



**WELLINGTON INTERNATIONAL AIRPORT LIMITED  
SUBMISSION TO THE COMMERCE COMMISSION  
SECTION 56G PROCESS AND ISSUES PAPER**

**SUBSTANTIVE SUBMISSION  
RESPONSES TO QUESTIONS RELATING TO WIAL**

**6 JULY 2012**

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## Executive Summary

### **Background to WIAL**

1. Wellington International Airport Limited (“**WIAL**”) is a nationally significant piece of New Zealand’s essential infrastructure. It is also recognised as providing high quality service and facilities, having recently been voted the best airport in Australasia at the 2011 World Travel Awards and reported as having the fourth best airport terminal in the world by USA Today and the Daily Mail.
2. The airport provides a significant and ongoing national economic contribution by connecting the Wellington region with the rest of New Zealand and the world. Passenger numbers at WIAL are forecast to double from five million to ten million per year by 2030. Efficient investment to cater for this growth will enable WIAL to sustain 21,000 fulltime positions in the region by that time, contributing \$1.6 billion a year to the regional economy with flow on impacts totalling \$3.1 billion<sup>1</sup> per annum.

### **Substantive Submission**

3. WIAL is an important stakeholder in the information disclosure regime and is pleased to provide this substantive submission with respect to the questions relating to WIAL included in Attachment One of the Commerce Commission’s Airport Services – s56G Reports, Process and Issues Paper (“**Process and Issues Paper**”).
4. WIAL recognises that this submission has been made after the Commerce Commission’s (the “**Commission**”) required submission date, and the reasons for the timing of this submission were outlined in WIAL’s initial submission on the Process and Issues Paper dated 29 June 2012.
5. As stated in WIAL’s initial submission, there are two components in the test for effectiveness of the information disclosure requirements under Part 4 of the Commerce Act (the “**ID Regime**”), namely:
  - a test as to whether sufficient information has been made available to interested persons; and
  - an assessment of that information to determine whether the purpose of Part 4 of the Commerce Act (the “**Act**”) is being met.

### **Sufficient Information**

6. In respect of whether *sufficient* information has been made available, WIAL notes that the information disclosed as a result of the ID Regime is detailed and comprehensive, extending the requirements that had existed in the Airport Authorities Act 1966 (“**AAA**”) for many years.
7. The ID Regime covers historical financial information, quality performance measures, forecasts of total revenue requirements, pricing methodologies, prices, and other key statistics. Furthermore, the price setting event disclosures require disclosures of methodology which enable interested persons to understand and assess the airline consultation in both process and substance.
8. WIAL has taken its disclosure reporting obligations seriously and devoted significant time and resource to completing its disclosures to a high standard. WIAL considers that the disclosures clearly provide sufficient information to enable interested persons to understand, and form a view on, WIAL’s performance.

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<sup>1</sup> Current Economic Impact of Wellington International Airport, BERL Economics, March 2009, Page 8

9. WIAL also notes that it voluntarily adopted a fully transparent process in its recent price setting consultation for the period 1 April 2012 to 31 March 2017 (“**Price Setting Consultation**”) under the AAA. WIAL published all of its key consultation documents on its website - [www.wellingtonairport.co.nz](http://www.wellingtonairport.co.nz). This further assists interested persons to understand the engagement WIAL has with its customers and the processes that exist under the AAA for setting prices.
10. WIAL considers that the consultation and information disclosure obligations set out in the AAA have worked well in New Zealand for a long period of time. This process has contributed to strong investment outcomes, high levels of service, efficient airports and modest prices. The ID Regime, including the consultation process on input methodologies has assisted the AAA consultation and price setting process by further narrowing the range of issues where there is a difference of view between WIAL and its airline customers.

#### **Assessment of WIAL’s Performance**

11. WIAL believes that the information disclosure regulation *is* promoting the purpose in section 52A in respect of the specified airport services, although this will become more readily apparent over time.
12. A conclusive *assessment* of the effectiveness of the ID Regime against the purpose statement for Part 4 of the Act will require a suitably long time-series of information to properly evaluate variations in actual ex-post investment, innovation, quality, demand, returns and costs (amongst other things). In the context of the proverb “the proof of the pudding is in the eating”, this process currently has had the ingredients mixed in a bowl and popped in the oven. Licking the spoon now is not going to give a true indication of the final product.
13. WIAL accepts that the Commission has been placed in a difficult situation that requires it to undertake this review without a suitable time-series of information. In the absence of a time-series of actual investment, innovation, service quality, efficiency and profitability trends to assess, WIAL demonstrates in this submission that:
  - WIAL has undertaken, and is forecasting to undertake, **investment** in a reasonable and appropriate manner. It has forecast to undertake \$65 million in investment in aeronautical expenditure over the next five year pricing period. This investment level ensures the airport utilises its assets effectively, provides customers with the quality of facilities expected, provides for growth in demand, and minimises constraints that could impact the regional economy and the competitiveness of the aviation industry.
  - WIAL is seeking to achieve **improvements in service quality** that reflect consumer demands, such as through its proposed South West Pier terminal enhancements that will improve passenger amenity as well as ease current congestion of the existing departure lounges.
  - WIAL is seeking **innovation** such as through its integrated and flexible terminal design and multi-use “swing gates” and stands, which allow for both domestic and international aircraft movements using the same facilities. This is required in order to optimise the use of WIAL’s small airport site and ensure the efficient use of its assets.
  - WIAL’s **return on investment** has been below its cost of capital in recent years due to the impact of external events, natural disasters (including earthquakes and ash clouds) and resulting demand fluctuations and unexpected cost increases. For example, this has included an increase in insurance costs of \$0.9 million following

the Christchurch earthquakes and information disclosure regulatory costs of \$3.7 million over the last 4 years.

