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Summary and analysis of Christchurch Airport's revised information disclosure for its second price setting event

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CONTENTS

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1. Introduction

Purpose of report

1. On 28 November 2014 Christchurch Airport voluntarily published a revised price setting disclosure describing the prices that apply from 1 December 2012 to 30 June 2017.[1] The revised information disclosure also provides information regarding the airport's planned approach to pricing for the period 1 July 2017 to 30 June 2032.

2. This report provides our summary and analysis of the information contained in Christchurch Airport's voluntary disclosure having taken into account the submissions received on our draft report.[2]

Summary and analysis of disclosed information

3. After information is disclosed by an airport, we are required to publish a summary and analysis of the disclosed information. The purpose of summary and analysis is to promote greater understanding about the performance of each airport, their relative performance, and the changes in their performance over time.[3]

4. Christchurch Airport is one of the three airports that are currently subject to information disclosure regulation under Part 4 of the Commerce Act.[4] Under this type of regulation, Christchurch Airport must publicly disclose information about its performance annually, and following a price setting event.

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[1] Christchurch also published its 2014 annual disclosure and voluntarily re-disclosed its 2013 annual disclosure at the same time. However, this summary and analysis report only covers the price setting re-disclosure. The pricing re-disclosure is titled Christchurch International Airport Limited: "Supplementary Voluntary Disclosures: Price Reset 1 December 2012; Annual Disclosure for the Year ending 30 June 2013", 28 November 2014 (available on Christchurch Airport's website).

[2] The 'draft report' refers to: Commerce Commission "Review of Christchurch Airport's revised information disclosure for its second price setting event" (22 May 2015).

[3] Refer: s 53B of the Commerce Act.

[4] S 56A of the Commerce Act sets out the Airport companies that are subject to information disclosure regulation under Part 4, namely: Auckland, Wellington, and Christchurch airports.

5. Christchurch Airport originally published the disclosure regarding its second price setting event (PSE2) on 19 December 2012, in accordance with our information disclosure requirements.[5] Following the findings of our review of that information—summarised below—Christchurch Airport reconsidered its pricing approach, without changing its prices. The information regarding the revision to the pricing approach was published on 28 November 2014.[6]

Original review of second pricing event was part of a wider exercise

6. Our original review of Christchurch Airport's PSE2 disclosure was undertaken as part of a wider exercise that reviewed the effectiveness of the information disclosure regime. This review was required under s 56G of the Commerce Act.[7]

Table 1: Publication dates for s 56 reports

Airport	**Draft report**	**Final report**
Auckland Airport	30 April 2013	31 July 2013
Christchurch Airport	15 October 2013	13 February 2014
Wellington Airport	2 November 2012	8 February 2013

7. We published an 's 56G report' for each of the three airports that described our review and our conclusions. Table 1 describes when we published draft and final reports for Auckland Airport, Christchurch Airport and Wellington Airport.

Findings from our original review

8. In our final s 56G report for Christchurch Airport we found some areas of performance where we had concerns. Our conclusion was that information disclosure had not been effective in limiting expected excessive profits over the 20-year pricing period on which the airport's prices for 2012 to 2017 were based. When the airport set its prices for the PSE2 period, its target return for that 20-year period (ie, 2012 to 2032) was 8.9%, which was above our estimate of the acceptable range of returns over that period (ie, 7.6% to 8.5%).

[5] Those requirements are set out in the "Airport Information Disclosure Determination" (Commerce Commission Decision 715, 27 February 2012).

[6] Christchurch International Airport Limited "Supplementary Voluntary Disclosures: Price Reset 1 December 2012; Annual Disclosure for the Year ending 30 June 2013".

[7] Commerce Commission "Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Christchurch Airport", 13 February 2014.

9. Our approach to assessing Christchurch Airport's returns over this 20-year period was specific to the information and circumstances relevant to the airport. We assessed the airport's price setting conduct over that period because, in its price setting disclosure for PSE2, the airport explained that its PSE2 period charges were the beginning of the recovery of the costs over the 20-year economic lifetime of its new integrated terminal project.

