

**Ms Charlotte Reed**

Input Methodologies Manager  
Commerce Commission New Zealand  
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Via email: [IM.Review@comcom.govt.nz](mailto:IM.Review@comcom.govt.nz)

19 July 2023

**RE: Part 4 Input Methodologies Review 2023 – Draft Decision**

**Dear Ms Reed,**

Airlines for Australia and New Zealand (A4ANZ) welcomes the opportunity to comment on the Commerce Commission’s draft decisions as outlined in the *Part 4 Input Methodologies Review 2023 – Cost of Capital Topic Paper*.

As the Commission is aware, A4ANZ is an industry group representing airlines based in both Australia and New Zealand; including international, domestic, regional, full service and low-cost carriers. Established in 2017, A4ANZ’s members include Air New Zealand, Qantas, Virgin Australia, Regional Express (Rex), and Jetstar.

The scope of A4ANZ’s submission will be limited to high-level commentary on the following:

- the Commission’s considerations and draft decisions relating to the cost of equity – including how the Commission proposes to account for the impact of COVID-19;
- the new sample of comparator airports; and
- the Commission’s decision on the TAMRP

In addition, we have included some comments on the limitations of the current regulatory regime for New Zealand airports, which underpins this and other relevant reviews undertaken by the Commerce Commission.

**General comments**

As an industry body representing airlines in both Australia and New Zealand, A4ANZ has a strong interest in ensuring that airport infrastructure on both sides of the Tasman is efficient and fit-for-purpose, supported by an appropriate regulatory regime. As monopoly assets, this is especially important to avoid the problems of both over (gold-plating) and under-investment, and the resulting impacts on airlines and travellers.

A4ANZ notes that the Input Methodologies (IM)s are a key part of the regulatory framework applied to airports in New Zealand, with the Information Disclosure (ID) regime designed to constrain airports’ market power through transparency requirements and a threat of further regulation.

To that end, A4ANZ acknowledges the thoroughness of the IM review, and appreciates the detailed explanations of the rationale behind and the considerations made in reaching the decisions set out in this paper. A4ANZ welcomes the Commission’s draft decision and the Commission’s approaches to determining

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key inputs for the regulatory framework in a post-COVID environment, and is supportive of this draft decision being adopted as the final determination.

## **Draft Decisions – Cost of Equity**

### ***Impact of COVID-19***

A4ANZ supports the approach the Commission has proposed – adding a premium to the long-term pre-COVID average beta – to calculate the asset beta for a post-COVID environment, in recognition of the impact of the pandemic.

The COVID-19 pandemic had a devastating impact on the entire aviation sector, and while future pandemics or shocks of this nature should not be ruled out, it is widely accepted that risk events, such as a pandemic, are already provided for in airport asset betas (particularly where the period incorporates share price data from 2020-2022) and WACCs. Pandemics have long been cited – along with other catastrophic events, such as natural disasters – by airport owners and operators, in offerings to investors, as risks that are already built-in to the asset beta.<sup>i</sup>

Historical beta overestimation due to the basket choice creates an incentive for overinvestment, which in turn has a consumer impact.

A4ANZ notes that the Commission’s approach also accords with that of the UK Civil Aviation Authority, informed by the Flint Report<sup>ii</sup> – and we welcome the Commission’s consistency with international regulators.

In an Australian context, the former Australian Competition & Consumer Commission (ACCC) Chairman cautioned airports attempting to recover lost revenues from COVID-19 through excessive pricing, noting that this would limit the ability of the sector to recover, and would negatively impact both consumers and the economy more broadly.<sup>iii</sup>

### ***Comparator Airports***

A4ANZ notes that the Commission’s draft decision proposes to adopt a sample of eight comparator airports from developed capital markets to best match the operations of a major New Zealand Airport.