- WIAL is seeking **efficiency gains** as a result of its ongoing capital expenditure programme and through its continued effective management of costs. To this end, WIAL is the most cost efficient airport in Australasia and is also forecasting a reduction in operating costs per passenger in real terms over the coming pricing period, despite new external cost pressures.
- WIAL has implemented a **new price structure** designed to encourage the efficient use of WIAL's constrained facilities, enhance future investment decisions and recover fixed costs efficiently. As an example, WIAL has implemented a peak and off peak landing charge, which commences in the second year of the pricing period, in order to encourage the efficient use of its runway which is currently constrained in peak periods. WIAL expects only modest changes in behaviour as a result of these modest time-based pricing signals, but also notes the efficiency benefit of recovering more fixed costs from customers at periods of peak demand to enable lower prices when there is spare capacity. WIAL has also introduced a parking charge to incentivise airlines to efficiently turn around aircraft services to enable the efficient use of aircraft gates.
- In its most recent Price Setting Consultation, WIAL has sought to achieve an **appropriate return** on its investment commensurate with the risks that it faces. In doing so WIAL has considered the full range of factors raised by customers during the consultation, which resulted in targeting a return of 8.0% over the next regulatory period, being below its cost of capital of 9.51%.
- WIAL's actual **future profitability** has significant risk, due to external factors, such as lower than forecast passenger numbers as a result of on-going global economic uncertainty. Its actual profitability will also be dependent on: achieving targeted costs for efficiencies; delivery of capital and maintenance projects on budget; actual funding costs; and other factors.

#### ***The ID Regime in Context***

14. Information disclosure has been a part of the economic regulatory regime for major New Zealand Airports for many years. The 2008 Commerce Act amendments transferred the disclosure requirements from the AAA to the Act. The Act certainly expands the detail required and specifies input methodologies to aid consistency, but substantial information on Airport performance has been available to interested persons for a long period of time.
15. The Commission's issues paper and its questions may be seeking to establish how effectively *new* information disclosure regulation under Part 4 is promoting the purpose in section 52A. Further, there appears to be a premise that the purpose in section 52A was not already being promoted. WIAL notes, however, that:
  - Substantial amounts of the information disclosed has historically been disclosed; and
  - the late inclusion of Airports in Part 4 was not based on any assessment of regulatory or performance failure.
16. WIAL believes that the AAA regime, including information disclosure and consultation, has been effective in New Zealand. This view was supported by Treasury, who stated:

*We note there is no crisis in the sector that would indicate the need for urgent action. Indeed, the macro indicators (passenger numbers, investment in airport infrastructure, entry of new airlines) are indicative of a sector in good health. There is risk that a hurriedly designed new regime might change incentives for the worse.<sup>2</sup>*

17. To understand why, then, Airports were added to Part 4 WIAL notes that the Cabinet Papers from 2007 describe the urgency as “*a robust regime is pressing given the current overseas interest in AIAL*”.
18. The further consequence of this is that there was not a proper assessment of either the genuine need for changes to the economic regulation of airports or the appropriate form. This quite rightly concerned Officials. For example, on 11 October 2007, the RIAU provided MED with highly critical comments on the then draft Cabinet Paper.

*“In particular, the analysis of the problems with the current regime does not appear robust enough....*

*1. The argument that the current regime is light handed is not in itself a problem as such. It needs to be demonstrated that problems actually exist...*

*2. There is little analysis of the effectiveness of the current consultative regime...*

*3. The paper argues that the claims of over-charging have some weight...it is important to explain why the officials concur with the view of one party...”*

19. Similarly, on 12 October 2007, Treasury briefed Hon Phil Goff expressing several concerns about inadequate analysis and quality of process regarding the development of new regulation. Treasury recommended that the Hon Phil Goff:

*“...note that, to the best of our knowledge, officials are not in possession of sufficient independent evidence on the conduct and performance of markets for airport services such that would enable us to conclude that the exercise of market power is causing markets to fail in this sector;*

*note that any putative overcharging, even accepting the airlines’ estimates, would be a small proportion of overall costs of passenger and freight air transport;*

*note that there appears to be evidence of timely and adequate investment in the sector, and that there are other signs that air transport markets are robust;...”*

20. WIAL acknowledges that this does not change the Commission’s obligations under Part 4 to both implement the regime and report to Ministers on how effectively it is promoting the purpose statement. However, it is useful context to understand that:
  - The ID Regime has supplemented and replaced a similar regime that had similar objectives; and
  - The previous regime was not shown to have failed – and indeed prima facie was seen as being effective.
21. In view of the above, the Commission may find it difficult, or indeed unnecessary, to distinguish between the impact of the previous disclosure regime and the new ID Regime. It would also be incorrect for the Commission to assume that the ID Regime has been put in place to rectify a demonstrated regulatory or performance failure.

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<sup>2</sup> Treasury report to the Associate Ministers of Finance (Hons Phil Goff, Trevor Mallard and Clayton Cosgrove), 17 October 2007

### ***Assessment of Effectiveness***

22. WIAL notes that the merits review process is ongoing and that this represents a further complication to the issues of timing dictated by the Act. WIAL notes the Commission's interpretation that it is required to undertake the review prior to conclusion of the merits appeal. WIAL considers that it would be inappropriate, however, for the Commission to use this unresolved difference of view, concerning asset valuation and cost of capital, as a basis for determining that the new ID Regime is ineffective.
23. WIAL considers that the test of the effectiveness of the ID Regime must not be reduced to a simplistic assessment as to whether the Commission would have set precisely the same set of charges if WIAL were subject to price control. Parliament has stated a preference for light-handed regulation and the on-going role of consultation under the AAA as being appropriate for airports. As a consequence, WIAL considers that it could not have been Parliament's intention that Part 4 operate as "de-facto" price control and, by extension, that variances from the use of specific input methodologies in price setting be the basis for justifying a conclusion that the ID Regime is not effective and the objectives in Part 4 are not being met.
24. WIAL agrees that it is premature for the Commission to consider the merits of alternative forms of regulation as part of this review. If the Commission and Ministers are concerned about any aspects of the effectiveness of the current regime, a comprehensive assessment of best practice alternatives and the potential costs and benefits of their application to the New Zealand context would be required.

