropriate commercial / residential development mix, sell down period, and planning and construction timeframes were adopted, we would expect the resultant MVAU valuation when compared to the Colliers $533m valuation to decrease materially in the vicinity of 10% - 15%.

Overall conclusion by BARNZ on the reasonableness of the 2009 and 2011 MVAU land valuations

The planning, economic and valuation advice obtained by BARNZ from ZPS, ME and PAL all identify that the alternative land use plan developed by Common Ground, and adopted by Colliers as the basis for the 2009 and 2011 MVAU valuations, is too aggressive in terms of the amount of commercial land included within the plan and that the length of the development period adopted by Colliers is too short:

- ZPS concluded that the proposed commercial space is manifestly in excess of what is likely to be realistically sustainable and the alternative land use plan by Common Ground does not reflect the underlying philosophy of the input methodology determination.
- ME concluded that Common Ground had overstated the sustainable commercial space by around 372 000m^2 to 408 000 m^2 and that the 17 year sell-down period adopted by Colliers was the minimum timeframe which could be adopted and, in reality, it may be 20 to 25 years before the proposed new dwellings would be sold.
- PAL concluded that it is questionable whether the alterative land use development is appropriately justifiable, legally permissible and financially feasible, and, as a result, the Colliers MVAU valuation is materially overstated, in the vicinity of 10% to 15% of the $533m adopted land value.

A 10% to 15% reduction in land value equates to a $50m to $80m over-statement of the land value.

[44] Letter dated 26 October 2012 from PAL to Mr J Beckett, Executive Director BARNZ, page 19.

As BARNZ submitted in its post-conference submissions in relation to Wellington Airport, BARNZ strongly considers that the Commission needs to engage its own independent valuation advisers, as the Commission did during the Airport Price Inquiry, to determine an appropriate land valuation.

Without independent verification of the appropriate MVAU value, the Commission will not be able to clearly assess the level of profitability of the Airport.

In addition, BARNZ reiterates the need for the Commission to review the valuation directions in Schedule A of its Determination and provide greater specificity and direction to planners in the development of the alternative land use plan, particularly around the need for economic analysis of the underlying market conditions regarding the supply of, and demand for, the land uses under consideration.

<u>The 2006 and 2011 Opus ODRC valuations of specialised assets</u>

Auckland Airport engaged Opus to revalue its specialised buildings and runway, taxiway and aprons as at 30 June 2006 and again as at 30 June 2011. Significant revaluations were booked in 2006 which were never treated as income. Auckland Airport's 2011 ODRC revaluation similarly includes further significant revaluations – again not treated as income. These 2011 revaluations amount to $60m for runways, taxiways and apron revaluations and $56m for infrastructure revaluations.[45]

Over the course of consultations in 2000 and 2006 advisors for BARNZ have raised ongoing questions with respect to:

- Whether the unit costs adopted by airport valuers are valid – i.e. do they represent a significant scale of construction or are they indicative for smaller incremental construction projects?
- Whether it is appropriate to be revaluing these assets on an incremental brownfields basis?
- Whether the add-ons which have been applied as part of the valuation for working in an operational airport environment, including additional security costs and air side costs, are valid? These add-ons are calculated by the valuers based on information provided by the airports and cumulatively, combine to factors of more than 2.5.
- Whether it is appropriate to be including costs which were never incurred in the first place when the assets were originally constructed, such as today's OSH, security and RMA costs?
- Whether instructions given by airports as to the level of holding costs or finance costs are appropriate?
- Whether the cost of capital adopted within the valuation is appropriate?

[45] Auckland Airport Annual Report for the year ended 30 June 2012, page 70, note 11 to the financial statements. Note the infrastructure revaluation will be partly attributable to aeronautical assets and partly attributable to other assets.

BARNZ therefore has serious concerns with respect to the reasonableness of both ODRC revaluations, and is strongly opposed to the on-going practice of airports revaluing specialised assets using ODRC. The use of historic cost or indexed historic cost is preferred by BARNZ.

3.11 What is the appropriate treatment for pricing purposes of assets held for future use?

BARNZ considers that assets held for future use should be excluded from the asset base on which charges are set. Such assets are not currently used in the provision of services. In a competitive market, suppliers cannot unilaterally increase prices to cover the costs of holding assets for the future. If Airports were able to charge for assets being held for the future, it would not provide any incentive upon an airport to make efficient decisions regarding the timing of acquiring such assets or the costs at which such assets are acquired.

Thus BARNZ considers that the cost of the Northern Runway land should be excluded from the pricing asset base until such time as it is efficient and appropriate for construction of the runway facility to commence on that land. BARNZ does not consider that the preliminary works undertaken from circa 2007 to 2009 for a short runway were appropriately timed. The commencement of that work was opposed by BARNZ at that time as being unnecessary and too early. Therefore the cost of the civil works incurred to date should also be excluded from the asset base on which current charges are set.

With respect to the noise mitigation costs, there appears to be a lack of clarity over the current treatment of these costs.

In the first PSE, Auckland Airport treated operating costs relating to the noise trust as an operating expense to be immediately recovered from landing charges and the forecast costs of insulating homes and schools as a capital cost, on which a return on and of capital was to commence to be recovered immediately, also via MCTOW based landing charges. BARNZ did not object to this treatment.[46]

In the second PSE, BARNZ's understanding, based on the written consultation material provided to BARNZ by Auckland Airport during consultation in 2011 and 2012, was that forecast expenditure related to noise mitigation activities was included in the forecast operating expenses[47] and the forecast capital expenditure on which prices were being set for the FY13 to FY17 pricing period.[48] BARNZ had therefore (apparently incorrectly) assumed that the previous noise insulation works undertaken during the FY08 to FY12 pricing period were included in the opening asset base on which the new charges were being set.

[46] While BARNZ's preference was for all noise mitigation costs to be expensed, BARNZ agreed to concede to the costs being capitalised when Auckland Airport undertook not to revalue the asset related to noise mitigation work. This was a separate commitment from the 10 year moratorium on asset revaluations, instead being seen as an enduring commitment.

[47] Refer Appendix H Auckland Airport Revised Pricing Proposal, 5 April 2012 which indicated that operational expenditure relating to noise costs of $3.6m are forecast to be incurred during the FY13 to FY17 pricing period.

