COMMERCE COMMISSION CONFERENCE HELD ON 7 AUGUST 2012 AT CLIFTONS, LEVEL 28, THE MAJESTIC CENTRE, WILLIS STREET, WELLINGTON, COMMENCING AT 9.00 A.M.

CHAIR: Right, can we make a start, please. I would like to welcome everybody to this conference today. We are here to go through the process of our assessment of the review of the Information Disclosure Regulation applying to specified airport services provided by Wellington International Airport under Part 4 of the Commerce Act. 08.58

My name is Mark Berry, I'm the Chair of the Commission and of this session at the conference. With me are members of the Commission who will be making the decisions required to fulfil the Commission's responsibilities under section 56G of the Commerce Act.

My fellow Commissioners are Deputy Chair, Sue Begg to my left, and Commissioner Pat Duignan to my right. Commissioner Duignan will need to be absent during the afternoon for a short time due to another official engagement, however, he will review the transcript in 08.58 full so that he is aware of what is discussed in his absence.

In attendance today with us are also a number of staff from the Commerce Commission who have been involved in this project.

I have got a standard outline of processes and procedures which I need to go through for the purposes of the record.

The Commission determined information disclosure requirements and input methodologies for airport services 08.59 supplied at Wellington, Auckland and Christchurch International Airports in December 2010, as it was required to do under those time constraints under Part 4 of the Commerce Act. We are also required under Part 4 to prepare a summary and analysis of any information disclosed, and to report to the Ministers of Commerce and Transport on how effectively Information Disclosure Regulation under Part 4 is promoting the purpose set out in the purpose statement of Part 4, namely section 52A.

In the current circumstances both the timing and much of the work required for these two tasks in fact overlaps. We intend to proceed with the section 56G reviews as our first priority and to publish a separate summary and analysis of the disclosed information as soon 09.00
as practicable after we have completed the section 56G reviews. We consider that this approach is the most logical and efficient use of our resources in the current circumstances.

We have received helpful submissions and cross-submissions from interested parties on the process scope and approach to our task of reporting to the Ministers under section 56G. A number of issues were raised and we published an update paper to address these.
We have also received helpful submissions and 09.01
cross-submissions on a number of questions we put to interested parties on Wellington Airport's disclosed information. It is those submissions and cross-submissions and our analysis to date that have formed the agenda for today's conference.

The objective of this conference is for the Commission to understand the impact, if any, that Part 4 information disclosure is having on Wellington Airport's performance in section 52A(1) terms and its behaviour.

I'll just turn to some procedural aspects of today. I 09.01
have a few points in which to elaborate on, administrative arrangements which were set out in the 31 July 2012 notification.

The Commission has carefully read all submissions and

cross-submissions. The conference is intended to focus on the areas where the Commission wants to test and deepen its understanding of the written submissions made by parties. The Commission does not usually allow new material to be presented at its conferences given that parties would not have had an opportunity to consider such information. The Commission considers, however, that some flexibility may be warranted for this conference as parties have an opportunity to provide cross-submissions on any new material following this 09.02
conference.

Just to recap. At the end of this conference there is this round of cross-submissions which we'll come back to later today and then we have our draft determination with further submission rounds, and there are two of those. So, we will permit some flexibility today if there is new material, but we'll address that as we come to it.

We have allocated time for parties to introduce themselves to the Commission and we have also allocated an hour of time later this afternoon for any of the three 09.03
airports, Air New Zealand, BARNZ and the New Zealand Airports Association to address the Commission if they wish to do so. We expect the session to be based on material covered during the day, and for those who were in attendance at our earlier input methodology conferences, we did this at one of those conferences where we gave parties a chance to produce a closing address based on any points they wanted to highlight or address from what had been discussed in the course of the day. 09.03

The conference has generally been organised around the areas of performance relevant to the purpose of Part 4. We appreciate that each of these areas of performance interrelate. However, for the purposes of this

conference we have simply arranged them as separate topics and allocated time according to where we need further understanding of submissions and cross-submissions. The timing and order do not reflect relevance or relevance importance. Furthermore, each topic may be relevant to any or all of the four objects set out under section 52A(1). The Commissioners will move through these topics throughout the day and ask questions on Wellington International Airport's performance and about the impact Information Disclosure 09.04
Regulation is having on that performance. Other questions will also be asked in order to understand whether Information Disclosure Regulation is having an impact on Wellington Airport's behaviour. Commission staff may also follow up on some of these issues. As you'll be aware from our previous conferences, once Commissioners have asked questions typically Commission staff are invited to do so. While the conference is focused on particular areas we wish to explore, the fact that we may not refer to other issues in our questioning 09.05
does not mean we have reached a view on any matter. The conference is simply focused on issues where the Commission believes that it will be assisted by further explanation and discussion.

While this conference provides an opportunity for views to be discussed, we would like to reiterate that the various rounds of written submissions remain the principal avenue by which the Commission seeks and receives interested parties' views. Please recognise the importance of the written material you present throughout 09.05
the consultation process and the need for your written submissions to set out your position in a comprehensive way. As I've already mentioned, following the conference, parties have the opportunity to make

cross-submissions. Cross-submissions on this conference
are due on 17 August. Everyone is invited to make
cross-submissions on any matters discussed at this
conference. There will also be an opportunity, as I have
already mentioned, to make detailed submissions on our
draft report.

As with previous conferences, we intend that there
should be as little formality and technicality as is
necessary. The conference is not adversarial and no
party will have the right to ask questions of any party 09.06
during the proceedings unless requested to do so with
leave from the Commission. During each topic session we
expect the relevant representative and expert of each
participant to sit at the table in front of us. Our
understanding is all independent experts have signed the
letter confirming that they have read the Code of Conduct
for expert witnesses under the High Court Rules and have
agreed to abide by those rules when speaking at this
conference.

Commissioners and Commission staff will ask questions 09.07
and we may on some matters direct the question to a
specific individual. In asking questions the Commission
will seek to canvass a full range of views on all issues.
We appreciate that these representatives may not be able
to answer all questions posed. If the timetable permits,
we may allow other advisors to respond to the
Commissioner's questions, otherwise the party's response
can be covered in detail in their cross-submission. We
will publish a list of matters that parties undertake to
come back to us on, on our website, together with the 09.07
transcript as soon as practicable following the
conference, and we anticipate that this material will be
available about around 10 August.

We usually get very prompt turnaround, as you'll know, from our stenographers.

The conference proceedings will be recorded. Microphones are available at the table for speakers. We also have a microphone on the stand located by the participants' tables. Please speak into the microphone when making your presentation and identify yourself for the record. Speak clearly and slowly so the stenographer does not have problems with the transcript.

The agenda provides for a lunch break and breaks for morning and afternoon tea. The agenda is flexible and we 09.08 may need to make changes as we progress. For example, I'm doing the session on quality and I'm not anticipating that that will necessarily go for as long as that time so that we'll move straight into the next session after that.

Commissioners will not be available for consultation with parties during the breaks. Tea and coffee will be available at the rear of the conference room. The conference room will be open during breaks, however, you should be aware that the room is not secure during the 09.09 day so please remain with your material or only leave non-confidential material behind you.

Just down to administrative matters, as seems to always be necessary for me to do. Bathroom facilities are located down the corridor out the back there. If we have to evacuate the building in the case of an emergency, please follow the direction of Cliftons staff and make your way down the fire exits. There is one fire exit next to the bathrooms to the left of the elevators, and the second is to the right of the elevators through 09.09 the glass door by the Cliftons office.

The contact person from the Commission at this conference is Ruth Nichols here. So, if you have any questions about today's proceedings in any way, if you

could have a discussion first with Ruth I'm sure she'll
be able to let you know what you need to know.

Finally, I understand that the parties have been asked
whether there is a need to discuss any confidential
material in closed sessions and that there is no such
need, and so I am proceeding on the assumption today that
we will not be faced with the prospect of the need for
any confidential sessions, but if there is any contrary
view in the course of the day, or if you have some
sensitivities as the day is progressing, if you could let 09.10
Ruth know in the first instance to alert us to that.

In order to assist the parties in planning for the
participation in the conference today we've set out
already an agenda with indicative topics and subject
areas that we will be discussing. We start with quality
and then move to revenue and profitability, then through
to expenditure, investment and innovation. The fourth
session is pricing and then there's a final session for a
range of other miscellaneous issues.

If we can now move to the introduction of parties, I 09.11
think the easiest way is perhaps to get Wellington
International Airport to identify themselves and their
participants. So, if we can have Wellington Airport
first, please.

MR SANDERSON: I'd like to introduce myself, Steve Sanderson,
current Chief Executive of Wellington Airport. On my
right I have Martin Harrington who is the Chief Financial
Office at Wellington Airport, and to my far right I have
Steve Fitzgerald who is the former Chief Executive of
Wellington Airport, he is now a Director of Wellington 09.11
International Airport and he's also the Chair of our
sub-committee on pricing and steering committee. We will
have a fourth person, Kieran Murray from Sapere who will
do a presentation at the end of the conference in the one

hour session been put aside.

CHAIR: Thank you. Perhaps if we can have the other airport representatives starting with Auckland followed by Christchurch, please.

MR SPILLANE: Thank you, I'm Charles Spillane, general counsel and general manager Corporate Affairs at Auckland Airport and I've got with me today Adrienne Darling, who is our regulatory and aeronautical pricing manager.

MR COCHRANE: Neil Cochrane, general manager Business Services Christchurch Airport, and I have with me today Andy Nicholls from Chapman Tripp supporting me. 09.12

CHAIR: Thank you. If we can now have Air New Zealand and BARNZ.

MR WHITTAKER: John Whittaker from Air New Zealand, general manager of Alliances and Government Relations. I wasn't involved in the pricing consultation itself but Sean Ford was our prime contact with Wellington during the pricing consultation. On my right I have Mark Toner from Webb Henderson who is acting as counsel for us and Nick McDonnell who has assisted us in preparing our submissions, thank you. 09.13

MR BECKETT: John Beckett, Executive Director of BARNZ, Kristina Cooper our legal counsel, Brent Layton our economic advisor, Mike Foster our planning advisor, and Dougal Smith our valuation expert.

CHAIR: If you can introduce New Zealand Airports Association.

MR WARD: My name is Kevin Ward, I'm the chief executive of the New Zealand Airports Association and I have with me Craig Shrive from Russell McVeagh.

CHAIR: Thank you, does that cover all the introduction of parties before we move to the first session? 09.13

Okay. Well look, I'd like to lead off by leading into the first session on the quality dimension to the Information Disclosure Regime.

So, the first topic is the level of service quality being provided at Wellington International Airport and the question revolves around this information disclosure regulation promoting outcomes such that the airports are providing services at a quality demanded by consumers subject of course to price and cost considerations.

The submissions and cross-submissions reflect that there are, it seems, no major concerns about service quality at the airport, although parties have raised concerns with the price quality trade-offs for luggage 09.14 handling and air bridge services, and if I can just park those matters to a later session today, we won't cover that trade-off in this session, it will come through in a later session. But can I just start out first of all by canvassing views on the question - can I just get confirmation that Wellington Airport's overall level of service quality is not a material issue for our review here today and if I could put that question first to BARNZ and Air New Zealand just to get your views on whether our reading of this matter is correct 09.15

MR WHITTAKER: Yes, that's a correct assumption.

CHAIR: Thank you; BARNZ?

MS COOPER: From our perspective we haven't had any of our airline members make us aware of any quality issues.

CHAIR: That answer also makes redundant Wellington's need to reply.

I take the submission from time to time you have had involvement such as the cleanliness of bathrooms was one, there might have been one or two other issues but perhaps you could let us know how you generally monitor those 09.16 aspects of quality and how you attended to those matters that might have been issues of quality to you.

MR SANDERSON: Yes. The prime quality matter at Wellington Airport now is ASQ model which is the

international standard for quality measures, and that captures a broad aspect of quality feedback from various people, from customers and passengers through the airport and airlines, and, as you've identified, one of the key aspects is the congestion in the southwest piers, and that is also mainly toilets that's come back with that, that's reported back, and we're now in the process of updating those toilets and that project is quite well advanced this year. But those ASQ reports, they're regularly examined by executive management and it also 09.16
comes up in our board reports, part of our balance score cards. So, the directors of the airport are also aware how we perform against those ASQ measures.

CHAIR: I'll come back to those ASQ measures. Can I just ask the airlines first, and BARNZ, you have made the point in your submissions, that you think you are more acutely aware of what consumer demands are in the process of setting quality standards; your view is that you should be materially involved in stipulating what those quality or quality standards should be. Can you just elaborate 09.17
on your views on that point?

MR WHITTAKER: We think that the risk is over-investment in quality rather than under-investment in quality under the current regulation, and so making sure that when customers value price very highly and are very price sensitive, that they are not being delivered quality in excess of what they require.

CHAIR: Can you give any examples of what you believe to be excess quality at Wellington Airport?

MR WHITTAKER: So, I can't off the top of my head but I can 09.18
come back to you with that.

CHAIR: Would BARNZ like to add any further comment?

MS COOPER: I think the recent Rock development would perhaps be an example of excessive quality. It won a number of major awards and architecturally designed and celebrated, but it does seem to be excessively constructed for the building where the costs are passed on to airlines, it seems to be more a public statement of regional pride rather than an efficient facility to process passengers.

CHAIR: How would you see your position being in terms of establishing quality standards? I take it from your submission you feel that you're not being listened to in terms of what ought to be quality standards. Is that a fair comment, or not? 09.18

MR WHITTAKER: So, I think, as I said, we are most concerned about significant investments in quality and the issue that BARNZ referred to there is one example of that type of investment where we feel that that was excessive.

CHAIR: Yes?

MR WHITTAKER: In terms of day-to-day operational quality, I don't think that we have any significant concerns.

CHAIR: Okay.

MS COOPER: BARNZ is not involved in the day-to-day operational issues at Wellington Airport, more aware of 09.19 them really at Auckland, and I think at Auckland there's regular involvement through the AOC with airline participants where airlines are able to comment on the capital expenditure plans and the upgrade plans by the airport to a level which is considerably below the statutory threshold for consultation. So, I think that's a key point, that airlines value that sort of level of consultation for projects which are going to cost $1 million or $2 million as opposed to the statutory level, which I think is up at, gosh, $60 million or 09.20 $70 million now.

CHAIR: Okay. Well, can I get Wellington Airport to come back. You say you do these consumer surveys and act and respond to them. How regularly do you do those surveys?

How frequently are you making these kind of consumer demand assessments for quality?

MR HARRINGTON: The SQs are quarterly but I guess one thing, just to elaborate on what Steve was talking about. The SQs are an important monitoring regime but the consultation or discussion process with airlines happens a lot more regularly. If I give a couple examples of that. We have a decision making CDM supporter, acronym, at Wellington Airport and part of that, that's a basic monthly meeting, I think there's nine stakeholders at 09.21 that meeting including airliner baggage handlers, NavSec and aviation security, and customs, and basically all those parties, and part of that, that's one of, I guess, the ways of regularly catching if there's any issues on quality so they can be discussed and they can be resolved, or certainly actioned as required from that meeting.

So, I think that's quite a strong way of capturing any issues that there may be regarding quality, whether it be under or over-investment. But also just on the 09.21 individual projects, again expanding from what BARNZ have just said, certainly Wellington Airport consults with its airlines at a lot lower level of capital expenditure than is set out at the statutory levels. So, to give another example, the southwest piers is a process that Steve mentioned that's been raised previously that's an area for improvement and a lot of that is driven from the A320s, new aircraft that Air New Zealand brought in, so that had some congestion there, and that's also been seen and observed in the SQ surveys. So, that process of 09.22 identifying the issues and actually trying to address the solution has been going on, I can't remember the exact dates but sort of a 12 to 18 months process of meetings and basically sending of plans, discussions of plans and that process is still going. So, it is an example of a live project where there has been a considerable amount of input and discussion between the parties.

CHAIR: Can I just for a moment examine the extent to which information disclosure has impacted on the quality standards thus far, up to the point of this PSE 2 round. I mean our reading is largely from a time perspective there that the Information Disclosure Regime has not had a material impact on service quality and the current service quality standards that are before us. Is that 09.23 your reading of the situation? And again, perhaps if I can start out with the airports and then take Wellington Airport after we hear from Air New Zealand and BARNZ.

MR WHITTAKER: We believe it's had no material effect.

MS COOPER: That's a fair statement.

MR SANDERSON: I think from Wellington Airport's point of view it does give transparency on the quality and the measures through the disclosure regimes, so there is transparency for all service users of the airport.

CHAIR: How do you see information disclosure impacting on 09.23 future rounds? What about future versions and service performance standards at the airport, you know, do you think that the Information Disclosure Regime is going to impact on that?

MR SANDERSON: I think the key thing is the consideration of the transparency of the regime and the reporting of that information. So that's certainly taken into consideration by the airport. But overall I think the information that we elect in terms of our quality will continue and is reviewed by the executive and directors, 09.24 and we address that quality if it falls below the thresholds that we set.

CHAIR: Is everything that you're taking into account in the Information Disclosure Regime, or are you taking into

account any external factors? Have we properly captured
everything that needs to be in the Information Disclosure
Regime?

MR SANDERSON: Well, it is still early days but, you know, I
think from a pure quality perspective, always an outside
looking in perspective rather than inside looking out is
always the best form of quality. Too often quality is
captured by internal measures and there's some areas that
I think that more work could be done.

MR FITZGERALD: Mr Chairman, the airport invested in the ASQ 09.25
survey methodology really as a direct result of the
Information Disclosure Regime. It would be fair to say
that Wellington Airport had looked at the ASQ
methodology, which was a global methodology, prior to
that but it is a relatively costly methodology, but when
we were looking at the Information Disclosure Regime it
was seen to be the best statistical way forward, and I
think through that process I think it was a good example
of collaboration between the airports and airlines where
we largely had agreement around that being the right 09.25
methodology, and largely had agreement about what would
be asked with a couple of issues at the margin.

So, I think the Information Disclosure Regime has
actually given us now essentially an agreed set of
statistical measures for quality against which to monitor
performance going forward and, as Steve mentioned, we're
already making investment decisions off the back of those
outcomes of those ASQ results.

CHAIR: Thank you, can I ask Air New Zealand and BARNZ again
whether they think everything is in the Information 09.26
Disclosure Regime that ought to be, and what impact you
may see information disclosures having in the future but
that perhaps it may not have had thus far?

MR WHITTAKER: I think in a discussion on quality it's very difficult separating quality from price and so if we ask somebody would you like this to be better they will generally say yes. If you ask them would they like to pay for it to be better, that's quite a different question and I think we all acknowledge that a large number of our domestic travellers, our Tasman travellers, who are the people that frequent Wellington Airport, are very interested in the price that they pay. And so the only thing, the way that within the regime quality is approached almost as a separate variable which should be discussed independent of price, I don't think reflects the trade-offs that consumers want to make in the real world. 09.27

CHAIR: We'll be coming through to this trade-off as the day progresses. Can I just check there's no further information you think needs to be in the Information Disclosure Regime?

MS COOPER: We think it represents a good starting point. As things evolve we may come up with additions but right now I think we're comfortable with what's being asked. 09.27

CHAIR: Okay, well look, can I just check and see if there's any further questions from my fellow Commissioners.

MR DUIGNAN: Just very briefly, have any of your surveys included the questions of people's views regarding air bridges given that it is a notable feature of developments in Wellington and in some other airports, that the introduction of, I think it's really introduction of the A20 but I stand to be corrected, has resulted in reversion actually to walking out in order to get into the back door, so this seems to be an acid test of the attitude of passengers, in a sense, to a degradation of quality which would cost a lot to remedy. So, I wondered if any of your surveys covered that sort of topic? 09.28

MR SANDERSON: I think the answer to that question is more in the collaboration, particularly with the airlines, so it is a quality innovation answer in so much as the on-time performance to the airlines and passengers is obviously very important and the air bridges and in conjunction with the stairways at the back of the aircraft just, you know, they increase the, or improve the turnaround aspect where passengers can disembark or embark on to the aircraft by the front or the back according to the seating allocation in the aircraft. So, one, it's a 09.29 service and a quality innovation for a system with the airlines on time performance, and equally that's again passed on to the travelling public if aircraft are on time.

MR DUIGNAN: It seems an interesting natural experiment that would lend itself to actually ascertaining the quality price trade-off if passengers were asked to, you know, sort of give their views, because it's one of the few situations where you actually have one set of passengers experiencing a different quality actually than others. 09.29 So, I just note you haven't gone into that sort of concept.

MR HARRINGTON: Just regarding the SQ, there's not a specific question regarding that, it's things like accessibility of gates and time to get to gates, things like that but there's not a specific question regarding the air bridge component of access to the air.

MR DUIGNAN: Thanks.

CHAIR: Any questions that staff members would like to raise? (No questions). As I predicted we're making fairly good 09.30 time. Quality hadn't been an issue that we had seen as being a particularly significant one for today and so I'll hand over now to Commissioner Duignan to start the session on revenue and profitability, and we will be working through this session until the morning tea break at 11 o'clock.

MR DUIGNAN: Thank you, Chair. As we will all be aware, an important aspect to the performance of regulated airports is their revenue and profitability, and given that this review is being triggered by the 2012 price setting event, the assessment of expected revenue and profitability arising from that event will inform whether Information Disclosure Regulation is promoting each of the objectives in the purpose of Part 4. 09.31

Among other aspects, the information provided at this particular session will inform the judgement regarding the effectiveness of ID in promoting outcomes consistent with WIAL having both incentives to innovate and invest, and being limited in extracting excessive profits, because it's the balance to achieve both of those objectives that is one of the key aspects of Part 4.

The information obtained in this session also will be relevant to the assessment regarding incentives for efficiency, improvement and provision of a quality 09.32 reflecting consumer's demands, particularly the components of revenue, and whether WIAL shares with consumers the benefits of increased efficiency gains.

So, in this session we want to increase our understanding of the parties' positions on key issues where there appears to be a difference of opinion or dispute relating to revenue or profitability, or where we are not able to fully obtain the information from the written materials we've received.

There's extensive comment in what we have received. 09.32 For example, there appears to be disagreement regarding both how reductions in prices that are described as wash-ups and contingent reductions in prices such as the incentives should be treated in forecasting revenue for

the purpose of assessing profitabilities. So, I'm about
to ask you questions on that. BARNZ and Air New Zealand
have suggested that profitability is properly calculated
a lot higher than it appears and that WIAL has suggested.

So, we would like to focus on three things. We're
going to try and understand better your views on the
inputs into profitability assessment, how they should be
determined for the review given how they're measured
under information disclosure, so, there's the question of
the treatment of some key inputs. And then we would like 09.33
to make sure we understand how WIAL - I'll just call it
"the airport" would be the easiest - the airport and
airlines have reached their views of objective
profitability for the pricing preferred. And then there
are some aspects which are going to be covered in future
sessions. Finally, we need to hear what effect
information disclosure has had as far as parties' views
are concerned on the current price setting event.

So, I'm going to begin with some specific questions
before we get on to the more general matters. 09.34

The first question which I'll ask on this occasion the
airlines to first explain their views on, is whether it's
appropriate for the Commission to take into account or to
remove from its conception of the revenue for
profitability assessment the terminal wash-up that has
been implemented as a reduction in prices for the
forthcoming period but it is, of course, essentially in
one sense a refund of payments made in the previous
period, thus there is the question of whether it's
appropriate to count it, in effect, by taking the prices 09.35
after the reduction as being applicable to the assessment
of the actual kind of profitability that Wellington
Airport is achieving in the current period. There is the
question, and perhaps in accounting terms as to whether

it is analogous to a past period adjustment, I say analogous, it's not suggesting that that accounting treatment is required.

So, could I begin by hearing the airlines' view of that matter, and then if we could hear the airport's view. It seems best to have it that way so we get to hear the issues on the table and then they can be responded to.

MR FORD: Sean Ford here from Air New Zealand. Basically, I think, in terms of the actual terminal wash-up, the view 09.36
there is that the revenue should be recognised when it's actually earned, so in that sense it should be recognised in terms of the previous period. It becomes quite complex with all the wash-ups in terms of things, in terms of actually understanding the overall performance when you sort of put them all together. But effectively we're looking at recognising the revenue when its earned.

MS COOPER: I'll ask Dr Layton to answer.

DR LAYTON: Yes, Commissioners, this was an issue on which my mind was exercised too in reading it and I was consulted 09.37
by BARNZ on it. I think your characterisation is correct. What these wash-ups are when they are reducing the price for the forward period is really a repayment of over recoveries in the previous period, so that they really should be applied back to adjusting that previous period. You can't just disregard them for the previous period because essentially the money has been given back. The time value of money has to be taken into account but they are an adjustment to that prior period. So, you shouldn't actually take that lower price because they are 09.37
repaying some funds that they had over recovered in the previous period as reflecting the price level in the forward period. It should be with excluding that.

On the other hand, there's also an issue because information disclosure isn't just about looking at profitability over time and so forth, it's also looking at what one would hope over time looking at the accuracy of forecasts being made. So, an understanding of how much is having to be refunded and whether there's any systematic bias in that; whether, for example, as one would expect the incentives are under the current regime for the airports to always in a sense under recover, over recover and then repay, even with the time value of money adjustments in it because of the certainty of having the 09.38 money in the hand rather than having to pay it back, whether that is actually having a bearing on how they're forecasting.

So, I think there needs also to be a calculation really on looking at how well they are doing in actually forecasting over time and that, of course, involves a different treatment than that of assessing the movements. So, for price purposes you have to take it back, for the other purpose you actually want to look at how well they have actually got the figure right up ex post. 09.38

MR DUIGNAN: Could I just intervene to say that I wasn't expressing a view, I was asking a question based upon submissions and I'm expecting that Wellington Airport maybe have a contrary view and rebut it. So, have we any further comment from the airlines? (No comment). Thank you, if I could move on to the airport's view on the question of the treatment of wash-ups.

MR FITZGERALD: Commissioner, I think this partly goes to the heart of one of the challenges the Commission has of essentially now looking at an Information Disclosure 09.39 Regime overlaid on a long-term actual price setting regime that has substantial commercial elements in it and as a general point, so we've interpreted the Information Disclosure Regime and how it works in conjunction with the Airport Authorities Act as being one where we don't believe it's the intention of the legislation to end one regime and start a prescriptive price setting regime without commercial elements.