### ***ID Regime and Commercial Agreements***

25. WIAL considers the current ID Regime as being a constructive enabler of commercial agreements between sophisticated airlines and airports as their service providers.
26. International practice is moving away from price control (or de-facto price control) to commercial agreements, monitoring and transparency. Australia has used a monitoring regime to assist and encourage commercial agreements as a substitute for its earlier price-control regime and there appears no reason why New Zealand cannot adopt a similar model.
27. WIAL has been open to commercial agreements for many years and currently has commercial agreements in place with all its major airline customers apart from the Air New Zealand Group.
28. A key to the success of the Australian airport regulatory regime has been that regulators have stood back from individual commercial differences, removed easy access to an "umpire" and thereby created the environment for airlines and airports to sit together at a table. The major ingredient that is missing in the current New Zealand process is 'time'.

### ***International Best Practice Airport Regulation***

29. WIAL has highlighted in its submission references to a number of reviews of airport regulation and pricing which have recently been completed in various countries around the world, including the UK and Australia.
30. WIAL notes that it has asked its economic advisors Sapere Research Group Limited ("**Sapere**") to undertake a review of recent developments in international best practice approaches to airport regulation and their implication to New Zealand. This review this will be provided to the Commission as soon as it is completed.

## Introduction

31. This is WIAL's substantive submission with regard to the questions relating to WIAL included in Attachment One of the Process and Issues Paper, issued by the Commission.
32. WIAL believes that information disclosure is the appropriate form of regulation, albeit that it has a number of reservations in respect of certain input methodologies to be applied in the ID Regime. These reservations have been expressed in previous submissions and are currently subject to merits appeal.
33. WIAL appreciates that section 56G of the Act requires the Commission to undertake a review of the effectiveness of the ID Regime (the "**Review**"). WIAL has already expressed its concerns on the proposed process in its initial submission on the Process and Issues Paper dated 29 June 2012.
34. WIAL recognises that the Commission is seeking to consult with interested parties in a timely manner; however, it reiterates that it is important that interested parties have a suitable amount of time to prepare their submissions. WIAL has been working to provide its submission to the Commission in a timely manner. To aid this process, WIAL provided an initial submission on process and scope matters on 29 June 2012. In that submission we advised the Commission that we were continuing to prepare our submission on the questions relating to WIAL included in the Process and Issues Paper. This submission is WIAL's response to those questions.
35. Given the importance of the ID Regime to WIAL, it considers that it is important that the Commission consider this submission as part of its Review.
36. The ID Regime commenced with the publication of the Input Methodology and Information Disclosure Determinations in December 2010, and with the Information Disclosure Determination updated in March 2012. To date the Commission has not released any Section 53B(2) reports, which are an integral part of the ID Regime.
37. As a consequence, WIAL considers that the timing for this Review presents a challenge for the Commission as it comes too early to draw any robust conclusions. WIAL recognises that the Commission has been given a seemingly impossible task in being required to undertake a review "as soon as practicable" by the Act, especially, as the Commission acknowledges, performance can only be assessed over time. In the absence of feedback to WIAL via the required Section 53B(2) reports, WIAL is also in a challenging position with respect to assessment of the effectiveness to date of the regime. Notwithstanding this position, WIAL has prepared this submission to provide constructive input for consideration by the Commission.

## WIAL Contact Details

38. WIAL will be pleased to provide any further information required in support of this submission. Our contact person is:

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## **Background**

### **WIAL**

39. WIAL operates on a constrained site of 110 hectares of land in Rongotai, a residential suburb within 8 kilometres of the centre of Wellington City. The airport has a single 1933 metre-long runway, 90 metre Runway End Safety Areas (“**RESAs**”) at each end of the runway, and is bounded by water at either end. At present all services operating at WIAL are short-haul (i.e. not beyond the east coast of Australia or South Pacific) however changes in aircraft technology will allow for utilisation of the runway by long-haul international aircraft creating an opportunity for new services to be established in coming years.
40. Until 1990, the airport was operated as an airport authority under a joint venture agreement between the Crown and the City of Wellington. The Wellington Airport Act 1990 provided for the incorporation of WIAL and the vesting of airport assets and liabilities of the Crown and Wellington City Council in the company. The Act declared the company to be an airport company within the meaning, and for the purposes, of the AAA.
41. In August 1998, the Crown sold its 66% shareholding to New Zealand Airports Limited, a company now wholly owned by Infratil Limited, an NZX listed company which has around 16,000 predominantly New Zealand-based shareholders. The remaining 34% shareholding in WIAL continues to be held by Wellington City Council.

### **Brief history of WIAL assets and recent investment history**

42. The Airport’s land infrastructure was substantially formed in the period 1953-1959. Prior to that period, an airport had operated at Rongotai using an alignment running east to west. To construct the new airport 150 houses were removed, a major hill was levelled and 28 hectares of land were reclaimed. The construction involved a compulsory acquisition process under the Public Works Act and approvals under the Harbours Act. A further reclamation to the south was undertaken in 1972 to accommodate DC8 Aircraft. The runway requires substantial seawall protection from Cook Strait.
43. In 1999, the airport’s new Main Terminal was commissioned at a cost of about \$116 million. The 40 year old “temporary” modified hangar used until that time as a domestic terminal was demolished and a single new terminal, absorbing the then Ansett NZ domestic and international terminal facilities, was completed. The roading network, vehicle parking and aircraft gates were totally re-developed.
44. In August 2005 a major expansion and upgrade of the international terminal (including aircraft gates, baggage and secondary processing facilities, international lounge and increased commercial facilities) was commenced. The upgrade was completed in 2010 at a total cost of over \$80 million.
45. In 2007 WIAL completed its southern RESA, including the construction of a road tunnel. Construction of the northern RESA was completed in 2008. These extensions ensured that WIAL preserved the existing operational functionality of its runway while complying with the increased Civil Aviation Authority (“CAA”) safety requirements. The total cost for construction of the two RESA’s was \$33 million.