[48] Refer Auckland Airport consultation document 05.01.04.01 Supplementary Information – demand and capex forecasts – 7 November 2011 at page 9 which listed noise insulation schools programme and noise insulation housing programme as part of the infrastructure minor works programme of less than $5m.

BARNZ has only recently learned from Auckland Airport that it's financial model in fact excluded the forecast capital cost of noise insulation works undertaken second pricing period on houses under the flight-paths from the asset base on which it set charges for the second pricing period. Instead the Airport has categorised these works as associated with the Northern Runway and therefore excluded them from Standard Charges.

There was therefore some ambiguity between the financial model and the written information provided during consultation as to the treatment of noise costs.

BARNZ considers that the noise insulation programme administered by Auckland Airport relates to all aircraft activities, and does not see it as a programme directly associated with the Northern Runway. The noise mitigation work would have been required at some stage irrespective of the Northern Runway. BARNZ considers that the noise insulation work undertaken to date is more appropriately treated as part of the current airfield cost centre. These costs are incurred in relation to, and are used as part of, the provision of specified airport services today.

4. IS AIAL OPERATING AND INVESTING IN THEIR ASSETS EFFICIENTLY?

4.1 Where and when do any capacity constraints occur at AIAL, and is additional investment necessary to address these constraints?

The table below summarises the areas in which BARNZ considers capacity constraints are currently occurring, or are likely to occur in the near future, the capital expenditure forecast by the Airport and BARNZ's view of whether any additional investment is likely to be necessary.

Areas of Capacity Constraint and Forecast Capital Expenditure

Areas considered subject to capacity constraints by airlines	Airport planned response	Capital expenditure forecast in charges	Whether additional investment likely to be necessary in current pricing period
Domestic terminal contact gates and apron	Interim works planned to the domestic terminal building to provide it with a further 6 years of life. Airport consulting with users over the location of a new terminal facility.	$29m	Yes – circa [$350m[49]] for a new domestic terminal, forecourt, apron and associated infrastructure
Domestic terminal security screening	Interim works referred to above include improvements to security screening facilities.	Included above	No
International terminal check-in counters	A project to investigate and install smarter technological solutions. The actual solutions are as yet unknown until investigations are completed.	$7m	No
International terminal fragile and oversize belt (commonly called OOG – out-of-gauge)	The airport has undertaken to investigate whether it is possible to install a second OOG in the international check-in hall, however this is dependent upon an engineering solution to the fact that maintenance facility buildings and the cart dock are located behind the eastern end of the check-in hall.	Included within $12m for baggage sortation system improvements	Unknown until engineering studies completed
International terminal emigration (Customs	AIAL is currently consulting with Avsec, Customs and BARNZ over what works are	Included in terminal	No

[49] Refer Auckland Airport consultation document 05.01.04.01 Supplementary Information – demand and capex forecasts – 7 November 2011 at page 10 which sets out forecast high level timing of domestic terminal cash-flows. This figure excludes runway or taxiway costs.

and Avsec)	necessary to enable the Emigration area to function more efficiently.	minor works, therefore less than $5m	
International terminal baggage reclaim	AIAL proposes extending the reclaim area westwards constructing an additional 3100 sqm to allow an additional two Code F reclaim belts to be installed after one older smaller belt is removed	$11m	No
The shared international taxiway used by aircraft to access Piers A and B	At airline request, AIAL brought forward the construction of a new taxiway (taxiway Lima) to directly service Pier B, which will eliminate the conflict with aircraft waiting to push back from Pier A.	$21m	No

4.2 What factors outside AIAL's control have contributed to the capex and opex forecast for the second PSE and to changes in expenditure since the first PSE?

There have not been any material changes in security requirements requiring substantial changes in capital or operational expenditure since the first PSE.

Increased insurance and regulatory costs are factors not wholly within AIAL's control which will have added to its cost base. However, BARNZ also observes that AIAL does have some influence over these costs, particularly its regulatory costs which are significantly influenced by the degree to which AIAL chooses to engage external consultants and advisors and the decisions it takes on whether to initiate merits review proceedings.

BARNZ does not consider that it is appropriate that AIAL has included the costs of its merit review proceedings within the cost base on which it has set its charges. These proceedings are not necessary to enable the provision of aeronautical services and were not required or requested by the airlines. The costs are forecast to amount to $4m over the pricing period.[50] The recovery of such costs should follow the event as ordered by the relevant Court and not be met wholly by users — which is the outcome Auckland Airport has delivered for itself.

The most significant change in operating expenses relates to the decision by the Airport to undertake marketing and route development activities, previously not undertaken by the Airport. In FY11 and FY12 Auckland Airport allocated $8.9m and $9.1m respectively of marketing and promotional costs to the aeronautical segment.[51] This represents approximately 14% of aeronautical operating costs. Going forward, the Airport has included approximately [$20m] of route development costs in the operating cost forecasts.[52] This is a cost entirely within the Airport's discretion. Moreover, it is not a cost which is required in order for the Airport to provide the

[50] Appendix H AIAL Revised Pricing Proposal, 5 April 2012.
[51] Refer pages 55 and 56 Auckland Airport Annual Report for the year ended 30 June 2012.
[52] Refer pages 36 to 40 of Auckland Airport's Reasons Paper on its Aeronautical Pricing Decision, 7 June 2012

specified airport services. IATA has advised BARNZ that it is not aware of any airports internationally seeking to include these costs in the operating base on which airport charges are set.

4.3	A.	How reasonable are AIAL's **capex** forecasts for the second PSE, and how do these compare to forecast and actual expenditure from the first PSE?

Overall, BARNZ considers that Auckland Airport has identified the key areas of capacity constraints in current facilities.

On the whole, BARNZ also considers that the Airport's forecast capital expenditure items included in the asset base on which charges were set[53] represent efficient, sensible and appropriate responses to the areas of capacity constraint in current facilities. The qualification to this statement relates to the potential location of new remote hard stands, with the Airport's working view being that they should be located in position for a future extension to Pier A. BARNZ members consider that the logical location is adjacent to Pier B, where they would ultimately be either contact gates with air-bridges or walk-on gates. The Airport has indicated that the location of the remote stands will be consulted upon before a final decision is made.