10. Christchurch Airport's target return for the PSE2 period only (ie, 6.8%) fell within our estimate of an acceptable range of returns for the initial five-year period (ie, 6.6% to 7.6%). However, its conduct for PSE2 appeared to have been primarily influenced by the demand-related considerations affecting the airport for the PSE2 period (in particular the impact of the Canterbury earthquakes), rather than information disclosure regulation. It was not possible to predict whether information disclosure regulation would constrain the airport's pricing behaviour in the future if demand conditions were to improve.

11. Further, we concluded that information disclosure regulation had not been as effective in promoting pricing efficiency as we would have expected at the time of the s 56G review. Christchurch Airport's PSE2 disclosure did not fully or transparently reflect its pricing approach. The airport had not provided sufficient information to allow interested persons to assess its expected profitability.

12. Our review also concluded that information disclosure had been effective in promoting incentives to innovate and to provide services at a quality that reflected consumer demand. We also noted there were a number of areas (operating expenditure efficiency, efficient investment, and sharing efficiency gains) where it was not yet possible to conclude on the effectiveness of information disclosure.

Christchurch Airport's voluntary disclosure following our report

13. Following our publication of the s 56G report, Christchurch Airport voluntarily published a revised version of its PSE2 pricing disclosure. This revised disclosure included changes to improve the transparency of its pricing approach that addressed a number of concerns raised in our s 56G report. We welcome Christchurch Airport's efforts to improve the transparency of its PSE2 disclosure.

14. The changes seek to improve transparency, without changing the pricing for the PSE2 period (unlike Wellington Airport, which changed its pricing before publishing its re-disclosure). Christchurch Airport has addressed a number of the concerns we had about the lack of transparency as to its pricing approach. We have set out our observations on the revised disclosure in this report.

Focus of summary and analysis of voluntary revised disclosure is transparency

15. We have focussed our summary and analysis of Christchurch Airport's voluntary revised disclosure on the transparency of the disclosure. In particular, we focussed on assessing the extent to which the revised disclosure improved the ability of interested persons to assess whether Christchurch Airport is limited in its ability to extract excessive profits.

16. This piece of summary and analysis is focussed on transparency because improvement in transparency was the purpose of the voluntary revised disclosure. Christchurch Airport has not changed the pricing for PSE2, so our assessment of profitability that we published in our s 56G report on Christchurch Airport does not need to be revised.

17. Christchurch Airport's revised disclosure has not led to changes to our conclusions on the effectiveness of information disclosure regulation in limiting Christchurch Airport's ability to extract excessive profits. Our estimate of Christchurch Airport's target returns over the 20-year period when it set prices for PSE2 remains at 8.9%, which is above our estimate of an acceptable range (7.6% to 8.5%).

18. We note that some of the changes to Christchurch Airport's pricing approach may result in a reduction of prices in future pricing periods—all other things being unchanged—beyond the PSE2 period, and therefore a reduction in targeted returns. However, the revised disclosure provides insufficient information to fully assess the future impact of changes in the methodology.

Material published alongside this report

19. We received three submissions, which we have considered in our summary and analysis and published on our website. The three submissions were from Christchurch Airport, the Board of Airline Representatives New Zealand (BARNZ) and New Zealand Airports. Our responses to the main points of these submissions are provided in Chapter 4.

20. We have previously published correspondence received from BARNZ that was received before publication of our draft report. We have considered this correspondence as a submission on the draft report alongside the other submissions.

Next steps

21. We recognise that changing some aspects of the information disclosure requirements for airports may help improve transparency. We are proposing that some of the issues relating to information disclosure and our assessment of such information will be considered as part of our input methodologies review.

2. Transparency issues in original pricing disclosure

Purpose of chapter

22. Christchurch Airport has approached its pricing differently to Wellington Airport and Auckland Airport. In this chapter we describe Christchurch Airport's original pricing approach for PSE2 and set out the key differences from Wellington Airport and Auckland Airport. We also explain our main concerns with Christchurch Airport's approach, as identified during the s 56G review. In Chapter 3 we discuss the extent to which we consider Christchurch Airport has addressed our concerns.

Summary of Christchurch Airport's pricing approach

23. At a high level, the approach to pricing that is most simple and transparent for stakeholders to understand is for an airport to set prices for each pricing period that targets a level of returns that is independent of the returns that will be targeted in future pricing periods.

24. In contrast, for PSE2, Christchurch Airport set prices for the PSE2 period in the context of the returns that were being targeted over a rolling 20-year period. The remainder of this chapter describes the reasons for Christchurch Airport's 20-year pricing approach and our concerns with Christchurch Airport's approach.

