



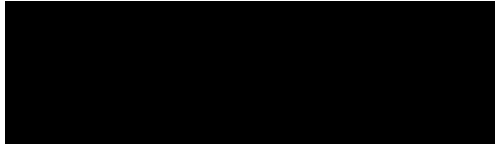
**REVIEW OF AUCKLAND AIRPORT'S 2022-2027
PRICE SETTING EVENT**

SUBMISSION ON PROCESS AND ISSUES PAPER
31 January 2024

INTRODUCTION

1. This is the New Zealand Airports Association's ("**NZ Airports**") submission on the Commerce Commission's ("**Commission**") process and issues paper that was released as part of the review of Auckland International Airport Limited's ("**Auckland Airport**") 2022 – 2027 Price Setting Event ("**Issues Paper**").

2. The NZ Airports contact for this submission is:



3. NZ Airports' comments focus on the regulatory framework issues and matters that are relevant to regulated airports in general. Auckland Airport will provide separate submissions specific to its price setting event ("**PSE**").

4. There is no confidential information in this submission, and it can be published in full on the Commission's website.

EXECUTIVE SUMMARY

5. NZ Airports is generally comfortable with the approach for the review proposed by the Commission.

6. Key views covered in this submission include the following:

- (a) The review is an important part of an effective information disclosure regime under Part 4 of the Commerce Act 1986 ("**ID Regime**").
- (b) Section 53B of the Commerce Act 1986 ("**Act**") provides the Commission with flexibility to run an efficient and cost effective review, while ensuring that its monitoring function contributes to an effective ID Regime. We encourage the Commission to maintain a tight focus for this review, and to not expand the topics for consideration set out in the Issues Paper.
- (c) The appropriateness of pricing decisions made by airports should be assessed based on the information that was available to them at the time the decisions were made – including the input methodologies ("**IMs**") in force at the time, appropriate updates to the IMs to reflect relevant developments since they were set, available guidance from the Commission, and views provided during the airports' consultation process.
- (d) The review process should not be used to re-litigate or second guess capital expenditure decisions. While it is appropriate for the Commission to assess the quality of information airports disclose about their capex decision-making, it is not appropriate for the Commission to provide views on whether a different decision should have been made.

PURPOSE OF THE REVIEW

7. The Commission notes that:¹
 - (a) section 53B(2)(b) of the Act requires it to publish a summary and analysis as soon as practicable after it receives a price setting disclosure; and
 - (b) the purpose of summary and analysis is to promote greater understanding about the performance of each regulated airport, their relative performance, and changes in performance over time.
8. NZ Airports notes that section 53B(2)(b) applies to all suppliers that are subject to information disclosure regulation – it is not a provision unique to airports. Accordingly, the Commission has used discretion to determine that the process for reviewing airport pricing disclosures and producing summary and analysis should be more intensive and extensive than for other sectors and / or the annual disclosures produced by airports.
9. NZ Airports does not dispute that approach, as it believes that summary and analysis under section 53B of the Act is an important part of maintaining an effective ID Regime for airports. In particular, the review provides an opportunity to:
 - (a) provide further confidence to consumers that airports are achieving the objectives of the Part 4 purpose statement; and
 - (b) identify any concerns for airports to address going forward, as each regulated airport is committed to ongoing improvements in performance.
10. However, we raise the point as a reminder that the Commission's statutory summary and analysis function is not intended to be a process to consider whether information disclosure is the right form of regulation for airports. While the Commission is permitted to include analysis of how effective information disclosure is in promoting the purpose of Part 4, that is not the same as considering whether the form of regulation should be changed, for which separate processes are available under the Act if ever required.

FOCUS OF THE REVIEW

11. The Commission notes that under section 53B of the Act it has the flexibility to decide how to carry out the review and which areas of performance to focus on.² NZ Airports is comfortable with this position – section 53B of the Act does not require the Commission to consider all aspects of performance at one time.³
12. In particular, it provides the Commission with the ability to ensure that any review process is as efficient and cost-effective as possible by maintaining a tight focus during reviews. A focused and targeted review can still be sufficiently rigorous to ensure that the Commission's monitoring function contributes to an effective ID Regime.
13. That said, NZ Airports believes that, in order to fulfil the requirement to publish a summary and analysis of the disclosed information and to adequately promote greater understanding of

¹ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraph [3].

² Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraph [16].

³ NZ Airports Association *Submission on the process and issues paper for Auckland International Airport Limited's and Christchurch International Airport's third price setting events (July 2017 – June 2022)* (28 November 2017), at paragraphs [9] and [10].

performance, the Commission must ensure that it takes a balanced approach to considering how performance is promoting all limbs of the Part 4 purpose statement (consistent with the purpose of information disclosure to ensure sufficient information is readily available to interested persons to assess whether the purpose of Part 4 is being met).

14. If the Commission consistently focuses on one limb of the purpose statement and / or ignores others, it will send a message that it considers some performance outcomes are more (or less) important than others and / or it may not fulfil the summary and analysis function. In particular:
 - (a) All relevant context provided in the disclosures (beyond profitability) must be considered for inclusion in the summary. While the pricing disclosures provide the most detail about expected profitability, and profitability may be simpler to quantify and measure relative to the other areas of performance, this does not mean that it should be given more weight when considering if the purpose of Part 4 is being met. The disclosures also include other valuable information about quality, innovation, and efficiencies. As the Commission notes, historical disclosures provide better insight into performance areas such as service quality, level of innovation, actual expenditure and returns.⁴ Airports spend significant time and effort ensuring a full picture is provided across all of their disclosures, including the rationale and context for the airport pricing decisions. This information should also inform the Commission's analysis of the performance of airports, to provide a full and balanced picture of the performance by airports over time. In this regard, NZ Airports welcomes the inclusion of quality, innovation, and efficiencies within this pricing review as other metrics of performance.⁵
 - (b) The same weight and attention must be given to areas of positive performance as to those areas that are perceived issues. Following the Issues Paper and the approach undertaken for Christchurch Airport's recent PSE4 review, it is apparent that the Commission's preferred approach is to assess profitability in detail while only considering other topics to the extent they are perceived as potential issues.
15. It is appropriate that reviews of pricing disclosures should conclude with an assessment of how effectively the purpose of Part 4 is being promoted. The overall purpose is to promote the long-term benefit of consumers, which requires consideration of each of the specific yet interrelated limbs of the Part 4 purpose and their combined impact on the overall purpose. Accordingly, this review should avoid considering different areas of performance in isolation, as doing so could result in conclusions being reached that are inconsistent with the overall purpose of Part 4.
16. For example, the quality and efficiency of services being provided should inform the need for and quantum of investment. In turn, this should inform the returns that are necessary for investors to fund the delivery of that investment given the risks involved. These areas of performance are all interrelated.
17. Further, the interrelationships between these areas of performance should inform the potential costs of regulatory error that the Commission ought to consider when making assessments of whether the Part 4 purpose is being effectively promoted. For example, where investment is required to address service quality issues, regulatory error when assessing profitability can create a risk that capital investment will be below the level required, which can then reasonably be expected to result in poorer service quality.

⁴ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraph [16].

⁵ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraphs [53], [62], and [54] – [61].

18. The potential cost of such a regulatory error can have an asymmetric impact on consumers. Airport charges make up a small portion of the airfare paid for by passengers. Constrained capacity in travel markets can result in significant increases in airfares, as recently demonstrated by the COVID-19 pandemic. Therefore, the cost to consumers of regulatory error when assessing profitability will be asymmetric if it results in airport capacity constraints, because the cost to consumers of higher airfares caused by capacity constraints can be expected to far exceed the cost to consumers of regulatory error that results in higher airport charges:
- (a) The asymmetric costs of regulatory error when estimating WACC is recognised in the electricity sector where under price control the WACC is now set at the 65th percentile for electricity distribution businesses and Transpower. While the Commission uses the mid-point WACC as a starting point for assessing airport profitability, since airports are subject to information disclosure only, it remains important for the Commission's assessment to build in recognition of the asymmetric risk, so that the mid-point WACC is not both the start and end point for assessment.
 - (b) That assessment should also recognise that since airport charges are a small portion of the overall airfare, the asymmetry of costs for airport consumers is different than for the energy sector. Passengers are unlikely to be harmed to the same extent if assessments err in favour of higher profitability, but are likely to suffer greater harm if assessments hinder investment in capacity.