There is not any forecast capital expenditure which BARNZ considers is occurring ahead of when it is required (unlike the first PSE when the initial Northern Runway works were undertaken from 2007 to 2009 and the previously proposed Stage 3B expansion of the international terminal building was being considered).

Unlike some previous capital expenditure proposals[54], the forecast works make sensible use of existing space, with cost efficient extensions or improvements planned which will enable current facilities to continue in use, as opposed to the construction of large scale expensive new areas, leaving old areas vacant and redundant which is what has, on occasion, been proposed previously by the Airport. In this regard, BARNZ was particularly pleased to see the proposals to:

- Expand the existing baggage reclaim facility westwards – rather than construct additional terminal space on the first floor to house an entire new reclaim facility, which would have left the ground floor areas vacant and unused.
- Invest in technological check-in solutions so as to avoid the construction of additional check-in space.
- Expand the ground floor processing areas of the ITB by enclosing the under-croft at the western end of the building to create additional space for passenger processing and meeters and greeters in the third pricing period – rather than construct additional terminal space on

[53] For the avoidance of doubt, the set of capital expenditure forecasts in relation to which this statement is made does not include the new terminal facility, which is still being consulted upon, and where the Airport has two options it is considering, one of which BARNZ holds serious reservations about. Nevertheless, BARNZ would of course hope to be able to make a similar statement about the new terminal facility once consultation there is concluded.

[54] For example the old Stage 3B international arrivals expansion consulted over in 2008 which involved the extension of the first floor international arrivals area over the road and into the car-park at a forecast cost of some $180m in 2008 dollars which would have left the current ground floor vacant and unutilised.

the first floor to house an entirely new meeters and greeters area, which would have left the ground floor areas largely vacant and unused.

Auckland Airport changed the approach to its consultation over capital expenditure planning in this price setting. At the early stages of consultation Auckland Airport laid out all potential projects and their likely costs on the table and asked the airlines to identify the priorities held by airlines. BARNZ consulted with its members and identified the following priorities on behalf of international airlines as at November 2011, which the Airport reflected in its forecasts:

- The construction of a dedicated taxiway to service Pier B, so as to alleviate the delays being experienced by aircraft on Pier A waiting to push-back. The Airport moved this project forward and it will be occurring over the 2012/13 summer.
- The construction of an out of gauge (OOG) screening facility in the eastern end of the check-in hall, which currently has a manual solution to transport OOG bags to the check-in hall.
- The construction of a walk-on boarding facility on Pier B, which would enable the remote hard-stands immediately adjacent to Pier B to become walk-on gates, as opposed to remote bussing gates as is currently the case. This solution meant that the number of bussing movements would remain at moderate and manageable levels, and would enable the construction of additional contact gates (at a forecast cost of $38m) to be deferred.

In the more than 10 consultations over the resetting of charges under the AAA which BARNZ staff have been involved with, this is the first occasion on which an airport has included airline priorities as a fundamental initial step in capital expenditure planning. BARNZ is informed by airlines operating in Australia that that is the standard approach taken by Australian Airports when developing their capital expenditure plans. To date, this has not been the case in New Zealand and therefore BARNZ wishes to positively endorse Auckland Airport's changed approach.

Auckland Airport is continuing to consult with domestic airlines and with BARNZ over the location of the new terminal facility which will provide domestic services for the next thirty to forty years. There are two options currently on the table:

- A northern location which would utilise the northern side of Pier B for domestic operations and require the expansion of Pier A for future international growth.
- A southern location which would involve the construction of a new facility between the current international and domestic facilities, which would then expand over the current domestic terminal site as the terminal is demolished.

BARNZ members hold grave concerns over the option of utilising the northern side of Pier B for domestic operations due to the expensive, disruptive, brownfields construction which would be necessary to extend Pier A, and which would involve the decommissioning of at least two contact gates and one or two remote stands before Pier A could be extended. BARNZ estimates that there would likely be a cost of circa $80m to international operations simply to get back to the same level of international facilities as today, before any additional facilities can be constructed. Pier B was consulted on with the airlines, and supported and signed-off by them, on the basis that it was the future international expansion path for the next three to four decades. The international airlines fundamentally object to the Northern side of Pier B becoming primarily domestic, thereby creating the need for international airlines to fund a highly expensive extension to pier A.

4.4	B.	How reasonable are AIAL's **opex** forecasts for the second PSE, and how do these compare to forecast and actual expenditure from the first PSE?

Auckland Airport's operating expenses per passenger are forecast to slightly decline over the forthcoming pricing period in nominal terms, from $4.89 per passenger in FY12 to $4.85 per passenger in FY17, hence declining in real terms.

However, there was a substantial increase in operating expenses per passenger towards the end of the current pricing period, which is built into the operating costs forecast over the next pricing period. This is of real concern.

In FY06 aeronautical company-wide operating and staff expenses were $4.23 per passenger. In FY09 this jumped to $4.95 per passenger and in FY11 to $5.39 per passenger.[55] The financial model on which charges were set in the first PSE in 2007 disclosed that the per passenger operating costs for the airfield and terminal pricing activities were $3.86 per pax in FY07.

This substantial uplift is in the base off which Auckland Airport is forecasting operating expenses going forward. This raises serious questions over the efficiency of the costs forecast by AIAL over the next pricing period.

As noted above under question 4.2, the most significant change in operating expenses relates to the decision by the Airport to undertake marketing and route development activities, previously not undertaken by the Airport, which added $9m to the Airports forecast operating expenses in FY11 and FY12, representing approximately 14% of operating costs.[56] Going forward, route development costs totalling approximately [$20m] have been included in the financial model used to set charges. Marketing and route development costs are entirely discretionary. They are not costs or activities required in order for the Airport to provide the specified airport services. There has been little transparency provided by the Airport as to the components of this cost, and even less transparency as to the direct quantifiable benefits from the Airport engaging in this activity and incurring these expenses. Airline representatives strongly question whether the majority of the growth would not have occurred in any event.

AIAL has sought to prove its efficiency through benchmarking itself with overseas airports as well as against the operating expenses reported by Christchurch and Wellington Airports. However this fails to address the fundamental underlying question as to whether the uplifts in AIAL's own operating costs in FY09 and FY11 were justified and whether FY12 represents an efficient operating cost base from which to forecast operating costs for the next pricing period. BARNZ continues to have serious reservations in this regard.