Twenty-year pricing approach

25. Christchurch Airport completed its integrated terminal project in March 2013 at a cost of $237 million, resulting in a doubling of the value of the regulatory asset base (RAB). In order to minimise price shocks and ensure that the total cost of investment is allocated fairly between current and future users, Christchurch Airport developed a 'long-run levelised constant real price' which allowed it to recover its costs over the economic life of the assets associated with the large investment.[8]

26. The levelised price path results in a lower price at the start of the 20-year period than would be established using straight-line depreciation as adopted by Wellington Airport and Auckland Airport. This relatively lower price is counterbalanced by an intention of a relatively higher price later in the 20-year period.

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8 The airport describes the levelised price as a ceiling for prices and takes into account its commercial judgment based on the market situation (such as demand-related considerations) to decide whether to set prices below the cap. In the case of PSE2, the airport initially set prices lower than suggested by the levelised price model in order to reflect the economic conditions created by the Canterbury earthquakes. The airport has stated that when prices are lower than the levelised price model this 'under recovery' will not be compensated for with 'over recovery' in future periods.

27. In our s 56G report, we indicated that Christchurch Airport's reason for wanting to establish a levelised price path over multiple price setting periods is understandable. Christchurch Airport's levelised pricing approach is consistent with efficient pricing principles and is conceptually easy to understand.

28. However, we also explained that we had significant issues with how Christchurch Airport had implemented the approach in practice, how the approach might be implemented in future, and about the extent the implementation of the approach was transparent to interested persons.[9]

29. We suggested that Christchurch Airport's use of a standard straight-line depreciation approach in its disclosures, in conjunction with its levelised pricing approach, may have meant that its pricing disclosures were less transparent than they could have been.

30. We also indicated that Christchurch Airport could have derived and disclosed forecast depreciated values of its RAB that were consistent with its levelised price path (ie, reflecting relatively low capacity utilisation in the short term, as well as an expectation of higher cash flows in the future). Doing so would have allowed interested persons to better assess the impact of its levelised pricing approach on expected returns.[10]

Rolling 20-year pricing period

31. In its submission on our draft s 56G report, Christchurch Airport explained that it planned to set future prices based on a rolling 20-year pricing period rather than a fixed period. This rolling pricing period meant that the airport intended to restart a 20-year pricing period each time that it reset prices (generally every five years). For example, for PSE3 it would reset a new levelised price path (assuming its commercial judgment did not require a lower price) for the next 20 years.

[9] Commerce Commission "Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Christchurch Airport", 13 February 2014, paragraphs E13-E14.

[10] Further description of our depreciation approach concerns is provided in paragraphs E24 to E28 of the s 56G report: Commerce Commission "Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Christchurch Airport", 13 February 2014.

32. The planned rolling 20-year pricing period made it more difficult for stakeholders to understand the level of returns being targeted by Christchurch Airport. The rolling price period approach and our concerns about it are described further in paragraphs F55 to F62 of the s 56G report.[11] We noted that this approach differed from the understanding that stakeholders had from the pricing consultation process and the original 2012 PSE2 pricing disclosure.

Details of pricing beyond 2017 were unclear

33. There are a number of details of how the pricing approach is going to be implemented in future price setting events that are important for assessing returns. The s 56G report (particularly Attachment F) highlights a number of these details that were not clear from the original PSE2 pricing disclosure.

34. For the s 56G report, we derived an estimate of targeted returns for the 20-year period by relying on a series of assumptions.[12] These assumptions were required because there were a number of aspects of the pricing—particularly beyond the PSE2 period—that the airport had not made clear. We were generally conservative in approaching these assumptions, resulting in a lower estimate of returns compared to alternative assumptions.[13]

35. The pricing model that Christchurch Airport provided to airlines during consultation on PSE2 price setting only included detailed calculations for the first 10 years, which made it difficult to fully understand all the assumptions underpinning the entire levelised pricing period.

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11 Commerce Commission "Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Christchurch Airport", 13 February 2014.

12 Given that Christchurch Airport was seeking to achieve its target return over 20 years, instead of over any single pricing period, our estimate of the target return in the s 56G report related to a 20-year period rather than just the typical five-year pricing period for the other airports.