From A4ANZ’s own exploration of comparator airports, we appreciate how difficult it is to find appropriate comparators for airports in Australia & New Zealand. As other regulators have noted, this is not a challenge experienced only by the aviation sector. However, the unique characteristics of airports on both sides of the Tasman – from the proportion of domestic vs international travel, split of aeronautical vs non-aeronautical revenue, ownership structures, financial leverage, variable hub characteristics, and the light-handed regulatory environments – make it difficult to find appropriate international airports for meaningful comparisons.<sup>iv</sup>

As such, we welcome the Commission’s careful consideration and selection of comparator airports. A4ANZ supports the criteria the Commission used to exclude airports from the comparator set and agrees that the airports outlined in the Commission’s draft decision are appropriate comparators at this time for major New Zealand airports. Additionally, we note that the approach taken by the Commission again accords with international practice.<sup>v</sup>

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### **Tax Adjusted Market Risk Premium (TAMRP)**

A4ANZ notes that the Commission’s draft determination has proposed a TAMRP of 7.0%. Consistent with our initial submission in 2022 – in which we noted that recent decisions by Australian regulators have used TAMRP’s of between 5.95% and 7.0% for essential infrastructure – we believe the 7.0% to be appropriate, and thus support the Commission’s decision on TAMRP.

### **Limitations of the Current Regulatory Regime for Airports**

When considering the matters contained in this review, we have reflected upon the relevant legislation governing the IMs – Part 4 of the Commerce Act (1986). Specifically, the primary purpose of this part of the Act which is set out in Section 52A, to *“promote the long-term benefit of consumers by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services:*

- (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and*
- (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*
- (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
- (d) are limited in their ability to extract excessive profits”*

Auckland Airport provides a case study in the limitations of the regulatory regime to achieve these objectives. Prior to COVID-19, analysis by Frontier Economics found that the total value of excess returns to the airport (across all operations) since privatisation was more than \$3.6 billion.<sup>vi</sup> At the same time, the airport company failed to invest appropriately in ensuring that its infrastructure was fit-for-purpose, leaving the airport and travellers vulnerable during recent extreme weather events<sup>vii</sup>, despite airlines agreeing to a master plan including capital upgrades more than a decade prior.

While all parties agree on the need for investment, the Airport’s recent announcement of a \$5.6 billion capital expenditure program over 10 years – along with signalling that its aeronautical charges would be significantly increased to pay for these costs – left airlines, including Air New Zealand and Qantas, both surprised and disappointed. There are a number of opportunities to make this investment in a much more efficient, prudent and cost-effective way – with some estimates suggesting for as little as a third of the stated cost – which the Airport has simply dismissed. Analysts further noted that the airport targeting a WACC return of 8.73% over FY24-27 was higher than their estimates of 7.7%.<sup>viii</sup>

A4ANZ recognises, however, that under the ID regime, the role of the Commerce Commission is limited to the publication of guidance in relation to the inputs, and the review and assessment of the airports’ financial information against such guidance. The experience with Auckland Airport demonstrates how this clearly isn’t sufficient to either constrain their ability to extract excess profits, or to incentivise appropriate investment. Greg Foran, Air New Zealand’s Chief Executive recently noted, *“at the end of the day, the airport can effectively do what it wants to do. And they do, and we live with the cost, which invariably ends up in a ticket price.”*<sup>ix</sup> This has flow-on effects on demand and then into tourism, impacting the New Zealand economy.

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A4ANZ would argue that this outcome is not in keeping with the objectives of Part 4 (above) which seeks to promote the long-term benefits of consumers. Issues such as unclear rules of engagement, a lack of information or detail on which to enable inputs to be challenged, confidentiality provisions preventing such challenges being put to the regulator early in the process of price-setting, and decisions after capex has already commenced; are all things that need to be addressed. We note that BARNZ has for several years sought greater powers for the Commission, to not only review airport expenditure plans, but to make binding decisions if it thinks the plans are unfair to affected parties.

