BARNZ CROSS-SUBMISSION ON WELLINGTON AIRPORT DRAFT REPORT SUBMISSIONS

12 December 2012

The submissions by NZ Airports, Wellington, Christchurch and Auckland Airports all make substantially the same points. BARNZ is therefore responding to all four submissions in the one cross-submission, structured in two parts.

Part A responds to points made more generally about the review being undertaken by the Commission of the regulatory regime for airports under Part 4 of the Commerce Act, and the relationship between it and the right that airports have to set charges as they think fit under the Airport Authorities Act 1966 (AAA). The key matters of this nature which are addressed in this cross-submission are:

- The balancing of the competing outcomes of incentives to invest *vis a vis* limiting the ability of suppliers to extract excessive profits;
- The role of input methodologies in judging the outcomes produced by airport pricing decisions;
- Whether it is too early for the Commission to be able to reach any definitive conclusions about the effectiveness of information disclosure in promoting the purpose of Part 4?
- Allegations that airlines are gaming the consultation process and the s56G process creating disagreements for the sake of disagreeing; and
- Misleading suggestions that the airlines are driving for heavy handed price control of airports.

Part B responds to some of the points made in the Airport submissions in relation to the Commission's analysis of the degree to which information disclosure regulation has promoted the purpose of Part 4 in relation to Wellington Airport. The key matters responded to under this group of topics are:

- The use of WIAL's 2017 forecast MVEU land valuation in the Commission's IRR analysis;
- Identification of the appropriate WACC range;
- How specific issues relating to WIAL's pricing should be treated within the Commission's profitability analysis;
- Whether costs per passenger are reducing as claimed by Wellington Airport; and
- The cause of the increases in WIAL's land valuations.

PART A – THE REGULATORY REGIME

Promotion of incentives to invest must be balanced against limiting excess profits

The Airports are inappropriately seeking to constrain the purpose statement to one focusing virtually solely on incentivising investment, continuing to promote the theory, which was rejected by Parliament, that this will inevitably over time benefit all consumers. These Airport submissions are inaccurate. Part 4 was enacted with the clear purpose of achieving outcomes which ensure that suppliers have sufficient incentives to invest, while at the same time ensuring that suppliers are limited in their ability to extract excessive profits from consumers. The last outcome is just as important as the first, yet Airports are persistently dismissing it.

The Airports' submissions are inconsistent with the intention of Parliament, which enacted a purpose statement recognising that the interests of <u>both</u> suppliers and acquirers. The Regulatory Impact Statement, which accompanied the Commerce Amendment Bill, noted that *'a purpose statement that focuses only on improving efficiency upfront, with the implicit expectation that over time all consumers will benefit'*, was not considered appropriate, with such an option being considered *'problematic in the context of natural monopoly sectors'* as *'a key objective of economic regulation in New Zealand is the protection of consumers from excessive prices over the long term'* which *'is achieved by explicitly providing for this objective in regulation'*.[1]

The Regulatory Impact Statement described the proposed purpose statement as one which *'includes both efficiency and distributional objectives, to provide for an appropriate balance between the protection of consumers and that of producers and investors.'*

Moreover, when the Commerce Select Committee reported back to the House, page 2 of its Report stated:

> Most submitters supported the purpose statement as drafted. Others argued that the primary objective in the purpose statement should be investment. <u>Although we agree that incentives to invest are important, we consider they need to be balanced against the need to protect consumers from excessive prices.</u> (Emphasis added)

This balancing of the interests of suppliers and acquirers in s52A was expressly recognised by the Minister of Commerce when moving that the Bill be introduced, read a second time and read a third time and passed:

> The issue is … how do we balance the need to protect consumers from excessive prices while ensuring the suppliers have incentives to invest, to innovate and to improve efficiency so we can be assured of reliable, efficient supply over the long term?[2]
>
> …the objective [of] the long term benefit of consumers of goods or services that are not faced with competition … is to be achieved by promoting outcomes consistent with those in competitive markets, including providing incentives to suppliers to invest, innovate, and improve efficiency <u>while</u>

[1] Commerce Amendment Bill, Regulatory Impact Statement, pages 19 and 20.
[2] First Reading of Commerce Amendment Bill, 646 NZPD 15157, 20 March 2008, Hon Lianne Dalziel, Minister of Commerce.