### **Contribution of WIAL (and its ongoing investment) to the economy and the competitiveness of the aviation market**

46. The aviation sector is a major contributor to the Wellington regional economy. Based on WIAL's planned investments and demand growth, WIAL is forecast to contribute \$1.6 billion a year to the regional economy with flow on impacts totalling \$3.1 billion per annum and will sustain 21,000 fulltime positions in the region by that time.
47. To provide some context for the BERL assessment, WIAL's economic contribution is greater than the entire Wellington agriculture and food and beverage processing and manufacturing industries combined.
48. Wellington Airport currently hosts over 5 million passengers a year, and more than 7 million visitors in total. In 2012 (financial year to March), 4.5 million of the passengers were domestic and 0.7 million were international. WIAL's 2030 Master Plan forecasts that total passenger numbers will double by 2030.
49. Wellington is a major hub of the domestic network for airline services. Its location at the centre of New Zealand makes the airport a gateway to 17 other domestic centres which in 2012 involved 82,000 domestic flights. Short haul international services with trans-Tasman and Pacific Island destinations involved 5,700 international flights in 2012.
50. Continued investment by WIAL in infrastructure that meets demand levels at an appropriate level of service quality is critical for the competitive performance of the aviation market, thus ensuring the regional economy is not inefficiently constrained. A lack of investment by WIAL which leads to capacity constraints or does not provide the opportunity for competition in the market, will be to considerable costs to consumers and the regional economy.
51. The impact of WIAL's investment decisions on the competitive performance of the aviation market was evident in 2007 when Pacific Blue entered the domestic market. WIAL completed development of further aircraft gate facilities just prior the commencement of the new services; without the additional gates WIAL would not have had the capacity to accommodate Pacific Blue at peak times and competition would have been constrained. As a result of the increased competition in the market air fares fell by approximately 20% and around 30% more passengers flew on New Zealand's domestic trunk routes.

### **The current environment for WIAL and its investors**

52. WIAL is faced with making significant investment decisions, that if deferred too long can constrain airlines, customers and the regional economy, and if undertaken in volatile economic conditions can result in a shortfall in investor returns.
53. WIAL is also faced with the permanence of investment decisions where facilities constructed for aviation uses are fixed infrastructure, require long development lead times and cannot be diverted to other uses if unexpected changes in demand occur. This exposes investors to significant risk and indicates the importance of investment decisions. By contrast airline investment in aircraft can remain flexible, with aircraft purchased or leased, and aircraft capacity that can be added, redeployed or reduced at relatively short notice.
54. WIAL has developed its investment plan having considered the demand for its services given the current and forecast economic conditions and has sought to earn an appropriate return given these conditions.

55. The air travel market itself is also fast moving with ongoing changes such as the size and type of aircraft in operation (for example, Air New Zealand's fleet changes and its rollout domestically of larger A320 aircraft), check in facility changes (such as airline self check in kiosks) and SmartGate processing for international passengers, to name but a few recent changes.
56. Airports also have a high level of fixed costs with fixed i.e. immobile assets which as a result represent a significant risk to airports in any period of economic downturn.
57. In summary, WIAL will be exposed to significant future volatility across business inputs, including funding costs, in the next pricing period. Hence, pricing disclosures by WIAL cannot be taken as an absolute reflection of WIAL's performance, only the actual returns, measured over a suitably long period of time, will provide a meaningful assessment of whether WIAL's returns are appropriate.

## **International Best Practice**

58. The regulation of airports continues to develop relatively rapidly. Long-term private sector ownership of airports has only existed in a few jurisdictions, including the UK, Australia and New Zealand. The default starting position of regulating airports in a similar way to natural monopoly utilities continues to carry considerable inertia. The fundamentally different characteristics of airports, which have sophisticated customers with counter-veiling power and strong incentives to encourage growth, require a different approach.
59. Subsequent to the issuance of the Commission's Determinations in December 2010, a number of reviews of airport regulation and pricing have been completed internationally, including in the UK and Australia. WIAL considers that these reviews provide important information and guidance as to appropriate forms of regulation and the risks of poor regulation. Specifically in relation to this s56G review, they provide examples of the effectiveness of information disclosure in encouraging strong outcomes.

### **Australia**

#### **Economic Regulation of Airport Services**

60. The APC issued its final report on the Economic Regulation of Airport Services on 30 March 2012.
61. The APC **supported the continuation of** the current Australian Competition and Consumer Commission ("ACCC") **monitoring of airport pricing and quality of service**. The Inquiry found the light handed regulatory regime **has been effective and should continue** to operate, with some enhancements, until 2020, with the next review by the APC in 2018. [emphasis added]
62. This report identified a number of key points, including:
  - a strong record of investment by Australian airports to meet the growth in air travel;
  - overall good customer service outcomes;
  - Australian airports' aeronautical charges, revenues, costs, profits and investment look reasonable compared with outcomes at overseas airports.
63. The full APC report is available at <http://www.pc.gov.au/projects/inquiry/airport-regulation/report>.