[55] Note these figures are for company-wide aeronautical activities, which is a wider subset than aeronautical pricing activities.
[56] See footnotes to question 4.2

4.5	To what extent does the demand forecast presented by AIAL as part of the second PSE accurately reflect expectations of future demand, and why?

MCTOW Forecasts

The Airport has forecast MCTOW growth of a 1.8% CAGR in its Final Pricing Decision.

In BARNZ's Assessment, the current MCTOW forecast growth looks realistic in the light of current market conditions.

Passenger Forecasts

The Airport is forecasting a CAGR for international passengers of 2.7%[57] over the pricing period and 3.1% for domestic passengers.

The long term CAGR for total passengers at Auckland Airport since 1998 has been approximately 5% pa (refer Auckland Airport 2011 presentation to Shareholders Association). This period encompassed events such as the Asian Financial Crisis, September 11, SARS, bird flu and the on-going GFC. This suggests that the average international passenger growth (excluding transit and transfer passengers) of 3.0% pa forecast by Tourism Futures International (TFI) and Airbiz is too conservative for the next pricing period.

In particular, BARNZ continues to consider that the international growth forecast by Auckland Airport of 1.8% in FY13 for international arriving and departing passengers is extremely low. This represents a lower growth than for either of the surrounding years, or indeed any other year in the pricing model. Actual international passenger growth was 4.9% in FY11 and 5.1% in FY12. While the recently announced withdrawal of services will mean that passenger growth of the same level as FY11 and FY12 is unlikely, the growth forecast for FY13 is still anomalously low. The enduring truth over the last two decades is that, even though airlines may come and go, people still fly. There have been several recently announced withdrawals of services, however the underlying demand to fly to those destinations still exists. For instance, even though Qantas will no longer be operating a direct AKL LAX service, passengers wishing to travel to North America may still do so on Air NZ, which has increased capacity twice on this route since the Qantas announcement, as well as still flying on Qantas or Virgin Australia via Sydney or other Australian ports, on Air Pacific via Fiji, on Air Tahiti Nui via Tahiti or Hawaiian Airlines from next March when it commences services. Even taking into account the recent service withdrawals, the forecast international growth of 1.8% in FY13 is still conservative and anomalous.

BARNZ considers forecast growth of 2.7% in FY13 for international arriving and departing passengers is more reasonable in light of recent events.

[57] Comprising a 3.0% CAGR for originating and departing international passengers and a (0.7%) CAGR for transit and transfer passengers.

4.6	How reasonable is AIAL's demand forecast for the second PSE compared to the forecast from the first PSE?

Forecasts for the first PSE were considered to be reasonable at the time, but the events of the GFC meant that those forecasts were not achieved. There was no discernible difference identified by BARNZ with the reasonableness of the first PSE forecasts in light of the information available at the time charges were set in 2007.

4.7	What role did information disclosure regulation play in negotiations concerning AIAL's expenditure forecasts?

Auckland Airport altered the methodology used to allocate the costs of its main arterial roads as a result of the development of the input methodology cost allocation guidelines. Previously the Airport used ACAM to allocate up to 95% of the cost of these main arterial routes to the aeronautical business. Now the Airport has modified its allocation to use the allocation of terminal space in the ITB as a proxy to allocate the costs of these main roads, resulting in an allocation of 62% to aeronautical activities.

Other than main roads, BARNZ did not discern any impact or role of information disclosure on the allocation of costs during consultation.[58]

4.8	What impact has information disclosure regulation had on the efficiency of AIAL's investment and operational expenditure?

BARNZ has not discerned any impact of information disclosure regulation on the efficiency of Auckland Airport's investment or operational expenditure.

[58] BARNZ notes that it is only consultation which is required under the Airport Authorities Act, with airports having the statutory right to set charges as they think fit under s4A of the Airport Authorities Act.

5. IS AIAL INNOVATING WHERE APPROPRIATE?

5.1 How does the level of innovation at AIAL compare to innovation at other airports both domestic and international?

The airline industry is an innovative one. There is constant change with new technology becoming the expected norm. Airlines are constantly adapting, and airports need to as well.

Auckland Airport is a leader among New Zealand airports in terms of innovation. It is not at the forefront of airport innovation internationally, but this is not seen as a bad thing, as early technology is often very expensive, and not necessarily trouble free. For example, common use check-in kiosks at a number of over-seas airports have not proved to be economical or popular with passengers, and in some cases, are being decommissioned in favour of other forms of self service or smart technology. Having waited a number of years before installing this technology (early installation was debated, but ultimately not supported, by airlines in the first PSE), Auckland Airport will have the benefit of lessons learned at other airports.

The timing at which new technology is able to be adapted is also dependent upon building programmes. It is not always possible to retro-fit existing buildings with new technology. This is the case with check-in for instance, where bag drops can be constructed from the car-park with new buildings, or where baggage reclaim belts can be inclined between floors.

5.2 What research and development (R & D) or innovation activities have been undertaken or are forecast to be undertaken by AIAL and what was the outcome [of] these activities (if they have been undertaken), or the expected outcome?

Auckland Airport is undertaking a project in this next price setting period to investigate introducing a common-use means of electronic or technology based self-service check-in which would supplement the dedicated kiosks installed by some carriers. What solution is appropriate will depend upon the costs and likely uptake of the solution and no firm decisions have been reached. $7m has been forecast for this project.

There is currently a joint project between NZ Airports and BARNZ to select a new schedule co-ordinator for international flights to New Zealand. A key outcome of this move will be a step up to web-based coordination which will enable airlines to log and request schedule changes over the internet.

A project which BARNZ is looking to accelerate with Auckland Airport is to do away with the manual departure cards currently filled out by passengers prior to their departure. The majority of this information is already captured through the ticket purchase and check-in process, and if it could be sent to the border agencies by the airlines, then this would remove a rather ‘antiquated’ step in the process of leaving the country.

5.3 How receptive is AIAL to innovation activity led by airlines?

BARNZ members operating at Auckland Airport have advised BARNZ that Auckland Airport has what they describe as an 'open door policy' with respect to suggestions by airlines with respect to innovation.

Auckland Airport has put considerable effort into encouraging airport users and service providers to adopt more efficient processes, and into facilitating a 'whole of airport' processing approach aimed at making passenger facilitation through the international terminal more efficient, initially through its Lean 6 Sigma initiative and more recently through its Collaborative Operations Group (COG) which airlines describe as providing each stakeholder at the airport with a better understanding and awareness of the issues and processes of other stakeholders.