So, in both the interpretation of what's happened in the past through the current price setting and what we're doing going forward we've sought to retain some of those commercial negotiations through the consultation process elements.

Second point I make is that the key thing to look at 09.40 in the disclosures is the outcomes around the inputs, and the terminology used has been that Wellington Airport has over recovered. I think you'll see in the disclosures that Wellington Airport has under recovered in the past period and in the first two disclosures that Wellington Airport has made returns on capital, as measured through the Information Disclosure Regime, have been in the 6% type range and, in fact, 2011, Wellington Airport earned 6.16% and that including revaluations, in 2012, 6.91%, well below both the Commission's view on our cost 09.41 of capital and, of course, the company 's view on our cost of capital.

So, what we're hearing about was actually a commercial concession that was a one-way risk sharing with the airlines. So, on a specific element the airlines were protected against any delay in investment which was, and we can - I think it's a matter of past submissions why there was a delay in that, but the airlines are now receiving in the next period a benefit from that despite the fact that Wellington Airport did not recover its cost 09.42 of capital in the prior period. So, I think that is a commercial risk sharing that has worked very very well in the favour of the airlines. We didn't get the opportunity to adjust in the forward period the

under recoveries from lower traffic volumes and from
higher externally imposed costs like insurance, like
regulation and other things. So, this was a very
selective one-way adjustment.

In terms of looking forward, I think if we have
incorporated into the current price setting similar
things again, and I think on a rolling basis you'll see
that each pricing period will have an element of
commercial adjustment where that's been agreed. As I
say, the alternative would be that the Information 09.42
Disclosure Regime acts as effectively de facto price
setting and that's not our understanding of what the
intent of the legislation is.

MR DUIGNAN: Just one follow-up question. When you refer to
this being in the same category as other risk factors,
isn't it correct to say that it's singled out because the
issue in question, namely the timing of completion of the
contract, kind of was pretty directly under your
management? So, it is a risk factor that is
distinguished from the sort of generality by being much 09.43
more controllable, although obviously other factors can
come into play; is that a fair comment as to why it is
separated out as it is separated out as wash-up?

MR FITZGERALD: The timing of capital is certainly something
that can be influenced by the airport. If we look at the
facts, and it's a matter of record, in the Commission
process, in the development of the input methodologies,
that there was, in capital programmes one of the main
factors on timing is that we attempt to get agreement
from airlines about the timing and quality scale of the 09.44
asset delivery, and that was very much the case in the
internal expansion, partly I think there is an efficiency
in delaying investment until it is required and really
this is an example of that incentive for efficiency, and

I think if we recall the period that investment was taking place, 2008/9/10, there was very good reason for the airport to rationally delay some of that investment because we weren't seeing in some cases the volumes coming through that we expected. So, in a sense that delay of capital could well have been the natural off-set to the lower passenger numbers in the event the delay in capital was then given to the airlines by way of a rebate in this following pricing period, whereas the reason, part of the reason for the delay in capital, being lower 09.45 passenger numbers, was then actually taken as an under recovery by the airport.

MR DUIGNAN: Thank you. Just lastly, you refer to looking at an item like this as having something to do with sort of increasing regulation. Could I just ask, I saw it as simply a question to be teased out in terms of looking at the numbers and trying to decide what is the appropriate way to treat them. Is there any issue between us?

MR FITZGERALD: If I misinterpreted your question, I apologise. I think the way Air New Zealand has 09.46 approached this issue has been one of essentially accusation, that we're gaming the system, and BARNZ advisors have advised us in that way, and the suggestion from that by other parties has been that the solution to this is really price control, and that's something, I suppose, that is behind my response rather than a response directly to your question.

MR DUIGNAN: It was just, really, how to do the numbers. I'll move on to the question of incentive payments and Air New Zealand has submitted that it's highly unlikely the 09.47 incentive payments will be made, and including the incentive scheme in the pricing model will result in a significant windfall gain to WIAL. The airport has argued that the effect of the incentive scheme, whether there's payments or not, will be to reduce the average price paid looking forward and I would like to tease out, then, what is the way in which the analysis actually will indicate the effect of the incentive scheme upon the revenue paid.

So, again, because I want to give the airport the opportunity to, in a sense, respond to an argument in this case too, I will again start with the airlines and other questions will be going the other way.

MR WHITTAKER: I think in terms of the incentive scheme we 09.48
demonstrated that it would be possible to achieve historic growth levels without paying out the incentive scheme, so that's our first concern. We're not saying it won't be paid out, it's possible someone will start at a service level that will qualify for the incentive, but it is also equally possible that growth levels could be achieved and the incentive scheme could never be paid in relation to the Tasman in particular. So, that was our first concern with the incentive scheme.

The second concern is that it doesn't reflect the type 09.48
of schemes which we would experience in workably competitive markets. So, the fact that it could be enticing a competitor, or someone to set up services while providing no volume rebates to the incumbent airlines, whereas at a level that on many routes exceeds the profitability of the airlines on the routes, that that's a significant distortion and quite different than the outcomes that we would see in competitive markets where there would be likely a volume rebate scheme that the incumbents could participate in as well, and that if 09.49
the incumbent airlines were unhappy about the supporting of a competitor, they could move to an alternative supplier and that the airlines have no such ability to do so in this case. So, we think the scheme is structured

in a way that it doesn't reflect the type of scheme that would be seen in workably competitive markets.

The third element that we're concerned about is the scheme seems to be funded entirely from regulatory revenue and that many of the benefits of growth flow into the unregulated businesses of Wellington Airport, and so that it doesn't seem to be sharing scope efficiencies between the regulated business and the non-regulated business.

MR DUIGNAN: Can I just intervene to say, the concept of funding such a scheme, I'm not quite sure how that works but perhaps rather than get into the technicalities here, it's a scheme - there's a forecast, I don't know that the concept of it being funded is the appropriate issue. The question is, without that scheme being there would the average price paid for both incumbents on the one hand and then new entrants on the other, be higher? 09.50

We'll let the airports sort of give a view on that in a moment.

MS COOPER: BARNZ has, I think like Air New Zealand, considerable doubts on whether it's actually going to result in additional growth. Our key concern which you said you're not addressing right now but our key concern is the funding which we can come back to later but there is just real doubt on whether it's going to result in additional growth. 09.51

MR FITZGERALD: Thank you, Commissioner. To make an initial point, I think growth is critical for community welfare, for New Zealand, and Wellington Airport sees part of its role as encouraging that for economic development for New Zealand and the region, and competition between airlines is key to that. And I think we've set out, as a generic point I think it's a very strong part of our pricing model, is that there is incentivisation for 09.51

growth because of the external benefits that would come from that growth. The reality is that all airlines share in growth through the way pricing works effectively because we in a building blocks model total costs and divide it by passenger numbers. So, the more passengers, the lower the price generally, and therefore all airlines benefit.

Now, the airlines that have indicated to us that they're expecting strong growth in the pricing period aren't directly represented at the table. Air New 09.52
Zealand had indicated to us that they expect a slower rate of growth than other airlines and slower than the average through the pricing period but Air New Zealand will benefit from the growth of other airlines because of an overall lower unit charge through higher passenger numbers.

In terms of mathematically how the incentive scheme works our calculations we've submitted on in the written submissions is that the incentive scheme will increase passengers by about 885,000 additional passengers over 09.53
the period and the average charge for passenger reduces by about 43 cents as a direct result of the incentive scheme. Wellington Airport's experience in dealing with airlines on a commercial basis and where we have struck commercial contractual deals with airlines, that they - that growth is a key component of those deals and airlines do have influence over the amount they can grow, and yes, that is of benefit to an airport and it's of benefit to a region.

In terms of workably competitive markets I think it's 09.54
actually a very strong function of how Wellington Airport is supporting a workably competitive market, both in the way we're dealing with customers in terms of recognising that the margin profitability is lower and therefore

putting incentive schemes in for additional passengers at
the margin actually reflects lower profitability at the
margin, I think you would see that in many competitive
markets where you do have marginal pricing at the margin,
and then in the downstream market I think with an
incumbent like Air New Zealand in this market with very
strong market power over its competitors, where you are
encouraging growth I think we are actually making the
market potentially work more competitively downstream for
the benefit of yes, the airport but also the region and 09.55
New Zealand.

MR DUIGNAN: Thank you. The topic may be revisited in the
pricing section. I just put it slightly differently,
just one point to the airport. It's a contingent
payment, in fact for our revenue section the issue is in
some sense a narrower issue. It is a contingent payment,
in other words, it's something that may happen or rather
when I say a payment, a contingent discount, and that the
question as I see it for the revenue topic is how should
a contingent discount, one that's not definitely going to 09.55
be there, be taken into account in our analysis of your
revenue?

So, I'll just ask that specific question. It's been
described as funding et cetera but that's not the concept
that I'm focusing on. It's a contingent, it may or may
not happen. So the question for the airport is how would
you explain it to your investors, for example, that you
may or may not have this payment?

MR FITZGERALD: There is a very direct link with the
assumption of revenue in that contingent payment, so the 09.56
contingent payment cannot be looked at in isolation.
Essentially, if that contingent payment did not exist,
the passenger number would be different and therefore the
revenue number would be different. So, I think to look

at the revenue payment in isolation and to say it may or may not exist in isolation is an incorrect way of looking at it. Because if you were to remove the contingent payment you would need to lower the passenger and lower the revenue forecast and you would actually come back to a lower overall revenue number and therefore a higher unit charge if the contingent payment were removed and its consequences followed through.

MR DUIGNAN: Thank you. You may cover this of course in cross-submissions and that will be another opportunity to 09.57
discuss the differential pricing implications in the pricing section.

I would like to move on now to the question of land revaluations - well, the question of revaluations but particularly the question of land.

The airport stated in one of the papers that its position as a landowner is no different to the situation in competitive markets where the landlord earns income from tenants and also owns the risk and reward of movements in capital value. I am interested to hear more 09.57
on this analogy which is advanced as to the reason why the concept of sharing those revaluation gains with consumers has been, as I understand it, rejected, and I want to pose that as a question, as to whether the implication is that it is rejected outright.

So, the question, starting with the airports, is your comment doesn't seem to take account of some observations in workably competitive markets where, in the first place, if a landlord is, or landlords in general are expecting an appreciation of the value of their property, 09.58
then we often find that yields are reduced in times of high inflation. So, the first point just was the point about expected returns, and I just wanted to be clear as to your view on that, and then we can move on to

unpredicted returns.

MR FITZGERALD: In terms of expected returns, the expected change in value is assumed to be revenue and it's not cash, it's not revenue, and so -

MR DUIGNAN: So that's correct.

MR FITZGERALD: So exactly the same in a standard landlord market where you would effectively factor in the capital gain as part of your return, that's exactly what is inherent in our pricing and return expectation both for price setting and for information disclosure. 09.59

MR DUIGNAN: And where there is disagreement between the parties in this, what is a negotiation or rather what is a consultation regarding prices? So, where as result of that consultation a case is being made for a different appreciation, what is your view on resolution of that?

MR FITZGERALD: Well, I think if we judge the outcomes again in the previous pricing proposal and the proposal that ran from 2007, there was an agreed, there was an element of difference between the parties which we sought to resolve commercially by setting a wash-up arrangement in 10.00 place for changes in actual land, change in actual land value, and in the event we have factored into our pricing that cap and collar basis of change in value. So, there has been a wash-up put in place because of, as a result of that commercial agreement.

And to go further, what actually happened between 2007 and 2012 was not inherently an underlying change in the value of property but more a change in methodology brought about in part by our consideration of the input methodology regime where the basis of valuation was 10.01 debated at much length. We took on board those many aspects of that discussion in the land valuation and essentially rebased land value from 2010 onwards. However, we then looked back and effectively credited to the airlines a substantial amount of that change in land value.

MR DUIGNAN: I will now give the airlines an opportunity to comment on what we've covered up to this point and I've got some further questions.

MR FORD: I guess from our perspective the issue around revaluations is that effectively the FCM concept, and you're basically looking at the NPV equals zero type approach, and in that sense, yes, acknowledge that the airports are including forecast revaluations in their 10.02 pricing models going forward. The big issue for us is around, two issues; one being the issue of what happens in the difference of forecasts; the other being what happens when at the end of the period you have a quite different outcome than what you're anticipating.

I guess in both those instances our view is that you really do need to bring it back to that FCM, NPV equals zero type approach.

Just in terms of what happened in Wellington and sort of the 2007-12 period, I guess a different view in terms 10.02 of where that ended up. We would not characterise the outcome there being a commercial agreement, being a commercial arrangement of any kind, and again it comes back to that point of, at the end of the day there is a significant change in value between what they were expecting and what they got, and from our perspective that needs to be reflected fully in the pricing model and wasn't.

MR DUIGNAN: Okay. Can I just go back to the airport and first - 10.03

MS COOPER: If I could just add, I think from BARNZ's perspective all expected revaluations have to be treated as income and that is the key principle which we adhere to. In Wellington's case with the wash-up it stemmed

from the history that over the 2002-7 pricing period there had been over $100 million expected valuations which were not treated as income which the airport had taken into its asset base on which it was about to reset charges and BARNZ felt that the airlines were basically really being targeted again for that to happen with a low forecast and to be faced again with an unexpected set of revaluations which wouldn't be treated as income. That remained unresolved right up until the 11th hour of the consultations process where as the airport set charges it 10.04
decided to put in place this wash-up with the intention they said of addressing the concerns of the airlines.

So, it wasn't actually something ever actually consulted upon and worked through and the devil is in the detail and that's what we've found out as it's being applied now, but can't be said to be really a commercial agreement, it was the airports solution to a concern which the airlines had and it was a valid concern because I think now as charges are being reset again there was about $100 million of revaluations, I think about 50 of 10.04
which were unexpected. So very large numbers that are coming out at the end of the process which have not been treated as income appropriately. I don't know if Dr Layton has anything to add?

DR LAYTON: Yes, the key is that they are and they have always reset the prices on the basis of the revalued assets going forward, so they are expecting return on those particular items, and my recollection of what happened in the previous consultation period is what Kristina arrived at the last minute, I haven't been involved in this 10.05
consultation round so I don't know what the story is in this one but I do know they set prices systematically and indeed there was a similar problem in the period up to 2002, if my memory serves me correctly, there was

revaluations as well. At that time we were debating very
vigorously whether these had any bearing on their return
at all.
MR DUIGNAN: Could I ask the airport - let's distinguish
between two things. One is the question of counting as
revenue a revaluation, the other is whether that is in
some sense shared. Now, as regards counting as revenue,
can I ask, there's the same issue that we were talking
about at the outset regarding wash-ups. The revenue that
is counted is, and I'm just asking if you agree, a 10.06
revenue for the period in which the revaluation has
occurred rather than a period beyond that. So, the
revenue counts in the past pricing period, not the one
that is beginning? Are you agreed with that proposition,
it's what our information disclosure requires but you
accept that?
MR FITZGERALD: Well, we are disclosing information in the
form required by the Commission that requires
revaluations to be counted as revenue and yes, that is
the way we are making disclosures and have made the 10.07
previous disclosures, if that was the question.
MR DUIGNAN: And your assessment of your own profitability
would have that revaluation counted as part of your
income for the past pricing period, you know, you would
recommend that an assessment of profitability would work
that way I take it?
MR FITZGERALD: Well, it is factually both in the disclosures
and also in accounting - in the way we account, that you
measure historic performance including those
revaluations. 10.08
MR DUIGNAN: Now then, if you were to be sharing that, and
that's a separate issue, with the airlines, again and in
a sense you have, or are proposing to share a part of it,
namely the part that represents the difference between

the two forecasts, as I understand it, and please confirm I've got that right, then you're sharing that, it is a sharing, is it not, that relates to revenue in the previous period?

So, again, I'm interested in your view as to how we should regard that sharing that has been agreed to for the purposes of our assessment of your current profitability.

MR FITZGERALD: That is correct, that we now have revenues that are, in part, projected revenues which are obviously 10.09
not earned revenues, that have taken into account a past revaluation event. So, I agree with your proposition about how that's to be looked at, but given the number of factors that can change, I suppose I would reiterate again that information disclosure is best viewed on outcomes rather than projections, and I appreciate that the Commission has a challenge at the moment in its section 56G review about trying to predict where our profitability will be under the Part 4 disclosures rather than what actually may happen, because a whole lot of 10.09
things may change.

MR DUIGNAN: Yes, that's an interesting topic, we'll set it aside for the moment but if I could just ask the airlines if they have any further comments on what we've just covered?

MR WHITTAKER: I think the key thing for us is that any difference in the regulated asset base, which is due to a revaluation, should flow through the revenue P and L account, and in this case there are significant levels of revaluation that have not flowed through the revenue 10.10
account.

MR DUIGNAN: I don't think that's quite accurate. They've flowed through the revenue account, it's just that I think you're saying they should be shared, which is a separate issue if I'm not mistaken. I think there's no doubt, and we've had the assurance that they are accounted for fully, the question is whether they are shared or not, which is a different matter. So, okay, we've got a common understanding.

Can I move on then to an aspect of the asset base on which you have used is the conversion cost element in which is a result of your interpretation of market value existing use, the major difference, not the only difference, but the major difference between - and I use 10.11 your interpretation because there have been earlier suggestions of other things being in there, in the market value existing use including past levelling costs and so on, but that is not how you are working with it at the moment, as I understand it. But you are including essentially conversion costs, in particular the holding costs during a conversion, a hypothetical conversion one might say, given that the actual conversion occurred in 1953 presumably, or thereabouts.

Now, the point of that is, there's two things. First 10.12 of all, you are seeking to earn a return on the current updated, in effect one might say replacement cost valuation of those holding costs period when in the five years it takes in your modelling or the modelling you've been advised on to develop the airport. So I just want to confirm that that is built into the pricing approach that you have applied for this price setting event, and your revenue reflects that?

MR FITZGERALD: Yes, that's correct.

MR DUIGNAN: And so before I proceed I just sort of give the 10.12 airlines an opportunity to give any view on that aspect of the future revenue path, and that is what we're focusing on, the future revenue path -

MR HARRINGTON: Commissioner, can I say one thing for clarity, small but important thing, to go back to the terminology Steve used regarding inputs and outputs, while the MVEU conversion cost was used as an input to what we believe is the principal valuation for setting of prices, ultimately the outcome, the final outcome of pricing had a number of concessions on WACC and certain things, smooth price path and certain things which ultimately the overall effect of return on assets is lower. So yes, it was an input to pricing but the output is the more important point that should be considered. 10.13

MR DUIGNAN: Well, I'll divert then, given that intervention. Am I correct in thinking, because it's a question as to understanding, that you in your submissions to us have taken that and described it as a reduction, in effect your cost of capital assessment rather than treated it in the way that you've presented it to us as a modification of your asset base view?

I know, and I do understand that, as you say, revenue is the bit that most people are finally concerned about and in a sense you're inviting to us just to look at 10.14 revenue by itself, but we are required not just to look at revenue, we've got to look at profitability, that requires that you bring an asset base to the table and I think that your invitation to us has been that we take your asset base but then the yield is where the concession is, or am I not interpreting that correctly?

MR HARRINGTON: That's right, and I guess the numbers that are in the submissions from the calculations that we put through, effectively we might be, or we have a WACC 9.15% using an example which is part of the price setting 10.15 process but ultimate return on assets is 8.1% on our MVEU assets, that's again put in the consultation papers and also through the submissions on this process and then using the commissions asset base of MVEU gives a return

of 8.9% -
MR DUIGNAN: So, there's a 0.9 there due to the inclusion of
the land conversion costs, that's an assessment, I think
it's what you've just indicated and I think it's correct.
Have you any further comment on that?
MR FITZGERALD: I think what comes out of Martin's point is
we're not looking at it in a single dimensional way,
we've been highly cognisant of the way the Commission is
reviewing asset base in setting price, we are highly
cognisant of the outcome from the revenue projection 10.16
we've made against both our own view of what the asset
base is in highest and best use terms, and we're also
highly cognisant of what return is projected based on the
way the information disclosures are currently formulated.
So, all of that goes into our decision-making process and
there isn't a single point upon which we made all
decisions.
MR DUIGNAN: Right. Let me just then lastly ask, that if
going back to this question of how we treat the bit of
sharing of past revaluation gains, again just to take, 10.17
and not jumping to any conclusions regarding exactly how
it should be treated, but if that piece was taken out of
the current revenue or removed for the purposes of
assessing current revenue, since it does relate to, in
effect, a sharing of the past period, and I realise that
the result would be to indicate that the historic results
for the past period were depressed below the levels
you've mentioned and I understand that, but if that was
done, then the 8.9%, could you perhaps now or if need be
later indicate to us what the effect on the 8.9% would 10.17
be?
MR HARRINGTON: I think we'll come back, if you don't mind, on
that point.
MR FITZGERALD: And I think it is important, and you did pick

up in your comments, Commissioner, that again the
implication of the comments made by some of the
participants is that this is about past over recoveries
that now we're seeking to have credited against future
returns.

Well, I think the evidence shows and the disclosure
shows there's been past under recoveries, and what we
haven't explored is what mechanisms could or should or
might be used to bring forward past under recoveries into
the future pricing period. We're talking about specific 10.18
one-way risk sharings that have been commercially agreed
with airlines, and I think there was a point made on
this, that this wasn't agreed but I think it was
acknowledged by participants that it was an
acknowledgment by Wellington Airport of concerns
expressed by airlines, so I would interpret that as being
commercial behaviour if not being a commercial agreement.

So, I think in calculating forward the specific points
of over recovery where clearly the airport has given
one-way deals on a couple of things that have gone in the 10.19
airline's favours and worn all of the down side risk of
the parameters that have not gone in the airport's favour
in the past recoveries.

MR DUIGNAN: Right. Just then to wrap up this session, of all
times in the recent past now's the time when one could
argue the future of property prices is more potentially
balanced than at many other occasions, in a sense there's
a lot of uncertainty that property price inflation will
continue, certainly if you look overseas, but you've
stated in one of your papers that the proposition of 10.20
sharing all revaluation in against and losses is a
challenge and in reality will pose an asymmetric risk to
WIAL.

Now, if the asymmetric risk referred to the past situation where it was pretty much expected that there would be above rather than below, that no longer would seem to be true so you could you just very briefly explain what was intended by the reference to asymmetric there?

MR FITZGERALD: I think to me the first comment, I don't accept, if this was the proposition, that in past periods we had a forward looking expectation that property prices would move above what was credited through airlines, I don't think that is actually the case. The fact that 10.20 through 2002 to 2007 there was property and price inflation above our expectation was not something that we could forecast. We have the expert reports from the time that showed what those forecasts would be. From the point forward - I mean, Commissioner, if any of us had a very clear view of what would actually happen to property prices, we would probably be doing something else rather than sitting here, but I think we are in a period where the expert view is that there may not be major changes against inflation. We took expert reviews, we had a 10.21 consultation with the airlines and we also took into consideration what the Commission was looking at through information disclosures, and in the current pricing period CPI inflation was a reasonable estimate of property prices. Now, that's almost by coincidence rather than design in our view that the forward looking price is roughly, the forward looking view of property will be that.

In terms of asymmetric risk, we have experience in having dealt with the airlines in the past couple of 10.22 pricing proposals where we have offered wash-ups on price where essentially the airlines have been very happy to take the up side where we would credit a wash-up for property price changes above expectation, but in previous consultations we've been very wary of taking any down side.

If you look at the nature of the business and the fact that we do not have price control, so we don't have a certain system where there is a regulator saying, if you under recover this time don't worry, we'll allow you to credit it next time, our view is the airlines would mount a very strong argument in the future pricing period to disallow any past under recovery of falls in land value. Now, that's perhaps a speculation on our part but we know 10.23 that our customers today may be different to our customers in future. We may have different substantial customers in the next pricing round than we have today. We will have substantial customers probably of different weightings in the next pricing round than we have today. So, any arrangement struck today under price setting we can be very certain that our customers will take the benefit of any risk sharing which is to their benefit, and I think we can be reasonably confident they would resist over recovery in the following pricing period if 10.23 we were to seek that because we had under recovered, and we know from experience that is the position of Air New Zealand and BARNZ, that it should be a one way arrangement.

MR DUIGNAN: I should invite the airlines to respond to that proposition regarding your position.

MR FORD: Sean Ford from Air New Zealand. I just want to categorically deny that's our proposition. Where we have been with Wellington in the past in terms of this whole issue of revaluations and where we need to look at going 10.24 forward is the asset base needs to reflect what the airport has actually paid for, whether that be through a, from a theoretical point of view, whether that be through either actually expending money or by having credited the airlines with the revaluation gains, then we do not have an issue going forward with there being an unders and overs type approach to that. We have experience of wash-ups in other places which go both ways, so, yeah, frankly that's not our position at all.

MR DUIGNAN: Well, are you saying that you would be prepared to accept that in the event of a reduction in values it's most typically going to be from the land component by definition rather than the building component, that you
would not just sort of agree to have that factored into 10.25
the following price discussion, but in effect it would be a separate binding agreement that there would be a payment, and in fact one might argue it would be better seen as actually being paid rather than just being part of the negotiations? So, can I just ask that question. You don't need to answer it in a sense but just to follow-up - I say you don't need to in the sense that we're investigating the airport rather than the airlines, but I must ask the question of you.

MR FORD: I guess the big issue there, as I say, is the 10.25
starting point ensuring you are actually ending up with a proper FCM NPV equals zero type approach.

MR DUIGNAN: Thank you.

MS COOPER: From BARNZ's perspective, symmetry has always been a key and we've always acknowledged if there was a wash-up agreed, which there never has been, then we would be happy to see it go in both directions so long as it was only if the initial revaluation was treated as income that any subsequent devaluation should have to be paid by
the airlines. So, for instance, if an airport revalued 10.26
its assets by $100 million but didn't treat it as income, if it had to subsequently devalue that by $20 million the airline should not have to pay back that $20 million given that they never received the benefit of it in

pricing in the first place. We have frequently given our example through our association with Dr Layton I think is with a wash-up agreement with Transpower many years ago where that did occur, there was an unders and overs, and it was a rolling three year cycle I think.

MR DUIGNAN: Okay, I think we have probably covered that topic to the point.