### **Europe**

#### **Airport Competition in Europe**

64. Copenhagen Economics has written a report for ACI Europe, which has been peer reviewed and guided by David Starkie and Harry Bush, on the nature of competition between European airports. This included a review of the development of competition and constraints over time, the competitive constraints upon airports, how far airports, (in the light of such developments), can be regarded as possessing monopoly characteristics with concomitant market power and the implications of this on the economic regulation of airports.
65. This report assesses how far airports, with high fixed costs and commercial incentives to expand traffic, can be regarded as classical monopolies and therefore requiring heavy handed economic regulation. It sets out the development of airports and the travel market over the last 20 years, involving deregulation of airline markets, corporatisation of 80% of

airports in Europe, airports being more commercially focused both in the undertaking of greater marketing and route development activities and also commercial activities which are reliant on passenger throughput, the countervailing power of global airlines and passengers being better informed through the internet. The report questions whether such developments have yet to be properly reflected in the thinking of regulators and policy makers.

66. Copenhagen Economics conclude that most airports should not require regulation, and that regulation risks obstructing the development of the very competitive forces that are most likely to benefit passengers and airlines long term. It highlights that the high costs of and difficulties with heavy handed economic regulation have been recognised in Australia, which was reflected in its move from a price control regime to the current price monitoring regime, and sets out the positive outcomes that have resulted in this market.
67. The full Copenhagen Economics report is available at <http://www.aci-europe.org/component/downloads/downloads/3278.html>.

### **United Kingdom**

68. The UK, having de-designated Manchester Airport in 2007 to leave only the three large London Airports regulated, has commenced a series of further reviews of regulation and capacity. What appears to be largely agreed upon is that price control has not resulted in sufficient or timely investment and that quality of service has been given too little attention. This has resulted in the UK Government debating a new Civil Aviation Bill before the Parliament which changes the regulator's primary duty to ensuring that economic regulation is focused on the interests of present and future passengers.
69. The CAA is at the same time reviewing the regulation to apply in "Q6", the five years from 2014, and has stated the following in its most recent (May 2102) update.

*The CAA intends to take a broad approach to ensuring that any future economic regulation at the three airports is passenger-focused. There are four key elements:*

- 1. Facilitating a process of CE [Constructive Engagement] between the regulated airport and airlines to discuss key passenger outcomes and the costs of delivery. This will take account of the alignment between airline and passengers' interests, unless the CAA has grounds to consider that this is not the case.*
- 2. Independent validation and assurance by the CAA to influencing the commercial discussions between airports and airlines to ensure they focus on passenger priorities and independently identifying passengers' priorities through evaluating available evidence and research. This includes engagement with the CAA's new Consumer Panel.*
- 3. Improving regulatory levers on airports so that they effectively deliver key passenger priorities.*
- 4. Undertaking initiatives alongside Q6 to further passengers' interests through improved airport-airline collaboration and greater transparency of information for passengers.*

70. The full CAA update is available at <http://www.caa.co.uk/default.aspx?catid=5&pageid=13440>

### **Relevance to s56G Review**

71. WIAL believes that the s56G review of the effectiveness of Part 4 can be informed by the effectiveness of information disclosure in other airport regulatory regimes. WIAL notes, however, that to be most useful, these international developments need to be expertly interpreted in the context of the scope of the s56G review.

72. WIAL has commissioned independent expert economists Sapere to prepare a report on "Recent developments in international best practice approaches to Airport Regulation - implications for New Zealand". The scope of the report will include an assessment of the effectiveness of the current ID regime in light of recent international best practice.
73. WIAL will provide the report to the Commission and other interested parties as soon as it is available.

## Considering Effectiveness in the Context of the Review Timing

74. As stated in WIAL's initial submission dated 29 June 2012, there are two components in the test for effectiveness of the ID Regime. Firstly a test as to whether *sufficient information* has been made available to interested persons; and secondly, an *assessment* of that information to determine whether the purpose of Part 4 of the Act is being met.
75. This submission identifies the extent to which WIAL's disclosures have met the requirement to provide sufficient information to enable interested persons to assess whether the purpose of Part 4 is being met. Notwithstanding that the ID Regime requires a sufficiently long time-series of information for an assessment on whether the purpose statement of Part 4 is being met, our submission provides some initial comments on the information that WIAL has disclosed that relate to the specific elements of the purpose statement.

## Understanding performance under an Information Disclosure Regime (the commission's overarching questions relating to WIAL)

Has information disclosure had any impact on WIAL's performance and in understanding WIAL performance, and why?

76. WIAL notes that the disclosure of information by airports is not new, as it has been part of the AAA requirements for many years. The ID Regime has significantly increased the level of detail of disclosure reporting of airport performance. In addition, the implementation of input methodologies for this reporting will enable easier comparison between New Zealand's three main airports and over time.
77. The ID requirements cover historical financial information, quality performance measures, forecasts of total revenue requirements, pricing methodologies, prices, and other key statistics. Furthermore, the price setting event disclosures require significant disclosures of methodology which enable interested persons to understand and assess the airline consultation in both process and substance.
78. WIAL has complied with the ID requirements and believe the disclosures made are substantial and provide considerable information to enable interested persons to understand, and form a view on, WIAL's performance.
79. WIAL, however reiterates its view that it is too early to assess whether information disclosure has had an impact on the performance of its business because assessments of annual ex-post disclosures, over a longer period of time, are required.
80. Furthermore, the absence of any Section 53B(2) reports, and the lack of opportunity for airports to engage in self-initiated behaviour change (if required) in response to the reports, further limits the ability of interested parties to assess whether changes in behaviour by WIAL are appropriate, or have occurred, under the ID Regime.

Has information disclosure had any impact on the effectiveness and scope of consultation as part of WIAL's second price setting event (PSE), and why?

81. The Commission established the input methodologies following a comprehensive and transparent consultation process. WIAL engaged comprehensively in this consultation and the engagement between WIAL, the Commission, airlines, other airports and the collective

team of engaged experts has provided a forum for substantial discussion and debate of economic parameters.