Key examples of recent projects or responses to airline innovative initiatives in the last few years include:

- The introduction of ground power units (GPUs) at contact gates which enable aircraft auxiliary systems such as lighting, air-conditioning etc to run from ground power (electricity) rather than the aircraft either needing to have its auxiliary engines running or diesel powered ground units used. This innovation involved the installation not only of the GPUs, but also of swipe on-swipe off electricity meters at each gate. This enables airlines to avoid having to burn a significant amount fuel each year, thus not only being more cost efficient, but also producing environmental benefits. Auckland Airport, BARNZ and Genesis were the joint recipients of the CILT[59] Award for Public Transport Innovation in relation to this project in 2007. The Airport is continuing to work with BARNZ and airlines over modifications to this system to make it more user-friendly and safer through the introduction of 'crocodiles' which are pulled out from the gate thereby eliminating the use of long cables and more economic through avoiding starting auxiliary engines on arrival.
- The installation of a wi-fi network in the baggage make-up hall and on the apron at the request of airlines in order to enable the installation of an electronic internet based baggage reconciliation system to meet new regulatory requirements for international hold stow baggage.
- Collaboration with Air NZ over the introduction of its domestic and international self-service kiosks for passenger check-in and bag drop.
- Working with Jet-star and Air NZ on domestic ground boarding and disembarkation so as to enable the front and rear doors of the aircraft to be used simultaneously, thereby speeding up the boarding process and reducing aircraft turn-around times.

BARNZ has been advised that cargo terminal operators (CTOs) and the Air Cargo Council hold a different view from the perspective of the needs of processing, storing and moving cargo. The Air Cargo Council considers that Auckland Airport has not been receptive to the needs of cargo operators, in particular the need for a secure (ie non-public) road on which to transport cargo from the CTO facilities to airside – which is currently via Check Point Charlie (the Avsec controlled access

[59] Chartered Institute of Logistics and Transport in New Zealand.

point on Cyril Kay Road to go airside on the airfield). BARNZ understands that the Air Cargo Council is considering making a submission to the Commission directly expressing the views of CTOs.

5.4	How does the level of R & D and innovation activities compare now to activities prior to the introduction of information disclosure regulation?

There has not been any discernible change identified as a result of information disclosure under Part 4 of the Commerce Act. However, airline managers have advised BARNZ that they have noticed an improvement and willingness of the airport to listen to airline ideas regarding operational matters, and views on matters of quality and innovation over the past three or four years, compared with, say, the approach pre 2009. This is considered attributable to a changed management attitude or focus rather than information disclosure.

5.5	What innovation has occurred in other airports in New Zealand or overseas in recent years?

BARNZ responded to this question at pages 20 and 21 of its 28 June 2012 Response to the Commerce Commission's Issues and Process paper with respect to Wellington Airport.

6. IS AIAL PROVIDING SERVICES AT A QUALITY THAT REFLECTS CONSUMER DEMANDS?

6.0 How receptive is AIAL to matters of quality raised by airlines?

BARNZ has added this additional question, to mirror the question asked in relation to innovation activities, because it is seen as a key question in assessing whether the purpose of Part 4 is being promoted, given that section 52A(1)(b) refers to suppliers having incentives to *'provide services at a quality that reflects consumer demands'.*

In speaking with the country managers of airlines operating scheduled passenger services at Auckland Airport, the response was that the airport is now considered to be responsive and pro-active in matters of quality raised by airlines. Jetstar provided the example of the Airport moving quickly to bring forward planned capital expenditure as a result of the addition of a ninth aircraft to Jetstar's domestic fleet. Another example was the installation of heaters for staff at the international check-in desks (something previously raised for a number of years with no resolution).

Airline managers felt that there was now a desire of the part of the Airport to understand the needs of the airlines now and engage with airlines, rather than make assumptions, which was the predominant approach prior to 2008. The improvement is seen to be due to changes in management style and attitude, rather than being attributable to information disclosure *per se*.

As noted above, BARNZ has been advised that cargo terminal operators (CTOs) and the Air Cargo Council hold a different view from the perspective of the needs of processing, storing and moving cargo. The Air Cargo Council considers that Auckland Airport has not been receptive to the needs of cargo operators. BARNZ understands that the Air Cargo Council is considering making a submission to the Commission directly expressing the views of CTOs.

6.1 What changes in quality have occurred since ID regulation was introduced?

Since the introduction of the service monitoring and on-time performance monitoring measures in the information disclosure requirements the Airport Facilitation Committee is provided with quarterly reports on interruptions. It has also been observed that there is a better response to interruptions to air-bridge availability, with engineer availability having been increased. This has resulted in additional cost, but the operational benefits are valued by airlines.

6.2 What, if any, aspects of quality do you think should or could be improved (or potentially lowered) at AIAL?

Discussing this question with airline station managers at Auckland Airport, the over-all response is that:

- The Airport has always been very strongly focused on matters of passenger quality, particularly in relation to retail activities.

- The Airport's responsiveness in relation to matters of aeronautical quality has improved over the last three to four years.
- The area where a focus on quality improvement is now required is in relation to the needs of staff working at the airport, many of whom are in relatively low paid positions. Provision of better public transport (admittedly not an Airport responsibility), car-parking facilities (such as covered walk-ways or shuttle buses to and from the staff car-parks which are located some distance from the terminals) and a competitively priced healthy staff cafeteria were particularly raised.

Station Managers supported the air-bridge and gate lounge refurbishment process recently commenced by the Airport, and while expressing a desire for it to proceed faster, also acknowledged that this was a matter of balancing disruption to services while gates were out of commission and keeping bussing operations to a manageable level, particularly during winter.

BARNZ has also consulted with the Air Cargo Council, which represents cargo terminal operators (CTOs), airlines operating freight services and other significant stakeholders in the movement of freight through airports (such as NZ Post or courier companies). The Air Cargo Council considered that the airport has not been receptive to the operational o security requirements for processing cargo. BARNZ understands that the Air Cargo Council is considering making a submission directly to the Commerce Commission setting out these concerns.

6.3	What consultation was undertaken on aspects of service quality during AIAL's second PSE? How does this differ from consultation on quality at the first PSE?