MR FITZGERALD: Commissioner, may I just make one further observation. In this discussion around wash-ups of land value, there seems to be almost an acceptance that that's 10.27
an appropriate thing to do, whereas our starting point of understanding is that in a workably competitive market, that that isn't normally the case. So, a tenant does not normally receive a cheque from the landlord at the end of the period when the landlord has revalued the land, nor does a tenant get a bill at the end of their lease period because land has fallen below the yield expectation built into their initial rent, and that effectively is the premise being suggested here.

Now, Wellington Airport is willing to have that 10.28
discussion and I think the proper forum for that is in a commercial negotiation about how pricing might work in a risk sharing sense, but the starting point in our current price setting is Wellington Airport is the landowner and landlord and effectively wears the risk and reward evenly balanced of changes in property value, as do most land owners in a workably competitive market, and that's really our starting point for the current pricing proposition.

So, the element of wash-ups is something that's come 10.28
out of some commercial discussions. I mean, you know, BARNZ and Air New Zealand suggest they're not but there would be no other reason why Wellington Airport would do it other than to try and recognise some of those concerns

and strike a different balance, but in a workably competitive market that's not typically the case and prices are set on a forward looking basis based on the current value of assets. That's what also happens in workably competitive markets in land rich businesses where land value is a component.

DR LAYTON: Commissioner, I have two comments to make. One is the issue about wash-ups in 2001-2002 when the negotiations or the consultation was occurring at that time, you'll recall that the Commerce Commission was 10.29
conducting an inquiry. Wellington at that period - which it reported on in 2002, Wellington has always insisted on market value existing use and at that stage had both holding costs and the costs of getting resource consents and a range of other levelling and charges included in that, and what the airlines actually reject was being tied if the Commission came out and said, oh no, your valuation has to be market value alternative use, which the Commission and its draft indicated was its thinking at that time, that then as a result of that agreement 10.30
they would end up wearing the down grade because this was a sharing arrangement that they had entered into. So, I think Wellington has taken that as a redirection - so there is a history behind it. The second point I would make -

MR DUIGNAN: Can I just ask that we do not canvass too much history; I hope we don't have to have a long discussion on that particular piece of history. So, carry on but please, you know, we need to avoid what could be quite a long recital of the history if we're not careful. So 10.30
thank you.

DR LAYTON: The second point is that in workably competitive markets you don't set the prices for five years without some adjustment mechanism in them, if you think there is

going to be some quite dynamic, so this is in fact a
regulatory environment that one is in here and not just
the same as an ordinary landlord.

MR FITZGERALD: Commissioner, I will be very very brief. One
missing bit of the history is that Wellington Airport
suggested and went into binding arbitration over land
values after that 2002 review, which has now been
reopened, and that binding arbitration was decided in
Wellington Airport's favour. The second point is I
disagree that rents aren't set in advance without 10.31
adjustment mechanisms, sometimes those adjustments to
market values are three yearly, times five yearly,
sometimes longer periods, that's a commercial discussion
between parties in workably competitive markets, and
Wellington Airport would be happy to have that sort of
discussion, but we're in effectively a five year reset
which is not that unusual for long-term use of property.

MR DUIGNAN: Right, I would note that we've had quite a
discussion about workably competitive markets but only
sort of very confined; that the Commission of course 10.32
canvassed the whole issue in very considerable detail in
the arriving at the IMs and did observe the wide range of
such markets, including long-term contractual markets. I
don't think it makes sense for us to rehearse that but I
just think there are some points being made about
workably competitive markets that were contested in that
discussion and, from my point of view, or the
Commission's point of view, in judging this particular
matter we will have to have regard to that earlier
discussion and the IMs that came out of it. So, I think 10.33
that probably is sufficient for that, but I did want to
quickly move on to understanding just in, trying to keep
it brief, the effect of the change in approach to land
valuation, and the difference between the zonal MVEU

approach and why this is of relevance. So, if you can indicate to us in our assessment of the profitability in this period, or this forthcoming period, but also in a sense the profitability in the recent past, which is something that we are required to consider, because we're trying to understand how information disclosure may have affected decisions relating to that profitability.

So, could you just explain how the change in your valuation approach, which you're entitled to do, no question about that, just as to the impact it has had and 10.34 why you think it's appropriate for that impact to have been reflected?

MR FITZGERALD: I think the zonal valuation approach was the approach Wellington Airport has used as its core valuation approach. However, Wellington Airport has always taken expert advice on a range of approaches in forming its view. So, pricing in the building blocks sense in previous pricing rounds, 2007, 2002 and before that, the zonal valuation approach to land was used and I think, probably familiar with the concept, it's looking 10.35 at the airport in sort of a typical uses, for example the runway being considered an industrial type use. Now, that process has benefits partly having been tested over time in things like the independent binding arbitration, that the airport and airlines entered into willingly after that. However, it was really the discussion that the Commission initiated for input methodologies that took us back to looking at a market value alternative use by breaking the land up into what would actually exist rather than what does the airport represent is what is 10.35 that next best alternative use approach.

Now, we formed the view that that was economically a robust basis, was market value alternative use against which to establish the next best alternative use, and clearly it's a matter of record and ongoing discussion that our view is the proper valuation of land in the context of workably competitive market is existing use being not the second best use but the first best use being as an airport.

So, really, the Commission's approach, this Part 4 process, the establishment of input methodologies, has really meant we've taken a blank sheet of paper as to what is the profitability of Wellington Airport's land against setting prices and we've formed a view, informed 10.36 by the discussion with the Commission, informed by that, that it is a market value existing use based on market value alternative use plus conversion costs.

So, in that sense the zonal approach is now historic and so in that sense the implication is almost one of, it's almost arithmetic rather than any type of policy judgement.

We've now taken for 2012 the approach to asset valuation we believe to be the best one in light of all the information we currently have, as I said, including 10.37 that very detailed discussion with a lot of experts in front of the Commission over the last couple of years.

MR DUIGNAN: Do the airlines have any comment to make on this issue?

MS COOPER: It's very clear the cost of anything is its opportunity cost. The opportunity cost was clearly established in the Commission's earlier hearings as being MVAU. The MVAU should be used and I wouldn't have thought MVEU should be dismissed in their assessment of profitability under this regime. 10.38

MR DUIGNAN: I don't think there's any need to invite his response.

MR FITZGERALD: Maybe for the record, Commissioner, our arguments on workably competitive markets and existing use are pretty well documented.

MR DUIGNAN: Right. Okay, the next issue that I wanted to move to is the calculation, or some areas of disagreement regarding the assessment of market value alternative use, and there's, I'm not sure "disagreement" is the right word but there's a difference of opinion regarding the way in which the valuers have calculated the market aspect, if you like, of the alternative use, and that in turn reflects in part the issue of whether the highest value possible alternative use has been correctly 10.39
identified or whether there are obstacles to that being the use, in other words town planning and other constraints.

So, how would WIAL, or the airport, suggest that the Commission which does need to, given the disagreement, consider the matter in its assessment because it is part of the process that we need to do to assess the overall situation in the airport against those four objectives. So, do you have an offering as to how we should deal with this issue where there is effectively a disagreement 10.40
among experts in regard to this matter?

MR FITZGERALD: Commissioner, Wellington Airport has fully met all the requirements of the Information Disclosure Regime in putting forward an expert report of valuation and that's what's required. It is Wellington Airport's primary information that we believe the Commission should be assessing in terms of information disclosure. Clearly there has been a consultation in the context of price with airlines around that information. We have fully considered and did make some amendments to the valuation 10.40
based on comments received from Air New Zealand and BARNZ and its experts, and so reconsidered the view of what the appropriate highest and best alternative use is and that's now submitted in the documents. Frankly we think

that the alternative view is incorrect and, in fact, doesn't correctly interpret the requirements of the valuation guidelines.

MR DUIGNAN: Can I just, though, you've suggested that Wellington Airport's own view has some special status, but surely the whole point of an alternative use consideration is precisely that it is a use for which in fact the executor of Wellington Airport are not experts, nor the board, we have to all of us look to an independent expert and in this case we do have two views. 10.41
It's not clear to me that there's a case, but that's why I'm asking it, as to why one of those views regarding a matter that, and it's a question again, is there some reason that we should believe the airport to be the appropriate informant on the view? You understand the point?

MR FITZGERALD: I understand the point and it's not Wellington Airport's view that we're asking the Commission to consider, it's the view of Boffa Miskell and Telfer Young who are the independent experts who were instructed to 10.42
perform the valuation in accordance with the Commission's information disclosure standards. So, in that sense you have an information disclosure by an independent expert that fully meets the Commission's requirements.

MR DUIGNAN: And another one is being tabled because of the process under the AAA Act, it's an unusual situation where there is a case for another party to have gone to all of that trouble. So, I just want to clarify or give you an opportunity, apart from the perfectly valid proposition that you are the party for whom the market 10.43
value alternative use is being commissioned, so that's definitely respected, but I just wondered if there was any particular aspect that you could point to that would sort of indicate that the piece that you've commissioned

has particular standing? I mean, in one sense I suppose it's whether there's something about your process of choosing your expert that you think would be worth mentioning to us, but if not we'll move on.

MR FITZGERALD: Clearly I think our experts are the leaders in their field, Boffa Miskell has particular experience and knowledge of the Wellington mixed use market. There is also a question of incentives where Wellington Airport's experts have gone through a process of putting forward a valuation, being challenged, reconsidering that 10.44 valuation, and being tested on their valuation. The challengers don't have that same level of incentive or scrutiny and, in fact, they are then clearly in the AAA sense advocating that particular view whereas the experts for Wellington Airport are aware that their view is the one being scrutinised by the Commission and many interested parties, and I don't know whether you're going to go into the detail of this but the key aspect is that the alternative view from other experts is that if Wellington Airport's land didn't have an airport on it, 10.45 it would be low density residential use. Given the land constraints of Wellington I think that proposition is simply incorrect.

MR DUIGNAN: Okay, we just want to air this and then we can move on but I give an opportunity for the airlines to provide any comment on the matter.

MS COOPER: BARNZ approached the valuation issue very seriously and put a considerable amount of effort into it during the current consultation, particularly because it was the first one applying the Commerce Commission 10.45 schedule A guidelines we went to the effort of getting an expert planner, who we'll pass you on to in a minute, who has extensive expertise in this area and in the competitive markets. We have an expert valuer as well and we also sought independent expert advice on the underlying costs from a quantity surveying firm, and we also sought independent advice on the economics of demand and supply for retail space, and all of those advisors were instructed on the basis of the Commerce Commission schedule A guidelines and also instructed as independent experts.

So, we categorically deny that they are advocates. There's no point BARNZ spending all that money to just put forward a biased view. We are endeavouring to get a 10.46 neutral and reasonable application of the Commerce Commission principles.

If I can just introduce you to Mike Foster, Zomac Planning, and I'll let him speak for himself as well, and Dougal Smith.

MR FOSTER: Members of the Commission, I've listed to what WIAL have had to say in terms of the land use, and so on. In my experience as a planner there is often a situation where there is a difference of view as to any land use. In this situation you have a group of experts for BARNZ 10.47 who have assessed the ultimate build-out possibilities and reached a particular view; WIAL's team have reached a different view. In my opinion, the way that you sort that issue out is you attempt to arbitrate the differences between the parties to see if you can achieve an agreed MVAU. That then sorts out that particular issue. Now, early on in -

MR DUIGNAN: Could I just intervene. Let me just pose it this way so we know the question that we need to consider here. We're considering the effectiveness of information 10.47 disclosure. We have a situation where it appears we've identified that there are two professional views being brought to this, and I appreciate you are answering it but I just thought I would frame it so we can all understand what as a Commission we would be responding to in this situation. This is a particular area where our response might comprise concluding that there is a need to adjust the way information disclosure works, for example to tighten up, and so I'm going to pose this question to both parties to tighten up the specification of what the alternative use valuation will need to satisfy to comply with the information disclosure requirements.

So, my specific question, and I've intervened for this 10.48
purpose, is whether a tighter specification of the parameters and the commissioning instruction to the valuer would reduce this? I don't think that an arbitration - I mean in this particular area of the two valuers, I don't think our sort of role extends to managing an arbitration of that. So, I just wanted to know whether that's an alternative, but I do understand you want to tell us about other ways of solving the problem so please proceed.

MR FOSTER: My comments are not directed towards the issues 10.49
between valuers, there is a well-recognised process to sort out valuation through the Valuation Tribunal if necessary in a number of different fields. What I'm particularly concerned about is the situation where there were two alternative town planning views as to the use of the final uses of the airport.

Early in the process I had suggested to BARNZ and WIAL that we should seek the view of Wellington City's planning department as to the ultimate scenarios.
Wellington City declined that request. Now, I was amazed 10.50
by that decision, even though they're a major shareholder in the airport company, Wellington City's attitude to the theoretical use would be critical to determining whether I'm wrong or Boffa Miskell is wrong in terms of their

perception of the land use patterns. So, I think it would be very constructive for the Commission to give more detailed instruction to the participants.

MR DUIGNAN: Reluctant though I am to have the Commission sort of commit to further work given we have quite a full programme, I mean I think unfortunately you're not - it is an issue which is quite major in terms of the amounts involved. So, I think we will not exactly welcome but certainly need to accept any specific views regarding how - whether there's any process in our specification 10.51 that could reduce the range here within the limitations of the IM process which involves a number of things, although this might just be an ID matter. So if you proceed with your other.

MR SMITH: Yes, my name is Dougal Smith for BARNZ, I'm a registered valuer and I would like to say that the valuation which we prepared for BARNZ on the Wellington Airport MVAU was based on the requirements of International Valuation Standards, and the Code of Conduct for valuers, and we are totally independent in 10.52 what we've done and there is no element of bias in that valuation. If we look at the valuation, a valuation is made up of a number of inputs and you've got to get the input right such that you can get the correct valuation. In this instance we have gone through and talked with planners, engineers to get good costs estimates and also we use market economics to look at the supply and demand profile of what the land could support. From those inputs we have then gone through and done the valuation or completed a valuation. The biggest difference in the 10.52 valuation comes from the projected use and the amount of commercial space within the proposed MVAU development plan. If that area was refined or could be sorted out between Mike and Boffas, the valuation would be much closer together but in the absence of getting any agreement in that, in that planning arena, there is a wide variance in the valuation. So, yeah, you've got to get a tighter spec.

MR DUIGNAN: Okay, I'll give the airports the opportunity to respond and then I think that, as I've indicated, given the emergence of this specific issue we will need to just reflect upon whether it was an inevitable unavoidable one that there is no kind of quick easy answer to, but if there is specific proposals, we would consider them and I 10.53
think that would be kind of a side issue from our 56G review but would have a direct relevance.

MR FITZGERALD: Commissioner, I think we again have the challenge of mixing two regimes here. We were operating under the Airport Authorities Act regime which effectively has a consultation, really an in-built arbitration process in it which we went through. Now, admittedly under that regime, and it will be pointed out no doubt by the airlines that the ultimate decision maker in that process is the airlines, but that's what's in the 10.54
legislation, what has been laid down by Parliament.

What the airlines and their valuers are talking about, and the term was used, a traditional approach to valuation which is an adversarial approach where you get two positions and somebody comes in to draw a line through the middle. Now, we didn't adopt that approach because we take that requirement under the AAA very seriously. So, effectively what you've got is Boffa Miskell and Telfer Young having put forward a strong proposition, it having been challenged, then Telfer Young 10.54
and Boffa Miskell moving their position to what they considered to be a compromise position, in a sense an arbitrated position, and then we've got still obviously an advocate position in a traditional sense remaining in

its spot. So, you don't have what you would have in a price control scenario where you have two contesting parties and a regulator there to arbitrate and make a decision, and we have not approached any part of this process as that being the likely or suspended outcome. So, I would put the view that essentially we have had that debate and we've had that decision and that decision in the context of price setting is one for Wellington Airport.

So, in the sense of information disclosure there's not 10.55
a process of consultation specified, and there's not a process of getting independent expert views. So, I think it then would be incumbent on the Commission to find fault with the views of Boffa Miskell or Telfer Young in forming a different view.

I think coming to your core point, we do believe and we've submitted in writing on this, that the scenario against which the airlines planning and valuation advisor submitted, differs from that of really a highest and best alternative use, and my understanding is part of it, 10.56
there's possible use which potentially could be a lower value use but we believe we're following the guidelines in seeking that what would essentially be the winning alternative use if there were a competitive market process.

I comment on the Wellington City Council aspect of this. I think it was naive to think you would get Council planning officials to hypothecate on a scenario that doesn't exist.

MR DUIGNAN: Thanks. Just to be clear, then, we are reviewing 10.57
the effectiveness of information disclosure and the point that I have specifically identified is not sort of wide-ranging ways to reconcile valuations, it is whether there is a defect that in a sense in our specification of

information disclosure valuations and as to what is to be interpreted by the term MVAU and whether that needs to be more tightly specified so as to achieve the objectives of information disclosure. That's the issue on which submissions would be appropriate. Mechanisms for reconciling different valuers kind of, I think, come in a rather different category.

So, I think we should move on from there unless Chair, we wanted to break at this point?

MR FOSTER: Commissioners, I would like to say I am not an 10.58
advocate.

MR DUIGNAN: I think we should respect the professionalism of the developers and I'll just invite the airport, as to the comment that was made could be interpreted as a specific comment and so I just wonder whether you intended that?

MR FITZGERALD: My intention, Commissioner, was to say that in a process set up with a landlord and a tenant with you both using independent experts, it's very rare for the landlord's expert to come up with a lower number than the 10.58
tenant's expert and therefore I think that the process -

MR DUIGNAN: I think stop there and that's a valid observation which we will just leave as a general observation. Thank you.

CHAIR: Can I just test one point. The theme seems to be coming out of the airport responses that they're faced with two almost conflicting regimes; the AAA and our information regime, and you're finding that the two are not in harmony and your position is to have preference for the AAA regime in the decision path you follow; is 10.59
that a reasonable observation or not?

MR FITZGERALD: Chairman, I think that was a little too stark. I think the regimes can operate together and I think they are operating together effectively. I think what doesn't

work is to try and slam them together and make them the
same thing. They are fundamentally different and I think
what Wellington Airport is finding is that the AAA regime
has worked effectively, it has worked effectively over a
number of decades in setting price. You know, the Part 4
was introduced and it is a matter of public record it
wasn't introduced because of any identified failing of
the AAA regime, the Cabinet papers show why it was
introduced, because of the Auckland Airport sale going on
and the protestations of one party, as Treasury put it. 11.00
So, we've now got a separate regime and they are not the
same but we actually think information disclosure is
working and that as a regime on its own it's adding
value, and that what it's doing is providing consistency
of information. It has certainly improved the way we've
gone about pricing under the Airport Authorities Act.
We've changed a number of the things we have done because
of the detailed interaction of experts under Part 4 but
we are now in two regimes, one of which is giving
interested parties information on which to form views, 11.00
and one of which is effectively being used for price
setting. They are separate, they are both working but I
think where the challenge is, is that some participants
are wanting them to become one in the same thing which
essentially would mean that de facto price control exists
because input methodologies are prescribed in detail and
are assumed to must be being used under the AAA. We
don't believe that was the intention.

So, effectively, we would say we've got two effective
regimes but they don't come together nor do they need to. 11.01

CHAIR: But in the case of asset valuation, I mean essentially
is it true to say that the Information Disclosure Regime
is having really no immediate impact, you're going down
the path of the way you've thought about this issue under

the AAA including as to how the process is followed as well?

MR FITZGERALD: Chairman, look, as we've explained, we've moved from zonal valuation to an opportunity cost basis for valuation and that's been a major shift in the way we've valued land. Our view, and it's a matter of record that we don't believe the competitive market test stops that second best use and that's a, for pricing particularly we believe it is the value in use that should be used. So, to me that is - that the input 11.02 methodologies in the Information Disclosure Regime has very materially looked at the way we look at valuation, the difference is we are still at difference with the Commission in actually determining in how Part 4 should work, which is the subject obviously of the Merits review.

But outside that, we do believe that we should be setting price based on what the value in use of our assets is, and whether those two things need to be drawn together I think is, we refer back to our end price and 11.03 our end revenue and therefore our end return is not formulaically set on each of these inputs. We have made a number of commercial judgments, we've made a number of concessions, that means that our overall return we believe when viewed by the Commission, both ex ante and ex post, will not be unreasonable.

CHAIR: Okay. Well, look, thank you for that. We've run a moment over time. So, if we can adjourn now for the morning tea break and we'll resume at 11.20.

(Conference adjourned from 11.03 a.m. until 11.24 a.m.) 11.03

MR DUIGNAN: We'll reconvene now. Prior to the break we were talking about the valuations. There was just one matter that I had noted, probably there's not much more to add other than noted because I don't think we here can come to a view, that is that as well as the difference in the potential use, that there is a difference, there are a whole lot of differences but there is a difference of some significance in regard to the development period between the two valuations.

I think perhaps the one matter that does lend itself to asking a specific question on is that BARNZ has suggested that there has been a change of opinion regarding the period brought in as a result of, or rather
in transitioning between the last pricing event and the 11.25
most recent one, and so I just thought I would ask whether there's any comment upon that specific issue of a change in methodology?

MR FITZGERALD: Commissioner, if I'm understanding the question correctly, are you saying about the take-up rate under the MVAU approach?

MR DUIGNAN: Yes.

MR FITZGERALD: It's a specific planning and take-up rate that's done on a specific circumstance, and in fact the
take-up rate of residential land, which I think is the 11.26
driver, is essentially the same under both the Wellington Airport's experts and BARNZ's experts. The fact is that BARNZ's experts have a larger proportion of residential land and therefore it takes longer to be absorbed into the market. I think my understanding of the question is the specific answer to why there's a longer absorption rate under the BARNZ expert valuation.

MR DUIGNAN: Thanks. It was useful to ask the question but I will give the airlines an opportunity just to respond to
that point, but if we want to get into detail then 11.27
perhaps the cross-submissions are the appropriate forum.

MR SMITH: I principally agree with that comment, that it's reflective of the land use split.

MR DUIGNAN: Right, so it's caught up in the bigger issue,

it's not really a separate issue but it magnifies the
difference and so it just illustrates the significance of
that issue as to differences in interpretations of
alternative use, and we have covered that but I do invite
you to include in cross-submissions any general
observations, not specific to this particular case
really, but regarding how well ID is working, because
this is a case where, in a sense, there is a question on
the table, not to say it can be answered, as to whether
there's some issue regarding the way it works, so that is 11.28
part of the 56G exercise and it should be responded to in
that light as well as in any sort of specific
configuration regarding assessment of Wellington
Airport's profitability as such.

Moving on, then. I will just ask one technical
question, I suspect I know the answer but I should put it
on the record. In regard to the different types, classes
of assets, buildings and civil works versus land, there
has been a bit of a different approach in terms of how
that has been valued, or rather the revaluations if you 11.29
wish, and in particular you've used a new ODRC valuation
based on 2011, and in that sense I just wanted to invite
any comment upon the difference between the input - the
ID requirements and the approach that Wellington Airport
has taken. So, if we can keep this quite brief but I
just wanted to canvass that matter, or provide you an
opportunity to give your view on that difference.

MR HARRINGTON: Commissioner, I think it's pretty much as
you've surmised, or summarised it there. When you put
its updated ODRC valuation and using Opus, valuation 31 11.30
March 11. So, we didn't index up the valuation from
2009, we actually got an updated ODRC valuation of
31 March 2011 and, from memory, I would have to check, I
don't think there was much difference between those two

valuations anyway if we had to use the indexing as proposed by the Commissioner in its IMs versus getting updated market valuation ODRC.

MR DUIGNAN: Do airlines have anything to add other than the obvious?

MS COOPER: I think we just observe that it's going to be a difference that's probably going to magnify going forward because Wellington Airport's 2009 valuation, which is its starting point for disclosure regulation information, was a 2009 valuation, therefore it was completely up-to-date. 11.31 So, while the differences are materially less in this instance, I think over time they're just going to become larger and larger, and it's another example really of the fact that the Government in setting up the input methodologies and putting this task on the Commission, really had the intention and the expectation that these input methodologies would actually reduce the differences between the airlines and airports in consultation and would actually guide the parties, and they certainly from BARNZ's perspective haven't. 11.31

MR DUIGNAN: Our question we were asking ourselves is whether ID is being effective in promoting the 52A objectives. We do not ourselves sort of tie that directly to use of the IMs but, then again, we have to recognise that we've put a lot of effort into the IMs so they do represent a judgement that is relevant. So, it's not the test, as we see it is not whether the airport is observing the IMs but the overall outcome.

The next aspect that is just again something to tidy up is that, just coming back to the question of wash-ups, 11.32 in the case of land, the wash-up that was discussed and worked on has turned out to be the difference between forecasts, whereas in the case of buildings it's the differences in values, as I understand the handling of the matter to be. So, very briefly, is there any significance in that difference, or rather any underlying rationale that they would be aware of that difference in treatment?

MR HARRINGTON: I don't believe so, Commissioner, off the top of my head other than just to maybe move the question slightly broader, just for the wash-ups was for the 2007-2012 period, the wash-up arrangement that was set there was to look at the valuation movements of land, civil and property land and equipment, and to basically 11.33 have, as Steve said, a cap and a collar on those forecasts, valuation movements, and then to assess the actual revaluation movement in five years' time and depending what the actuals were, to calculate a wash-up arrangement across those three categories of asset.

MR DUIGNAN: Do the airlines have any comment?

MR FORD: I guess the one point I would like to note is just sort of reflecting the fact that, as we were discussing earlier, that the nature in which that wash-up arrangement came around, just the details about how that 11.34 will actually work remain somewhat murky and I think that is a key difference, certainly between Air New Zealand's position and the airport's position as to what the outcome of that should be.

MR FITZGERALD: I'm not sure that we're aware it was murky Commissioner, we'll maybe follow that up after the session.

MR DUIGNAN: Yes, it does have a degree of complexity to the issues, it would seem, as illustrated by the fact that the zonal change is seen as having, in a sense, kind of 11.34 made invalid whatever was agreed on that basis. So, I just wondered if, you know, to some extent there, for good reasons quite possibly because of changes, there is a certain ambiguity about exactly what the nature of the agreement was; is that a fair comment or do you think it was crystal clear exactly at every aspect?