> requiring them to share efficiency gains with consumers and to limit excessive profits. (Emphasis added) [3]
>
> [The bill's] overall aim is to provide protection for consumers against excessive prices and poor quality when buying what are important infrastructural services where there is no real prospect of competition, while at the same time ensuring that suppliers have incentives to invest, innovate and improve efficiency. (Emphasis added) [4]

This balancing of the interests of suppliers and acquirers in s52A was also repeatedly recognised by the members of Parliament during debates on the Commerce Amendment Bill. However Airport submissions have either selectively or incompletely quoted from Members' speeches in such a way as to present a misleading picture of a focus on incentives to invest.

For example, Mr Nandor Tanczos's description of the objective in s52A(1)(a) of the promotion of investment as being 'absolutely vital' was quoted at page 10 of Auckland Airport's submission. However, Mr Nandor Tanczos's statement just three lines later in Hansard, in the same paragraph, that the s52A(1)(d) objective of limiting the ability to extract excessive profits was also 'vital', was not included in the quote in Auckland Airport's submission.

Similarly, the quote by Auckland Airport of the Hon Simon Powers' speech during the first reading of the Bill was edited to remove remarks made by that Member, acknowledging the equal importance of sharing the benefits of efficiency gains with consumers and limiting the ability of suppliers to extract excessive profits. These omitted remarks occurred immediately between the sentences quoted by the Airport. The key sentences omitted from the Mr Power's statement were the following:

> Equally important to the new test is that the supplier shares with consumers the benefits of efficiency gains, including through lower prices. Indeed, we add to that particular purpose statement a limitation on those suppliers' abilities to extract excessive profits.

The omission of these key parts of the speeches of Mr Nandor Tanczos and the Hon Simon Powers created a misleading impression that incentives to innovate and invest had been the sole objective discussed by those members. In actual fact, both members had also recognised the 'vital' nature or 'equal importance' of limiting the ability of suppliers to extract excessive profits. The full text of these two quotations is set out in Appendix 1 at the conclusion of this cross-submission.

Whether Airport pricing decisions should be judged against outcomes produced by the input methodologies

The Airports are submitting that it was reasonable for them to adopt pricing approaches which differ from the Commission's input methodologies, in light of the fact that:

[3] Second Reading of Commerce Amendment Bill, 649 NZPD 18313, 2 September 2008, Hon Lianne Dalziel, Minister of Commerce.

[4] Third Reading of Commerce Amendment Bill, 649 NZPD 18546, 2 September 2008, Hon Lianne Dalziel, Minister of Commerce.

- The regulatory regime is a light-handed one of information disclosure only;
- The price setting provisions in the AAA allowing Airports to price as they see fit were specifically retained;
- ID is new and there was no guidance until now on how the Commission would assess the disclosed information; and
- The input methodologies are still subject to merits review and, as such, are not yet confirmed.

BARNZ fully acknowledges that airports are only subject to information disclosure regulation and retain the ability to set prices as they think fit under the AAA. As such, the Airports are correct to observe that it was entirely open for them to adopt pricing approaches which differ from the Commission's methodologies. Herein lies the underlying cause of the problem.

However, having adopted pricing approaches which differ from the Commission's input methodologies, the reasonableness of those different approaches adopted by the Airports now falls to be considered by the Commission in the course of its assessment of how effectively information disclosure regulation has been able to promote the purpose of Part 4. The fact that Airports are entitled to adopt pricing approaches differing from the Commission's input methodologies, does not automatically cause those differing pricing methodologies to be appropriate, reasonable or in accordance with the outcomes sought under s52A. Those questions fall at the heart of the matters being considered by the Commission as it undertakes its s56G review.