Consultation on quality did not so much occur within consultation during the PSE, as opposed to continuing to occur within ongoing Airport Committees such as:

- The Collaborative Operations Group
- The Airbridge and Baggage Sortation System Operating Committee
- Various Safety Committees covering ground, landside and apron safety
- Annual consultation forecasting the TSC. As the TSC has now been terminated this dialogue is to be replaced with a specific capex consultation structure comprising:
    - biannual capital expenditure consultation with the BARNZ Costs and Regulatory Committee every May and November at an overview level
    - quarterly consultation at an operational level with airport stakeholders
    - detailed consultation on key projects on as required basis
- The Airport Facilitation Committee which meets monthly, and receives quarterly reports on on-time departure delays under the information disclosure requirements
- The Airport attending the Airline Operators Committee as and when required
- Individual meetings between airlines and the Airport.

Overall, airline station managers described the Airport as having a greater willingness to listen and being more open to airline input on matters of quality, operations and innovation than was the case in 2007 at the time of the first PSE.

6.4 What role did information disclosure play in negotiations concerning service quality during AIAL's second PSE?

As consultation[60] occurred during the vacuum between the old information disclosure regime under the AAA and the new information disclosure regime under Part 4 of the Commerce Act, information disclosure has not to date played any material part in determining service quality. However, as an information bank starts to be created as a result of the disclosures and the monitoring of interruptions to key services and resulting delays to on-time performance, the information collected under information disclosure should start to contribute to discussions concerning service quality.

6.5 Do the current ID requirements capture the right measures of quality?

This will be seen over time, but BARNZ considers current requirements represent an appropriate starting point.

[60] BARNZ notes that it is only consultation which is required under the Airport Authorities Act, with airports having the statutory right to set charges as they think fit under s4A of the Airport Authorities Act.

7. IS AIAL SHARINGTHE BENEFITS OF EFFICIENCY GAINS WITH CONSUMERS, INCLUDING THROUGH LOWER PRICES? DO PRICES SET BY AIAL PROMOTE EFFICIENCY?

7.1 How do the prices set by AIAL reflect previous efficiency gains? How did the prices set by AIAL for the first PSE reflect previous efficiency gains?

To the extent that an airport reduces its operating costs through efficiencies, or is able to make decisions that improve the efficiency of the timing or extent of capital expenditure, then these efficiency gains should theoretically be reflected in prices, if they are carried through into the next pricing period.

However, the *quid pro quo* also applies, and to the extent that an airport inefficiently increases its operating costs or makes investment decisions which are not optimal in timing or scope, then these additional costs will also flow through to airlines in prices.

As outlined above in response to question 4.4B above, there was a substantial increase in operating expenses per passenger at Auckland Airport towards the end of the current pricing period of more than $1 per passenger, which is built into the operating costs forecast over the next pricing period, and which is of real concern. To BARNZ, this raises serious questions over the efficiency of the costs forecast by AIAL over the next pricing period.

Auckland Airport has publicly highlighted that its Lean 6 sigma initiative resulted in cost savings, in the vicinity of $3m pa, coming on-line from FY09.[61] However, such efficiency gains have not been reflected in the prices set for two reasons. First, these efficiency gains were achieved after the first PSE occurred, therefore were able to be retained by the Airport during that pricing period.[62] Secondly, the Airport adopted a practice of moving any gains from cost savings into marketing and promotion activities – therefore the net impact for airlines was one of cost increases.

There is therefore no evidence to suggest that the prices set by Auckland Airport reflect previous efficiency gains. Rather, any such previous savings were absorbed into redirected spending on promotion and marketing activities, resulting in increased costs being reflected in prices set.

7.2 To what extent do changes in the pricing structure at AIAL at the second PSE better reflect efficient pricing principles (eg, are prices subsidy-free, do they have regard to service capacity, do they take account of consumer's price sensitivity) relative to the first PSE?

Allocation of common costs and assets

The allocation of the costs of the arterial roads serving the airport has improved between the first and second pricing period, such that commercial activities are now making more appropriate

[61] Refer Auckland Airport Presentation on FY10 Annual Results, 26 August 2010, slide 14.
[62] With the exception of operating costs relating to the TSC which were subject to an annual wash-up.

contribution towards the costs of these roads, as compared to the first pricing period when 90% to 95% of the costs of these arterial roads were included in aeronautical charges.

However, the appropriateness of the allocation of space on the second floor of the international terminal building has deteriorated. In the first PSE, common space (ie circulation space, corridors, toilets etc) on the landside first and second floors was allocated in proportion to the use of the terminal building. This reflected the fact that both commercial and aeronautical activities occur on the second floor. In the second PSE, Auckland Airport has allocated all the common space on the landside area of the second floor to aeronautical users. This is despite the fact that a large proportion of space on the second floor is occupied by commercially leased airline lounges and tenanted office space. This area is shown in the plan included as **Attachment 6**. Common space on the second floor comprises some 1798 sqm, all of which has been allocated to aeronautical users. An adjustment to asset values of between $1.25m to $2.5m is estimated as necessary, depending upon the extent of this area which is treated as common space.

Aeronautical Terminal Charges

Auckland Airport has introduced a domestic passenger charge in its second PSE.

Previously domestic terminal costs were recovered partly via the Airport setting a higher MCTOW rate on domestic jets, partly from revenue from airline leases of operational areas such as check-in space and the baggage make-up area and partly via the international PSC levied on international airlines (previously the international departure charge paid by departing international passengers). At the time charges were set in 2007 it was estimated that there was a cross-subsidy which ranged from approximately $1 per domestic passenger if only directly allocated costs were considered, to $2 per domestic passenger if corporate overheads and shared costs were taken into account.

In the second pricing period Auckland Airport has moved to align the MCTOW rates for all jet aircraft, terminated the leases of domestic operational areas and introduced a domestic passenger charge of $1.98 per passenger. Analysis by BARNZ indicates that a domestic passenger charge at this rate meets all directly attributable capital and operational costs associated with domestic terminal activities. It also makes a small contribution to corporate overheads, but not at as high a level as the international-only airlines which BARNZ represents considered appropriate.[63] Nevertheless, the move to a specific domestic passenger charge is a move in the right direction to eliminate the previous subsidy (so far as the terminal is concerned), and is at a level which is reasonable, albeit still favourable towards domestic carriers at the cost of international carriers.