13 We were generally conservative in the airport's favour because our assessment was based on what the airport could have considered reasonable at the time it set prices given its understanding of the input methodologies and information disclosure requirements. In many cases, the assumptions are required where the input methodologies do not describe a specific approach and there are a range of options that might be considered reasonable. This conservative approach to assumptions was consistent with our approach used for assessing Wellington and Auckland airports.

Pricing approach implemented on a pre-tax basis

36. Another concern identified in the s 56G report was that Christchurch Airport had implemented its pricing approach on a pre-tax basis, rather than a post-tax basis consistent with the information disclosure framework.[14] Airlines stated that this approach created confusion.

37. There was disagreement between Christchurch Airport and the airlines about the impact of using a pre-tax basis rather than a post-tax basis. We also did not agree with Christchurch Airport's assessment of the impact of its approach. It was therefore difficult for us to assess the forecast target return that Christchurch Airport might have expected us to estimate for the 20-year levelised pricing period on a post-tax basis.

[14] Commerce Commission "Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Christchurch Airport", 13 February 2014, paragraphs E54 and E55.

3. Main changes introduced in revised information disclosure

Purpose of chapter

38. Christchurch Airport has made changes to its pricing approach—as shown in its pricing re-disclosure—that at least partially address most of the concerns we identified in our s 56G report. This chapter describes the main changes that Christchurch Airport has introduced in the revised information disclosure.

Main points to note from the changes

39. The main points of note from the pricing re-disclosure and related advice that Christchurch Airport has given us that we describe in this chapter are:

    39.1 the airport has abandoned its rolling pricing period and introduced a fixed 20-year pricing period;

    39.2 the airport has developed a new implied depreciation method, which seeks to aid transparency; and

    39.3 the airport has moved from disclosing information on a pre-tax basis to a post-tax basis.

40. These changes are discussed in the sections below.

Fixed 20-year pricing period

41. As discussed in Chapter 2, Christchurch Airport signalled that it would start a new 20-year pricing period at the start of every pricing reset (ie, every five years). The airport has signalled that it will no longer use a rolling pricing period and will revert to a fixed 20-year period beginning (1 December 2012 to 30 June 2032).[15]

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[15] Christchurch Airport confirmed its commitment to using a fixed 20-year pricing period in its submission on our draft report. Refer: Christchurch International Airport Limited "Submission on: Review of Christchurch Airport's revised information disclosure for its second price setting event – draft report for consultation" (12 June 2015).

42. Because of Christchurch Airport's proposal that it would set prices as a series of 'overlapping' (or 'rolling') 20-year periods, we did not include any analysis of our assessment of the airport's expected profitability performance in the final s 56G report for Christchurch Airport. This is because the lack of information in Christchurch Airport's proposal regarding how its approach to overlapping 20-year periods would work in practice meant that its expected profitability performance was not transparent.

43. The change to a fixed 20-year pricing period improves the ability of interested persons (including us) to analyse Christchurch Airport's expected profitability. However, it remains difficult to undertake a performance assessment of Christchurch Airport's expected returns over the 20-year pricing period because of other transparency issues.[16] The revised disclosure provides insufficient information to fully assess the future impact of changes in the methodology.

New implied depreciation method

44. In the s 56G report, we suggested that the use of an economic depreciation method would be more consistent with the levelised price path. Economic depreciation reflects all changes in asset value (either up or down) other than due to capital expenditure. The forecast RAB value would no longer be rolled forward using standard depreciation and indexation assumptions.[17] Rather, the forecast RAB value in each year would be derived by adding capital expenditure and deducting economic depreciation.

Christchurch Airport have adopted an implied depreciation method for its disclosures

45. In response to our comments in the s 56G report, Christchurch Airport has adopted an implied depreciation method which it considers is more consistent with its levelised pricing approach. Christchurch Airport has restated its 2012 pricing disclosure using this implied depreciation method in an effort to make its pricing disclosure more transparent.[18]

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16 A 'performance assessment' refers to assessment of the returns that Christchurch Airport could expect to earn in practice if certain matters (such as the timing of cash flows and the treatment of the revaluation wash-up from PSE1) are treated in an alternative way that may be more accurate, but where that alternative treatment is not required by the regulatory requirements that were in place at the time prices were set. Our reasons for assessing profitability over 20 years for Christchurch Airport is given in paragraph 34.