MR FITZGERALD: We believe the agreement from 2007 was clear and in fact, therefore, the clarity of that agreement was that that wash-up did not need to apply and, therefore, effectively applying the agreement Wellington Airport again has used commercial judgement and made a concession to actually apply that wash-up in a situation where it wasn't strictly captured by the 2007 pricing determination. 11.36

MR DUIGNAN: Yes, it may be a case where the term "murky" means that if something has changed from the time at which an agreement was struck, you could either say that it's crystal clear that therefore the agreement is null and void, or alternatively that it was murky because the agreement didn't specify what would happen in those circumstances. So, I can see murky, if you don't regard it as a value laden term, could be sort of, you know, the appropriate term to apply.

There was no provision, is the technical point, as to 11.36 what would happen in these circumstances and the airport takes the view that therefore the agreement ceased to exist and that's understood. I don't think there's any point in discussing that further but I think that's where -

MR FORD: Can I just clarify one point there. My sense of agreement usually involves two parties agreeing to something. That was not the case in respect of what happened in 2007.

MR FITZGERALD: Commissioner, I think the clarity is that 11.37 there has been a wash-up incorporated into the forward looking prices, one that was not either required through any legislation in either regime and not required by the previous agreements. So, I think the fact that there has been a substantial commercial concession is clear and I think the aspect of agreement, I mean Wellington Airport would very much enjoy sitting down with Air New Zealand to negotiate a commercial agreement. The fact is that Air New Zealand is sitting here wanting a price controlled regulatory outcome while other substantial customers of Wellington Airport have done commercial agreements with Wellington Airport.

MR DUIGNAN: Right, we're getting into wider territory about people's motivations. We will have an opportunity to 11.38 talk about behaviour right at the end of this session, if I manage to get through it all, and we'll certainly have one later in the day. So, I think we'll leave that.

Now, we're coming to - no, there's one more topic regarding values before I move on to cost of capital issues actually, so I'll present the next topic and then I should just see whether there's anything out of what has been a pretty specific Wellington-oriented discussion that the other airports wish to comment on.

The final topic is just the one that has been 11.38 observed, the difference between, the biggest difference between the actual treatment, that it appears, as I understand it, Wellington Airport has applied and the information disclosure treatment probably, well definitely relates to the inclusion of conversion costs. So, I just wanted to ask your assessment of the implications of this for the future.

The inclusion of the conversion costs in the asset base, and they are holding costs so the development of the airport over five years, a five year period, what the 11.39 holding cost of that would be, the inclusion of that does increase substantially the asset base, it also increases in a time of increased valuations the revaluation gain. So, we have two factors that appear in the airport's description of the, what has happened over a given period, the asset basis has gone up higher than the ID disclosures will show and the asset base sort of will always have an additional piece to it of, I think it's $123 million at the moment, or something like that, and secondly, because of that, the revaluation gain will also be correspondingly higher.

So, that's the facts between the two descriptions. They're not necessarily to be associated with the two acts but in some sense they perhaps are. We could call them one, the AAA description and the other the ID description or the Part 4, ID description. It might not be entirely fair to the AAA Act, it's much more open. So, that's what the future holds. 11.40

So, in terms of the promotion of the objectives of the Act, of Part 4, and the terms of interested parties' understanding, which is the subset of ID that we have to be concerned with the bigger piece but we are concerned with the section 53(2)as well, I just wanted to ask first the airport's view upon that difference, and the implications in those terms, and then I'll ask the airlines and then I'm going to ask as a general question the other airports. 11.41

MR FITZGERALD: Commissioner, I think you correctly characterise there's two aspects of it; one is the asset base is higher and the revaluation gains are higher, and it's important to point out that those revaluation gains are credited to revenue, so they actually dilute the impact of having a higher asset base because there is a greater revaluation credited to revenue. 11.42

MR DUIGNAN: Under your presentation of your pricing decision?

MR FITZGERALD: That's correct.

MR DUIGNAN: In the AAA context?

MR FITZGERALD: In the AAA context, that's correct. Therefore in an ID context, when we are comparing actual revenue and hypothetical asset gain under the ID input methodology approach, then that impact is actually diluted through the numbers, so, because our revenue is lower than it otherwise would have been because we've credited a higher valuation gain to land. So, I think you correctly in the last session calculated in your head that the impact when compared against a consistent ID described asset base is less than 1%. So, that is the variable, I think it's 0.8% was the variable that you 11.43 could attribute to the existence of holding costs on land values. So, that is at an input level and, therefore, once we then look at all of the other aspects of the AAA regime; the consultation, the commercial concessions, the smoothing, the commercial discussions that we've had around AAA, that is only one factor that varies between ID and AAA, and many others go the other way. So, on a net basis, as we've submitted, the impact is actually minor diluted and in fact is part of a net outcome that we consider to be reasonable. 11.44

I think one thing that is clear on the ID regime is that the transparency is there, all the information is there, we are submitting absolutely in line with the Information Disclosure Regime so interested parties can know and can very readily pull out those differences, and I think part of the issue is that interested parties, you know, its interested parties that are most vocal clearly are the customers, are pulling out the differences that go one way and I think we need to look at the differences that have gone the other way as well to look at the net 11.44 outcome.

MR DUIGNAN: Thanks. Airlines?

MR WHITTAKER: I think that a difference of $100 million in asset regulatory base may be 0.8% in terms of return, that's probably 20% in terms of profitability or 25% in terms of profitability, so should the question of are excessive profits being earned as a result of that, I think that's very instructive.

MR DUIGNAN: Thank you, and thanks for being succinct.

MS COOPER: I'll just respond quickly on the issue of revaluation gains being credited to income. The fact of the matter is Wellington Airport isn't crediting all of its revaluation gains to income, it's only the forecast revaluation gains which are a relatively small fraction. 11.45

MR DUIGNAN: Right, and that goes back to the wash-up versus accounting descriptions.

MS COOPER: Yes.

MR DUIGNAN: That's fine.

MS COOPER: Even the wash-up itself is not of the full unexpected revaluation gains.

MR DUIGNAN: Yes, I agree. Okay. I'm going to move on to WACC now but before I do, we've had quite an extensive discussion, it's actually about revenue that we were discussing, and so if there's any brief comments, it's 11.45 just an opportunity, please don't feel you have to take advantage because we do want to move on.

MR COCHRANE: We've got no specific comment to make, we're in the middle of our consultation with the airlines. We've resubmitted a proposal in terms of that in terms of a detailed discussion from Wellington. I won't make any comments on that but there are a few points we'll come back to on cross-submission.

MR SPILLANE: Charles Spillane here. I echo Neil's comments there. We have made our pricing decision and we look 11.46 forward to this equivalent process when you come to that in due course. I would, though, note Mr Fitzgerald's comments about how the two regimes work together and I would endorse that. I don't see them as being exclusive

regimes but ones which rather can work together with the
Information Disclosure Regime plan that's playing its
role and the AAA process also playing its role.
MR DUIGNAN: Thanks, we'll move on to cost of capital.
Wellington Airport has indicated that its calculations
for the purposes of price setting are based upon advice
from Tony Samuel and Stuart Shepherd under the auspices
of the Sapere, never know how I'm meant to pronounce
this, it's wisdom I believe, but the Sapere Group. Now,
we understand and there's going to be another foray, 11.47
discussions about the parameters, the specific parameters
of the cost of capital, so I will confine myself to some
specific questions directed to Wellington Airport. In
particular in the IMs and Wellington Airport did
participate in this discussion, there was extensive
discussion of the so-called leverage anomaly in the
Brennan Lally model and the concern that this created an
incentive where the cost of capital calculation for the
entity was undertaken using its leverage that it was an
undeniable fact that the numeric result would increase if 11.48
the leverage increased, and that seemed to be an unusual
situation where it was in calculative terms feasible for
our regulated entity but an entity subject to information
disclosure is - I'm using the term to encompass that,
could increase the calculated cost of capital by its own
decisions, which is anomalous in terms of the way one
thinks about capital markets, that's why it's called a
capital - an anomaly in the discussion of it, but also
more seriously would have apparently incentive effects
and perverse ones. 11.49

So, I just wanted to ask, there's no specific
reference to this issue in the report on which you based
your decisions, as far as I can tell, and so I wondered
if you had considered it yourselves since you were

participants in the IM process and you're participants in the Merits review and before you adopted that recommendation that you should use your own leverage, or put it another way, it appears to create an incentive for you to increase your leverage if that is to be the approach you apply going forward. So, I wanted to provide you with the opportunity to comment on that because it's an obvious observation.

MR FITZGERALD: Commissioner, I think one of the difficulties we had in the IM process, and it's still a matter of 11.50
ongoing debate, is the way in which the Commission -

MR DUIGNAN: Excuse me, I don't want to get into a discussion of the IM process. The matter that I've raised was not disputed by any of the parties. The fact that there is - that things point in that direction, even Transpower which has got some debates about it, their experts acknowledge that there was a result of the nature of the type I talk of. So it was purely a comment on that incentive matter and it reflects on ID because it is that you appear to have chosen to adopt an approach to cost of 11.51
capital that creates a perverse incentive for yourselves, and I just wanted to know whether you'd thought of that?

MR FITZGERALD: Our approach to leverage in the context of pricing was to adopt a leverage that is appropriate for a firm of Wellington Airport's type, and almost by definition Wellington Airport and its board adopts a capital structure that it considers appropriate in all the circumstances to exist, and Wellington Airport exists in a competitive market for capital financing. So, Wellington Airport's actual leverage and Wellington 11.52
Airport's theoretical appropriate leverage I would say are very similar.

The adoption, the Commission's use of 17% to us seems to be out of sync with both of those. It does not seem to be appropriate for pricing for us to use a leverage that, one, as a board we would not consider to be efficient or appropriate for Wellington Airport to actually have in any circumstance, and secondly, not one that relevant peers would adopt in an infrastructure business.

MR DUIGNAN: Could I ask, then, just very briefly, did you receive any advice regarding - given that there was a specific discussion of that point and the reconciliation between the sample which was used for other purposes and 11.53 the, you know, deriving the leverage from it, I just wondered if that was a consideration you took into account, that specific consistency point? It sounds - and I quite understand it because your advisor doesn't appear to have taken that into account, so I take it you didn't.

MR FITZGERALD: In pricing we have adopted a cost of capital that we have considered to be appropriate for Wellington Airport's pricing, and we see the ID cost of capital more as being an average industry benchmark which 11.53 is useful for information disclosure, but essentially establishes a point around which you might consider a range. For pricing we need to determine a pin-point cost of capital to put in a formula, not the same information disclosure where essentially a benchmark is being established against which actual outcomes need to be compared.

MR DUIGNAN: Thanks. Given that, the question was about whether Wellington Airport had received information on a specific matter, I don't think there's any point in 11.54 asking parties on it. The questions are obvious, they were discussed in great detail in the IM process. So, what I would like to move on to in my very last question, almost, just a very quick comment upon the treatment of the main area of the terminal, its switch and its designation. So, I think we all know what we're talking about so I will just go straight to ask for the comment first from Wellington Airport and then from the airlines.

MR FITZGERALD: In terms of cost allocation, we have consulted on an allocation of cost based on the actual use of the spaces in the terminal. I think the question arises because in the past pricing period a substantial commercial concession was made that allocated areas to commercial areas only that very obviously are used by 11.55
passengers, primarily we're talking about thorough fares.

I think part of the misunderstanding about this area is it's seating areas for food and beverage which is at issue. That's a small part of the issue. The main issue is about the general thorough fares to get from the check-in areas to the aircraft. Many of those in the past consultation were 100% allocated to commercial space which clearly and evidently is not their use. So, we believe the 2012 approach to cost allocation is accurate.

MR DUIGNAN: Then I'll just ask the airlines if they have any 11.56
comments apart from what you already said in your submissions.

MS COOPER: That's not actually a correct reflection of the main issue as far as BARNZ is concerned. We fully acknowledge that the thorough fares through that main terminal area should be termed a common space and shared between commercial use and aeronomical use, and we have no problem with that or with the allocation percentages. Our issue is with the foodcourt, with the tables and chairs that people sit on, with the bar leaners they 11.56
drink beers on, with the booths they watch TV in the bar, our issue is that space being treated as 75% aeronautical because in our view it's fundamentally commercial and it has been commercial since the terminal opened around

1997.
MR DUIGNAN: Having covered that topic I think that the last
topic that I would, because I have just a moment more, is
we will be having a session to some extent about comments
on how behaviour has been affected by the ID regime later
but I just would be interested in any specific aspects as
they relate to the revenue and profit, well revenue
calculation and then the assessment of profitability.
So, I don't think we want a checklist, I was really more
interested in any specific points that you wish to 11.57
register that might not be obvious rather than the
obvious checklist of matters that you have learnt about
from the ID, if you see what I mean.
MR FITZGERALD: I think the general point is that
Wellington Airport has found the Information Disclosure
Regime to be highly informative in both our consideration
of issues for pricing and also in how we approach the
relationship with customers going forward. We think, as
I sort of summed up before the break in answer to a
question from the Chairman, that the two regimes can work 11.58
in harmony. That actually the transparency of
information and the narrowing of issues is important and
that there is no doubt that interested parties have
substantial information against which to engage in other
forums. I think where we stop short on use of the
Information Disclosure Regime absolutely without question
in pricing is that that's not our view of the intention,
and where we see the benefit of the Information
Disclosure Regime is in the quality of the negotiations
and discussions between the airport and the airlines on 11.59
important issues, and it's a matter of record that
Wellington Airport would like to move to a position of
having commercial agreements with all its customers and
we think information disclosure is an important sort of

underpinning for those sorts of discussions.

MR DUIGNAN: I'll provide the airlines an opportunity to
respond in regard to this behavioural question but you
did indicate, and so I just pose that, a moment ago in
the cost of capital discussion that despite the fact
there had been a great deal of discussion of - as it
happens, the leverage anomaly is just one example, in the
context of preparations and implementation of the ID
regime, that nevertheless that had not actually impacted
on your decision about your cost of capital. I'm not 12.00
disputing that it should have, I'm just saying that you
did appear to indicate that you didn't see us sort of
bring that discussion, which was very extensive, as
having any particularly significant relevance to what you
did on cost of capital. So I should just give you an
opportunity to comment upon that observation.

MR FITZGERALD: I think that the observation that we didn't
apply each of the input methodologies in our pricing does
not mean that we didn't consider them, and it does not
mean that they don't have current and ongoing effect. I 12.01
think the example you use of cost of capital more broadly
we think in a discussion with our substantial customers
about what is a reasonable return for Wellington Airport,
the discussion pins on what is the requirement of return
for ongoing investment by the investors in Wellington
Airport, in Wellington Airport, not what is an
appropriate cost of capital on average for major airports
in New Zealand. And I sort of draw the other example of
A minus credit rating. Wellington Airport does not and
cannot get an A minus credit rating. Christchurch has 12.01
it, by reference from Standard & Poor's, by Government
ownership, and Auckland has a scale differential to
Wellington Airport. So, I don't accept the notion that
the fact we haven't applied the IM approach to being a

basis for it not having been affected or not being factored into our consideration, and also I think on an ongoing basis our customers and interested parties have access to that information as one of the points against which to base a commercial discussion and negotiation, and clearly the airlines, Air New Zealand and BARNZ and, as I say, the other airlines have not been as engaged, but Air New Zealand and BARNZ have used those points extensively in the consultation, we've fully considered them and under the AAA made appropriate decisions. 12.02

MR DUIGNAN: I'll wrap the session up by just letting the airlines just purely comment on in a narrow sense, if you understand what I mean, as to whether there's any points that have specifically come out of what is a behavioural matter that you wish to make. If you're making really controversial points I'll have to give a further opportunity to Wellington and then wrap it up.

MR WHITTAKER: I don't think we've seen any substantial changes as result of ID. I hear the word "negotiation" used regularly, there is no aspect we would characterise 12.03 as negotiation. It is consultation under the AAA with the AAA being used to set prices as the airport sees fit and that has not changed since prior to ID.

MR DUIGNAN: Yes, I'll very briefly note that I don't think changing from consultation is an outcome that we would expect ID to achieve, so I think you're - it's the tenor, I think you're reflecting on the tenor of the consultation because I don't think we could possibly set up changing from consultation as being the expected result, but thanks. 12.04

MR BECKETT: You're just asking for general behavioural points. One observation I would like to make, if I may, and I know it's somewhat personal but for 11 years I was responsible for the shipping negotiations for all dairy

products for New Zealand, and I know from that what
negotiation means. I've found this a totally different
experience, where certainly you discuss the things, the
material put in front of us has been professionally
prepared but you feel at the end of each meeting you've
been ignored.
MR DUIGNAN: Right, that's a fair observation.
MR FITZGERALD: That requires a response. Wellington Airport
negotiates and has got negotiated agreements with
substantial customers. Air New Zealand is not willing to 12.04
negotiate, so the claim that there isn't negotiation is
actually a reflection on the fact that Air New Zealand is
unwilling to sit down at a table and negotiate with
Wellington Airport over prices. Other airlines have and
have agreements in place and are therefore not
represented in this regulatory debate about whether
consultation is negotiation.
CHAIR: I'll come back to this in the session starting at
2.15, that there is an aspect of revisiting this conduct
issue. If we can park that at the moment I'll come back 12.05
to that. If we can move to expenditure.
MR RYAN: Paolo Ryan for the Commission. Now, Wellington
Airport has noted in its cross-submission that the
Commission's most recent published estimate of cost of
capital, which was published in April 2012, wasn't
available to it of course at the time of its consultation
but the earlier cost of capital published in 2011 which
gave a mid-point of 7.06 was at that time.
The question is, for the purpose of assessing
profitability ex ante, which cost of capital should the 12.06
Commission use, or should there be adjustments made to
either of those particular estimates?
MS COOPER: If I could answer. During consultation, BARNZ
sought advice from Dr Layton on cost of capital and our

question was, my instructions were, whether there was any valid reason to depart from the Commerce Commission methodologies that were set for information disclosure when setting prices, but as part of that work Dr Layton sourced the Commerce Commission input methodologies and updated them. So, our latest update I think was in December 2011, and that update was 7.1% which is virtually identical to the 7.06 that the Commission came out with in April.

MR FITZGERALD: To answer the question, Chair, when cost of 12.07 capital is essentially being used as an ex ante benchmark I think it's actually quite reasonable to use the then current cost of capital to assess, well, was the return in the last year higher or lower than the airport's cost of capital in the last year. The issue that raises, in making that observation Wellington Airport would essentially take it on faith that the Commission is not going criticise Wellington Airport for having a return that is not consistent, that is inconsistent with information it didn't have available to it at the time. 12.07 However, the cost of capital of a business is the cost of capital of a business and that is an evolving and fluctuating issue. So, I think the ID regime is about ex post review of returns.

If the market cost of debt has fallen and Wellington Airport has inadvertently earned a higher return than its then current cost of capital, I would expect the reports to the Commission simply to note that. Alternatively, if the cost of debt has gone up from what are pretty historically low levels at the moment, to note that 12.08 Wellington Airport has earned an actual return that is looking like it's below its cost of capital because it's debt rising, it's very much a question that Wellington Airport is at a loss to understand at the moment, how the

Commission is going to comment on the actual returns that are coming out from these disclosures and how cost of capital is going to be used in its assessment.

MR DUIGNAN: Well, we are consulting on exactly that type of issue in this forum but we don't always express, you know, you've got the IM so that tells you quite a lot as to how we're going to apply them, that was - your view was being sought just now, so yep. So, I don't know - when you say you're at a loss, it's because we're consulting with you. 12.09

MR FITZGERALD: So we don't currently know.

MR DUIGNAN: That's fine.

MR FITZGERALD: That's probably a better expression.

MR RYAN: Just one follow-up question on that point. Given it is an ex ante assessment of profitability, should the Commission be using the mid-point or 75th percentile of that cost of capital estimate?

MR FITZGERALD: I think there would be a discussion. I think in terms of setting a target cost of capital, I think if we were in a price regulated regime it is best to look at 12.10 the set of parameters around variation and err on the side of ensuring investment takes place. That seems to be a reasonably typical approach but we're not - I think where I'm struggling with the question a little is that it suggests there's a bright line pinpoint test and I would be disappointed if that were to be where the Commission got to after its consultation on cost of capital, that there is a bright line tick or cross based on your actual return and an absolute cost of capital, because I don't actually believe cost of capital is a 12.10 defined subject, that that leads itself to pinpoint answers. I think when you are in a price controlling mode, you have to set a pinpoint cost of capital and accept the consequences of getting it wrong but you're not in that, the Commission is not in that mode, the Commission is in an information disclosure regime which allows it to take a broader assessment of a range of potential acceptable costs of capital.

MR DUIGNAN: Thanks.

DR LAYTON: We'll put it in writing.

MR BECKETT: May I make a comment. It would seem to me it would be sensible for the Commission to pay as much attention to the 25th percentile as it pays to the 75th percentile. 12.12

MR DUIGNAN: Again, we'll look forward to the submissions.

MS BEGG: We're just now going to move on to the final session before lunch and that is going to look at Opex, CapEx and innovation, and we have received a lot of submissions and information on this so I wouldn't like you to think that the shortest session that we have for this implies anything about the importance, but rather we just want to explore areas where we need further information. Of course, in assessing performance of airports it's important to look at whether they're operating 12.12 efficiently and whether they're investing for the long-term interests of consumers, and we're interested in exploring to what extent information disclosure is affecting behaviour in this area.

We're going to use the first part of the session to look at Opex and CapEx, and whether they are consistent with an efficient airport operator, and, as I said, what impact information disclosure has had on performance. Then, in the second part of the session we'll briefly discuss some issues related to innovation. 12.13

So, my first question is one for BARNZ. In your submission you did say that in the past Wellington had operated, its Opex was reasonably efficient so there was a positive statement there which we don't see all that often I must say from the customers of regulated businesses, but you have expressed a bit more concern looking forward and you have proposed that the Opex - for example, the Opex per passenger in 2007 would be an appropriate level of Opex going forward, and I just wanted to get your feedback on why you've chosen that date. Is there some science behind it or is it just a point in the past where you thought things were going well? So, I'd just be interested in your comments.

MS COOPER: Yes, operating costs from 2000 to 2007 stayed 12.14
relatively constant at $2.31 per passenger and BARNZ focuses on operating expenses per passenger because that allows the overall total level of operating expenses in the airport to increase the passenger volumes. 2007 was the last year we had the actual operating expenses per passenger for the airport pricing models so that was why it was chosen as the starting point. We've then escalated it forward for CPI from there, which gives the airport a significant increase, and then as well the passenger volumes have also increased substantially. So 12.14
it lets the airport operating increase for two reasons; CPI and passenger growth. So, we think it was quite a generous reasonable approach and the reason that we wouldn't use 2010 to 2012 is because there was a substantial increase in operating costs there, where the airport's operating costs jumped about 25%, so the airport has put considerable focus into what its operating costs are doing for the next pricing period from 2013 to 2017 but we believe that's starting off from a substantially higher base than is efficient. 12.15

MS BEGG: Anything in that Opex, the 2010, that is of particular concern?

MS COOPER: There was just the fact that - I mean it substantially increased. I think a key factor is probably the amount of money that the airport has put into the regulatory regime knowing that it can charge all of that back to airlines. Now, considerable gripe, to use the word, which BARNZ has over pricing forecasts at the moment by the airports is that they're all putting in their costs of the Merits review, whereas most airlines aren't participants in that Merits review, and we see it as a shareholder's choice and should be worn by the shareholder.

MS BEGG: I'll get Wellington to respond, not just on that 12.16
specific question of course but the more general.

MR HARRINGTON: Just a couple of points, I guess. The process, without wanting to go through all the detail we went through in the submissions but certainly the 2012 cost base we used the pricing was part of our budget for the whole of the company budget, so the whole of company budget went to the board and the usual processes that we go through that process, that's the starting point.

So, to say that you can go back in time to 2007 and index that forward, and there wasn't more information 12.16
available, is incorrect. So, those 2012 costs needed as part of the consultation process, that was our basis. I think it's well documented the reasons for that, with regulatory being part of it and earthquake costs being another substantial increase which obviously we can't avoid. So, there are, we believe, very good and strong reasons for the increase, which are large, and we put through that, the detail of that to BARNZ and airlines as part of consultation.

Also, as a general point, going back in time for the 12.17
2007-12 period there are obviously a lot of regulatory costs we've incurred through the ID and IM regime which we didn't know when we started the process and we're not going to materialise or recover all those costs and we're

not seeking to recover those costs. So, again, I guess it goes to a reissuing arrangement which we've absorbed those costs previously but not looking to recover those historic costs going forward.

MR FITZGERALD: Just a general comment. I think in consultation we put forward our detailed operating costs build up and it did have those major new items that were outside our control in them. Insurance being a very obvious example with the Christchurch earthquake, and
ability to get insurance at reasonable levels is 12.18
something we worked very hard at with brokers and underwriters, and we actually believe we came out with a reasonable, a pretty good result compared with other firms but it's a substantial increase. And then the regulatory regime. I mean clearly now in New Zealand being a major airport you have additional costs of regulation, and for shareholders not to recover a return on their costs doesn't to us make logical sense. So, while we sought, we sought feedback from the airlines on
any concerns about the specifics, it was just a general 12.18
benchmarking approach that we didn't find terribly informative.

MS COOPER: We do find, in our defence, if we ever try and get into specifics we get into the argument, are you trying to micro manage our airport Kristina. So, we're damned if we do and damned if we don't.

MS BEGG: Just a more detailed question, there was the issue that has been debated in some of the submissions, is about the costs of the additional three employees to
undertake gate allocation, which appears to have been a 12.19
take over of functions that Air New Zealand provided in the past, and I'd just be interested in Wellington's comments on why they've decided to do this, and then BARNZ perhaps can have a response on that.

MR FITZGERALD: Thank you for the question. I think there's two aspects of that; one is, therefore it is a cost transfer and therefore the net cost to airlines we believe is relatively neutral. So, therefore it's an anomaly in the sense of a cost increase because it's just shifting where the cost falls for the function of gate allocation. The rationale is quite clear and that is that essentially one market participant, and the dominant market participant has been the allocator of capacity at the airport for itself and its competitors, and when we 12.20
looked internationally we found New Zealand and Nigeria were the two examples where that's the case.

So look, I think this is us playing catch-up with the rest of the world in having an independent allocator of capacity and clearly the airport has a wider responsibility to make sure there's equity in the allocation of space and the timing of gates and turn-around, and there is a variation in the quality of gates from a turn-around perspective and a preference perspective, and there needs to be an even handedness to 12.21
that, and having a single market participant do that is not normal and has been changed.