Airfield Charges

Auckland Airport aligned domestic and international jet MCTOW rates in the second PSE. BARNZ supports this move as there was no justification for continuing the differentiation between international and domestic flights of the same aircraft type.

[63] The solely international airlines which BARNZ represented considered that terminal overheads should have been allocated in proportion to terminal space, which results in a 15% allocation to domestic activities. At the time of the Revised Pricing Proposal, BARNZ calculated that would produce an initial domestic passenger charge of $2.10.

MCTOW rates for aircraft under 40 tonnes remain, however, at a lower rate of 62% of the rate of aircraft above 40 tonnes. It has been many years since a full review of the MCTOW curve was undertaken. Quite possibly this has not occurred since corporatisation in 1988. It has to be questioned whether aircraft under 40 tonnes (which represent 42% of movements, 13% of passengers and 8% of landed tonnes) are meeting an appropriate share of costs (given that they only contribute 5% of airfield revenue). The combination of lower charges through a lower MCTOW rate and a lower aircraft weight may be resulting in these aircraft not meeting their long run incremental costs.

While Auckland Airport proposed aligning MCTOW rates for aircraft over 40 tonnes, it did not address the situation of aircraft under 40 tonnes. The international-only airlines which BARNZ represents therefore requested the Airport commit to undertaking a full review of the cost drivers and appropriate MCTOW curve during the next pricing period, so that, in 2017 when charges are being consulted on again, this work is available for airlines and the Airport to consider.

7.3	To what extent have airlines and other consumers of AIAL's services been able to make price-quality trade-offs that best meet their needs for the second PSE? How does this compare with the first PSE?

While there is not the ability to make price-quality trade-offs within the published charging structure set by Auckland Airport, the opportunity provided by Auckland Airport at the commencement of the consultation process for airlines to indicate what capital expenditure projects they saw as being of priority, gave the airlines the opportunity to make price-quality trade-offs in the charge setting process. For instance, the decision to construct an international bussing and walk-on boarding facility at the base of Pier B allowed airlines to indicate that they were prepared to meet the forecast $13m cost of this project in order to keep bussing operations at a manageable level, but did not, at that time, see the need for a $38m project to construct two additional contact gates. This opportunity was not present to the same degree during the first PSE, and to BARNZ's knowledge, has not been experienced in such a direct fashion at any other New Zealand Airport, despite being common practice at Australian Airports. It was valued by the airlines operating at Auckland Airport.

7.4	To what extent do AIAL's prices promote certainty and stability / How does this compare relative to the first PSE?

The removal of the Terminal Services Charge (TSC), while not favoured by some airlines due to the reduction in transparency and removal of the one truly agreed charge, is favoured by other airlines due to its slightly unpredictable nature. The TSC was forecast each year, with a wash-up occurring at the end of the year to reflect actual costs and actual passenger throughput. Thus airlines had either a debit to pay or a credit to enjoy, depending not only upon the accuracy of the Airport's forecasts of its costs and timing of capital expenditure, but also upon the accuracy of that airline's own passenger and movement forecasts and the accuracy of the passenger and movement forecasts of all other airlines. While the process was well understood due to its long running nature, (having been in existence since 1977), its removal does improve certainty and price stability for airlines.

However, the approach of the Airport in relation to asset valuations going forward at the end of the current 10 year moratorium creates a decidedly uncertain environment moving forward into the third PSE. Auckland Airport has advised the airlines that it reserves its views on revaluations generally until the next pricing round and substantial customers can have *'no expectation that Auckland Airport's approach to the revaluations in 2012 will be followed in future pricing consultations'*.[64]

7.5	How do airlines and other consumers of AIAL's services expect their demand to change in response to the prices set by AIAL in the second PSE?

BARNZ will defer to individual airline responses in relation to this question.

7.6	What impact has information disclosure had on the pricing methodology set by AIAL for the second PSE?

BARNZ has not seen any change to pricing methodology that is considered directly attributable to the information disclosure regime.

[64] Auckland Airport Reasons Paper on its Aeronautical Pricing Decision, 7 June 2012, page 26.

8. COMPARATOR AIRPORTS

8.1 What airports provide a useful benchmark for assessing the performance of AIAL, and why?

BARNZ considers that benchmarking of airports is very much secondary to consideration of the actual assets and costs of the airport in question and its financial performance in relation to such costs, both in the year in question, and also over time.

Nevertheless, from time to time BARNZ has endeavoured to compare New Zealand airports against other airports in Australia. Australian airports are considered most appropriate for any benchmarking exercise as Australia has the closest similarities to New Zealand in terms of its labour market, regulation and laws. That said, even benchmarking with Australian airports is fraught with difficulty, and adjustments need to be made in order to enable comparisons on a like for like basis.

BARNZ has previously provided the Commission with recent benchmarking work comparing the three main New Zealand airports with relevant Australian airports during the section 56G process in relation to Wellington Airport. This work is still current (although will require updating once Christchurch Airport sets its charges).

BARNZ notes that the benchmarking work which Auckland Airport has included within its Reasons Paper as it set its charges, and at pages 70 to 73 of its Price Setting Disclosures, measures a greater range of costs than specified airport services, and includes costs levied by third party providers of services other than specified airport suppliers. It includes charges from third parties such as Government Departure Charges, charges from air navigation service providers such as Airways and charges from providers of security services such as AVSEC. The picture provided by the Airport's benchmarking of turn-around costs therefore disguises the charges levied by the airports by virtue of charges by these third parties being included. New Zealand Airways charges, for example, are much more efficient than many overseas providers of air navigation services, which will result in turn-around costs at New Zealand airports appearing more favourable than at overseas airports where relatively more expensive air navigation costs are incurred. The Auckland Airport benchmarking work of turn-around costs therefore needs to be treated with considerable caution by the Commission as it includes costs and providers which are outside the jurisdiction of the section 56G review being undertaken by the Commission.

BARNZ considers that the methodology which it has employed for the benchmarking work it has provided to the Commission, which only includes charges paid to airports, is more appropriate for the purpose of the task before the Commission.