82. In its Price Setting Consultation, WIAL considered the merits and relevance of the Act as it applies to price setting under the AAA. WIAL considers that it has continued a consistent approach to consideration of the Act disclosure obligations and the input methodologies determined by the Commission, namely WIAL:

- acknowledges the clear overlap in base methodology for determining an appropriate return, i.e. the use of a building block model;
- has adopted some changes to its 2007 approach to pricing as a result of considering the extensive advice, opinions and discussions about building block parameters;
- has adopted some other minor changes to its 2007 approach to pricing in areas where the impact is not material in order to reduce the cost of duplication of the different record keeping and reporting processes;
- notes that the Government did not intend the ex-post reporting methodologies to operate as de-facto price control; and
- continues to propose some different approaches for pricing under the AAA on the basis that they better reflect WIAL's circumstances and WIAL's considered view of the most appropriate approach to price setting.

83. With respect to specific building block inputs, WIAL confirms that it has adopted the following methodologies:

- Asset valuation

WIAL commissioned a Market Value Alternative Use ("**MVAU**") valuation of land undertaken in the manner prescribed by the Commission. However, consistent with its previous submissions to the Commission and its merits appeal, WIAL considers that conversion costs should be included in the land valuation.

WIAL also commissioned an Optimised Depreciation Replacement Cost ("**ODRC**") valuation of its building and civil works assets. While this differs from the annual Consumer Price Index ("**CPI**") uplift methodology prescribed by the Commission, WIAL confirms that the difference in total non-land assets was less than \$1 million in the commencing asset base used for pricing.

- Cost allocation – WIAL's allocation methodology is consistent with the input methodologies.
- Tax - WIAL's tax calculation methodology is consistent with the input methodologies.
- Cost of capital – WIAL's advisers used the same cost of capital approach as the Commission, but consistent with its merits appeal WIAL applied parameters specific to WIAL and does not consider an industry average approach to be valid for price setting.

84. As a consequence, WIAL considers that there were only a limited number of differences in WIAL's approach from the input methodologies and it fully explained the reason for these differences in its consultation documents and in the price setting disclosures.

85. WIAL notes that it was disappointed during the recent consultation that Air New Zealand and Board of Airline Representatives of New Zealand ("**BARNZ**"), rather than engaging on the economic validity of WIAL's assumptions, simply emphasised the differences to the Commission's input methodologies and appeared to regard the ID Regime as a price control environment. An example of this was Weighted Average Cost of Capital ("**WACC**"),



where WIAL considers its own, specific cost of capital is the only relevant measure for price setting, while acknowledging that a disclosure regime may appropriately be based on industry averages. This approach by airlines diminished the benefits of the AAA process working side-by-side with the ID Regime.

86. WIAL also introduced greater transparency for the recent Price Setting Consultation by publishing all key consultation documents on WIAL's website throughout the consultation. These are available on WIAL's website at [www.wellingtonairport.co.nz](http://www.wellingtonairport.co.nz). This provided interested parties with the opportunity to understand and assess WIAL's proposals and the responses of its substantial customers. We note that 22 external persons registered on WIAL's website to receive automatic updates during the consultation.
87. While the ID Regime remains in its infancy, the information disclosed by WIAL in the most recent pricing consultation was more transparent. We believe the consultation process has been more effective, and that this effectiveness will increase over time.

What aspects of performance and behaviour should we focus our efforts on for this review for WIAL?

88. WIAL considers it reasonable for the Commission to evaluate its commercial behaviour during the consultation process, including its response and feedback to airline comments and whether its pricing and other commercial approaches demonstrate reasonable and appropriate behaviour. As noted above, WIAL responded properly, and with an open mind, to all issues raised by customers and made a number of changes as a result of consultation. The consultation documents, together with the price setting disclosures, provide significant information for the Commission to assess WIAL's consultation behaviour.
89. The Commission will need to assess and consider the package of reasoning, process and commercial concessions or incentives provided by WIAL in addition to the building block inputs as together these produce the forecast revenue requirement. WIAL believes the Commission should, to the extent that the Commission can, (given the timing of this Review) focus on reviewing performance and behaviour that assesses how effectively all four outcomes listed in the Part 4 purpose statement are being promoted by information disclosure.
90. We note that the Commission should not rely on a simplistic comparison of specific inputs to the pricing calculations as against the input methodologies. To do so would be to replicate the impact of price control (which was not the intention of Part 4), pre-judge the merits review and overlook the wider package of information that makes up WIAL's overall performance,
91. WIAL also notes that the topics of the questions proposed by the Commission do not align with the outcomes listed in (a) to (d) in the purpose statement. For example, the current questions focus on whether WIAL is investing efficiently or innovating appropriately, rather than whether WIAL has the incentives to invest or innovate in the first place.
92. WIAL believes the performance and behaviour questions currently proposed by the Commission, namely the performance of recent and expected returns, and the behaviour of airports during recent price setting events, are too narrow to properly assess the impact of the ID Regime on promoting all four limbs of the purpose statement of Part 4 of the Act. The emphasis of the Review also appears to be incorrectly placing a higher focus on limb (d) which WIAL believes is inappropriate.

93. To the extent that the price setting process of each Airport is relevant, the Commission should assess whether Airports have incentives to engage with airline customers on tailored approaches that help to promote the Part 4 purpose statement. Consistent with the views of the APC, WIAL considers that slavish adherence in pricing to the input methodologies set for the ID Regime would in fact indicate regulatory failure<sup>3</sup>.

## Assessment of profitability

What is an appropriate level of target return for WIAL, and why is the level appropriate?

- What is an appropriate level to reflect normal performance, and why?
- What is an appropriate level to reflect superior performance, and why?