It is self-evident, that, having been required by statute to develop input methodologies, the Commission would apply those input methodologies when undertaking its analysis under s56G or s53B. Section 52S provides that input methodologies must be applied by every person entitled or required to recommend, decide or determine whether or how regulation under Part 4 should be applied. It is fanciful for the airports to assert that there was no guidance on how the Commission would assess the disclosed information. Indeed, the Hon Lianne Dalziel, Minister of Commerce, commented on the important role input methodologies would have in any analysis by the Commission during the Committee stage of the Commerce Amendment Bill:[5]

> The provisions relating to the input methodologies are the most important provisions in this bill apart from the introduction of a purpose statement for this particular part. Given that these rules determine how financial statements should be prepared for regulatory purposes, they actually allow the Commerce Commission to identify whether a natural monopoly business is taking monopoly rents. So they are the fundamental part of any form of regulatory control under the legislation, including the very light-handed information disclosure regime …

While the Airports retained their ability to price as they thought fit, unhampered by the input methodologies specified by the Commission, the Commission's task under s56G is to assess whether, in those circumstances, information disclosure regulation has been able to effectively promote the purpose of Part 4. It is nonsensical for the Airports to suggest that the fact that they retained the ability to set prices as they saw fit, means that it is inappropriate for the Commission to apply the input methodologies. It is the manner in which the Airports have exercised this power they have to set prices as they see fit, which is the very question being tested in the s56G review process. Has

[5] Commerce Amendment Bill in Committee, 649 NZPD 18545, 2 September 2008, Hon Lianne Dalziel, Minister of Commerce.

information disclosure been effective at limiting the ability of airports to use this power to extract excessive profits?

Finally, BARNZ notes that the Commerce Act itself provides in s53 that the input methodologies continue to be applicable and required to be applied under s52S, pending the outcome of any appeal against an input methodology determination. The lodging of a merits review appeal does not make the input methodologies inapplicable or any less in force.

Whether the Commission is able to reach any definitive conclusions?

The Airport submissions all allege that it is too early for the Commission to reach any definitive conclusions with respect to whether information disclosure has been able to effectively promote the purpose of Part 4. The Airports submit that, just as the Commission has concluded that it cannot yet judge whether information disclosure is creating appropriate incentives to invest, improve efficiency or share efficiency gains, the Commission similarly should conclude that it is too early to assess whether excess profits are being earned. The Airports consider that, whether excess profits have been earned will not be known until 2017, after the end of PSE2 and after new charges for PSE3 have been set, and that it is only appropriate to assess whether profits are excessive in light of actual outcomes – not forecast outcomes.

Section 56G is very specific in terms of the timing of the review – it must occur as soon as practicable after any new price for a specified airport service is set in or after 2012. Parliament therefore expected that the Commission would be able to reach some meaningful conclusions as to how information disclosure had been able to promote the purpose in Part 4 over the first two to three years of the new disclosure regime operating and in relation to the charge setting processes undertaken by each of the Airports.

This reflects Parliament's expectation that the input methodologies determined by the Commission under Part 4 would, while not being binding for pricing purposes, nevertheless be directly relevant to the process for determining charges and reduce the areas of difference. The Explanatory Note accompanying the Commerce Amendment Bill noted that:[6]

> Providing for specification of input methodologies provides better information to guide consultations between airlines and airports and pricing decisions.

Clearly, Parliament wanted a report undertaken early in the life of the input methodologies in order to ascertain the impact achieved by the specification of input methodologies and moving Airports to information disclosure regulation under the Commerce Act. It is axiomatic that undertaking a review as soon as practicable after the setting of new prices will necessarily mean that a large portion of the analysis needs to be undertaken on an *ex ante* basis, applying the forecasts used by the Airports when they set those charges.