The Australian regulator, the ACCC, has recommended reforms to airport regulation, with a focus on retaining a light-handed approach, whilst allowing access to independent arbitration in the case of intractable disputes – over such issues as capex plans and pricing. In its response to the Productivity Commission’s Inquiry in 2019, the ACCC argued that *“Providing airlines with access to arbitration would provide a constraint on the monopolist airports’ market power without jeopardising investment. We have not argued for price regulation that applies to other monopoly infrastructure in Australia or to airports in other jurisdictions.”*

*“A commercial arbitration regime would be a pragmatic and flexible solution under which both airports and airlines can seek arbitration if negotiation between the two parties break down due to the exercise of market power. It is likely that having recourse to arbitration will be enough of an incentive to come to an agreement in negotiations, meaning that in practice few parties will seek to initiate arbitration.”<sup>x</sup>*

Whilst A4ANZ acknowledges that reforms to the regulatory settings in New Zealand are not part of this review, we believe that it is important context. The existing regulation of New Zealand’s monopoly airports comes at a cost to the community, both financially and through lost opportunities for improving the quality and efficiency of airport services.<sup>xi</sup> The status quo means that all parties are now facing into a protracted process – with the deferred PSE4 proposal from Auckland Airport still to be reviewed in 2024, following the Final IM publication later in 2023 – all the while with serious disputes over pricing and approach to investment.<sup>xii</sup> Without resolution, there are genuine concerns that airports will commence capex programs structured in such a manner that effectively pre-commits parties to even higher prices in PSE5.

Enabling agreements between airports and airlines on inputs and pricing to be reached in an efficient and timely manner, with appropriate avenues for challenge and resolution of disputes, assists in providing certainty to the sector and investors – allowing airports to move forward quickly with fit-for-purpose infrastructure for New Zealanders and international travellers.

### **Concluding Comments**

As the aviation sector – and New Zealand more broadly – continues to recover, it is essential that the regulatory settings are fit-for-purpose, supporting the achievement of Part 4 objectives. As the IMs represent an important component of the regulatory regime, A4ANZ welcomes and supports the Commission’s careful consideration of the issues outlined in the draft IM decision, and thanks the Commission for the opportunity to make a submission in response.

We would be pleased to discuss any part of this submission with the Commission.

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Yours sincerely,


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**Dr Alison Roberts, Chief Executive Officer**

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<sup>i</sup> TDB Advisory. 2022. NZ Commerce Commission: Part 4 Input Methodologies Review 2023. A report prepared for BARNZ.

<sup>ii</sup> Flint. 2021. Support to the Civil Aviation Authority: Estimating Heathrow's beta post-COVID-19

<sup>iii</sup> ACCC Airline Competition in Australia Report. 29 September 2021.

<sup>iv</sup> Airlines for Australia & New Zealand. 2018. Supplementary Submission to the Productivity Commission. Pp 7.

<sup>v</sup> Qantas, 2023. Submission on NZCC IM Review – CEPA report on cost of capital.

<sup>vi</sup> Frontier Economics. 2018. *The performance of airports in New Zealand*. Report prepared for A4ANZ.

<sup>vii</sup> <https://corporate.aucklandairport.co.nz/news/latest-media/2023/auckland-airport-impacted-by-flooding>

<sup>viii</sup> Morgan Stanley Research. June 2023. Auckland International Airport (AIA.NZ), Price Setting Event, Chapter 4

<sup>ix</sup> <https://www.travelweekly.com.au/article/air-nz-ceo-calls-for-changes-to-airport-controls-in-australia-and-nz-describing-current-situation-as-completely-bizarre/>

<sup>x</sup> Australian Competition and Consumer Commission. March 2019. Productivity Commission Inquiry into the Economic Regulation of Airports - ACCC submission in response to the draft inquiry report.

<sup>xi</sup> <https://www.nzherald.co.nz/business/auckland-airport-slammed-for-runway-maintenance-closures-thousands-of-travellers-affected/3K5P3W45CBISUJBM42BZKXYTRU/>

<sup>xii</sup> <https://www.airnewzealand.com.au/press-release-2023-quantas-and-air-new-zealand-joint-statement-auckland-airport-closes-the-door-on-new-zealand>