9. WHAT ARE THE STRENGTHS AND WEAKNESSES OF THE CURRENT ID REQUIREMENTS?

9.1 What are the additional costs to AIAL of complying with information disclosure?

BARNZ will defer to Auckland Airport's response to this question at this stage, not having transparency over the costs of the Airport meeting information disclosure requirements. However, consultation forecasts provided to BARNZ by the Airport did disclose that the Airport was forecasting $4m of costs associated with the merit review proceedings over the pricing period.[65]

9.2 How much of the information disclosed during the recent price setting round would have been publicly disclosed, or disclosed to airlines, in the absence of information disclosure regulation?

BARNZ considers that the same amount of information would have been disclosed to airlines during consultation in the absence of information disclosure regulation under Part 4 of the Commerce Act. The introduction of information disclosure regulation under the AAA in 1999 resulted in an immediate and noticeable uplift in the amount and quality of information provided to airlines during consultation. Prior to this, detailed cost forecasts, pricing models, WACC reports and valuation reports had all been withheld from airlines, with high level summaries only being provided. Thus the move from information disclosure regulation under the AAA to information disclosure regulation under Part 4 of the Commerce Act has not had any impact on the level of information disclosed to airlines during consultation, as sufficient information was already being made available.

In terms of the disclosure of information to the public, information disclosure regulation under Part 4 of the Commerce Act has had a significant impact in the case of Auckland Airport. Previously, the Airport only released a relatively small amount of information publicly. The price setting disclosures required by the Commission following any PSE, have resulted in a materially larger, and more detailed, set of information being released by the Airport to support its price setting decisions.

9.3 What are the benefits to AIAL, airlines and other consumers of AIAL's services of using the information disclosed?

BARNZ sees considerable benefit to users in being able to measure actual performance (particularly in relation to costs, revenues, activity levels and capital expenditure) against the forecasts made in respect of these matters as prices were set.

[65] Appendix H, Auckland Airport Revised Pricing Proposal, 5 April 2012.

9.4	What additional information (not captured in responses to the questions above) could be added to the current ID requirements that would better help you assess whether the purpose of Part 4 is being met?

As BARNZ commented in its Response to the Wellington Airport Issues paper, BARNZ considers that further information needs to be disclosed in the following areas:

- *Disclosure of the costs, assets and revenues associated with the price setting event.* By only having disclosures presented across specified services as a whole, without the price setting event costs, assets and revenues shown separately, then readers cannot clearly ascertain the profitability of the services where the Airport used its AAA power to set the charges. The costs, revenues and performance of the services that charges are set for is camouflaged by the costs, revenues and performance of other services (such as leased activities or negotiated charges) having also been included.

- *Changes to the asset base resulting from cost allocation.* Generally speaking, disclosures to date have not included sufficient information or detail to understand the causes of changes in cost allocations, whether they are reasonable and whether they are stable or likely to be reversed in the future.

- *The inclusion of leased assets within the schedules assessing the regulatory profit of the Airport.* BARNZ considers that as well as disclosing the performance of each of the segmented activities, there also needs to be disclosure of the financial performance of the pricing asset base – i.e. the set of assets and costs for which the Airport set charges using its price setting powers under section 4A of the AAA. It is this decision, and the profitability of these charges, which provide the primary signal of whether the airport is limited in its ability to extract excessive profits. Currently, there is no transparency over the performance of Airports in relation to the charges which they set using the section 4A AAA power.

- *Disclosure of costs and assets for each key service provided by the airport in the price setting disclosures.* BARNZ has noticed a trend during the second PSE for airports to be less willing to disclose the costs and assets associated with providing particular services. For example, while Wellington Airport's initial information separated its domestic and international activities, subsequent information provided in WIAL's actual proposals omitted this information. Moreover WIAL was never able to provide airlines with supporting information on the level of costs and assets associated with charges such as counters, parking or storage. Auckland Airport similarly did not provide airlines with an allocation of costs and assets between its domestic and international terminal activities, stating that it had not undertaken this analysis. BARNZ was only able to undertake its own analysis by virtue of the base information provided to it by Auckland Airport during the first PSE. Without such information it is difficult for interested persons to meaningfully or reliably assess whether cross-subsidies are occurring or are likely to occur within the charges set. BARNZ therefore considers that the price setting disclosures should include an obligation for each airport to provide a statement of the assets (both direct and indirect), required capital return, depreciation, tax and operating costs (both direct and indirect) for each category of charge which the airport levies.

In addition, since the last submissions were made on the Wellington Airport review, BARNZ has identified two further areas where it is considered that the current ID requirements could be further improved:

- Including disclosure of percentage growth figures and including more useful totals within the demand forecast schedule. Because the schedule is only disclosed as a PDF, any interested person seeking to use this information has to constantly have a calculator in hand in order to make any sense of the information. Adding better totals, and including disclosure of percentage growth figures, would improve the practical usefulness of the forecast demand schedules in their disclosed format, without adding any discernible cost.
- Adding a standard form summary of the land valuation outcomes, including the amount of land, value per ha, movement in overall value and changes in allocation, to the disclosure schedules. This information is currently not present in the disclosure schedules and most interested persons will be unlikely to have the time or desire to wade through long valuation reports to obtain this information (not all of which will be present in the valuation report in any event).

Recently BARNZ was asked to direct an aeronautical service provider to publicly available information relating to land values at one of the three airports, so as to assist that party in a rental rate review. Surprisingly, it was quite difficult to point to an easily locatable statement of per ha land values – both for that airport and with respect to another airport the same experiment was applied to. Given that airports disclose the details of land values in individually prepared valuation reports, with no standard format between valuation reports, it can require some quite detailed reading to extract key details – if they are even provided on a per ha basis. BARNZ therefore considers that a relatively simple improvement to the information disclosure reports, which would significantly improve the accessibility of information relating to valuation issues to consumers of airport services (at minimal additional cost to airports), and which would enable ease of comparison between airports and tracking of information over time, would be to add a section disclosing land valuation details on a per ha basis, including land areas. This could include disclosure of:

- The total area of land allocated to the RAB, broken down to each of the three identified airport activities
- The changes in area allocated that year
- The value per ha, both overall and broken down to each of the three identified airport activities and the movement in value on a per ha basis for that year
- The resulting land value, both overall and broken down to each of the three identified airport activities.

This information could logically be included within the notes to Schedule 4 on an overall basis, and in the notes to Schedule 7 on a segmented basis.