MR WHITTAKER: It is not a net neutral cost game. We have the same people still requesting to be allocated a gate and being allocated a gate and then telling the aircraft to move on to the gate. It is an operation on the day piece that I don't think does - that there weren't any issues with it before but I'm not surprised that a competitor airline would wish to increase our cost base if they can do so. 12.21

MR FORD: I would just like to add that the allocations have always been done in accordance with parameters that are issued by the airport company in terms of understanding what can fit in what gates and those sort of things.

MR FITZGERALD: Can I just note we have had complaints by competitor airlines and that was part of our consideration.

MS BEGG: I was just going to ask if they have a different perspective.

MS COOPER: We did receive feedback from one other airline that they welcomed the move to independence. From BARNZ's perspective we wondered whether it would have been more efficient for the airport to perhaps take over the function at peak times of the day and perhaps left 12.22
Air New Zealand with responsibility for allocating the gates at times when there was spare capacity.

MR FITZGERALD: So, responding to that, I think the peak of gate allocation is not necessarily the peak of the concern, I mean where aircraft overnight is an issue, so it's who's allocating the gate at midnight effectively then depends on who is the occupant of the gate first thing in the morning, and I think the idea that we'd then have a shift of people who would come on for two hours or three hours and do that and then hand back to Air New 12.23
Zealand for a period is a rather strange one. Again pushing against international convention of having an independent allocation of gates.

MS BEGG: Okay, I'm going to move on to CapEx but I'll just check whether there are any Opex questions staff have?

MS OXLEY: Isobel Oxley. One question from the Commerce Commission, it's a question for Wellington actually. What impact does the allocation of the food hall into the aeronautical assets actually have on Opex? A specific question about the allocation of the food hall but also 12.23
if you could widen it as well to the allocation of other assets.

MR HARRINGTON: I think it's $3 million for the food hall, from memory. That's just the food hall.

MS OXLEY: Is that just per annum or over five years?

MR HARRINGTON: Maybe we'll come back for cross-submission on it. It's $3 million I believe is, actually to be more specific is the asset based transfer so you would have the impact of that on the return.

MS OXLEY: Sorry, is that the impact on Opex?

MR HARRINGTON: No, it's the asset value, $3 million on the asset value.

MS BEGG: The amount will depend on the allocation of the overall, overall allocation of costs, I guess. 12.24

MR HARRINGTON: Maybe just for clarity we'll respond in a cross-submission.

MS BEGG: Thank you. Just turning to CapEx. From the submissions we gather that apart from two specific areas, there seems to be general agreement between Wellington and the airlines on future requirements for investment, and I would just like to check with BARNZ and Air New Zealand that the two main concerns that you have had are with the profile of the forecast and what's been called front loading of the CapEx, and the other was the works 12.25 being undertaken to achieve compliance for code D and E aircraft, and bearing in mind that Wellington has made some changes there and deferred some expenditure. I just want to check that they're the two main areas of concern that you do have?

MS COOPER: That's correct, from BARNZ's perspective.

MR FORD: Yes, similarly from Air New Zealand's.

MS BEGG: Just then looking at the question of the front loading. Wellington's partly offered to address this through wash-up in terms of the terminal development 12.25 expenditure, Air New Zealand and BARNZ still remain concerned about other projects where that doesn't happen, but I just really wanted to get a feel for how far does that go towards addressing your concerns and how concerned do you remain with the profile of the remaining projects that aren't subject to a wash up?

MS COOPER: I think by and large it mainly addresses the concern. It picks up the most material issues.

MS BEGG: Air New Zealand?

MR FORD: I agree with that from a practical level, I guess. From a philosophical point of view it does become an issue of how much do we pay for things in advance of when they're actually needed rather than just sort of speculating investment down the track and building it 12.27
into pricing now. We would much rather be paying for things as they come in, in stream.

MS BEGG: Just Wellington might respond. You thought of providing a wash-up for the other expenditure, what was the reason for the balance that you've come up with?

MR FITZGERALD: There is broad agreement, and I think we're hearing that, on how capital expenditure is looked at. There is, as we heard earlier, extensive consultation on capital expenditure well below regulatory thresholds and that's an ongoing process, so I think this is an area of 12.27
general broad agreement. The wash-up on large things is noting that it's not only their scale but their uncertainty that you are trying to predict the in-use date, sometimes up to six years in advance of that date because of the regulatory cycle, so the level of uncertainty, the scale and other things does do that because our intent is not to charge for things until they're in use. We, in good faith, go through a process of trying to accurately estimate when something is coming in use to add into the pricing, into the calculation of 12.28
price. How it ends up in the final unit price is a function of whether there's benefits in smoothing or you take things in lumps but that's separately consulted on. So, I don't think there's any disagreement about the

process. I think if you took it that further step and, you know, again this is something that in a commercial agreement you may agree a different approach, but if you take it to the next step of individual reconciliation of date and time of every level of CapEx, our view is that it's very resource - quite resource intensive and what it also does, from a regulatory perspective, is it removes the incentive on the airport to officially manage its costs, we would become just a cost pass through, and from a regulatory perspective I would have - my understanding 12.29
is that there is some regulatory benefit in putting some risk on the airport of expenditure level which clearly in the last consultation, in the 2007-2012 we faced capital expenditure that wasn't forecast that was requested by airlines, particularly around changes to the baggage make-up area as a result of introduction of the A320s which was not known in 2007. We proceeded with that and I think - we try in this sense there's quite an adversarial feel but in the Opex and CapEx field we understood requirement with Air New Zealand with the 12.30
A320s we brought forward some million and a half worth of expenditure into the pricing period. We didn't seek a recovery of that capital for the period and we're not seeking a catch-up on that capital, so there's absolutely swings and roundabouts and in those cases, those incentives we're comfortable with, but again, if there was a one-to-one commercial negotiation, any range of different outcomes is possible.

MS BEGG: Just then turning to the compliance expenditure which has been largely deferred, I just wanted to check 12.30
there's still $3.5 million of expenditure in this period and I just wanted to check with Air New Zealand and BARNZ whether you thought, was that a reasonable outcome from your point of view or do you still feel that that

expenditure isn't actually required in this pricing period?

MS COOPER: It's quite a technical question so I think we might need to come back in writing later.

MS BEGG: That's fine.

MS COOPER: What I would note, though, is this overall issue of sort of speculative investment or of Wellington Airport investing up to code D and E aircraft when it's really only got less than one a week of those sort of aircraft coming through its airport. It permeates more 12.31 than just the forecast compliance work but also relates - and the RESA, the RESA cost a good $5 million more than they needed to because they were constructed to that larger requirement and it's a question of whether the appropriateness of current users being charged for something which they don't require which is constructed to a standard higher than needed.

MR FITZGERALD: Can I respond and say I don't believe that represents the views of all substantial customers. I think that's an Air New Zealand view; it's being 12.32 expressed by BARNZ. We know Qantas' 737-800s do require that runway length and so I think that's, you know, I think that's a specific Air New Zealand issue that's been well debated over whether we're providing the facility for one airline or multiple airlines.

MS COOPER: I'll just respond there. I'm certainly not talking about the length of the runway and the RESA, because I acknowledge there are airlines like Qantas and Pacific Blue that required those. The specific point I'm making is the width of the tunnel was constructed by 12.32 Wellington Airport to code D and E requirements which put an extra $5 million on to the cost, that's what we were advised by Wellington Airport, and that to my knowledge is not a cost that is needed by any of the airlines. So, it is not BARNZ expressing an Air New Zealand position.

MR FITZGERALD: To address that issue specifically, Wellington Airport has always been an international airport and has had code D and E aircraft operate regularly over many years. We currently have mostly code C aircraft and we're striking the balance of that. Where we come down to the specifics of what's in the current pricing period, which is really the purpose, we believe the airlines are misinterpreting the requirements of those expenditures. The two specifics are really 12.33 residential acquisition where we have a non-compliant taxiway for the use of both code C aircraft as well as larger aircraft, and also other smaller compliance expenditure.

So, this issue was consulted on in detail. There were many changes made, many concessions made. We've ended up with a small subset of projects that Wellington Airport's operational and compliance team believe are required. We believe when we undertake a project it should be undertaken with a long-term view rather than a short-term 12.34 view, and I think we've struck a very reasonable balance between providing for the aircraft currently operating and also providing for a 20/30/50 year future for Wellington Airport.

MS BEGG: Thank you. Then I gather it is still somewhat controversial. I would just like on the Opex and CapEx to ask the question that you've been asked before, which is to what extent has Information Disclosure Regulation had an impact on how you've gone about forecasting for Opex and CapEx and coming to the arrangements that you 12.34 have? First of all I would just like to note that I've found very helpful the greater disclosure of information that you've made this time round. I've thought if that can be attributed to ID, that is a positive outcome for interested parties, but just in terms of the parties that have been involved in the process I'll ask the airlines to comment and then perhaps Wellington to respond.

MS COOPER: It didn't actually notice any difference on the consultation process or the information that was provided within consultation on the forecasts for expenditure and investment. I think the airport followed a very similar process to what it has always done.

MS BEGG: And that's been a satisfactory process? Given that - I mean, if you see the debates we have for other 12.35
regulated businesses on Opex and CapEx, this is a fairly unusual situation where we don't have major debates, so.

MS COOPER: I'll take your word for it.

MR FORD: I guess just the one issue is there were some changes to the categories that we used which was just the airport aligning itself with the ID requirements, so in that sense I guess there has been a mirroring.

MR FITZGERALD: Commissioner, I think the information disclosure is not new so it's shifted from the AAA to the Commerce Act. I think one thing in looking at the impact 12.36
of ID, I think under this review you're really looking at the new information disclosure which is an expansion and a greater specificity of the information disclosure, I think that overall transparency has been in place and has been good. If you've found benefit in the additional level of detail, that's great but I think over a number of pricing periods we've endeavoured to provide information in great detail for responses by airlines.

MS BEGG: Thank you. I'll just check from staff whether they have any questions. 12.36

MR RUSS: Nick Russ, Commerce Commission. One follow-up question about Air New Zealand's preference to pay for CapEx once it comes on line. Did you actually mean as it comes on line, or did you mean just a wash-up because the same impact, and the follow-up to that, how would you respond to the airport's discussion about the impact that has on incentives? Would you rather have a full wash-up with reduced incentives or efficiency, or something in between?

MR FORD: I guess what we're looking for is we're not paying for things in advance of when they're needed, effectively. That's really what it boils down to. I'm not sure if that answers your question or not.

MR RUSS: I guess that's the first part of it but obviously 12.37 the point made by the airport was if things are only paid for when they're achieved they can't achieve efficiencies against a forecast, kind of like a cross pass through, how does that sit from Air New Zealand's point of view? Would you rather have incentives to achieve efficiencies or would you rather have pass through on CapEx?

MR WHITTAKER: I think we're not suggesting that the corollaries shouldn't happen and the airport should build things before they're ready to comply with the CapEx forecast. I think it's been recognised there is 12.38 potential for front loading of CapEx forecasts and it's not our observation that we find large amounts of CapEx occur after they were forecasted, it's more our observation, as in this wash-up, that CapEx occurs after it was forecast, and I think there should be a wash-up that reflects that.

MS BEGG: Okay.

MS COOPER: I think the experience that BARNZ had during our recent consultation with Auckland Airport suggests a number of international airlines I think would favour the 12.38 mid-approach wash-ups on those large projects but for ordinary run of business capital expenditure it's set a budget and then the incentive is for the airport to stick with it with some certainty for airlines.

MS BEGG: Okay, we'll move on to innovation. Obviously
innovation is an important element of the performance of
a business and, again, we are looking at whether
information disclosure has had any impact on innovation
at Wellington. We've had quite a few submissions in
cross-submissions on innovation. They've perhaps
highlighted a bit of a debate as to who's responsible for
innovative ideas, although in the end I'm not sure how
important that is. As long as Wellington is open to
innovation, that probably addresses most of the concern. 12.39
And we understand that innovation is not addressed as a
specific issue in consultation and overall it doesn't
seem to be a major issue, but I've just got a couple of
questions. My first one, I'll start with the airlines.
That is, how does the level of innovation at Wellington
compare to other airports internationally and
domestically? Do you have a feel for that, whether
Wellington is up with the play?

MR WHITTAKER: We don't see any significant difference.

MS BEGG: So no obvious things they should be doing that 12.40
they're not. Has BARNZ got any thoughts on that?

MS COOPER: No.

MS BEGG: Does Wellington look at what other airports are
doing and consider whether there are innovations that it
should be bringing here?

MR SANDERSON: You know, I think the key to innovation, and
probably the silence of Air New Zealand and BARNZ, is
collaboration. Wellington Airport works with the
airlines and with its other customers on innovation
through the airport and I think that's been well 12.41
documented. That goes from kiosk to even at a
collaborative, in our operation looking from a beginning
of a process to an end of a process, and that includes
all the - from the airlines, asset, customs, whatever

part of the airport it is, everyone is trying to solve solution, share cost savings through efficiencies and I don't think there's any contention in that area.

MS BEGG: So, from the airline's point of view is there anything more than Wellington could be doing to support innovation; ideas that you're bringing to them or that they could be bringing?

MR WHITTAKER: I think it's correct to characterise that many of these innovations are actually resolutions of operational issues on a day-to-day basis and there is 12.41
good collaboration on a day-to-day basis in resolving those kinds of things and putting in sensible solutions. Certainly not an issue we would highlight.

MS BEGG: In one of Air New Zealand's submissions there was a suggestion that Wellington had been a bit slow and a bit reluctant to adopt some of the innovations proposed by airlines.

MR WHITTAKER: I think in terms of our kiosk development we slated Wellington as the second, ended up being the third because we had delays in agreeing either the price or the 12.42
ability to place those kiosks within the Wellington footprint.

MS BEGG: But not seen as a current issue, ongoing issue. BARNZ have any thoughts?

MS COOPER: No.

MR FITZGERALD: Can I make one comment. Wellington Airport's geography does basically require a collaborative approach to particularly capital problems because it's such a small site and such a small area and there's an ongoing collaboration at the moment over the extension of the 12.43
terminal to the south and how to solve some issues around security screening and regional aircraft, I think it's a good example, the kiosk example ended up a very good result. I think the difference with Wellington was that

Wellington Airport is a fully common user space whereas I believe the other airports, Air New Zealand has more specified - it's own areas, had more control. But I think I characterise that as a pretty small point and we were very supportive I think in encouraging and were publically praised by Air New Zealand for the innovation around kiosk which was world leading.

MS BEGG: Okay, just to wrap up this session I just repeat the question we've been asking, which is has information disclosure, the changes, had any major impact other 12.44
than - any aspects of information disclosure that could be improved that would make things better, any thoughts? Perhaps I'll start with the airlines again.

MR BECKETT: The comment I would like to make, Commissioner, I found the quality of the information that came to us was very good indeed. Very good to be able to see what was happening, it was very well explained and we understood it all, and it seems to me that a lot of this ends up coming back to the spreadsheet that actually does the calculation of what the return is in the end, and I think 12.44
the rules laid down in the input methodologies enabled us to construct an alternative model, in other words to reconcile, to build a simple model that reconciles with the Wellington Airport's model and then to change that to what we believe the parameters should be and it's a very simple process and one can see from that very readily what the returns from that actually are. So, I think all of that is very good.

MS BEGG: Okay, thank you. And Wellington?

MR SANDERSON: Well, I think the disclosures on innovation are 12.45
clearly documented and they do basically set a base line but Wellington Airport certainly goes well beyond those base lines in terms of innovation in collaborating with the other airlines, not just Air New Zealand but with

other airlines trying to look for innovation. As Steve pointed out the common use of terminal, the swing gates switching between domestic and international airport, so we're trying to use the efficiency use of assets and utilisation. So, you know, they always are there and we'll continue to look for those efficiencies.

MS BEGG: Just before I finish I'll check with staff. (No questions). Back to you, Chair.

CHAIR: We have run a little over time, so let's break for lunch. If we can come back at 1.20. We'll have half an 12.46
hour for lunch as set out in the programme, so we'll start back at 1.20.

(Conference adjourned from 12.46 p.m. until 1.22 p.m.)

CHAIR: I assume that we have everybody in attendance who is proposing to participate in this session. So I will hand over to Commissioner Begg to do the questions on the pricing session.

MS BEGG: In this session we're going to have a look at the role of prices, in terms of issues here are in terms of setting prices which promote efficient outcomes and 13.23
another key focus will be on the extent to which efficiency gains have been shared with consumers. ID requires, as you're all aware, airports to disclose information in relation to pricing methodology, standard pricing incentives as well as pricing stats. In the submissions and cross-submissions there have been a number of issues that have been highlighted in relation to Wellington's pricing structure, and where the efficiency gains have been passed on.

Thanks for all those submissions, there is a lot of 13.23
detail that has been provided to us which has answered a lot of our questions, and just from those submissions our understanding is that there are some main areas of disagreement which would include the introduction of

charging for the runway at peak times, and the mandatory parking charge and the hourly check-in charge, charge for check-in desks, the incentive schemes are another area of controversy, which we've already talked about to some extent, the common terminal charge for domestic and international passengers, the lower mac tower charge for heavier aircraft and some concerns about cross-subsidisation.

Another area of concern has been airlines have believed that there is further scope for them to be able 13.24 to make price quality trade-offs, and an important issue, of course, has been noise mitigation initiatives as well. As I've said, we've got lots of information on these areas and so we won't go into detail in all of them but we'll just - I'm going pick out a few areas that I think we'd benefit from further discussion.

So, the first area I would like to turn to is really to get from Wellington a feel for the economies of scale that Wellington has. This is efficiency being achieved as we get greater through-put, how that's being factored 13.25 into the forecasts of expenditure and whether or how these efficiency gains have been passed on to consumers, shared with consumers.

MR FITZGERALD: The build-up of the building blocks approach to pricing and forecasting each year's expenditure against each year's passengers has inherently in it the passing on of benefits of economies of scale to the extent that you can put more people through the same level of investment, but Wellington, Wellington Airport is getting to a point, as many major airports do, where 13.26 you go - you will have steps of that investment and cost base changing in a step and then efficiencies coming through. Having gone through a similar process more than a decade ago at Sydney and having examined this in more detail, airports do hit diseconomies of scale in that incremental investment becomes more expensive. That's a site specific issue and Wellington Airport's geography and constrained land site means that you're starting to stack capacity rather than build it out. So, you wouldn't see or you wouldn't expect to see over the long run, sort of a 20 to 50 year view, a smoothed economy of scale graph. The specific nature of aircraft structure doesn't lend itself to that. But coming back to the specifics of this pricing period and we talked about the 13.27 incentive scheme, 880,000 extra passengers reduces everyone's charges against the counterfactual by about 46 cents, I think the number was, so we are flowing that cost efficiency through to unit price.

MS BEGG: Air New Zealand?

MR WHITTAKER: I agree with Steven. Airports have steps and Christchurch, for example, is about to go through a major investment hurdle step where you would expect to see probably prices change as a result of that. I would have thought that Wellington actually had gone through that 13.27 step and this would actually be more a five year period we would see efficiencies of scale coming into play rather than the opposite. As a gross level I think we've probably got around about a 15% increase in investment going on in terms of regulated asset base over this period and a 54% increase on prices. At a gross level we have claimed reductions in the real cost per passenger and equal sized increases in the real revenue per passenger. So, if there are efficiencies it certainly doesn't seem that they're being passed to the consumers 13.28 for the long-term benefit of consumers.

MS BEGG: Something that struck me when I read your submission was the per passenger revenue growth was 3% real per year and I think you, this is from memory so I might not have this exactly right, and the reduction in, it was Opex, it was an annual Opex reduction, I think it was 2% real per year. So, that's obviously an increasing gap and to me I must say I wondered how does that demonstrate the sharing of efficiency gains. Have you got a comment on why you've got that profile of the two different aspects?

MR FITZGERALD: I think the specifics are obviously all in the submissions but I think what we've - what you're seeing by way of increment is then the end result of also a smoothing approach. So, as you've seen in submissions, 13.29 we've ended in 2011-12 at well below our recovery of cost of capital, and for reasons that we've noted, we've gone through an unexpected GFC with lower passenger numbers than we have effectively passed through the expected benefits of additional benefits to airlines and then not received them, we've had unexpected Opex increases and we've had the changes in valuations.

So, what you would see if we didn't go with a smoothed approach is actually a stepped catch-up and then a different price profile. What you're seeing is a net 13.30 result, is something that through our proposals and through consultation we believed, we put forward the view that it was better for customers to see a graduated and smoothed price path rather than stepped changes and jumps and a big increase followed by decreases et cetera. So, I think to then look at the price profile in the five years and then try and equate it to operating costs doesn't quite work for that reason.

MS BEGG: In terms of the change in the balance between revenue and costs, is there an element of not just 13.30 catch-up but trying to make up for what was an under earning in the past, as you see it?

MR FITZGERALD: No, there's none. So essentially we have taken those 6.1% returns, 6.9% return, that's history.

We are looking at an NPV equals zero approach for the
next five years on a forward only looking basis. In
fact, the opposite is true in the sense that we've got
those couple of wash-ups that then decrease the revenue
targets for the five years we're now in.

MS BEGG: Anyone else?

MS COOPER: I think the reason there's been such a stepped
change in prices is because there's been a $100 million
revaluation in the assets. So, from BARNZ's perspective
we don't see any efficiency gains seen by consumers at 13.31
all. It's just been substantially increased prices of
between 8% to 9% per annum every year for five years.

MR FITZGERALD: I think the record will show that that's where
that's - we don't want to go back over the input
methodologists and also I think looking at it on a per
passenger, per passenger real basis is the best way to
look at price change because you're looking at the impact
on end consumers in real terms rather than sort of a more
histrionic numbers coming from airline submissions.

MS BEGG: Okay, we'll move on there I think. The other 13.32
element, of course, with economies, economies of scope,
so this is regulated and non-regulated businesses, and I
would just be interested in Wellington's comments. This
actually relates, similar comments to the discount being
provided to new airlines and there's, like, Air New
Zealand saying that Wellington will benefit from the
non-regulated part of the business. So, I just wondered
to what extent you're passing on the benefits of
economies of scope and how that's affecting your pricing
behaviour? 13.33

MR FITZGERALD: We have constrained our analysis to the
specified services and we haven't got the specific
analysis of the other services which do add their own
investment profile, investment requirements on top of

revenue. So, I think it's a mistake to suggest that
they're sort of free additional revenue coming from those
but frankly we saw it as outside the scope of disclosures
and outside the scope of the regime to analyse that in
detail.

MS BEGG: Can I just, it's a question for the airlines about
the discount and how you've sort of characterised it, and
Pat touched on this, it was almost the suggestion you're
paying for it, the regulated business is paying for it.
Is that because you think that these, or additional 13.34
airlines or increased output - I think you've said you
think it will occur anyway and therefore the discount is
having to be made up by yourselves, whereas I think
Wellington's characterising it as new business that
otherwise wouldn't be there in which case everybody wins;
is that the difference that's between the parties?

MR WHITTAKER: I think in terms of should the growth occur
without the incentive being paid, then that incentive has
been accounted as a cost of doing business for Wellington
and revenue is being recovered to pay for that cost of 13.34
doing business. So, in that case it would seem to me
that's clearly a windfall gain for Wellington because
it's putting in a cost of the incentive or the lack of
revenue collected as a result of the incentive while
collecting revenue to pay for it.

On the other hand, it does seem that there isn't a
sharing of the scope efficiencies that go on. For
example, if those extra passengers come through and sit
in those foodcourt outlets and consumes food, one assumes
that Wellington shares in the benefits from that in the 13.35
way that they're able to charge rent for those outlets,
and yet we see the seating for those outlets now being
charged as regulated asset based rather than the
opposite. And so sharing of those scope gains we would

expect to see maybe the opposite occur, that you would
say, look, we've got these gains, they're being shared
with consumers for the long-term benefit of consumers,
therefore we can afford to have a different allocation of
the asset base.

MS BEGG: BARNZ?

MS COOPER: I think we address this in the last page of our
cross-submission but the Wellington Airport financial
model very clearly shows that the cost of the incentive
scheme is some $11 million over the five years and that 13.36
$11 million is included as a cost, so it directly
increases the amount of charges that are being charged by
airlines. So, to call it a discount I think is an
incorrect characterisation. This is a situation where a
firm has increased its charges and then called it a
rebate to consumers and it just isn't.

MR FITZGERALD: Commissioner Begg, it's a matter of fact that
if we had of used Air New Zealand's growth rate and had
no incentive scheme, the unit rate would be higher. So,
it is a lower charge as a result of putting in a 13.36
stretched target and the incentive scheme that we know is
required to deliver that. I think it's unfortunate you
don't have Jetstar or the Virgin Group, Pacific Group
sitting here because I'm sure they would say what they
say to us, is that we will not be growing services at
Wellington Airport, we will not be growing services in
New Zealand generally without some incentives and without
some support, and I think that is because they are trying
to boost capacity at the margin which is fundamentally
the least profitable level of capacity. It's well above 13.37
marginal cost in terms of what the end price ends up
being, but by not putting on those growth passengers the
entire average cost, you're not disincetivising those
marginal passengers from actually travelling. So, in

abstract all airlines participate in that. In reality in
the way airline yield models work, it seems to be the low
cost passengers, sorry, the low cost airlines and the new
airlines that are coming in and stimulating that demand
which the airport price structure recognises.

MS COOPER: I think when other airlines say they'd like a
discount, they are not expecting to have an uplift of
original charges so they end up in neutral position
overall. A discount is supposed to be a cost saving.

I also just note that in terms of preparing its 13.38
submissions for both this Commerce Commission process and
the airport pricing consultation, you know, BARNZ has
been in full communication with its other members,
including Jetstar, Pacific Blue, Qantas as well as
Air New Zealand, and everything that BARNZ has written in
this document has been reviewed by those airlines and
supported by them. Because there seems to be a
suggestion that BARNZ is simply acting as a lackey for
Air New Zealand and not reflecting the views of other
airlines, which I would strongly reject. 13.39

MS BEGG: Can I just check with staff to see whether this
particular issue of the discounts et cetera, if there's
anything more that you wanted to ask?

MS OXLEY: One question, I wondered if WIAL can tell us what
impact they think the incentive scheme will have on the
revenues for the non-aeronautical activities?