It would be completely counter to the interests of consumers, and the intention of Parliament in directing that the review occur as soon as practicable after charges are set, for the Commission to conclude that it is not able to reach any conclusions until seven years of actual results have been

[6] Explanatory Note to Commerce Amendment Bill, pages 34 - 35

disclosed. If Parliament had wanted a report to occur after seven years of disclosure, then s56G would have been worded that way.

Instead, Parliament very precisely requested a review as soon as practicable after charges are reset in 2012, knowing full well that the timing of such a request meant that the Commission would be assessing several years of actual information and (depending on the timing of the report being completed) up to five years of forecast results.

The Commission's conclusions with respect to whether the ability of airports to earn excess profits has been limited clearly need to be acknowledged as being based largely on forecast results, however, that does not in any way undermine conclusions reached by the Commission with respect to each Airport's expectations over the level of profits it expects to earn as a result of its charge setting approach and the inputs it has adopted in its price setting process. The Commission is assessing whether information disclosure regulation under Part 4 is promoting outcomes which limit the ability of airports to earn excess profits. How each Airport has exercised its right to set charges under the AAA is evidence directly relevant to answering this question.

Whether Airlines are gaming the process disagreeing just for the sake of it?

The Airports allege that airlines often disagree with the consultation process simply to create disagreement and to prevent the system from appearing to work, stating that airlines continue to disagree with consultation proposals for no other reason than not wanting to suggest that they consider airport conduct appropriate and the current regime ineffective. This is an unfounded and unhelpful accusation.

BARNZ has been scrupulous in undertaking its analysis by application of the Commerce Commission principles wherever possible. If this analysis indicated that a proposed charge was reasonable, then BARNZ has not hesitated to reach that conclusion, and advise both its member airlines and the relevant airport of this. Thus, BARNZ has concluded that:

- The airfield landing charges, aircraft parking charges and charge for transit and transfer passengers proposed by Auckland Airport were all reasonable;
- The new domestic passenger charge at Auckland Airport was justified, albeit approximately 10% too low;
- The new terminal charges for passengers at Christchurch Airport for international, domestic and turbo-prop passengers were all at reasonable levels and would not result in over-recovery.

However, where BARNZ's analysis indicated that charges are not justified, and will likely result in excess returns being earned, then BARNZ will similarly advise its members, and the relevant airport, of this too. Thus, BARNZ has concluded that:

- The charges proposed by Wellington Airport will result in it earning significant excess returns;

- The international passenger charge at Auckland Airport will result in it earning significant excess returns; and
- The airfield charges set by Christchurch Airport will result in it earning significant excess returns.

Similarly, BARNZ has been prepared to acknowledge that individual inputs to the financial models of Airports are reasonable where this is the case. For example, BARNZ has acknowledged that:

- Auckland Airport's 2006 MVAU asset valuation was appropriate, both as charges were reset in 2007 and again in 2012; and
- Christchurch Airport's 2012 MVAU land valuation was plausible and within a reasonable range.

Within the s56G review process, BARNZ has also been willing to acknowledge where aspects of the purpose of Part 4 are being achieved or promoted. For example, BARNZ has acknowledged that:

- Wellington Airport's level of innovation and service quality are appropriate;
- Auckland Airport's level of innovation, investment and service quality are all appropriate.

The allegation that airlines are disagreeing simply for the sake of it is completely baseless and mischievous.

Insinuations Airlines want heavy handed price control

Airports have also sought to portray airlines as seeking heavy-handed regulation. This is not correct.

While BARNZ acknowledges that the Commission has stated it is not intending to make recommendations as to whether any changes to the current form of regulation are required, and, if so, what form such changes would take, the mischief being sought to be created by the Airports and their Association through painting a false picture of airline objectives needs to be corrected.

