Christchurch International airport Limited

PO Box 14 001
Christchurch 8544, New Zealand
Telephone (+64 3) 358 5029
Facsimile (+64 3) 353 7730
christchurchairport.co.nz

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Ruth Nichols
Senior Legal Counsel
Commerce Commission
PO Box 2351
Wellington 6140

Dear Ruth

SECTION 56G SUBMISSION ON PROCESS AND ISSUES PAPER CHRISTCHURCH AIRPORT

I have pleasure in submitting Christchurch International Airport's (***CIAL***) submission on the Section 56G Process and Issues paper, published on 8 February 2013 as part of your review of the information disclosure regime.

Our submission is comprised of a number of components, which include:

1. CIAL Process and Issues Paper response.
2. A consolidated paper from PricewaterhouseCoopers on their expert advice to CIAL on the Weighted Average Cost of Capital ***(WACC)*** to be used as a commercial basis in the setting of aeronautical prices.
3. A spreadsheet containing the calculations of CIAL's Internal Rate of Return (***IRR***) following the approach developed by the Commission for the assessment of returns for Wellington International Airport, for both the five and ten year periods (PSE2 and PSE2/3) as referred to in the Process and Issues Paper.
4. A spreadsheet supporting the analysis of the effects of tax treatment on prices, as referenced in Question 3.12.

In making this submission I wish to reinforce the key elements that have underpinned the reset of our Aeronautical Charges on 1 December 2012.

Consultation Requirement

CIAL is required by the Airport Authorities Act to consult on major investment decisions in excess of 20% of the asset base value. The new integrated terminal (ITP) involved a capital investment of approximately $215 million. Our domestic terminal had reached the end of its useful life, and a replacement was needed to overcome the shortcomings increasingly experienced over recent years, meet the changing service standards required by our airline customers, and to provide a more efficient service delivery.

In approving this investment, our Board and shareholders have required that CIAL achieve an appropriate return over the life of the asset. This is an essential requirement for any investment approval as airports would not commit to major infrastructure investment unless there was confidence that an appropriate return would be achieved.

A significant but separate consultation process was held in 2008 and 2009 on the actual terminal development, its functionality requirements, the capital cost forecast and how it would meet airlines' future business model needs.

Pricing Methodology

The pricing methodology discussed with major airline customers as part of this price reset process was developed on the assumption that CIAL will efficiently recover the capital investment made in ITP. We consulted on the approach taken by CIAL in setting the prices, and in particular the time profile of cost recovery through which CIAL would achieve appropriate returns.

In developing the methodology, CIAL had an objective to ensure that it achieved a return over the life cycle of the ITP. This is done by developing a levelised price path that would ensure an appropriate recovery of the necessary revenue, while at the same time providing our customers with a revenue recovery approach that would avoid inter period price shocks. This, we believe, will provide significant benefit to our airline customers, and will enable them to make long term planning decisions in terms of their network aircraft fleet configurations/schedules and the cost of using services at Christchurch Airport.

Revenue Inputs

We have largely followed the input methodologies set under the Information disclosure regime determined in December 2010, despite not being required to use these methodologies for setting prices.

In using the input methodologies where feasible, our focus was on ensuring transparency of information and enabling the consultation process to focus on the more commercial issues - namely the prices and how they would be charged, rather than lengthy discussion on the various component inputs into the revenue makeup.

There was however one variance to the Commission's input methodology – our choice of the appropriate WACC. We cover reasons for this variance in depth in our Process and Issues Paper response. We believe the approach taken is appropriate and more reflective of the risk and the required return for ITP over the future.

During the consultation we listened to our customers' responses and following in depth consideration made a number of changes in response to airline feedback.

In developing the price path to be applied we took into consideration the state of the aviation sector and the specific economic circumstances of our customers. CIAL accordingly set a transition price path that we believe adequately balances the need of airlines, the users of Christchurch Airport, CIAL and our shareholders. However, as further detailed in our attached response, CIAL still carries a significant risk for this price reset period as a consequence of the earthquakes - particularly around the demand forecast in the early years of the price reset period.

Sharing of Burden

CIAL has acknowledged that it must share in the burden arising from the effects of the Canterbury earthquakes. We do not expect our airline customers to have to carry the full risk and accordingly in setting the levelised price path we have accepted a permanent under recovery of $15.9 million (on a present value basis). In addition by setting the levelised price path we have deferred revenues that must be recovered in future price reset periods.

This is reflected in the internal rates of return being observed for PSE2 and PSE3 and the increases required in subsequent price reset periods.

Stakeholder Benefits

Following the commissioning of ITP we believe Christchurch Airport consumers are now benefiting from a modern and well performing airport, delivering quality airport services at levels reflecting both passenger and airline demands. CIAL has demonstrated an extremely effective operating capability delivering efficient and innovative services, at charges which are very reasonable having regard to the investment made by CIAL, and when benchmarked against comparative airports.

Conclusion

CIAL is operating in a very competitive and demanding market. We would be very concerned if the Commission undertakes its review starting with a presumption of market power, rather than considering pricing decisions and the expected profile of returns within the broader market context. We urge the Commission to give full consideration to the life-time risks and returns of major investment initiatives, such as ITP. The focus should not be on individual price reset periods but rather on the trend of returns over a series of price control periods. We expect the Commission's review to confirm that CIAL should be able to receive an appropriate rate of return over the life of the ITP.

If you have any further queries on our submission please do not hesitate to contact me and we will provide further information to assist your understanding.

Yours sincerely

Neil Cochrane
GENERAL MANAGER BUSINESS SERVICES