MR FITZGERALD: No, we can come back on that. I think, yeah,
in terms of the revenue amount, there's also an impact on
investment as well.

MS BEGG: Okay. I was just going to move on to this question 13.39
of cross-subsidisation. Wellington, you've submitted
that there's no cross-subsidisation of the services
because marginal costs are very low in the short term and
all services cover the marginal costs, but you make also

a comment that if long run incremental costs or externalities are included, subsidies may exist for runway use in peak periods. I just would be interested in your explanation of what, if you were to look at it in a long run incremental cost point of view, what cross-subsidisation do you think might happen then?

MR FITZGERALD: I think to make the general point, this pricing proposal takes a graduated and measured move towards efficient pricing. That comment is particularly small aircraft at peak periods. You know, a 19 seat 13.40
aircraft taking up a runway slot in peak periods does use the same asset for the same amount of time as a large jet. We have essentially kept a size graduated charge, the sort of MCTOW based charging, so that smaller aircraft pay less. When we're in a period of congestion, the appropriate cost is that scarce resource and really the 19 seat aircraft from an externality point of view is potentially putting back a jet with many more people on it from travelling at their desired time. So, you've got all those impacts going on and so there is an economic 13.41
case for a much flatter charging schedule for that scarce runway usage in peak periods.

MS BEGG: So you're saying smaller aircraft are still being potentially cross-subsidised if you took a long run incremental cost view?

MR FITZGERALD: Yes, because the cost of the next increment of runway capacity is something we haven't specifically calculated but I think we can conceptually envisage is a very very large cost because it won't be on the current site, it will be somewhere else in the region and require 13.42
transport links and various other things. So, the long run increment of runway capacities is a very large number and therefore at a point of congestion we need prices to allocate capacity in a way that's most efficient. I

think our pricing proposal is a modest step towards that level of efficiency and it recognises that congestion is something that will increase over time and that efficient allocation of capacity is something that we think is something that is a work in progress and will need to vary over time to make sure that we get the best net gain for everyone, and the assumption is that essentially a passenger is a passenger and they have relatively equal level of demand on an aircraft, that may not necessarily be the case but the data to get beyond that is beyond the 13.43
scope of our current pricing review.

MS BEGG: And the reference to externality as well as long run external costs, that's a concern about congestion, there's no other externality that will need to be brought into the picture?

MR FITZGERALD: Congestion has negative environmental externalities if departure and arrival times aren't allocated. That's pretty well addressed in New Zealand through airways control. However, it's inevitable we have an element of stacking in a congested - so, if you 13.43
have an aircraft inefficiently using a runway slot because they simply don't have the demand that equals cost then you are, then you arguably have those noise and fuel burn and other externalities, but that's getting quite theoretical on an externalities debate.

MS BEGG: Do the airlines want to say anything?

MR WHITTAKER: I think if we're confining ourselves to the runway at this point, we haven't seen any evidence that the runway is any more congested than it was ten years ago. I think we presented evidence about runway 13.44
movements. There is a suggestion from Wellington that at peak times the current demand is in excessive low where minima capacity, I don't know of any airport in the world that seeks to constrain its scheduled demand to its low

weather capacity. So, that seems like a frivolous argument to me, that somehow there was a requirement to try and constrain demand to below that level, or to that level. So, we see that movements are in total substantially less than they were many years ago.

We have acknowledged the possibility of congestion occurring at some point at Wellington and we have made substantial investments to prolong that point. So, we have aircraft, jet aircraft, we're in a five year programme to upgrade the capacity of each aircraft by 28% 13.45
which would cope with far more than the projected growth over that period of time. We've invested in ATR aircraft to upgrade the capacity of our turbo prop fleet, and so we don't see in the near term that congestion issues which might require peak pricing are going to occur at Wellington. But, in the meantime we have made these investments and now we're having a pricing regime which is changing on us, has a degree of lack of certainty about it and having made investments to deal with the problem that potentially could have occurred. 13.45

MS BEGG: So, you don't object in principle to the idea of congestion charging; your concern is a timing one?

MR WHITTAKER: At some point where Wellington is constrained to a single runway if demand continues to grow and aircraft sizes do not grow faster than demand, there is the potential for that runway to become congested. We think it's well short of that point at the moment so putting congestion charging on prices, if airlines respond to it, ultimately it may result in a loss of utility for consumers. 13.46

MS BEGG: And given how resistant people seem to be to congestion charging, you don't see that there's any element of benefit from Wellington starting this in sort of quite a slow way so it doesn't have to do it at any great rush, it can test it and see what the reactions are and learn from that? You don't see any advantages to -

MR WHITTAKER: So, I think that signalling that at some point when it's required the type of structure that it might take could be helpful, enabling airlines to plan with that degree of certainty, but I think that introducing it prematurely, as I said, risks loss of utility for consumers. If airlines responded by reducing the capacity in the peak, that reduces a lot of connection opportunities, reduces the chances of people getting to 13.47 the capital city when they want to. I think there are greater risks by premature introduction than there is by testing it out, if that's the hypothesis.

MS BEGG: I think Wellington make the point that if you were to apply efficient pricing principles, Ramsey pricing, and then pricing at the peak is one of the more obvious things to do and something that the airlines themselves do. So, you're arguing against congestion charging and if you're right, that's one thing but how do you respond to the argument that actually even if congestion pricing 13.48 wasn't just so, leaving a bit more of the charge at the peak is an efficient thing to do?

MR WHITTAKER: I don't think we've considered that argument because the prime argument that we understood it to be, or this particular pricing principle was a congestion pricing principle, not a Ramsey pricing principle.

MS BEGG: Okay, I'll get BARNZ because you have a slightly different view on congestion charging, you seem a bit more positive about it but I might be wrong there.

MS COOPER: I think we just recognise that from an economic 13.48 perspective there can be a time when it's efficient. So, I don't think that's really any different from Air New Zealand apart from they have more of an operational perspective and knowledge on whether it's required right now. A key issue of course is to make sure that congestion charges do not end up ultimately resulting in monopoly profits, that's something we are very concerned about watching going forward.

MS BEGG: Okay, Wellington any responses on that?

MR FITZGERALD: Thank you, Commissioner. The Ramsey pricing and efficient pricing has always been a significant factor in our arguments for moving to a peak/off peak pricing regime. They feature in all of our submissions and all of our consultation documents. So, look, I think 13.49 our arguments are very much two-fold. One, that congestion is a reality and is an increasing reality. We well and truly exceed low visibility usage already so it's not true that we're trying to constrain capacity back below usage below the low visibility capacity. Our key is we see congestion moving towards good visibility capacity in the relatively new term and are looking to introduce ways of introducing incentives.

I think Air New Zealand by introducing a larger seat capacity fleet on average does actually mean they'll be a 13.50 beneficiary of that and in fact we've come almost late to this issue and Air New Zealand has recognised that it needs to increase fleet size for capacity reasons. The two things aren't in conflict, they actually work well together and Air New Zealand is actually ahead of the incentive in that sense, but I think it's also important to note Air New Zealand is not the only airline in the market, and not only are we talking about the major airlines, we're talking about nine seat aircraft that seat capacity in our peaks, we're talking about general 13.50 aviation aircraft potentially, but certainly nine seat scheduled aircraft and others.

So, I think the proposition that Air New Zealand seems to be progressing, which is essentially let us manage capacity, well, again, they are one market participant and I don't think it's appropriate to leave the one market participant, albeit the dominant participant, the Government owned participant, I don't believe it's sufficient to leave capacity management in that guise.

So, the other point to make is I think again this very gradual approach we're taking, in fact on a unit basis Wellington's past prices have on a per passenger basis been far lower for small aircraft than for jet aircraft, and that's really the opposite, and what we're doing this 13.51
first stage is almost reversing a perverse incentive to get prices to be fairly consistent amongst individual passengers rather than moving to a point where there's large penalties for being on a small aircraft where economic efficiency may drive you to, but we're a long way from that.

MS BEGG: Just a question -

DR LAYTON: I just want to raise a point that's related to congestion charging and what we were discussing before lunch, essentially there being two regimes here, the 13.52
Airport Authority Act and the Information Disclosure Regime, because under the Airport Authority Act the airports are entitled to set charges as they see fit and they do have a degree of market power and in that environment congestion charging is likely to lead them to, in fact if they're setting prices on that regime, to actually want to constrain capacity because they have entitlement to keep raising prices for a congested charging regime. So I think that the regime of two things and particularly the AAA - 13.52

MS BEGG: Just to stop you there. Have you got any evidence that Wellington is not invested in capacity -

DR LAYTON: No, but as they move on, as in this regime, they certainly are raising their prices and you certainly will have, if they're allowed to set charges as they see fit, an incentive to in fact raise their prices at that congestion period, but there's no mechanism in the AAA if that's what's controlling price setting for ensuring that doesn't spill over into in fact getting excess returns and doesn't then even go forward and lead to an incentive which is there in that sort of regime to ensure you don't actually increase capacity as fast as you would in a workably competitive market.

MS BEGG: Do you see ID having some influence in that, 13.53
providing better information et cetera, if such behaviour were to occur?

DR LAYTON: It may provide that information if the information disclosure information does actually reflect the views about what would be the outcomes in a workably competitive market. But just putting out essentially under information disclosure, as is Wellington's approach at the moment, what its views should be, the appropriate answers under the AAA doesn't actually achieve that aim.
It's making its information disclosure broadly in line 13.54
with the Airport Authorities Act, not in line with the Commerce Act. So, it isn't actually making any disclosure about the differential between those two to the ordinary person, to interested parties other than the airports - airlines who may have the special information required to actually - valuations and so forth to make the adjustments themselves, but these are not available either to people who are not intimately involved but are still interested or for people who are in airlines but
not actively engaged in the airport at the moment. So I 13.54
do see that there's a problem in that issue.

MS BEGG: Wellington?

MR FITZGERALD: Commissioner, I think the key capacity constraint we're talking about, particularly in the

longer run, is runway capacity. I think if there's any disincentive to invest, I think then we need to firstly reveal what that increment in capacity we're going to invest in is. I think runway capacity in the Wellington region does have some elements to it that are competitive; you've got Air New Zealand operating particularly concentrated around peak periods in Paraparaumu, and so that is - you know, by pricing Wellington, in Wellington the peaks as in Paraparaumu, you do have some additional capacity that's being 13.55
incentivised at an airport that's not controlled by Wellington Airport. I think the characterisation under the Airport Authorities Act can earn excess profits through congestion pricing doesn't accord with the long run practice of a building blocks approach under the Airport Authorities Act, and really mirrored largely in information disclosure. It is about setting that maximum allowable revenue, and then what we're talking about is the recovery of that maximum allowable revenue, not changing the amount that we're seeking to recover. 13.56

So, I think it's an incorrect point to say there's anything in congestion pricing itself that is pointing towards us earning more revenue than under a scenario of a less efficient pricing structure.

MR WHITTAKER: One point that might be helpful is I think in an unconstrained runway the question is more about the appropriate allocation of costs to users based on how they generate that cost. In a monopoly asset, users should get the correct allocation of costs, and in a smaller users a much smaller runway footprint and 13.57
therefore it requires a much lower regulated asset base and probably the operational expenditure on that runway is lower because damage to the runway is lower because of being a lighter aircraft.

MS BEGG: So, that's true outside of peak hour but obviously in peak hour you've got the opportunity cost of the other -

MR WHITTAKER: Correct, historically in an uncongested time at an uncongested airport, an appropriate allocation to use is a lower cost for a smaller aircraft. In a congested airport opportunity cost becomes the key issue, and our contention and what we've said is that point hasn't been reached yet, and so to prematurely place those costs and prematurely rebalance the costs towards the smaller 13.57
aircraft is an incorrect allocation of cost until that congested point becomes reached.

MS BEGG: That's right, although giving the signal to parties can obviously be useful as well so people know the direction in which the business is going so they can plan.

MR WHITTAKER: And I would agree with you and I acknowledge that signalling the type of structure that might take place when that congestion occurred would be a useful thing, but actually imposing those costs on users who 13.58
shouldn't be bearing them I don't think is useful.

MS BEGG: Okay, I think we'll leave it there. We've got obviously clear differences in view as to whether congestion is an issue or not.

MR FITZGERALD: Can I make one further point of corollary is that by having higher charges in the peak, you have lower charges in the off peak. I think that's where -

MS BEGG: Good if that happens although it's not necessarily following I guess.

MR FITZGERALD: It must follow in the sense that if you have a 13.58
fixed maximum -

MS BEGG: If you have a constrained revenue, that's right.

MR FITZGERALD: In a constrained revenue, we do have any charges that are out of the peak not being - your point is if you were to accept, and I don't, that the issue that congestion is not yet a problem the Ramsey pricing principle mirroring airline yields in a very very modest way is of itself an improvement in efficiency.

MS BEGG: Do you have any feel yet as to how the airlines will respond to this peak charging? Do you think they'll - there will be a reasonable amount of responsiveness or will it be quite unresponsive demand to this higher cost?

MR FITZGERALD: Our expectation at the time, and it's been 13.59
some time since price setting and I'm now out of the executive running of the business, was that there would be very little response, and I think that is because we looked through to the airline yield models and effectively when you have, using just an example of a trunk service, Wellington-Auckland, when you've got peak period charges at $200 to $300 and you've got off peak charges at sort of $60 to $90, by changing the price by a couple of dollars in the peak you are not going to see the move, large amounts of equipment or capacity into a 14.00
period into which their ability to extract fare is far far lower. So, we didn't expect to see a marked change and I think that the same exists in regional services where the yield from those peak services is dramatically greater than the yield at off peak services. So, effectively you come back to the net impact at an Air New Zealand level primarily being a Ramsey pricing impact, and where we expect to see some of the more initial impact on capacity is that sort of nine seater smaller area, and the margins where people can move a bit. 14.00

So, it is very much, I would say, a toe in the water tentative move towards congestion pricing and not going to have a dramatic impact and our congestion numbers. I agree with the Air New Zealand analysis, that we've got a

few movements in the peak, you know, and it is a handful,
it may be three or four movements in the peak at the
moment that are spare so we don't want to chase people
out of the peak inefficiency, but we want to make sure
that the signal there that the right aircraft are using
those slots as they fill up.

MR SANDERSON: If I can add to Steve's point, there has been
some discussions with smaller airlines about moving some
of those nine seaters to 15 seater aircraft outside of
those peak areas. So, there are some behaviour changes. 14.01
Even though it may be only 30 minutes but those
30 minutes do help in terms of clearing the same asset
for a large A320 versus a nine seater.

MR WHITTAKER: Just for clarity, there is a risk that two
things are being confused here. One is peak pricing and
the other one is a pricing model which is shifting a
greater component of the costs to the smaller aircraft in
addition to peak pricing. So, both of those things are
occurring and I generally agree with Steve, that peak
pricing probably won't, to the extent that it's been 14.02
introduced, probably won't result in airlines doing much
different. The overall cost of the smaller aircraft
incurring higher costs in both the peak and the off peak
as that transfer to smaller aircraft in the name of
congestion, so moving from an allocation of true cost to
an allocation of opportunity cost, will impact on those
small aircraft and is likely to result in reduction of
services as those aircraft are no longer viable to
operate. So, again, our issue is around moving to a
congestion opportunity based model prematurely and the 14.02
impact that that will have on some consumers, it's a
different discussion regarding peak pricing and Ramsey
pricing.

MS BEGG: Is there any way of managing congestion, more

administrative means et cetera that you think Wellington
should be exploring along with perhaps the pricing
options? Are there any things that they're not doing
that they could be doing to delay this problem?

MR FORD: I think we're having discussions with a range of
sort of airports across the country, including with
Airways, and obviously Wellington is part of those
discussions, Wellington is one of the airports that's
involved in those things. I guess part of our concern
this time around was that we didn't feel that those 14.03
discussions had really progressed to a point whereby we
had exhausted all potential opportunities and we believe
there are still operational things that can be done to
increase the capacity that's available, amongst other
things. In terms of actual details of what those might
be, happy to come back to you on that.

MS BEGG: Okay.

MR FITZGERALD: We agree pricing signal is not a magic bullet
for congestion and we are trying - we have many
initiatives underway to try and extend the capacity of 14.04
the runway and its allocation. Economically more
efficient pricing is only one of them. The collaborative
decision making that Steve spoke about at the start is
another where we try and make decisions jointly with
stakeholders, and Airways is a participant in that and
we've got an initiative underway where, I think now it's
already happened, that Airways has team member sort of
planted with our team. So, the tower has a major role to
play, Airways corporately has a role to play, of course
Air New Zealand has very strong role to play, all of 14.05
that's absolutely necessary, we're committed to all of
it, but we think economic pricing is another tool and
useful as well.

MS BEGG: Okay, I would like to then - I'll just check with

staff whether there's anything in the interim. (No questions) - move on to the common charge for domestic and international passenger use of terminals, and Wellington has submitted that this is justified because the domestic passengers will use the north pier as volumes increase but we have BARNZ, for example, saying, noting that domestic passengers are much more straightforward and cheaper to process and they use significantly less space to process, domestic customers rather than international ones. So, obviously this is an 14.06
area where we would be interested in a bit more feedback on the justification for levering the same charges on domestic and international passengers for terminal use.

MR FITZGERALD: I think a couple of points to make are that domestic passengers already use the northern end -

MS BEGG: To what extent? I'm interested.

MR FITZGERALD: In the domestic peaks, daily. It's in constant, you know, common use is the northern pier. So, I think we've got Air New Zealand with a strong preference of using the southern pier and sort of wanting 14.06
to almost carve up the airport in a domestic/international sense that frankly can't exist and doesn't exist within Wellington Airport's footprint. That will increase over time.

I think we probably are no longer taking cost reflectiveness to its third decimal place in trying to work out price because we've adopted in the current pricing an overlay of more efficient pricing as we've just discussed, which by its very nature is not related to operating cost or the amount of capital. So, you also 14.07
can't have the two things exist together otherwise you don't end up with a solution.

That said, you know, Wellington Airport is highly efficient in its asset utilisation because of those swing gates. So, an international airline is not paying for an international gate that is only used for international, and the domestic operators are not paying for a gate that they use a couple of times, a gate exclusively because international operators also contribute to the cost of that same area.

On the point of complexity of international travel, while there are some extra processes, at Wellington at the moment we are talking about trans-Tasman travel which frankly is relatively straightforward. As a regular 14.08
trans-Tasman traveller I'm a baggage free trans-Tasman traveller and I think we have an efficient process and use of facilities, we're not talking about some of the long haul travel which unfortunately Wellington doesn't get where you see people with large amounts of baggage and more difficult processing arrangements.

So, in summary, we believe that the common terminal charge is a fair and reasonable approach to pricing within a framework that's looking for more efficient pricing signals than average cost reflectiveness. 14.08

MS BEGG: Air New Zealand or BARNZ?

MS COOPER: When BARNZ was consulting with Wellington Airport and preparing this cross-submission, you know, I went back to the airlines asking when are domestic operations using that international terminal facility and the operational people were scratching their head, they couldn't honestly remember. Maybe it's going to be changing over time but we just don't believe that there is sufficiently common use to have that entire new Rock terminal, which was consulted on and portrayed as being 14.09
an international development, to be allocated to the domestic activities. It just doesn't seem an appropriate allocation of costs. Our experience at another airport which has had swing gates for many many years is that the

airport looks at the use of them and then apportions it and the swing gate is allocated 80/20, I can't remember which way but we've always found that quite reasonable. For Wellington's approach to just say the whole terminal is common, rock stock and barrel is unreasonable because when do domestic passengers go through the MAF facilities, when do they go through the customs facilities, when are they actually going to be using those lounges that are air side on the international operation, and if there is going to be any domestic use 14.10 it's going to be at the very small time when international operations aren't occurring and it's also going to put extra costs on to airlines because of aviation security costs, because aviation security is going to have to go through the area and make sure the area is secure and clean.

So, I think the airport practice is quite extreme and hasn't reflected an appropriately balanced and reasonable allocation of costs.

I have a note here, out of interest, this is an area 14.10 where what BARNZ is looking for is an appropriate allocation of costs, and this is an area where ironically we're actually - by applying that principle we're actually looking at having the international charges be higher than the domestic for the use of this terminal space, but we believe that it's important to take a principled approach.

MS BEGG: Has Air New Zealand got anything to add?

MR WHITTAKER: I think we would agree with all of those points, that it does seem highly inappropriate that 14.11 something can be built for one purpose and immediately charged to users who don't use it, in a few years of the major investment being made.

MS BEGG: Something I find useful when Wellington comes back perhaps with its cross-submission, I think there's a distinction drawn between cost allocation approach, which I think is what the airline is talking about, and efficient pricing which I think Wellington is talking about, and there seems to be between those two different things, there's different views being expressed. So, I would find it helpful if someone could spell out how that works.

MR FITZGERALD: And Commissioner, it is a hybrid because it has to be a hybrid. We've not moved away from cost 14.12 reflective pricing in its entirety but we have tried to introduce some elements of economic efficiency which don't lead you down average cost, average attributable cost. So, we have ended up with a hybrid, so you won't find a purity of either model in our pricing. I think, you know, the northern pier development was designed from day one to be swing gate and to be multi-use, so it's not correct that it was designed as an international terminal. The record shows, we've submitted in the IM process all of the documentation, all of the meetings 14.12 that BARNZ and Air New Zealand attended, you know, we note that the incentive of shifting costs between international and domestic is one that favours Air New Zealand to make international more expensive. Wellington has historically had a disproportionately high international charge with a $25 departure fee, which was not cost reflective, on to international passengers. We are gradually moving to a pricing outcome where passengers that essentially receive the same utility of use of the airport are paying roughly the same amount. 14.13

MS BEGG: Is there a Ramsey element - I think I might have read that in Wellington it's less of an issue, but perhaps in other airports the international travellers might be less elastic, but I think I read that wasn't the case in Wellington.

MR FITZGERALD: And that's almost, you know, an international IKO principle that you should subsidise domestic travel with international because international travellers have a high propensity to pay, but I think Air New Zealand and other operators operating out of Wellington would say the Tasman is highly price sensitive. You would regularly find it's cheaper to fly to Sydney than to Gisborne out of Wellington, and therefore I don't think that Ramsey elasticity argument exists between international and 14.14 domestic at Wellington. I think you actually find less price sensitivity on regional and - you certainly find less fare competition on regional routes than you do on trans-Tasman routes where price is quite a significant issue in the capacity put on by airlines.

MS BEGG: Okay. I'm just conscious that we're running out of time -

MR WHITTAKER: I disagree that the Tasman has different price sensitivity than domestic, for some individuals there are individuals who fly on the domestic routes who are not 14.14 price sensitive, but also there are some individuals who are highly price sensitive, particularly because the airfare is 100% the exponent of their expenditure, going to visit friends and family, whereas on the Tasman tends to be a much lower portion and the customer is wearing the entire journey cost rather than just the airport cost in total.

Secondly, I get very uncomfortable about characterising this as a potential Ramsey pricing argument rather than a cross-subsidy of users argument. 14.15 I think that there should not be large cross-subsidies between one group of users and others, and that protecting the long-term benefits or providing - looking after the long-term interests of consumers requires that

that's not the case.

And lastly, I want to make it clear that we're not trying to encourage Wellington into inefficient operations. If it's efficient to use those assets more and to gradually use them more for domestic, we fully support that, we only ask that the costs are reflected appropriately as that starts to occur rather than this sudden one terminal approach which cross-subsidises.

MS BEGG: I think you have to use the term "cross-subsidy" carefully but perhaps we'll just move on to my last 14.16 question, which is, well, Wellington has changed its pricing methodology quite significantly. I was just going to ask Wellington whether that had anything to do with information disclosure, the changes there, or is it just something that you decided was a good thing to do? So, has the information disclosure regulation influenced the way you've set your prices and the process you've followed through with the airlines?

MR FITZGERALD: It's hard to single out the significant impact of information disclosure but my opinion is that the 14.16 amount of focus, attention, resource that's gone into regulation and pricing at Wellington Airport over the past four years has been a significant factor in how carefully we've looked at this area, and, you know, the expert reports and consultant reports that were done as part of input methodologies, we started looking at price structure as part of the IM development and in fact it was really out of scope of the Commission's information disclosure but you may recall we got some external studies done and we did some external benchmarking on 14.17 efficient pricing to feed into an argument about the wider role of Part 4, and that really did help inform our thinking about price efficiency and where we were going.

I mean it's a bit of a hypothetical question to say would we have done it without information disclosure in price structure. We certainly could have, whether we would have put quite the effort and input on to it, you know, it's hard to say. I mean I have to say a few of the concepts are things that individuals, including myself, have brought from experience in other airports and having done similar things elsewhere and the involvement we have at, you know, in other markets. So, there's elements of a change of personnel as well.

MS BEGG: Sure. And Air New Zealand or BARNZ, anything you 14.18
would like to comment?

MR WHITTAKER: No, thank you.

MS COOPER: We haven't found the information disclosure inputs to have had very much impact at all on behaviour of Wellington Airport as it sets charges and in its pricing consultation.

MS BEGG: I'll just check whether any further questions -

MR SANDERSON: Commissioner, if I could just add, as the late entrant into pricing disclosures for Wellington Airport,
almost joining Wellington Airport probably three weeks 14.19
before the pricing disclosure and therefore consequently the pricing and information disclosures, and coming from another airport where we were also going through a pricing event, when I did join Wellington Airport I was pleasantly surprised about the process that the information disclosures was having an effect on the considerations against the pricing event, and many sub-committees were set up with Steve as Chair and other directors, on parts of other risk management as well.
So, it was quite a thorough process and the information 14.19
disclosures certainly had an impact, in my view, on the pricing event with our consideration against the methodologies.

MS BEGG: Thank you.

CHAIR: We're now coming to the last session which is going to have questions around a range of different topics including the impact that information disclosure has had on conduct and processes, the role of impact summary and analysis and the Merit reviews, and finally whether some wider information disclosure requirements may be appropriate, and my questions are going to trace in some parts matters that have already been canvassed today but we'll see how it goes, but you'll be able to abbreviate answers to some of these depending on how we've gone. 14.20

Can I just start by making a statement simply about the context of this hearing today and where our report is heading.

Section 56G requires us to report to the Ministers as to how effectively Information Disclosure Regulation is promoting the purpose of section 52A in respect of the specified airport services. It seems to me, hearing the parties' views today and reading the submissions of parties, the airports and the airlines are coming from very different legislative perceptions and histories to 14.21
this.