Approach to assessing profitability

19. The Issues Paper states that, for clarity, as Auckland Airport's price setting occurred on 7 June 2023, the IMs that apply to this review are the IMs that were in force at that time.⁶
20. NZ Airports welcomes this clarification. However, we consider additional clarification is required, as the Commission could be misinterpreted as suggesting that appropriate updates to the 2016 IMs will not be considered. In particular, it was appropriate for Auckland Airport to:
- (a) Update the asset beta and leverage estimates in accordance with the 2016 IM approach. This includes updating the large comparator sample to account for changes in listed airports and using the most recent two five-year periods of data.
 - (b) Not make a 0.05 downward adjustment to asset beta based on clear expert evidence that such an adjustment was not empirically justified (as subsequently accepted by the Commission in the 2023 IM Review).
 - (c) Use an updated economy wide TAMRP of 7.5%, which the Commission had established for other sectors in more recent updates to their IMs.
21. This position is consistent with the broader position that analysis of the appropriateness or reasonableness of airports' decisions must be based on the information that was available to the airports at the time they made those decisions, and which set their expectations of how their decisions would be reviewed. This includes the IMs in force at the time the PSEs occurred, appropriate updates or changes to those IMs, available guidance from the Commission, and views provided during the airports' consultation process.

⁶ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraph [32].

22. The Commission proposes to consider returns for both priced and all regulated activities when assessing cost of capital and profitability.⁷ It will be important to bear in mind that non-priced activities cannot be assessed in the same way as priced activities. As was discussed and accepted by the Commission during the PSE3 reviews, assessment of non-priced activities requires a longer-term view because prices are not set on a building block basis and prices are not set in timeframes that coincide with aeronautical pricing periods.⁸ For example, a lease can be long term and / or rent will depend on current market values.

Assessing investment

23. In light of Auckland Airport's significant capital investment programme, the Issues Paper states that:⁹

We plan to assess whether Auckland Airport is planning to invest when and where required. We propose to consider the investment rationale, such as needs identification, project sequencing, options considered, customer engagement, constraint and contingency factors.

24. The Issues Paper signals that although the Commission will principally rely on investment plan information in the PSE4 disclosure to draw conclusions, it may also gather limited additional information where necessary to inform its analysis of whether the airport is investing its assets appropriately and in a way that meets the quality consumers demand.¹⁰

25. NZ Airports makes the following points on the Commission's proposed approach:

- (a) It is appropriate for the Commission to review the sufficiency of information provided in the disclosures to assess whether the airport is demonstrating that it is seeking to promote the Part 4 purpose statement – ie has the airport clearly explained its investment rationale and the process to make decisions, including consideration of customer feedback? Would further explanation and information be helpful in some cases? This is consistent with the purpose of the summary and analysis to promote a greater understanding of performance.
- (b) However, this is a performance area where it will be particularly important for the Commission to adhere to its own caution that the review "does not determine the specific choices that Auckland Airport ought to have made in its pricing decisions, nor what we would have done in its place".¹¹ The complexities involved in decision-making on capital expenditure mean that it would be inappropriate for the Commission, as part of the summary and analysis process, to seek to second guess the decisions made by airports.
- (c) In that context, while the Commission may wish to gather limited additional information, it will need to be careful to ensure that this does not provide a forum for participants in airport pricing consultations to raise new concerns or put forward new evidence or arguments that were not put to the airports during the consultation

⁷ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraph [36].

⁸ Commerce Commission *Review of Auckland Airports Price Setting Event 3 – Final Report* (1 November 2018), at paragraph [X33].

⁹ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraph [52].

¹⁰ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraphs [20] and [52].

¹¹ Commerce Commission *Review of Auckland Airport's Price Setting Event 4 – Process and Issues Paper* (30 November 2023), at paragraph [17].

process. For example, it may be appropriate for the Commission to request additional information to verify or clarify information provided in disclosures.