Airlines are not seeking heavy handed regulation of Airports. On the contrary, airlines consider that the structure of the industry, with relatively few participants, means that it is uniquely suited to a negotiation-arbitration form of regulation, which is located at the lighter end of the spectrum of possible regulatory responses. This would incentivise the parties to resolve issues of charging, quality, investment and service levels on an industry basis, with the option of arbitration available as a back-stop mechanism for the small number of occasions where agreement proved impossible to reach.

BARNZ is not advocating any form of heavy handed price control being placed on the Airports, and it is inappropriate for the Airports to be planting misinformation suggesting otherwise.

PART B – THE COMMISSION'S S56G ANALYSIS OF WELLINGTON AIRPORT

Use of WIAL's forecast MVEU land valuation as the closing IRR value

The Airports all criticise the Commission for using Wellington Airport's forecast MVEU land value as at 2017 for the closing (or terminal) asset value in the Commission's IRR analysis. The Airports argue that the use of an MVEU closing value predisposes the Commission to conclude that excess returns will be earned over PSE2, therefore making the Commission's calculation a 'logical circularity'. In addition, the Airports argue that it is unknown what asset value Wellington Airport will use to reset charges in 2017, or whether the forecast revaluations will be achieved or exceeded, therefore the Commission's calculation is 'unstable'.

In the first instance, BARNZ notes that the Commission has used the 2017 forecast MVEU valuation contained in Wellington Airport's pricing documentation used to set charges. The Commission has not estimated this valuation. It has lifted it straight out of Wellington Airport's pricing model. There is nothing unstable about the value – it is Wellington Airport's own forecast of its MVEU valuation in 2017 which it used to set the charges which will apply in the final year of PSE2. As such it is the most appropriate terminal valuation figure for an IRR analysis concluding in 2017 which is endeavouring to forecast the level of return likely to be earned by Wellington Airport until that date as a result of the pricing approach which that Airport has adopted.

Moreover, BARNZ considers that there is nothing uncertain over what valuation methodology Wellington Airport would use in 2017 to reset its charges for PSE3, should the Airport still have the ability under the AAA to set prices as it thinks fit.

Wellington Airport used an MVEU land valuation to set its charges in 1997, in 2002, in 2007 and again in 2012. Wellington Airport's own financial model has the Airport's charges at the end of PSE2 still based on the Airport's own MVEU land valuation. Wellington Airport strongly advocated the use of MVEU valuations before the Commerce Commission in the Airport Price Inquiry during 2000 – 2002 as well as during the development of the input methodologies over 2009 – 2011. Moreover, Wellington Airport is still continuing to argue for the use of the MVEU land valuation methodology in the merits review proceedings it has lodged appealing the Commission's determination that land should be valued using an MVAU valuation methodology. In addition, it is still espousing the use of MVEU in its submissions to the Commission during this s56G review.

All the evidence clearly points to Wellington Airport continuing to use an MVEU valuation for its land for the purposes of setting prices. There is not one skerrick of evidence indicating that the Airport might be open to considering any other form of valuation methodology, in spite of the Commerce Commission on two occasions now having clearly indicated that MVEU valuations are inappropriate for pricing purposes as they reflect the expectation of monopoly returns.

BARNZ notes that while Wellington Airport criticises the Commission's assumption that the Airport will continue to price off a revalued MVEU asset base as premature, the Airport offers no assurances that it will change its approach or even reconsider it. The only undertaking made by Wellington Airport in its submission is that it will consult and consider airline views and the Commission's reports as it resets its charges.[7] BARNZ considers that the absence of any commitment or

[7] WIAL Submission to the Commission on its s56G Report, para 57.

undertaking by Wellington Airport to reconsider its long-standing, publicly espoused, adherence to the MVEU land valuation methodology, reinforces the validity of the Commission's conclusion that 'it is reasonable to assume that, at the very least, Wellington Airport expects to price off its current forecast of the closing asset value for PSE2.'