17 Rolling forward refers to the method of calculating the RAB value at the end of a year, based on the RAB value at the start of the year.

18 Christchurch Airport has also used this methodology for its annual disclosure for 2014 and restated its annual disclosure for 2013 on the same basis.

46. We welcome the effort that Christchurch Airport has expended to develop its new implied depreciation method. The introduction of the approach to calculating implied depreciation is intended to address our concern published in the s 56G report that the PSE2 closing pricing asset base value (when established using straight-line depreciation) did not provide a good estimate of the airport's expected future cash flows.

47. Christchurch Airport's revised depreciation method calculates the implied depreciation by taking the forecast revenue for the PSE2 period (at the levelised price) and subtracting the airport's forecast returns (at its target post-tax cost of capital), forecast operating expenditure, forecast tax and forecast revaluations. The use of the levelised price for forecast revenue is consistent with Christchurch Airport's intention that its discounts below the levelised price for the PSE2 period are intended as a permanent under recovery and will not be recovered in future periods.[19]

48. Conceptually, the introduction of an implied depreciation approach by Christchurch Airport is an improvement in that it better reflects the demand considerations that are implicit in the 20-year pricing approach; however, some issues with how the approach has been implemented remain. We are open to engaging with Christchurch Airport to help facilitate further improvements in the implied depreciation approach that would be useful before interested persons can have full confidence in the transparency of the disclosure.

Interested parties are not convinced that the revised approach gives greater transparency

49. In a letter released alongside the draft report and submissions received on the draft report, BARNZ raised concerns about Christchurch Airport's calculation of implied depreciation and, consequently, the RAB value disclosed. BARNZ considers that Christchurch Airport's levelised pricing approach is unnecessarily complex and does not support the use of this approach for future pricing events. BARNZ has significant concerns about Christchurch Airport's use of its target post-tax weighted average cost of capital (WACC) in its calculation of implied depreciation.

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19 Christchurch Airport's estimate of the RAB using its implied depreciation methodology uses the airport's target cost of capital rather than the input methodology compliant cost of capital. Consequently, the calculation of implied depreciation using Christchurch Airport's forecasts may not be considered appropriate for annual information disclosures. Christchurch Airport's annual information disclosures are outside the scope of this report. This issue will be considered as part of the review of input methodologies.

50. Christchurch Airport's implied depreciation method provides a reasonable reflection of the asset value at the end of PSE2 that it intends to recover through prices for the PSE3 period and beyond.

51. The concerns of submitters regarding Christchurch Airport's implied depreciation approach have been considered and are discussed in Chapter 4.

Christchurch Airport approach reflects its headline target post-tax return

52. As discussed further below, Christchurch Airport has indicated its calculation of future prices will be undertaken on a post-tax basis. This change in policy has been given effect in the calculation of implied depreciation. The implied depreciation calculation is based on using Christchurch Airport's headline target post-tax WACC of 9.76% (prior to the application of discounts).

53. By calculating the implied depreciation using its headline target return of 9.76%, Christchurch Airport has established a closing pricing asset base value for the PSE2 period that more accurately reflects its expectation of future returns under the levelised pricing approach.[20]

Christchurch Airport approach reflects the return of un-forecast revaluation gains

54. Christchurch Airport revalued its assets when setting an opening asset base value for setting prices at PSE2. Prices for the PSE1 period reflected Christchurch Airport's forecast of revaluation gains over the period. The actual revaluation was greater than forecast. Consequently, at the time of setting prices at PSE2, Christchurch Airport reduced the revenue requirement for the PSE2 period in order to return the benefit from the un-forecast revaluation gain to its customers.

55. In its revised disclosure, Christchurch Airport's calculation of implied depreciation incorporates the rebate for revaluations by grossing up the forecast revaluation from the levelised price for the value of the rebate. We note that this treatment is consistent with our preferred treatment of Wellington Airport's wash-up (rebate) relating to its 'Rock' terminal.[21]

56. Christchurch Airport's calculation of implied depreciation assumes that the revaluation gains from the PSE1 period are fully rebated during the PSE2 period (rather than over the 20-year pricing period). This assumption avoids the need to carry forward any un-amortised gain from one pricing period to the next.

