A STAR ALLIANCE MEMBER

AIR NEW ZEALAND

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Charlotte Reed
Input Methodologies Manager
Input Methodologies Review 2023
Commerce Commission
PO Box 2351
WELLINGTON 6140

Email IM.Review@comcom.govt.nz

Dear Charlotte

Part 4 Input Methodologies Review 2023 – Draft Decision – Cost of Capital Topic Paper – Cross Submission

Submissions on the Commerce Commission (Commission) Draft Decisions on the 2023 Input Methodologies Review were published on 26 July 2023. Air New Zealand (Air NZ) welcomes the opportunity to make this cross-submission in response to some of the issues raised by other submitters in relation to the airport cost of capital IM.

Air NZ is of the view the Commission has clearly and comprehensively demonstrated that the resulting returns under its proposal would sit well within the range of returns expected in the New Zealand market. While the airport submissions, and those of its advisors, weigh heavily into why the Commission's proposed approach is wrong, there is little if any rebuttal of the Commission's reasonableness checks, including the RAB-multiple analysis. We strongly support the Commission taking the opportunity – for which the IM review is designed - to work with stakeholders to identify issues, risks and opportunities in the airport sector and examine how regulatory settings can help deliver the right outcomes.

Air NZ has identified four key themes raised in other submissions where Air NZ holds an opposing view. These broad themes are:

- The Commission has overstepped the mark in making a material change to its comparator set of airports;
- The proposed approach undermines the regulatory certainty and stability that had developed since 2010;
- The level of returns "allowable" under the revised approach will not be sufficient for investors and investment will be inhibited; and

- Any reduction in airport charges will flow into airline profits with no benefit to end-consumers through lower fares.

Air New Zealand's position on these four themes is detailed below:

The Commission has correctly identified an appropriate set of comparator airports

This IM Review is only the second to occur after more than a decade of the IMs being in effect. It is to be expected that over this time the Commission and other stakeholders will have developed a more nuanced approach to the mechanics of the IMs, including the appropriate parameters to be used in assessing what a reasonable return might be.

In this regard, the refinement of comparator airports to establish a more appropriate comparative set reflects a better understanding of the sector, which better matches the environment in which the New Zealand airports operate. Air New Zealand agrees with the approach taken by the Commission to identify an appropriate set of comparator airports and refers to TDB's 9 August 2023 report prepared for BARNZ which addresses this issue in detail.

The Draft Decision does not undermine regulatory certainty and stability

Some submitters appear to believe that there should be no change to the IM settings as this would undermine the stability and certainty of the regulatory regime. This ignores the purpose of the review process. As the Commission points out in its process and issues paper, the IM Review offers an important opportunity to work with stakeholders to identify issues, risks and opportunities in the airport sector and examine how regulatory settings can help deliver the right outcomes. It is entirely correct for the Commission to take a forward looking approach which takes into account the fact that over time stakeholders have gained a greater understanding of how the regime works, including insights into how the regime can be modified to better reflect the intent of Part 4 regulation, and the proper response to the shock that COVID-19 represented.

Airports claim that the Draft Decision will result in more resource and effort required during pricing consultations and subsequent disclosures to develop WACC estimates appropriate to individual airport circumstances. Air NZ notes that the existing regime has not prevented airports from targeting returns above the mid-point WACC established under the IMs and that we would expect the same approach by airports in the future.

Investment will not be inhibited

As stewards of critical New Zealand infrastructure, it is incumbent on airports to provide facilities and services adequate to meet market requirements in an efficient and practical manner. It is therefore disappointing that some airports are claiming that the level of return resulting from the Draft Decisions would inhibit efficient investment in aeronautical assets when the Commission's reasonableness tests demonstrate that the resulting level of return continues to benchmark well against long-run New Zealand market returns particularly considering that the major airports face lower risks than the average firm. Market evidence, in the form of the RAB multiple analysis of Auckland Airport, highlights that investors have had no concerns with regulatory settings applicable to the airport. As noted by TDB in its July 2023 report for BARNZ, current settings may be resulting in an overestimate of WACC, meaning the "airport sector has been and probably remains an attractive proposition for the local and global investment community." As TDB goes on to say, "any subsequent adjustments in the parameter estimates should be directed towards lowering the WACC." All of these factors support the view that investors will continue to support investment in airport infrastructure.

It should also be noted that Information Disclosure relates only to the airports' aeronautical activities. Airports can, and do, generate significant returns from their non-aeronautical complementary activities and investors are likely to consider this holistic picture when assessing airport performance and the appropriate level of investment, and return.

Air NZ found it surprising that a number of airports (and Council owners) outside of those regulated under the Part 4 Information Disclosure regime made submissions against the Draft Decisions, using a pro-forma template, referencing a potential adverse impact on investment in the regions. To the contrary, Air NZ's concern is that the cost of Auckland Airport's latest redevelopment plans (in part driven by an over-inflated WACC) will impact demand for future regional air services to and from Auckland, with associated impacts for traffic levels at regional airports. Notwithstanding the resultant changes to charges, Air NZ has continued to support several terminal developments at regional airports. Notable recent examples include Nelson, New Plymouth, Taupo, and Rotorua.

Airline customers will benefit from efficient levels of airport investment, including through lower airport charges

Airport submissions regarding whether airlines would pass onto customers any reduced airport charges are not supported by facts or data, are contrary to Air NZ's view and experience, and in fact are irrelevant to the Commission's decision.

The Part 4 Information Disclosure regime is focused on *airport* performance and overall economic efficiency. In any case, airline pricing occurs in a dynamic, competitive environment where changing profits over time will lead to market entry and exit and resulting changes to capacity and fare levels as this competitive dynamic plays out. This is evident in the data IATA is providing as part of its cross-submission. By contrast, this is not the case with the monopoly airport sector which requires a regulatory regime, albeit currently a regime at the light-handed extreme of the Part 4 spectrum, to ensure consumer interests are maintained.

Allowing excess returns by airports will only result in inefficient and unaffordable airport investments. It will ultimately be harmful to consumers and will also undermine the ability for airlines to invest in new fleet and service offerings responding to customer requirements and sustainability drivers over coming years.

Air NZ looks forward to the Commission confirming its Draft Decisions. Please contact [redacted] if you have any queries relating to this cross-submission.

Yours sincerely

[redacted]

Sean Ford
Manager Aeronautical Suppliers