Given the sensitivity of the IRR analysis to the impact of the closing asset value, BARNZ requested Futures Consultant's Ltd (FCL) to examine this issue, and the submissions made by the Airports criticising the Commission's approach. FCL's report is attached. FCL concludes that, given that WIAL has chosen to continue in PSE2 its long standing preference to use MVEU values for price setting, *'it is entirely reasonable and appropriate that the Commission uses WIAL's MVEU closing values for assets in its internal rate of return analysis'*. FCL continues that *'there is no bias upwards in returns from the Commission's approach as the realistic assumption to make for the purpose of assessing the effectiveness of information disclosure is that WIAL will continue to pursue what it claims to be the right approach to setting charges for it.'*

FCL goes on to observe that as the Commission's purpose is to identify how effective information disclosure regulation has been in promoting the purpose of Part 4 of the Act, then '*the Commission has rightly used WIAL's actual observed behaviour in disregarding input methodologies relating to asset values as the basis of its analysis.'*

BARNZ therefore considers that the Commerce Commission is quite correct to use Wellington Airport's forecast MVEU valuation of its land as the closing asset base in the IRR analysis undertaken by the Commission to predict likely forecast returns of Wellington Airport over the seven year period from FY11 to FY17.

The appropriate WACC range

A number of matters relating to the appropriate WACC for the Commission's analysis have been raised by the Airports. In particular, BARNZ wishes to comment on the following points made in the Airport submissions:

- The Commerce Act specifically provides that firms subject to information disclosure regulation are not obliged to apply the WACC input methodology, therefore the Commission needs to be also undertaking its calculations using the Airport's WACC;
- The Commission's 7.06% to 8.04% WACC range is not commercially realistic;
- The 75th percentile WACC estimate should be used for both *ex ante* and *ex post* analysis; and
- An incentive based regulatory system means suppliers should be aiming for and producing results which exceed the Commission's targets and allowed revenue.

With respect to the first point, that the Commission should also be undertaking its analysis using the WACCs adopted by each of the Airports because Airports are not obliged to apply the Commission's WACC input methodology, BARNZ notes that this is the same point the Airports made with respect to pricing principles and the answer is the same. That an Airport is not required to apply the Commission's WACC determination begs the question as to the reasonableness of the Airport's targeted WACC. The fact that Airports are entitled to adopt a WACC differing from the

Commission's does not automatically cause the Airport's WACC to be appropriate, reasonable or in accordance with the outcomes sought under s52A. It is the very reasonableness of the return produced by the charges set by the Airports which must be judged by the Commission.

On the second point regarding whether the Commission's WACC range of 7.06% to 8.04% is commercially realistic, BARNZ notes that Auckland Airport is currently issuing unsecured, unsubordinated fixed rate bonds with a maturity period of seven years at 4.73% per annum. This suggests that the Commission's 7% to 8% WACC range is commercially realistic.

The fourth point highlighted above indicates why the Airports' argument in the third point above, that a 75th percentile WACC estimate should be adopted, is inappropriate. As observed by the Airports, suppliers strive to perform better than their targets. As such, it is inappropriate to allow charges to be set at a 75th percentile WACC estimate. This point was made by BARNZ in previous submissions where it was noted that rather than make an *a priori* judgement that returns at the 75th percentile are acceptable, the long term interests of consumers would be better served if returns are measured *ex ante* relative to the mid-point WACC estimate (ie the 50th percentile) with a judgement, being made *ex post* as to whether returns have been on average excessive, or have fallen short. If returns were measured in the first instance against the 75th percentile estimate, then a consistent pattern of returns at the 75th percentile over ten years would be considered to be acceptable, whereas any reasonable person would consider that it looks very much like systematic over-recovery and a failure to limit excess returns.

BARNZ also refers to the submission it made in its response to the Commission's draft report that airports fundamentally differ from gas and electricity distribution businesses due to the large complementary retail and car-parking revenue sources open to airports as a result of the regulated activities, which means that allowing prices to be set at a higher WACC estimate is not necessary in order to incentivise investment. The large complementary revenues available as a result of the provision of the regulated activities mean that a mid-point WACC for the regulated activities is more than sufficient to encourage investment.