[20] We use the term 'pricing asset base' when discussing Christchurch Airport's implied depreciation approach because other assets in the RAB, such as leased assets are still subject to straight line depreciation.

[21] Commerce Commission "Summary and analysis of Wellington Airport's third price setting event" (30 June 2015), paragraph 29.3.

Method results in a lower closing asset base value

57. Christchurch Airport's implied depreciation method results in a lower pricing asset base value than that resulting from straight-line depreciation. Given the profile of the revenue under the levelised price path, when using depreciation values consistent with that path, interested parties might have expected the pricing asset base value at the end of PSE2 to be higher than the pricing asset base value derived using standard depreciation and indexation assumptions.

58. Two key reasons explain why the pricing asset base value under Christchurch Airport's implied depreciation method is lower than the pricing asset base value under straight-line depreciation:

    58.1 The move to a post-tax cost of capital has resulted in a lower overall target return due to concerns with how Christchurch Airport converted its post-tax target return to a pre-tax target return when setting its levelised price.

    58.2 Forecast revenue under the levelised price has been grossed up for the rebate of revaluation gains prior to PSE2.

59. We are satisfied that these reasons explain why the final pricing asset base is lower than might have initially been expected when the implied depreciation approach is applied.

Christchurch Airport has moved from a pre-tax basis to a post-tax basis

60. As described in paragraphs 36 to 37, Christchurch Airport's original PSE2 disclosure showed that pricing was established on a pre-tax basis. This approach resulted in an effectively higher return than the headline target return of 9.76% because of the method the airport used to convert its post-tax WACC to pre-tax WACC (prior to the application of discounts). The disagreements over the conversion of WACC from post-tax to pre-tax also created transparency concerns.

61. We welcome this change and expect that it will improve transparency and reduce excessive returns (all other things being unchanged) after the PSE2 period. However, the revised disclosure provides insufficient information to fully assess the future impact of changes in the methodology. Submissions on this issue are discussed further in Chapter 4.

4. Responses to submissions

Purpose of chapter

62. This chapter summarises the main issues raised in submissions on the draft report and our response to these issues.

Submissions on the Christchurch Airport draft report

63. We received three submissions on the Christchurch Airport draft report. These submissions were from Christchurch Airport, BARNZ and New Zealand Airports. We also received correspondence from BARNZ prior to us publishing the draft report, which largely covers the same issues as the submission from BARNZ.

64. BARNZ's submission and prior correspondence included comments on the issues below.

    64.1 The transparency of Christchurch Airport's disclosure and its implied depreciation methodology.

    64.2 The impact of the move from a pre-tax WACC to a post-tax WACC.

    64.3 The treatment of un-forecast revaluation gains.

    64.4 The effectiveness of information disclosure.

65. Christchurch Airport and New Zealand Airport's submissions included comments regarding the transparency of Christchurch Airport's disclosure and the effectiveness of information disclosure.

Transparency

66. BARNZ states that Christchurch Airport's revised information disclosure has left the pricing methodology partly obscure. BARNZ considers that it is still not completely clear how the airport applies the implied depreciation approach over the 20-year pricing period. BARNZ believes that there is still a lack of clarity about how the price setting would be done for each subsequent period as many factors will change from one pricing period to the next.

67. BARNZ considers that the link between the profile of the implied depreciation profile over the 20-year pricing period and demand considerations remains unclear. BARNZ is sceptical that the method can be improved such that interested persons can regard the method as transparent.

68. In its submission, Christchurch Airport has reiterated a number of the responses its advisor Incenta had previously provided to BARNZ about concerns it raised regarding the implied depreciation methodology.

69. Christchurch Airport accepts that it has not provided detailed forecasts of cost and demand for the 20-year pricing period from 2012 and that its supplementary pricing disclosure is not fully transparent at this time.

70. Christchurch Airport acknowledges our suggestion for more information about the remainder of its 20-year price path and its concern as to the returns Christchurch Airport targets after 2017. Christchurch Airport intends to respond to these concerns in the lead up to and during its pricing consultation for the 2017 price reset. In particular Christchurch Airport has indicated that at this time it will:

70.1 address the modelling gaps identified in the s 56G report;

70.2 take stakeholders through the process for resetting the long-term price path;

70.3 re-forecast opex, capex, demand and WACC for the new pricing period (PSE3) and the period to 2032;[22] and

70.4 ensure that the Incenta implied depreciation methodology allows that analysis of current (PSE2) prices can be made independently of forecasts for the remaining 15 years of the price path.