94. The appropriate level of target return for WIAL to reflect normal performance, over time, is its cost of capital. At the WACC input levels at the time of pricing, this was 9.51%.
95. Superior performance should attract a premium to this level, but this is not a concept specifically built into the setting of target returns by WIAL under the AAA consultation process. In fact, WIAL sets, through consultation, challenging targets for efficiency and traffic at a 'normal' performance cost of capital.
96. Variability from the target return can, and is, built into annual targets as a result of commercial concessions and smoothing such that the target return could be expected to be received over time. Variability in actual returns will also be experienced from actual inputs differing from forecasts. The recent actual performance of WIAL, explained below, has under-achieved target returns for a range of reasons.

## Information disclosure profitability

97. WIAL has disclosed its Return on Investment ("ROI") for the year ending 31 March 2011 in its annual information disclosure report dated 31 March 2012. This information allows interested parties to assess the regulated returns of the airport.
98. The ROI disclosed for the year ending 31 March 2011 was 6.16% (comparable to a post-tax nominal WACC). The ROI to be disclosed in the annual disclosures for the year ended 31 March 2012 is currently being finalised but is expected to be approximately 7.0%. These returns are materially lower than WIAL's cost of capital and reflect the variability that can occur in returns in any particular year.
99. The ROI for 2011 and that estimated for 2012 were impacted by a number of factors including:
- WIAL incurring higher costs than were included in the previous pricing consultation forecasts<sup>4</sup>;
  - Changes and differences in the impact of revaluations from those included in the previous pricing consultations<sup>5</sup>;
100. In addition to the ROI being low, WIAL notes that the returns have been calculated using an asset base including land at MVAU. As previously submitted to the Commission and

<sup>3</sup> Australian Productivity Commission Inquiry Report, "Economic Regulation of Airport Services", 14 December 2011, page 97

<sup>4</sup> Explanation of these variances is provided in Schedule 6 of the annual information disclosures

<sup>5</sup> WIAL's consultation forecasts assumed that a higher contribution towards the return would be derived from asset valuations than has occurred in the regulatory return reported under the Commission's information disclosure requirements

consistent with its current merits appeal, WIAL considers that, to be consistent with the purpose statement, land should be valued as Market Value Existing Use (“MVEU”). Application of an MVEU valuation approach would lower the ROI further.

101. While the ROI disclosed for 2011 and estimated for 2012 are lower than the WACC derived by the Commission under its input methodologies,<sup>6</sup> WIAL reiterates that the Commission determination of WACC is inappropriately set too low and it does not provide investors with an incentive to continue investment and preserve dynamic efficiency.
102. The ROI disclosed for 2011 and estimated for 2012 are a clear illustration that actual ex-post returns can vary materially from that forecast during pricing consultation.

### **Forecast profitability**

103. During the Price Setting Consultation, WIAL estimated a cost of capital specific to its business, which is forecast to apply for the five year pricing period. WIAL has provided comment in the Price Setting Event Disclosure for the Pricing Period 1 April 2012 to 31 March 2017, dated 30 April 2012 (the “Price Setting Event Disclosure”) on how its WACC was established for consultation <sup>7</sup>.
104. WIAL sought advice from Sapere in respect of appropriate levels of cost of capital, and which is referred to in the Price Setting Event Disclosure. Sapere provided recommendation on a mid-point and uncertainty adjusted estimates of WACC.
105. The WIAL specific WACC determined during the Price Setting Consultation is however not WIAL’s target return for the pricing period due to the commercial concessions made by WIAL. The resulting revenue requirement determined during the consultation process resulted in the forecast return on assets falling below WIAL’s company specific WACC. These concessions were made in consideration of WIAL’s overall commercial approach to consultation, including the prevailing economic situation and WIAL’s intention to lessen the impact of the change in prices and have a smoothed price path over the pricing period to avoid any price shocks.
106. WIAL’s forecast return for the recent Price Setting Consultation was 8.0% utilising WIAL’s consultation assumptions.
107. Over time, WIAL is seeking an average ROI to at least meet its cost of capital requirement. WIAL takes a long-term view on achieving its target return on invested capital, which is reflective of the commercial concessions that were applied during the Price Setting Consultation.
108. WIAL suggests that the Commission approaches the matter of profitability assessment in a manner that reflects the early stage of the ID Regime. WIAL suggests that the starting point for assessment is the Section 53B(2) reports. In these reports the Commission can share its views, including an appropriate performance “deadband” around its assessment of WACC. Performance outside of this deadband should trigger the companies to explain the basis for this performance. It would be expected that this assessment process would evolve as the ID Regime matures.
109. In respect of how normal/superior performance should be assessed in detail is a complex and difficult proposition for the Commission. To make these sort of assessments requires

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<sup>6</sup> Refer to the Commerce-Act-Specified-Airport-Services-Input-Methodologies-Determination-December-2010

<sup>7</sup> Refer to pages 28 to 33 of WIAL’s Price Setting Event Disclosure. Detailed comment is also provided in pages 48 to 52 of WIAL’s Final Pricing Document which is available on WIAL’s website - a copy of the Sapere advice is also available on WIAL’s website

not only an assessment of profitability, but also an assessment of performance outcomes (namely price, costs and quality). It is inevitable that some form of trend analysis and benchmarking would be required to assess superior and normal performance. Given that the ID Regime is its infancy, it would seem that this level of assessment may be unrealistic at this time.

How should we assess profitability, given the airports inter-temporal use of wash-ups, discounts and other discretionary mechanisms?