Specific WIAL Issues in Profitability Calculations

Wellington Airport has raised two key objections to the Commission's profitability analysis, namely:

- The Commission has inappropriately included the wash-up for deferred capex from the first PSE as income in the second PSE, which has an NPV effect of $8.8m; and

- The Commission has applied its industry WACC estimate without adjusting it to reflect Wellington Airport's specific circumstances (namely that it is a BBB rated company and has a greater exposure to risk as only four airlines operate scheduled services). Wellington Airport estimates these WACC changes have an NPV effect of $10.8m).

Wellington Airport asserts that adjusting for these two factors reduces the surplus to just $0.114m.

The first point relates to a situation in which an airport provides a credit in a subsequent pricing period due to it not undertaking capex in the timeframe it forecast when determining its required revenue for the first pricing period. The question for the Commission in undertaking its analysis of profitability is whether the revenue attributable to the deferred capex[8] should be treated as revenue in the first pricing period or the subsequent pricing period.

BARNZ considers that the Commission's approach of including the capex wash-up as income in the second pricing period is correct. The payments by users of a return on and of capital expenditure in the first pricing period for a project which was in the event deferred for several years, is akin to pre-paid income and should therefore be treated as income in the period in which the revenue is off-set against charges – namely the second pricing period. BARNZ does not consider that the Commission's approach will disincentivise such wash-up arrangements. On the contrary, BARNZ considers the Commission's approach will actually make such arrangements more likely in the future as an airport will know that, if it defers capital expenditure, and washes up any over-payment in the following pricing period, then any such over-payment will not be treated as an excess return in the *ex post* analysis the Commission undertakes of the first pricing period, but rather will be treated as income in the second pricing period when the airport treats it as a credit in the charge setting process. The Commission's approach creates certainty for supplier and consumers alike.

By contrast, in the present case, where information disclosure under Part 4 is just commencing, Wellington Airport is incentivised to argue the over-payment should be treated as income in the first PSE, because it is largely outside the period of time over which the Commission is evaluating ex post profitability. This naturally would result in the Airport's regulatory revenue for the period being evaluated appearing lower than it actually was.

On the second point, BARNZ repeats its previous submissions that cost of debt matters should be based on an assessment of efficient costs and structure within the airport sector and not on an individual airport's specific costs and structure.[9] Decisions by individual firms to have a higher leverage ratio and as a result incur a higher debt premium and debt issuance costs should not be passed onto consumers, which should only have to compensate firms for efficiently incurred costs.

Wellington Airport has also continued to argue that actual revaluations should not be treated as income. This is contrary to the fundamental principle that where prices are set using a nominal WACC on a revalued asset base, then all revaluations must be treated as income in order to avoid breaching the NPV=0 principle. The Commerce Commission has accepted this principle and applied it in the development of its input methodologies and information disclosure requirements, noting that all revaluations, not just forecast revaluations as alleged by WIAL, need to be treated as income when assessing profitability. In its Reasons Paper for Airports the Commission stated:[10]

> …if a nominal cost of capital is applied to an inflated/indexed asset base, any revaluations of the asset, such as an upward revaluation for inflation, must be treated as income in the ROI for profits to be monitored effectively.
>
> The same principle applies, however, even where a revaluation occurs for reasons other than economy-wide inflation, and where the extent of the revaluation differs from the change in the CPI. Because the use of a nominal WACC with a non-revalued asset base is consistent with FCM, <u>any revaluation gain must be treated as income in the ROI</u>. (Emphasis added)

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[8] That is, the required revenue as per the Airport's financial model to meet the return on and of the unspent capex, and associated tax.

[9] Refer BARNZ Post Conference Submission, 17 August 2012, page 20.