71. Christchurch Airport has stated that it is committed to providing us and other stakeholders the information needed to understand its long-term pricing strategy and the implication for the return on and of capital in any pricing period.

Our response: we welcome the further planned improvements, given our concerns that transparency is not yet sufficient

72. Information disclosure, while being light handed, is still intended to promote the overall Part 4 purpose as set out in s 52A. As stated in the s 56G report, if information disclosure is not effective in meeting its purpose under s 53A, it is unlikely to provide the appropriate incentives for promoting conduct consistent with s 52A. The relevant purpose of information disclosure under s 53A is to make airport's expected performance sufficiently transparent such that interested parties are able to assess whether airports are limited in their ability to earn excessive profits.

[22] Christchurch Airport has stated that for the first 5 years from 2017, forecasts will be as detailed as they would be if prices were set under the standard methodology. For the remaining 10 of the 15 years, the forecasts will be as detailed as is possible for forecasts of that duration.

73. The supplementary pricing disclosure published by Christchurch Airport represents a significant improvement in the transparency of its pricing approach. However, it currently does not provide the transparency required for interested parties to fully understand the return Christchurch Airport is now targeting over its 20-year pricing period. We therefore welcome Christchurch Airport's commitment to providing greater transparency in the future.

74. BARNZ's concerns about Christchurch Airport's implied depreciation methodology appear to primarily stem from its disagreement with Christchurch Airport's 20-year levelised pricing methodology. We do not share BARNZ's concerns about the Airport's use of a long-term levelised price and we consider that the implied depreciation methodology is instrumental in promoting greater understanding of Christchurch Airport's pricing intent. Our greatest concern is whether interested parties are able to understand Christchurch Airport's expected returns over time and are able to assess whether the airport is limited in its ability to earn excessive profits.

75. We hope that ongoing dialogue between the parties during the consultation for the 2017 price setting event, as well as any changes we might make to improve the input methodologies and information disclosure regime through lessons learned during the s 56G review, will help to bring the understanding of the two parties more into line.

Move from pre-tax WACC to post-tax WACC

76. BARNZ agrees that Christchurch Airport's move from a pre-tax WACC to a post-tax WACC was an improvement in transparency but also considers that it results in a substantive value impact. BARNZ estimates that the move from a pre-tax WACC to a post-tax WACC results in a $36 million difference over the pricing period.

Our response: we agree that this change will result in lower expected returns

77. We agree that the change from a pre-tax WACC to a post-tax WACC is likely to result in lower expected returns over Christchurch Airport's 20-year pricing period (all else being equal).

78. Christchurch Airport's supplementary pricing disclosure was silent on whether the change from a pre-tax WACC to a post-tax WACC would result in a change in the expected returns over the 20-year pricing period. This is another example of how Christchurch Airport's supplementary pricing disclosure does not provide the transparency required for interested parties to fully understand the return Christchurch Airport is now targeting over its 20-year pricing period.

Treatment of un-forecast revaluation gains

79. BARNZ submitted that the High Court has clearly endorsed the principle that all revaluation gains should be treated as income. BARNZ submitted that we should, therefore, treat the un-forecast revaluation gains at the beginning of PSE2 as income.

Our response: our assessment of conduct was based on the requirements at the time

80. Consistent with our approach in the s 56G review, we do not consider it appropriate to treat un-forecast revaluation gains as income for the purposes of assessing Christchurch Airport's conduct at this time. As we explained in our final s 56G report in response to BARNZ's submission on the same matter (at paragraph F98):

> [F]or the purposes of assessing Christchurch Airport's price setting behaviour when it set its prices for PSE2 (ie, its conduct), the airport would not have considered that we would assess its profitability based on grossing up its revenue for the revaluation wash-ups. This is because doing so is not consistent with the current information disclosure requirements. As is discussed in Attachment E, our conclusion on the effectiveness of information disclosure in limiting Christchurch Airport's ability to extract excessive profits relies on our assessment of the airport's price setting conduct based on the input methodologies and information disclosure requirements that were in force at the time the airport set its prices for PSE2.