Airports are saying that, you know, there was no identification of a problem and that shadow regulation was never intended, and we have full submissions on that in the course of the input methodology hearings and we've heard the airports touching on that today.

In contrast, the airlines are pointing to parts of the legislative history that identify that some kind of price effect was anticipated to be likely as a result of this new Information Disclosure Regime. And it seems to me 14.21
that when we report back to the Ministers we have to make an assessment of two worlds, one with and one without Information Disclosure Regulation, what if any difference has occurred as a result of that.

I'm hearing today that there's been a lot more transparency of information and BARNZ has made a concession in part that that has been useful, but can I just start by almost following Sue's last question and testing with the airlines. If we move to the crucial matter of what has changed in terms of conduct in the price setting event, you know, BARNZ and Air New Zealand have said that this negotiation started out at a false high price, that the concessions made so-called commercially were not bona fide commercial negotiation 14.22 concessions.

Can I just get a feel for how you would view the difference with information disclosure as opposed to the world without it under this latest price round in relation to how you went about the commercial consultation/negotiation.

MS COOPER: I think that Wellington Airport has engaged in more consultations I think than any other airport under the Airport Authorities Act regime, so it had a very good pattern for how to go about consultation. So, I don't 14.23 actually think there was any greater information disclosed to the airlines during the consultation process than there would have been otherwise in the absence of the information disclosure. I mean I think the difference has been that with the requirements to provide additional information to the Commission, you know Wellington Airport made the decision to put its information on the website and make it available to the public. So, I think that's the difference. There wasn't actually any additional impact I think during the 14.23 consultation process, it's more that it was more widely available to a large group of people should they wish to look at it.

CHAIR: So, your view is that there was no change in terms of

this latest price setting event --
MS COOPER: No.
CHAIR: -- compared with the world without disclosure regime?
MS COOPER: No, I don't.
CHAIR: Did you find the airport had the same negotiating position, the same position on market power to impose prices -
MS COOPER: Yes, adopted the same position, that it was consulting, it had the right to set charges as it sought fit, the Airport Authorities Act obtains an obligation 14.24 for it to act commercially and therefore it says it has no choice but to set prices at as high a level as it can do.
CHAIR: So, this new regime did nothing to reduce the level of cost negotiation, it did nothing to reduce the level of dispute that might have arisen between the parties?
MS COOPER: We entered consultation with the hope that it would have reduced the level of dispute and with the hope that obviously with reducing the level of dispute it would reduce the costs, and that was the basis upon which 14.24 we instructed our advisors. It was always the Commerce Act principles are the starting point. You then look at those to see if there's any valid reason to depart from those in the context of prices being set as opposed to the information disclosure set by the Commission. But no, that didn't work out in reality. The airports, I could go so far as saying disregarded the Commerce Commission principles, but more in fact it was they spent a lot of time finding reasons why they could not follow them, I think would be a way of characterising 14.25 the Airport's approach to the input methodologies.
CHAIR: Would Air New Zealand like to add any comments?
MR FORD: No, I think that summed it up quite nicely.
CHAIR: Can I ask Wellington Airport how they see their

conduct in this latest price setting round and why they think conduct may be different under Information Disclosure Regime?

MR FITZGERALD: Thank you, Chairman. The conduct in the price setting process was demonstrably different as a result of information disclosure. One thing, and I don't think it's been in dispute, we changed our asset valuation methodology to use an opportunity cost approach as a basis, and then we have isolated the difference between the Airport's view on the appropriate basis for setting 14.26 price and the Commerce Commission's view of asset valuation for information disclosure. So, I think that there is absolute clarity about the difference, both numerically and from a process perspective. I think essentially we've ended up with quite a narrow band of differences between the Airport and the airline view.

We've heard today effectively nothing specific on operating costs other than, like to go back to a low water mark benchmark, but no specific issues with the cost structure, no really specific issues with the 14.26 capital structure, there were no specific issues with the optimised depreciated replacement cost of major assets, there were no specific issues with traffic forecasts as at that stretched mark, and we came down to the holding period for land and a couple of parameters in WACC being the difference and information disclosure actually narrowed that difference. I think one of the negatives of information disclosure and this process, and potentially the section 56G process, was that it sort of characterised those discussions with a view to addressing 14.27 comments to the Commission rather than addressing comments genuinely in what we would have liked to have been more a two-way dialogue with the airline, well, with Air New Zealand and BARNZ bringing specific different processes, sort of win/win proposals to the table. Really, I think we had an element of stifling of debate through information disclosure because it was very much around you're ignoring the Commission's input methodologies therefore we're going to go and tell on you to the Commission and we'll get more price regulation out of it. That has been a bit of regulation gaming that has had a negative uncertain developing regime alongside what was a regime that was working well for the industry.

We have got an industry with good investment. We 14.28
heard today no problems of quality, quality for consumers, prices are benchmarked in line with industry peers. This is an industry in good shape; not taking up public funds, providing good quality services, and what we've now got is a regime that has been characterised a little bit in this what I hope is a relatively short period of time in the long run view of assets, that there's a bit of game playing going on, you know, facing the Commission, and sort of inhibiting the dialogue between basically the sophisticated customer/supplier 14.29
relationship.

CHAIR: To what extent, if any, did the prospect of this section 56G inquiry have? Was that a factor that in any way conditioned your conduct in this latest price setting round?

MR FITZGERALD: Yes, look, I think you made the point sometimes about shadow regulation. Look, I think airports have always been subject to shadow regulation. The Airport Authorities Act was shadow regulation and I don't think we object to shadow regulation in the sense 14.29
that if our conduct is demonstrably unreasonable - we acknowledge we have market power, if our conduct is demonstrably unreasonable then there will be processes that are gone through to relook at how things are set.

The reality is that that shadow regulation that existed under the AAA has been effective and has moderated outcomes. Information disclosure has provided more transparency and more moderation of outcomes and this 56 review, 56G review is also part of that shadow regulatory regime where we know that our conduct is under detailed scrutiny, and we believe that we are incentivised to act reasonably and we believe we have acted reasonably in that context. So, I think that's okay.

I think where we've - where I think our problem has 14.30 been is the sense that we were expected to be acting as though we were under price control by effectively putting ourselves under price control by using the regulators IMs specifically in pricing so the impact was direct price control. Shadow price control, you know, is accepted and I think has been effective for a long period of time. The scrutiny level has increased, the processes have increased, and therefore the level of shadow price control has increased and I think our behaviour in price setting has been reasonable, has been open, has been 14.31 transparent and we've come out with a fair outcome.

CHAIR: Look, I'll move on to some further questions about our summary in an analysis reports. Just before I do it I'll pick up on one matter that was raised by BARNZ that I want to explore a bit further; that is, why does Wellington Airport include an estimate of its litigation costs as part of its costs base, given that, you know, you're not just talking about Merits review but, as you'll know, you've extensively engaged in Judicial Review in other proceedings? So, I think BARNZ expressed 14.32 a view that ought to be a shareholders' cost but can you just take me through what you're rationale is in including that as part of your capital base.

MR FITZGERALD: It's a cost of doing business in this

regulatory context. Talking about Judicial Review under
the AAA, we of course have never instigated Judicial
Review, we've defended legal action and that is a
pattern - and we've successfully defended it but it's
been an expensive exercise and it's a pattern of
behaviour that I think is predictable as the cost of
running an airport business in New Zealand under the
current regulatory settings.

So, if you took the opposite view, that shareholders
are allowed to earn an appropriate risk adjusted return 14.33
on their investment minus costs of litigation, then you
would have no investment because returns would fall short
of what is required to invest in the business. So, I
think it is like, almost like taxation. It's a
predictable cost, it is a cost that will be borne through
the business. If we're in a workably competitive market,
firms that don't recover their costs and their cost of
capital in responsibly doing business, go out of
business. So, I don't see why litigation, predictable
litigation cost, you know, in reasonably protecting the 14.33
company's position should be treated any differently to
any other cost.

CHAIR: Would BARNZ like to reiterate their point on that?

MS COOPER: I think it just means that because Wellington
Airport - Wellington and Auckland and Christchurch
actually, are forecasting these costs into their
operating base, they've got no incentive to actually
conduct that litigation efficiently or perhaps sit down
and make a reasoned decision as to whether it's cost
effective in proceeding in that particular matter. They 14.34
know that they will cover their costs in the Merits
review, the airlines have to pay the airport Merits
review costs, an airline which chose to participate in a
Merits review has to pay its costs as well. And then -

well, the airport's effectively granting itself costs without waiting for the outcome.

CHAIR: Perhaps if we can take further written submissions if parties wish to make them on that point, that will be helpful.

Just turning to summary and analysis requirements under section 53B(2), and these are questions which I'll put first to Wellington but I'll also invite the other airports to respond to it given that they are issues that they have raised as well. 14.35

Wellington Airport has argued in essence that we should have done section 53B analysis before we in fact held this section 56G inquiry, and Wellington Airport also suggests that summary and analysis reports may encourage behaviour change by the airports. As I read your submission, this is one of your platforms, if we had done these in the other order and done our section 53B analysis first, things may have been different. For example, I quote two parts out of the Wellington submission stating, if the Commission identifies areas of 14.35 concern in its summaries, then airports may wish to take action to address those concerns.

That's in your submission of 29 June followed in the same submission by a reference to saying that there is a prospect of self-initiated behaviour change in response to these reports.

Can I just start by getting from you what your view is about what our summary and analysis reports are likely to cover or what they should cover?

MR FITZGERALD: Chairman, if you'll indulge us, could I 14.36 possibly ask you to reverse the order and maybe ask the New Zealand Airports rep to respond first, if that's okay.

MR SHRIVE: Just in terms of a general position on section 53B, well, it's in part legal analysis but in part, think about where they fit in the regime in the context of this review. So, in essence, the review is about the effectiveness of information disclosure and I suppose our position is those annual summaries are an important part of the Information Disclosure Regime, so it makes some sense that those should be given an opportunity to work in terms of making a regime whole and reporting on its effectiveness.

CHAIR: My question was, though, what do you expect the reports to contain? 14.37

MR SHRIVE: I'll come to that point. So, I suppose there's no prescription, well, there is a prescription but no set prescription in the Act as to exactly what they contain, but as pointed out in Wellington's submission we would expect that in going through the information, if the Commission had identified concerns both in the way in which disclosure was being made and/or had observations and particular aspects of performance, then it would be free to say so and I think as Wellington Airport's 14.37 submission has said, then that could be a good or effective tool for airports to consider whether appropriate performance measures are required in response, and just to conclude that, that seems to be a core component of the way an effective Information Disclosure Regime might work.

CHAIR: Okay, well look, I would have to say we're still exploring a new regime and it's not abundantly clear to me what the marked differences may be between summary analysis and what we're doing under section 56G, but if I 14.38 can just take up Wellington Airport on that quote that I've just taken from your submission. Say we put out a section 53B(2) report which identifies what we see to be some kind of problem, in other words we reach a view, and

I'm not saying we have reached any views but let's say we think that information disclosure is not actually promoting the purpose of the Act in some material respect, such that, for example, problems with asset base and WACC for example cause us to reach conclusions that you are engaging in excessive pricing.

Now, are you going to do anything in conduct terms in response to that?

MR FITZGERALD: We could and I think that's - we don't know what we don't know. Our interpretation of the, as we've 14.39
talked about, this parallel two regimes, and the fact that they do both constitute shadow regulation and we are cognisant of frankly everything the Commission says in that forum.

Now, we have set prices for five years. As it happens, you know, we are currently running behind in terms of traffic forecasts and other elements, but initially I think we put forward disclosures that show returns that we believe based on the Commission's prescribed asset base are well below our cost of capital. 14.40
So, I suppose we would be surprised if the Commission could draw a conclusion from that, that in relation to those disclosures there was any problem with the level of price that existed during those periods. But we're very aware that we're talking about five sub-parts of the purpose statement, so when it comes to quality of service, when it comes to innovation, when it comes to investment, those things are an ongoing point of discussion. We have the collaborative decision-making forum. So, I think we are looking for - well, we don't 14.40
know what those will contain and that's just an open question, that it's part of the regime, is that there will be reports and we're not aware of the content, but to the extent they provide guidance and views on various

elements of that, there are opportunities for self-initiated behaviour change which if those reports came out, if there were suggestions of issues and then we could respond to it, your 56G report would be informed by those steps.

CHAIR: So, how would the self-initiated change happen? You know, you've set prices for five years so you would reopen the contracts, for example, if we identified a problem?

MR FITZGERALD: Well, I think you're talking about one of the 14.41
five sub-parts -

CHAIR: I understand and we do fully understand the cumulative effect, but just for argument's sake, if we can just go through and take, say, the issue as to the price component and let's say we have some concern and you now say you're going to have some self-initiated change, what I want to know is if we were to do that, how and when would you go about the self-initiated change?

MR FITZGERALD: Chairman, I think that's a little unfair a question in the sense of - 14.42

CHAIR: I'm simply responding to what you've said in your submission. You're the one who's raised the issue of self initiation.

MR FITZGERALD: Our issue is, well, in fact I think we've also acknowledged that the Commission has a challenge set by the legislation and the timing of 56G is not of the Commission's choosing, we acknowledge that and we understand that, but we also, in acknowledging that challenge note that the regime is developing, so we don't know what we don't know. The regime is in its very early 14.42
stages and the 56G is asking for you to opine on the effectiveness of the regime before all the components have really been put in place.

CHAIR: I'm actually talking about the 53B reports which we do yearly, as I understand it, so let's say in year 2 we do a 53B report which raises a concern which may raise on your analysis a self-initiated response. My point is how - I mean are you going to reopen the contract?

MR FITZGERALD: That is an avenue that is possible under the Airport Authorities Act regime. It's also possible that it would feed into a five yearly, into the next price setting regime because I think we are talking about long-term behaviours. It's also our desire over time that we have commercial agreements in place that 14.43
supplement that pricing regime. So, we have a number of tools available and we will be looking with great interest at what those 53B reports say, but if you're asking me will we treat a 53B report as being a price control report and reflect through exactly what you want us to do by way of cost of capital targets, I think that's probably unlikely, but I suspect your analysis will be more fulsome than that and it's very difficult to predict what it would say.

CHAIR: I've got a follow-on question which is much on the 14.44
same theme but you've made much of the fact also that this is premature in light of the Merits reviews and we've set out reasons why we believe we must still proceed with this inquiry today notwithstanding that position, but let's say, you know, by year 2 or 3 the High Court delivers its judgment and they either uphold the Commission's WACC, for example, or deliver a number which is at variance with the one you are using, what would your self-initiated response be against that scenario? 14.45

MR FITZGERALD: Well, by that point in time we'll have some actual measures of actual performance because where we are at the moment is we're predicting a return, and as we know for 2011/2012 we predicted 8% to 9% and we earned 6%. So, we will have a series of data points that differ from these prospective data points.

I would also make the point that information disclosure when it comes to cost of capital, we still don't see that the benchmark being established in information disclosure for the Commission to use against actual returns is necessarily the right return on capital for an individual firm's pricing consultation and decision. But, as I said, I don't want to prejudge the company's response to what I'm sure will be a much more thorough outcome - 14.46

CHAIR: Let's assume in three years' time you've got this much fuller level of data, much more accurate feel of what the returns are looking like. What if that level of return you have achieved at that point is looking out of alignment with the High Court ruling, what's your reaction and response going to be to that?

MR FITZGERALD: Well, we'll also have the Commission's analysis of what that return is. If the question is, will we apply a High Court information disclosure WACC retrospectively or into an early change of pricing and reset prices, I don't know the answer to that. I think that's a decision for the company and the board taking into account all of the information available to the company which will be the Commission's views, the High Court's views and actual performance in that period, and I think for - you know, we've gone through a period of under recovery. I think what I also note is that a cost of capital should not be seen as a ceiling on returns, it should be seen as a return that is fair to earn on average over time. So, we may be at a point in the cycle, and it may be that the best time to revisit those returns is in the next detailed price consultation round with airlines rather than try to immediately adjust 14.47 14.47

to a pin point estimate. But again, it's highly speculative.

CHAIR: Would either Auckland or Christchurch wish to comment on any of these matters?

MR SPILLANE: I put my hand up earlier but Mr Fitzgerald made some of the points I was going to make but I think I could help you with one or two examples of where we have in the past undertaken a self initiated change to our prices. One occurrence was during the Asian crisis when we elected not to proceed with changes in our pricing 14.48
which had been consulted upon and were set to be taken, and we did that in reaction to the effects that crisis was having on the industry and in particular our airline customers and the travelling public. So, that's an example of where we do do that.

Mr Fitzgerald has identified we could reconsult and the Airport Authorities Act does provide for that and we have the machinery with which to do that rather quickly and efficiently and we have, in fact, done that consultation on international pier B in the past where 14.49
we've worked with airlines to get a project underway in a way which I think the parties were relatively comfortable in the end. So, we do have the flexibility to deal with those sorts of things. It does concern me, though, to hear in a continuing way the conflation of the Information Disclosure Regime and the input methodologies with price control regime, and the sorts of language which lead to that type of conclusion I think are going too far to what the regime was intended to initiate.

CHAIR: Christchurch? 14.50

MR NICHOLS: Mr Chairman, on the topic of what would be in the 53B reports, I mean that's a good question and something that we'll obviously focus on a bit more in the cross-subs. I just recall back at the 2009 conference

when we were sort of turning our mind to this and I think at the time we were saying we see those reports as being a really important part of the process of the regime once this thing beds in and we have been highlighting I think quite consistently the risk we see in the sort of annual snapshot that will come from the information disclosure reports. Christchurch feels that quite acutely having just made its large investment and having to think about how it's going to recover that sensibly over a long period of time. The regime coughs up these information 14.51
disclosure reports which are meant to inform all stakeholders about how the company is travelling. It's going to be an annual snapshot out of a 20/30/40 year business. So, the commentary that the Commission wraps around that at the end of each year is going to be really interesting and really important to make sure that you feel that stakeholders are taking the right things out of information disclosure reports. We're probably not going to agree with everything that you say but I think that that's going to at least be a much more mature informed 14.51
discussion each year, and then when you think about that running in parallel to the pricing cycles again it's going to get quite interesting and be quite a three-way conversation as we head into - you know, as we head into each sort of five yearly reset, and you'll be making some judgement calls about what issues you put on the agenda I suspect as we go along, and also how definitive you feel you can be after two reports, three reports, four reports.

So we say, look, all those things lie ahead of us and 14.52
it's going to be a really interesting three-way discussion, you can feel it coming, and so, you know, we absolutely - but at the same time if the alternative is these abstract snapshot yearly information disclosure

reports with nothing else wrapped around them, then that's, from the Airport's perspective, that's as much a risk, so we're up for that conversation but we do see that's going to be a rich part of the framework going forward.

CHAIR: Thank you. Would either BARNZ or Air New Zealand like to make any comment on that topic?

MS COOPER: I think not so much on the content of the 53B reports but just to emphasise that we see, we strongly support the Commission proceeding with the 56G review as 14.52
soon as practicable which we believe is now in the case of Wellington Airport.

CHAIR: Thank you. Okay, look, I've just got one more last question and it relates to a BARNZ submission, that we should consider whether information disclosure needs to extend to other services outside of aeronautical services, and the suggestion is that we should do this under section 56A, and it seems to us that this would be technically outside of the current section 56G inquiry but the question still remains whether we should consider 14.53
this issue under section 56A, and if BARNZ could just very briefly articulate precisely why they think we should do this, that would be informative for us to take into account.

MS COOPER: I think one can approach this question in two parts. First of all, in terms of assessing the effectiveness of information disclosure on promoting the long-term interests of consumers one needs to look at whether the current definitions of the specified airport services are appropriate, and of course they were 14.54
developed ten years ago, and so there's I think quite a timely question whether they actually need to be updated. A classic example of course is all the new IT infrastructure and we have WiFi networks in all three

bag halls at the airports which are essential facilities
for the airlines to carry out the regulatory requirements
in the bag hall. Now, those costs are not monitored and
they're not reviewed. So, there's the question, yes, of
updating the current three specified airport activity
definitions. Then there's also the related question for
passengers, for consumers coming to the airport they're
not just paying for the costs of the use of the
aeronautical facilities, they're also paying for their
carparking or for the taxi access charges and those are 14.54
quite large sums which can in some cases be more than the
cost of travel for a passenger, and in Australia we note
that the ACCC now regularly monitors those land transport
action costs, so we think it's actually an important
issue for the Commission to just turn its mind to.

CHAIR: Would Air New Zealand like to add to that before I
hand it to Wellington Airport?

MR WHITTAKER: No, I think we agree these are related services
which are closely linked to the supply of services, so
the returns on the related services, given some of the 14.55
issues we've raised, are appropriate for the Commission
to consider.

CHAIR: I'll invite Wellington Airport and any of the other
airports who may wish to respond given it is potentially
a common issue.

MR FITZGERALD: Thank you, Chairman. One of the points you've
made at the outset is that there wasn't a case made for
the inclusion of airports in Part 4 in a traditional
regulatory review context. The Treasury noted at the
time that the industry appeared to be working well, the 14.56
regulatory backed assessment unit noted that the
Government did not go through the normal processes to
increase the regulation on airports. We're now in a
forum where we're not having, essentially not having had

the current level of additional regulation tested or justified we're now talking about, now the proposition is that we extend the regulation further. I think that is quite rightly outside the scope of the 56G report and unnecessary. I think if you go to the specifics of what's the cost of travel to a passenger, then the Commission will have to be taking into account taxi pricing and airfares, and I think to separate out just the bits that are competitive within, and contestable within the airport boundaries I think actually a large 14.56
part of the cost of travel for many consumers is their airfare, and in a market where in many point to point journeys there is no choice. So, look, we're not calling for regulation of regional airfares but I think there is a stronger case for regulation of regional airfares than there is for regulation of commercial services at an airport.

CHAIR: Do any of the other parties wish to respond to that?

MR SPILLANE: I have only one thing to add to Mr Fitzgerald's point and it is simply that the dual till regime that 14.57
New Zealand airports have been operating under since the establishment of commercial airports in this country has actually delivered airport infrastructure which really is second to none on an international basis providing the level of service that consumers wish to have and one where you don't get the sorts of infrastructure failure that we see overseas and we have seen in other now regulated industries. So, I don't believe that the dual till regime is one that is not serving New Zealand well, and I think in fact quite the contrary, it is serving 14.58
New Zealand extremely well.

MR COCHRANE: Chairman, from Christchurch's perspective I would like to add my support to comments made by Charles and Steve. I believe the dual till system is working very well, Government determined it would stay in place and therefore I think it would be incorrect to extend the jurisdiction of 56G.

CHAIR: Thanks for those comments. As I mentioned at the start, we don't see 56A as a matter that is on the agenda today, I just wanted to get comments while we had the benefit of your attendance here today. Do we have any questions from the staff on that? I've run a little over time. I'm not quite sure what appetite there is going to be for people to come back and make closing submissions 14.59 or whether you may be satisfied just to do written cross-submissions, but if I can just take questions from staff and then we can try and agree a timetable for the rest of the day after we've done that. (No questions from Commission staff). Can I just get an indication whether any parties do wish to make presentations by way of summary orally today to give emphasis to key points, or whether you may be happy just to exercise the cross-submission right?

MR SPILLANE: The airport is comfortable with 14.59 cross-submission.

CHAIR: Due on 17 August.

MR SANDERSON: Wellington Airport would like to do a presentation following afternoon tea, we've brought Kieran in.

CHAIR: That's fine.

MR WHITTAKER: We didn't make comment on some issues on the way through, we would like to attend then.

MR COCHRANE: And Christchurch would like to make a brief comment, Chairman. 15.00

CHAIR: What's a reasonable time to break for you to prep for your responses? Is half an hour adequate, if we came back at 3.30, would that work?

MR FITZGERALD: Make it shorter, Chairman -

CHAIR: Let's come back at, say, 3.20. Thank you.

(Conference adjourned from 3.00 p.m. until 3.17 p.m.)

CHAIR: I think we can make a start for this final closing session. If we can just note for the record that there is a new participant at the table, Mr Kieran Murray in attendance for Wellington International Airport.

MR SANDERSON: Mr Chairman, if I may invite my friends Air New Zealand and BARNZ to go first and then maybe we can finish with a presentation and possibly be a little bit more lighthearted. 15.18

CHAIR: It's fairly lighthearted today as it is. I wasn't sure what the batting order would be and I actually looked at the agenda and wondered if we had done that batting order for some reason, but I'm happy to go with that, Air New Zealand and BARNZ, followed with the other parties if that's fine with you people.

MR WHITTAKER: Sure, thank you for the opportunity to make a brief presentation. I think that when we think of the genesis of today, that it starts with the fact that Part 4 of the Commerce Act was introduced and airports 15.19
specified services were included in that because by definition it is a monopoly supplier making a monopoly supply, and that's what Parliament determined when it decided to put that into the Act, and that in putting it in there, it was to protect consumers from the potential of monopoly pricing impacts bearing on consumers, and our expectation was that Part 4 and the threat of the 56 or the process including the 56G process would make a difference. As Vector I think said in its submission, you know, this is part of a regulatory regime which also 15.19
includes the threat of price control, and we expected that we would see differences both in process, in the nature of consultation, and in outputs which reflected the fact that the ID regime now existed and unfortunately

we don't believe we've seen that, neither in process, in inputs or in outputs, and so the results are very much as we have seen in the past. I find it quite unusual that there is a suggestion that the expectations of Wellington Airport were not very clear and that they should have further time to engage in what must be externally directed self-motivated behavioural change. I think that the input methodologies are the clearest expectations that could be communicated to Wellington Airport and that a 53B review commenting on variances to 15.20
the input methodologies is no clearer than having the input methodologies that had extensive consultation, extensive discussion at the time, I just fail to see how anything could be clearer than they were as a pathway to guide Wellington to the right point, and I look at where we've ended today, where Wellington Airport has reasserted that they have acted reasonably and that the outcomes are reasonable. It's very clear that any light that's been shone on behaviour or outcomes to date has not caused them to change their views that the outcomes 15.21
that - the outputs, the outcomes are reasonable, and so I'm not sure I would expect any different with the 53B report either. And likewise, it seems to me that the other airports are also comfortable with the outcomes of the Wellington process, both in terms of inputs and outputs, and we haven't heard anything to the contrary, and so that we can also assume that they do have that degree of comfort with achieving similar types of things in the future themselves.