[10] Commerce Commission Input Methodologies (Airport Services) Reasons Paper, para 2.8.14-15

Wellington Airport has also continued to argue that land should be valued at MVEU. This issue has been thoroughly debated during the recent development of the input methodologies and the Airport Price Inquiry ten years ago, with the Commission concluding on both occasions that an opportunity cost valuation of land is the appropriate valuation methodology. The fact that Wellington Airport is continuing to press for MVEU makes a mockery of its criticism of the Commerce Commission undertaking its IRR analysis on the basis of Wellington Airport continuing to apply an MVEU valuation methodology.

Claims that costs per passenger are reducing

Wellington Airport's submission makes claims of reducing average costs per passenger.[11] This is incorrect. On a per passenger basis forecast operating costs are 34% higher in PSE2 at $3.10 per pax than they were in FY07 and were forecast to be in PSE1 (when costs were approximately $2.30 per pax).[12] Even when converted to real dollars, costs per passenger have still increased, as shown by the Commission in in Figures B5 and B7 of its draft report. While the Airport might be forecasting real reductions in average operating costs over PSE2, this is after steep rises in unit opex in the second half of PSE1. As a whole, costs per passenger have risen over the time period covered by PSE1 and PSE2.

Claims that increases in land value were a result of unexpected market movements

Wellington Airport has claimed that the increase in its land values between 2007 and 2011 'were generated because of market events not expected by WIAL or the airlines'.[13] This is not correct. QV data clearly shows that the property market in the Wellington region is still some 95% below peak market levels in 2007.[14] There have not been any market events causing land values to increase over this period as a whole. The increase in Wellington Airport's MVEU land valuation was through a combination of Wellington Airport's valuers adopting an alternative use plan containing significantly greater areas of commercial land use, with correspondingly less housing areas than in previous valuations, and increased holding costs being applied for the hypothetical future conversion of the land to use as an airport.

[11] WIAL Submission to the Commission on its s56G Report, para 143 and 187.
[12] Refer BARNZ Response to Commission's Issues Paper for Wellington Airport, 28 June 2012, page 15.
[13] WIAL Submission to the Commission on its s56G Report, para 52.
[14] http://www.qv.co.nz/aboutus/pressreleases/Spring+buyers+keen+but+supply+tight+-+8+November+2012.htm

APPENDIX ONE – FULL TEXT OF HANSARD QUOTES

Key words missing from Airport quote underlined

Full quote of Mr Nandor Tanczos during the first reading of the Commerce Amendment Bill, 20 March 2008, 646 NZPD 15167

Section 52A, "purpose of Part", which is also to be inserted in the Commerce Act by clause 4, states: "(1) The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services— (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets;" – that is absolutely vital and it was lacking in the previous framework – <u>"and (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and (c) share with consumers the benefits of efficiency gains in the supply of all or any regulated goods or services, including through lower prices; and (d) are limited in their ability to extract excessive profits." That is vital.</u>

Full quote of the Hon Simon Powers during the first reading of the Commerce Amendment Bill, 20 March 2008, 646 NZPD 15159

The bill introduces a new purpose statement for Part 4 in new section 52A(1), inserted by clause 4 to promote the long-term benefit of consumers in markets … by promoting outcomes …" that ensure "suppliers of regulated goods or services— (a) have incentives to innovate and to invest". That in itself is a worthy statement , and in National's view it would be very difficult to disagree with it because it includes the replacement and upgrading of new assets. It also makes sense that those suppliers have incentives to improve efficiency and to provide those services at a quality that reflects consumer demands.

<u>Equally important to the new test is that the supplier shares with consumers the benefits of efficiency gains, including through lower prices. Indeed, we add to that particular purpose statement a limitation on those suppliers' abilities to extract excessive profits. The reason for introducing this statement is that the general purpose statement for the existing Commerce Act, of promoting competition, is considered to be unhelpful for sectors where competition is not viable.</u> So a new test relating to the long-term benefit of consumers requires inclusion and clarification, but equally important in many respects is the incentive for these organisations to invest in the long-term infrastructure of New Zealand.