81. We do not consider it necessary or appropriate to change our approach at this time. However, the treatment of un-forecast revaluation gains, as well as revaluation more generally under information disclosure requirements for airports, may be the subject of further exploration and development during our input methodologies review.

Effectiveness of information disclosure requirements

82. New Zealand Airports has stated that a new regulatory regime inevitably involves an element of learning by all parties, and that understanding of effective disclosure will continue to evolve in response to feedback from us and other interested parties.

83. New Zealand Airports considers that Christchurch Airport's decision to produce voluntary supplementary disclosure statements to improve the transparency of its 2012 price setting decision demonstrates that the airport is genuinely committed to providing robust disclosures which carefully explain its decisions and approaches, allowing interested parties to understand and scrutinise airport performance over time.

84. Similarly, Christchurch Airport has acknowledged that it has been on a learning curve as to the best form of disclosure for its non-standard pricing approach. Christchurch Airport considers that its decision to develop its revised implied depreciation methodology, in order to improve the transparency of its pricing approach, demonstrates the effectiveness of the information disclosure regime.

85. Alternatively BARNZ notes that while information disclosure has at least revealed that Christchurch Airport targeted excessive returns when setting prices for the 20-year period from 2012–2032, it cannot prevent it.

Our response: Information disclosure is influencing behaviour but could be more effective

86. As stated above, information disclosure is intended to promote the overall Part 4 purpose as set out in s 52A. However, information disclosure is not price quality regulation and our information disclosure requirements and input methodologies do not dictate how airports set prices. Under the AAA, airports are able to price as they see fit.

87. Christchurch Airport's response to the s 56G report shows that information disclosure is clearly influencing behaviour, although some transparency issues have not yet been solved. However, as noted in the s 56G report, we consider there are changes that could be made to information disclosure that would strengthen the incentives for airports to price consistent with the Part 4 purpose. A review of the input methodologies is in progress and is currently expected to be completed by December 2016.

88. As part of the input methodologies review, we will engage with stakeholders, to identify and implement potential changes to the input methodologies and information disclosure which will allow for the improved assessment of profitability for regulated airports.[23]

[23] Commerce Commission, Input Methodologies Review Invitation to contribute to problem definition, 16 June 2015, includes a discussion of the potential areas for review as part of Topic 6: Airports profitability assessment.

5. Summary of our observations on the revised disclosure

Purpose of chapter

89. This chapter summarises our observations on Christchurch Airport's revised PSE2 disclosure.

Summary of our observations on the revised information disclosure

90. In summary, our observations on the revised information disclosure are as follows:

    90.1 although there are still some areas for improvement, Christchurch Airport's efforts to improve the transparency of its disclosure following our review of its original disclosure are welcomed;

    90.2 the most significant improvement is the move from disclosure of information on a pre-tax basis, to a post-tax basis that is more consistent with the input methodologies that we apply when assessing profitability;

    90.3 the introduction of an implied depreciation approach by Christchurch Airport is an improvement in that it better reflects the timing of capital recovery considerations that are implicit in the 20-year levelised pricing approach;

    90.4 we are open to engaging with Christchurch Airport to help facilitate further improvements in the implied depreciation approach that will allow interested persons to have confidence in the transparency of the disclosure; and

    90.5 the main area in which Christchurch Airport could further improve the transparency of its disclosure is by providing improved information about the 20-year period that is referred to when setting prices for any particular price pricing period.

91. Overall, Christchurch Airport has addressed most of the concerns we had about the lack of transparency as to its pricing approach. We welcome the effort that Christchurch Airport has made in improving the transparency of its disclosure, and consider these improvements will help improve pricing efficiency in future. We also welcome Christchurch Airport's commitment to further improve transparency during its next price event.

92. We have not updated our conclusions on the effectiveness of information disclosure regulation in limiting Christchurch Airport's ability to extract excessive profits as a result of this summary and analysis. This is because, based on the information provided in the revised disclosure (which does not reflect any impact the change from a pre-tax to a post-tax approach might have on targeted returns), Christchurch Airport's target returns over the 20-year period remains at 8.9%, which is above our view of an acceptable range (7.6% to 8.5%).[24]

[24] Our position on the effectiveness of information disclosure regulation and the submissions we have received on this is further discussed in Chapter 4.