So, our view is that the input methodologies and 15.22
information disclosure have not met their purpose. We've talked about information disclosure today but part of that regime is input methodologies and the 52R describe the purpose of input methodologies was to promote

certainty for suppliers and consumers in relation to the rules requirements and processes applying to the regulation or proposed regulation of goods and services under this part. I suppose we expected that when the Commerce Commission published input methodologies that there would be a degree of certainty for us about what the outputs that would come as a result of those input methodologies being in place. We acknowledge that they are not price control, that they are not to be slavishly followed necessarily, but we expected that the results 15.23
would be much more certain than they have been. We certainly didn't expect to see revenue increasing by 54% over the five years period, if you will excuse the histrionics, and we did not expect to see the level of profits that are forecast in the regulatory accounts of Wellington Airport as a result of the Information Disclosure Regime.

In terms of the inputs, we believe that the adoption of the MVEU methodology, as we've submitted, has resulted in land valuations of more than $100 million, or an 15.23
increase in the regulatory asset base of more than $100 million compared to an MVAU type approach which has substantial impacts on the revenue profits of Wellington Airport, and the weighted average cost of capital which we are still not sure whether Wellington regard their WACC as 10.51% and that they've offered a concession of 1% or whether they've regarded their WACC as 9.1%, there seemed to be differing claims throughout their final pricing decision, that that is far in excess of the return which we had expected as result of 15.24
information disclosure.

We have not seen any substantial change, as we've noted, in terms of behaviour in the process, nor in the outcomes of the process. As Wellington noted clearly in

its final pricing decision, they regarded the regime, the Information Disclosure Regime, as a light-handed regime, they noted that the retention of the price setting provisions in the AAA was part of that regime, or part of the legislative framework, and that there was an expressed provision that they need not apply the Commerce Commission cost of WACC methodology. However, having said that, I don't think that the existence of the AAA has constrained the ability of the ID regime to work. I think that if the AAA had not existed and/or the 15.25
provisions relating to the AAA, it seems to me that the light-handed regulation would still not have delivered what we had expected as the outputs from it, because it is light-handed, because Wellington are acting appropriately as a private company seeking to maximise returns for their shareholders, and they are able to do that under the AAA and they are equally able to do that under the Information Disclosure Regime of Part 4, and that unless they are motivated for some reason to change that behaviour, that is how they will continue to behave 15.26
and how they should in responsibility to their shareholders.

We note that the external market also was surprised. We've supplied as part of our submissions the first New Zealand Capital Report where they characterise this as an eye-watering price reset, and so it seems that it was not only us that had some expectations about what might happen differently under the ID regime, but that other people may also have had that view and been surprised at the outcomes. 15.27

And lastly for us, I think, in terms of the timing of this review and whether the Commission can form views about the effectiveness of information disclosure, the review was clearly set down by Parliament to occur after a pricing round. It seems that there is a presumptive expectation that something different would have occurred in the pricing round which would allow for formation of views on whether information disclosure had been effective. We think this is not a very short period of information disclosure but a very long period of pricing impacts on consumers of airport services going back as far as 2002 and the Commission's involvement in it then when it first expressed concern about airport pricing, and that both Parliament and ourselves had a clear 15.28 expectation that ID would affect this pricing round and that has not been realised in our view.

As we discussed a few minutes ago, the impact of this is very real on consumers. The impact is proposed to continue for five years and we think that consumers deserve something different than this and the protection that the Commerce Act, Part 4 of the Commerce Act sought to provide for them.

CHAIR: Thank you. Can we have BARNZ next, please.

MS COOPER: Thank you. BARNZ is here today representing five 15.28 airlines, Qantas, Jetstar, Virgin Australia previously known as Pacific Blue, and Field Air and Airworks, which are two smaller freight operators, and we have taken particular care to ensure that the views represented today by BARNZ, both here before the Commission and in our written submissions, reflect the views of those airlines. We would also like to emphasise that all of the BARNZ experts have been engaged as independent experts in accordance with the Commerce Commission Code of Conduct and they have not been instructed to act as 15.29 advocates and they are not acting as advocates.

The question the Commission has before it today is how effectively Information Disclosure Regulation has been able to promote the long-term interests of consumers as set out in section 52A in respect of the specified airport services provided by Wellington Airport.

In BARNZ's view the simple and clear answer is that Information Disclosure Regulation by itself has proven to be completely ineffective. Wellington Airport has either disregarded or dismissed as irrelevant the Commission's input methodologies and we would like to emphasise and particularly draw the Commission's attention to four major departures.

First, it has adopted a WACC of 9.5% which is 15.30
significantly above the Commerce Commission's estimate of a reasonable airport WACC range of 7.1% to 8%, and in doing so we've heard today that the airport did not take into account the Commission's airport methodologies and principles in developing its WACC. Dr Layton has advised BARNZ on the admission of WACC and has outlined to the Commission his expert opinion there are no valid reasons or circumstances unique to Wellington Airport which would justify that airport adopting inputs different to those used by the Commission when the airport calculates its 15.30
WACC for the purposes of setting charges.

Second key departure is that the airport has adopted an overstated alternative land uses valuation and BARNZ has gone to some considerable effort to obtain independent expert advice on this area. First we have had Mike Foster of Zomac Planning who has provided advice to BARNZ that the amount of commercial land contained in the airports alternative land use model is, in his words, fanciful and this advice has been provided to the Commission already. 15.31

Because of the fundamental difference in the alternative land use plans between Mr Foster and between Wellington Airport's advisors, BARNZ then obtained a further expert advice from Market Economics. Market

Economics investigated the underlying demand for retail services in the catchment area and their advice was that that demand did not support the Airport's assumed size of the commercial area and that the Wellington Airport land use plan would result in it being one of the largest commercial centres in Wellington second only to the CBD and surpassing all other existing centres which Market Economics considered extremely unlikely given the underlying retail demand.

BARNZ has also engaged Dougal Smith of Property 15.32
Advisory Limited and Mr Smith was here today. He is a valuer. He was engaged to undertake a valuation of Wellington Airport's land applying the Commerce Commission's valuation guidelines as set out in its input methodologies. Property Advisory revalued the land at just $1 million a hectare. By contrast Wellington Airport's valuers valued it at $1.4 million a hectare in its alternative use. This is one of the key differences between the advice which BARNZ has received and the Airport, and it has a key impact on profitability 15.32
assessments, and BARNZ strongly urges the Commission to engage its own independent valuer to review the reasonableness of Wellington Airport's land valuation.

The third key difference is that Wellington Airport has continued to add holding costs to its land value. It's a valuation methodology known as MVEU. This methodology was rejected by the Commission in its 2002 Airport inquiry and also rejected by the Commission in it's 2010 input methodology. The commission considered it was in excess of the opportunity costs value of the 15.33
assets, which is the benchmark for a workably competitive market. This practice of Wellington Airport moving to MVEU adds a further $1 million per hectare to Wellington Airport's land valuation to end up with a

total value of $2.4 million per hectare as compared to the $950,000 advised by Property Advisory Limited to BARNZ.

Fourth key departure the Airport has made from the Commerce Commission input methodology is that it has only partially treated its asset valuations as income in the charge setting process and it continues to assert that any future unforecasted revaluation gains will also not be included as income in future charge setting processes. Rather, the Airport will simply use these revaluations to 15.34
increase future charges to airlines and to the travelling public without the Airport having had to incur any cost or undertake any additional investment.

In addition to these four key differences the Airport's operating costs have dramatically increased such as we believe they're no longer at an efficient level. The Airport is constructing statements of regional pride such as the copper sheathed, multifaceted Rock at significant cost and is charging consumers a full return on this architectural statement, and the Airport 15.34
is engaging in speculative investment for aircraft types that are not regularly operated to Wellington Airport and are unlikely to be regularly operated to Wellington Airport.

Clearly Information Disclosure Regulation has been completely ineffective in placing any limit on the ability of Wellington Airport to extract excessive profits. The Airport has carried on as if the AAA regime is the only regulatory regime.

BARNZ has provided the Commission with its assessment 15.35
that over the next five years airlines will end up paying the Airport $99 million in charges than would the case if applying the Commerce Commission input methodology framework. Information disclosure has not resulted in

the Airport sharing the benefits of any efficiency gains with consumers.

The Airport emphasised the importance of sufficient incentives to innovate and invest. BARNZ fully acknowledges the Airport earning a sufficient return to justify investment in what has to be acknowledged as expensive lumpy and long-term assets, however, the extraction of excessive profits is not necessary in order to provide an incentive to invest.

Returns at the Commission's framework level are more 15.35 than adequate and would be welcomed by many investors.

Part 4 is designed to balance the interests of suppliers and acquirers, that is why paragraphs B, C and D all refer to reflecting consumer demands, to share benefits with consumers and to limiting the ability to extract excessive profits. Part 4 is not solely concerned with incentivising investment as the airports would have the Commission and politicians believe. Transfer of wealth to suppliers from consumers having to pay excess charges are contrary to the purpose of Part 4 15.36 and therefore directly irrelevant to the Commission 's deliberations on whether or not information disclosure has been able to effectively promote the long-term interests of consumers as set out in section 52A.

The Government's hope that the input methodologies would act as a guide to the consultation process and would diminish the areas of contention or difference between the airports and airlines has not proven to be the case in relation to Wellington Airport's pricing decision. The Airport has rather based its decision on 15.37 its own self-interested views on key matters such as asset valuation, WACC and treatment of revaluation.

While information disclosure may highlight that the long-term interests of consumers is not being promoted,

by itself information disclosure cannot effectively promote the outcomes desired in section 52A. This is particularly the case with airports which have the statutory right to set prices as they think fit by virtue of section 4A of the Airport Authorities Act. The Court of Appeal has held that this power under the Airport Authorities Act even enables airports to set charges which contain monopoly profits. For so long as the airports continue to have the right to set charges as they think fit, information disclosure is rendered 15.37
nugatory in its ability to promote the long-term benefit of consumers of airport services.

In BARNZ's view the credibility of the light-handed regime is at stake here. The only option now is for stronger regulation of Wellington Airport in the form of negotiate arbitrate regulation. We note that the Commerce Act was designed to provide a basket of regulatory options along a spectrum from the most light-handed regulation of information disclosure stepping up to negotiate arbitrate, then pricing paths 15.38
and finally to customised price control. BARNZ is not looking for heavy-handed traditional price control. However, if there is not an improvement in the regulation of airports, then the credibility of the light-handed regime will be totally undermined and consumers of airport services at Wellington will be left with facing the prospect of ongoing relentless and unjustified increases to charges with no options open to consumers to resist the extraction of these excessive monopoly profits. 15.38

CHAIR: All right, thank you. I'll give Wellington the last right of reply so I think if I can pass over to Christchurch next, please.

MR COCHRANE: Thank you, Chairman. I would only like to make a few comments particularly as we're still in the middle of consultation with our airline customers and accordingly I won't make any comments on inputs and outputs but one thing I would say, whilst we've yet to decide on prices for the next period, the airport methodologies have been considered to have had quite a considerable influence in developing a pricing proposal. One thing I would like to raise is really with respect to the section 56G review and it's particularly with respect to major investments. 15.39

As you know Christchurch is just in the process of finalising a $240 million investment in a new integrated terminal and the recovery of this return is over a long life investment and therefore has a long-term recovery period of over 20 years. In this situation individual price resets cover only a fraction of the life of the long life assets. So, airports might recover more or less revenue within a regulatory control period for such an asset depending on the timing and condition of the pricing period, and, as you know, we've been exposed to 15.40 certain events where the ground has shaked. We've had major earthquakes which has had a huge impact on demand and also when the recovery period will be for Christchurch and the tourism sector.

So, in this context the thing we would just like to draw to the Commission's attention, we need to be smart about what conclusions we can draw from an assessment for any single pricing period especially when long-term economic outcomes are uncertain. Simple unqualified conclusions may not be possible. So to this end I'm 15.40 really seeking direction from the Commission, and particularly considering large lumpy investments such as our terminal we're seeking an articulation from the Commission that how it sets out effectively information

disclosure is promoting the purpose of Part 4
particularly when we have long life investment, it's over
a number of regulatory control periods and what shall
that outcome look like, so we're really seeking
conclusions to that so we know how, particularly in terms
of framing our pricing proposal, it will enable us to
ensure we meet the requirements. Thank you.

CHAIR: Thank you. I've just lost track, we're either
Auckland or New Zealand Airports Association.

MR SHRIVE: Thank you, Chairman. So, New Zealand Airports in 15.41
its coming to this process, I suppose its key concern is
to seek the right balance for the review. So we
appreciate that on the one hand the Commission is
required to undertake a meaningful review now by the Act.
On the other hand, I think it does need to be accepted
that it's very early in the life of the regime. So, I
think some of the key concerns for me in the submissions
to date have been the calls which have been reinforced
today for conclusive determinations on whether, or that
information disclosure is not working whereas I think our 15.42
view is it's still a work in progress. That said we're
not trying to avoid the review or render it toothless and
we do acknowledge that information disclosure is an
important form of regulation and we also accept that
information disclosure can and should promote outcomes
with the Part 4 purpose statement.

So, following from that we accept that the review
should assess whether airports have incentives to behave
consistently with Part 4 and whether there is evidence
that they are behaving consistently with Part 4. 15.42
However, we still think that it needs to be borne in mind
how information disclosure properly works and in that
context we agree with the summary that the Commission put
forward in the final reasons paper in the information

disclosure determination process, where it said that an effective Information Disclosure Regime provides transparency to interested persons on the performance of regulated suppliers and provides an ongoing source of information so that trends can be identified and monitored over time. And the Commission also identified there that publicising information can create the right incentives for airports to monitor their own behaviour accordingly, which we agree with.

As I've mentioned, the key challenge now is that this 15.43 review comes very early and it's before information disclosure is fully operational, so that ongoing source of information is not yet available and to some extent that puts the Commission in a difficult position and I think some of the questions we heard today from the Commissioners perhaps reflect that, and in particular it's issues around how forecasts can be reconciled against the fact there's no actuals at this stage.

However, we think a lot of the challenges can be addressed by focusing carefully on what section 56G 15.44 requires, and just quickly to highlight two points in that respect. One, it's about how effectively the Information Disclosure Regime under Part 4 is promoting the Part 4 purpose statement. So, it's not a general question or an abstract question of whether information disclosure is the right form of regulation or whether other forms of regulation would be better, it's very focused on the regime that has in fact been established.

So, in that context we strongly support the Commission's position that it's not empowered to consider 15.44 as part of this review whether other forms of regulation should apply.

And secondly, the requirement is to report on how effectively information disclosure is promoting the

purpose. So it's not, as I've said, asking for a report
on whether the purpose has been achieved, whether it's
been met or whether information disclosure will ever be
effective or whether it's failed. Put simplistically, it
really could and should be a report on progress. Again,
that makes good sense to us given that we're in the
infancy of the regime.

And in that context we think the most effective way of
ensuring the purpose of information disclosure is met is
focusing on the information disclosed and making sure 15.45
that is robust, and as we've said, there is a limitation
in that respect at the moment and we appreciate the
Commission's indication that it will acknowledge that
limitation and we also are concerned about an
over-reliance on forecast at this stage, and we're also
concerned that, how do I put it, the lack of information
at this stage doesn't lead to an undue focus on what has
been going on in pricing. Although we accept that is
relevant, it's perhaps not completely realistic to expect
an information disclosure will have an immediate and 15.46
material impact on the inputs into the pricing decision,
and strictly speaking from a legal perspective the
information or the input methodologies are not strictly
relevant to whether information disclosure is effective.
That said, in practice of course they are very relevant
and we've heard today I think from all of the airports
that the input methodologies are carefully considered and
in effect positions are developed where the onus is on
airports to establish or justify departure from the input
methodologies which seems to be the only sensible way to 15.47
draw a balance between the fact they're not directly
binding but they are relevant.

So, just to draw my points to a close, just to
reiterate, we think the focus should be on the

information disclosed, what that tells us about performance. We also appreciate that this review is another tool or mechanism to bring further transparency to airport performance but what we would be concerned about, if this review was the first time problems were identified with performance and that resulted in some sort of definitive conclusion that information disclosure wasn't working. We're strongly of the view it must be given an opportunity to work properly. Thank you.

CHAIR: Thank you, I don't want to raise another question now but if I can just signal something for legal submissions for all parties. People have resiled or particularly the airports have resiled against the use of input methodologies, they're things, as I'm hearing it, somewhat divorced from the Information Disclosure Regime but the question I'm just pondering is how are we to assess the promotion of the purpose in section 52A without regard to the input methodologies. I mean, feel free to rephrase or deal with other questions but I'm just agonising over the interpretation of that particular section 56G and the interrelationship of our input methodologies and how can we opine on things achieving or promoting rather than, as you've pointed out promoting the purpose of that, you know, if we can't take into account input methodology conclusions how would we assess section 52A promotion without that. 15.48 15.49

MR SHRIVE: We'll certainly come back on that.

CHAIR: Okay. Auckland?

MR SPILLANE: I'm happy to wait for written submissions. There's nothing I can express to you orally that would be more persuasive now than would be in writing, happy to save time and get on to my colleagues in Wellington. 15.49

CHAIR: Wellington Airport, you've got the last say for today.

MR SANDERSON: Thank you, Mr Chairman. I'd just like to acknowledge Steve Fitzgerald helping today from his transition from the executive to directorships and I think he has helped in some continuity here in that process.

The regime has only literally just begun and has not been fully implemented. The only questions the Commission can logically ask is whether the information supplied meets the information disclosure requirements, can the information supplied be improved and to what end did it influence the parties, and to that end today's 15.50 conferencing has gone a long way into answering that question.

A recent pricing event was certainly influenced by the ID regime and if I can add from a late participant into this process and from an insider view into Wellington Airport, the information disclosures and particularly - and the IM's were certainly considered by the executive and the board and the sub-committees from the board. The pricing event outputs are forecasts in historical recent disclosures, namely Wellington 15.50 Airport's 2011 and 2012, 6.2% and 6.9% respectively. This highlights the volatility and the uncertainty of the industry. For the pricing period 2012 to 2017 Wellington Airport forecasts a modest return on assets of 8.1% or 8.9% using the Commission's approach to valuation, both returns below Wellington Airport's actual cost of capital of 9.5%. Again these returns represent forecast returns. Whilst based on reasoned logic and expert advice will undoubtedly not eventuate as predicted. This is obviously due to various external and external factors 15.51 such as natural disasters and the Christchurch earthquake, and airlines which do have foot loose ie mobile assets and they can be shifted around. What I can say is that Wellington Airport's actual return will most likely not be its WACC of 9.5% at the end of the five year pricing period. The only thing that is certain, and if I can add beside death and taxes, is that Wellington's return may be lower and very unlikely higher.

We are fully mindful that the Commission and other interested persons will be assessing the input's performance under the new disclosure regime and in turn assessing our performance against that produced by using the IMs. As a consequence there is no doubt that this 15.52
required additional consideration by Wellington Airport in setting its prices.

Commercial agreements between major airports and airlines represent the best outcome for the sector. The goal is achievable as evidenced by both historic and current successful examples. Airports are plying an increasing role in partnering airlines in growth initiatives and joint marketing. In fact, some airlines rely on airports to develop routes and services for the better of New Zealand. 15.52

Wellington Airport has highlighted in its submission references to a number of views of input regulation and pricing which have recently been completed in various countries around the world. It has also submitted a report by Sapere to evaluate regional input valuations within Australia and the UK and the implications for New Zealand.

I now invite Kieran Murray from Sapere to present their summary findings.

MR MURRAY: Thank you, Steven. Mr Chairman, I have prepared a 15.53
hand out with my comments on it. I have copies for the Commission and all the participants in the conference. I can hand that out now or perhaps at the end.

CHAIR: Perhaps at the end. This is simply going to be material for cross-submissions so participants will have both your submission and the transcript from today.

MR MURRAY: Thanks, Mr Chairman. As Steven said, we prepared a report that was submitted to the Commission, it was prepared by Stuart Shepherd and Murray McCole and Joanne Smith. Stuart Shepherd was unable to attend today for a family matter. I'm speaking to the report on his behalf. The report looks at recent developments in airport regulation in the United Kingdom and Australia. We're very conscious that the section 56 review by the 15.54
Commission is not looking at alternative formation of regulation but any assessment of information disclosure requires some comparison with some other possible outcomes and we think to inform those possibilities our report looked at the outcomes that are expected from information disclosure in the United Kingdom and in Australia.

We took the reasons that were stated by the regulators and public agencies in those countries and grouped those reasons against under the heading of the New Zealand 15.54
section 52A to try and provide some form of comparison but we've taken the words as they were in the UK and Australian findings and therefore they may not match exactly. There is a large volume of material. The Australian Productivity Commission doesn't write succinctly so our report was attempting to summarise that. They are our concluded reviews of that material. I'm going to cover some of the highlights now. It's not intended to be comprehensive but it is our view of what those reports were finding. 15.55

Just as a quick thumb nail of the regulation in Australia and the UK. In both countries they do have, they regulate airports differently from how they regulate other sectors subject to economic regulation. They have

CPI minus X type regimes that apply in network sectors. They don't apply that regime to airports.

In Australia they've had an information disclosure price monitoring since 2002 and that's been confirmed in reviews in 2006 and 2011. It is subject also to the potential for services to be declared under the Competition of Consumer Act.

In the United Kingdom under the current process of implementing the EU Airport charges directive which sets out a charging framework, including information 15.56
disclosure and consultation requirements and the Civil Aviation Bill is also proposing a tiered licence system which would attain a targeted licensing regime for Heathrow, Gatwick and Stansted but all other airports would be subject to either just the information disclosure or in fact not subject to the regulatory regime.

What I now quickly go through in terms of under each of the purpose statement headings in our Commerce Act, how the regulators in those regimes see information 15.57
disclosure contributing to those purpose statements. The first one in terms of promoting long-term consumer benefit.

The Australian Productivity Commission, or the closest we could see to the discussion around that was their concerns or potential concerns about market power and their concern, came to the view that market power was concerned only to the extent it affected community welfare which in relation to airport charges they felt was, or airport actions was typically small because 15.57
airport charges were a small proportion of the total fares paid by passengers and airlines were very good at price discrimination through their charging structures. That then transfers primarily between corporates, between

airlines and airports and that they were primarily concerned about the impact of distortive - regulation distorting investment and services.

The UK regime is shifting to a much greater focus on passenger experience. The Civil Aviation will have as its primary responsibility to consumers and they're expecting that the regime will deliver greater to the interests of passengers, particularly for investment.

In promoting workably competitive outcomes the Australian Productivity Commission emphasises the 15.58 importance of commercially negotiated outcomes and the role of information disclosure, price monitoring as they call it there, in that process. They warn about too long or too short regulatory review periods that parties might not deal in good faith if the period is too short or too long. They suggest about five years is about right. They do note that the commercial negotiation culture is taking longer to develop than the Productivity Commission anticipated but they don't find a systemic problem in that. The UK is preferring competition with regulation 15.59 only where expected to deliver clear benefits and that is related to the three London airports.

Incentives to invest have been a prominent feature of the regulatory findings in both Australia and in the UK. The Australian productivity Commission has come to the conclusion that investment in airports compares favourably to other regulated or other Australian infrastructure, and have viewed the potential for or negotiations between airlines and airports as being the best place to evaluate new investment proposals, they 16.00 call it an iterative cost benefit approach. Similarly in the UK the emphasis in moving to the new Bill is around incentives to alleviate congestion, investments to alleviate congestion and improve passengers experience.

They look at the incentives to meet consumer demand and in Australia the Productivity Commission is concluding that there's with a few exceptions increased productivity or increasing and constant efficiency. They remark that airports do monitor passenger experience and that that is consistent with the airline's own commercial businesses. Similarly in the UK, they're finding a greater focus on priority of the entity in reliability and efficiency, and passenger experience is the primary measure. 16.01

Finally, on limiting excessive profits, the Productivity Commission reviewed benchmarking across a number of studies and struggled to find an apples with apples comparison but concluded that overall price monitoring was achieving reasonable outcomes for charges revenues costs, profits and investment.

The UK were concerned that where airports that had insufficient investment capacity may exploit the market power but viewed the regional airports, which is all airports really other than the three London airports, as 16.01
facing competition and recently dedetonated Manchester airport which is the third largest airport because of the competition it faced from Liverpool.

So, stepping back, our review from looking at UK and Australia airport regulation is that in both countries they have moved to adapt their regulatory framework to the more dynamic aeronautical service market that is emerging due to market liberalisation, the evolution of business models particularly the business models by airlines, and particularly the emergence of low cost 16.02
carriers have taken a view that the regulatory and commercial factors limit airport market power, that they've seen increased consumer price sensitivity especially with the growth of leisure travellers and

online booking, that they've seen airline negotiating
position has been enhanced by the information disclosure
and generic competition law, and they're seeing that the
airport's commercial success has been strongly linked to
passenger numbers and consumer experience. There's
alignment between the airport's interests and passenger
interest.

Both regulators concluded that even were airports to
price to airlines higher than a competitive level,
airline pricing practices means that the consumer welfare 16.03
effect of those charges is relatively small.

They comment that they place emphasis on the
commercial negotiation culture but that the effectiveness
of information disclosure does take time to develop and
for the culture to change, and broadly the New Zealand
Part 4 approach seems on our review to generally align
with the direction of airport regulation in both the
United Kingdom and in Australia, although possibly
greater emphasis is given in both of those countries to
passenger experience and to minimising the regulatory 16.04
burden. Thank you.

CHAIR: Right. Does that bring a conclusion to your
presentation?

MR SANDERSON: (Nods).

CHAIR: Okay. Well, that's the end of the proceedings today.
Cross-submissions are due 17 August, as I've already
mentioned. I guess it's only now to thank everybody for
their attendance here today. These are a very
informative way to test the material, it does actually
assist us greatly to move away from hundreds of pages of 16.04
written submissions to actually test and have a live
discussion, it certainly does assist us in the review of
issues and so thank you to all participants for their
attendance and engagement today.

Thanks to staff also for setting things up, Ruth Nichols for overseeing the process and all the other assistance we've had from staff and also the stenographer and sounding systems there. It's great that everything has gone well today without any hitch.

Okay, with that I'll call this conference to a close. Thank you.

(Conference concluded at 4.05 p.m.)