110. Profitability must be assessed against an appropriate WACC and market-based asset value<sup>8</sup> and that assessment needs to be made over a suitably long timeframe to allow for an average return to be robustly assessed. Adopting a suitably long timeframe should “average” the impact of fluctuations in demand, actual performance and investment cycles. Where it does not, this will likely be revealed by the Commission’s Section 53B(2) reports, which WIAL can respond to. This approach is consistent with the purpose of the ID Regime.
111. The ROI disclosed under the ID Regime will be informative for assessing trends, however, it is important that a company specific cost of capital is sought by businesses to ensure that investors are receiving an appropriate return on invested capital, commensurate to the risks that businesses face. While actual ROI’s may vary over time, a business must earn its WACC on average to enable ongoing investment.
112. Outcomes from consultation result from a package of inputs including building block assessments and commercial considerations. Individual components of the inputs cannot be assessed on a standalone basis as changes in one input may have led to a change in other inputs to commercial considerations during the consultation. Returns forecast by WIAL for the next pricing period reflect the combined outcome of WIAL’s consultation and it is the consideration of these actual returns compared to WIAL’s WACC that is appropriate.
113. WIAL has published its Price Setting Event Disclosures, Auckland Airport has recently announced completion of its pricing consultation and Christchurch Airport is expected to complete its consultation in late 2012. WIAL expects the airport consultation and pricing approaches to be different between airports, including the treatment of any wash ups, revaluations and discounts. Consequently, WIAL considers that the actual ex-post return over time is the key comparison to assess profitability.
114. WIAL established a company specific WACC in consultation, as detailed above. However, following commercial concessions adopted in consultation, WIAL is not seeking to achieve this WACC over the next pricing period (it must endeavour to do so over the longer term, albeit that future commercial considerations cannot be determined now). We highlight that WIAL’s forecast return for the recent Price Setting Consultation for specified airport services is 8.0% utilising WIAL’s consultation assumptions, and 8.9% if the Commission’s approach to valuation is used. Both of these are below WIAL’s cost of capital.

How reasonable is WIAL’s revenue forecast for the second PSE compared to the first PSE forecasts, and why?

<sup>8</sup> WIAL’s positions on WACC and asset valuation have been well articulated during the input methodology consultation and for convenience has not been repeated in this submission.

115. WIAL's revenue forecast for the second PSE was based on the same methodology as the first PSE, namely a building block approach. In addition, the key inputs to both PSEs were based on advice from WIAL's independent advisors regarding traffic forecasts, land valuation and WACC, and operating and capital expenditure forecasts were based on forecasts prepared by management.
116. Consultation for the second PSE took over 12 months, and involved the exchange of substantial amounts of information and numerous meetings. The feedback received helped inform the final pricing, and the views expressed by the airlines and their advisors resulted in modifications to the inputs to the pricing model.
117. For the second PSE, the airlines agreed with key components of the model including:
- Traffic forecasts; and
  - Material components of WIAL's capital forecasts.
118. Following the calculation of the forecast revenue requirement using the building block inputs, WIAL applied a number of pricing concessions that significantly reduced the revenue required by WIAL. These concessions totalled \$93 million over the pricing period and included:
- a reduction in WIAL's own WACC to 9.51% and also the WACC applied for an airport developer in the MVEU valuation for land (value of \$49.1 million);
  - an allowance of \$14.5 million for a prior period revaluation wash up; and
  - a smoothed income growth path for the pricing period. The revenue path set results in WIAL only achieving its required revenue adjusted for commercial concessions in the final year of the pricing period in 2017, before a reduction due to the smoothing adjustment.
119. In addition to the setting of the revenue forecast, WIAL reviewed and updated its price structure. This included a published incentive arrangement to encourage airlines to deliver traffic growth in order to increase the sustainable passenger base and enable efficiencies to be shared with passengers in the longer term.
120. WIAL notes that it is unlikely to be highly informative to compare revenue forecasts from one pricing period to the next since each of the inputs are likely to have changed and therefore will not be comparable. For instance, changes are likely for each of the inputs below:
- Commissioning of large capital projects;
  - Variations in volume forecasts;
  - Changes in capital costs;
  - Changes in revaluation forecasts;
  - Changes in contracts and commercial agreements;
  - Changes in operating costs due to unexpected events. For example, the substantial increase in insurance premiums following the Christchurch earthquake and increase in regulatory costs.
121. Differences in view between WIAL and its customers on specific inputs at the end of consultation have tended to be overstated by BARNZ and Air New Zealand. The transparent documentation demonstrates that the revenue forecasts only materially differ in

relation to land value and cost of capital issues, which are fully offset by the commercial concessions made by WIAL.

122. To be consistent with the purpose of the ID Regime, the Commission's focus should be on the investment, service quality, efficiency and profitability trends of the business over a reasonable period of time. These are most appropriately measured as outputs from the airports activities, not as pricing inputs.

How reasonable are WIAL's asset valuations, and why?

123. WIAL prepared asset valuations as part of consultation which it considers was robust and appropriate.
124. In completing asset valuations for pricing WIAL:
- Engaged Telfer Young to prepare a land valuation. Copies of the valuation reports were included as part of WIAL's Price Setting Event Disclosure<sup>9</sup>. The information disclosed allowed substantial customers participating in the consultation, and other interested persons, to consider WIAL's asset valuation.
  - Commissioned an MVAU valuation for land consistent with the input methodologies. This land valuation was based on a Master Plan undertaken by urban planners Boffa Miskell.
  - Valued its land at MVEU being a MVAU valuation plus airport conversion costs. This methodology is consistent with the binding arbitration undertaken between WIAL, Air New Zealand and Qantas in 2002/03 and in accordance with WIAL's extensive submissions to the Commission during its consultation of the input methodologies and information disclosure determinations. References to the economic material supporting this approach are also set out by WIAL in its Final Pricing Document<sup>10</sup>.
  - Engaged Telfer Young to value buildings and Opus International Consultants to value civil works. These assets were valued at ODRC.
  - Held several meetings and exchanged expert valuer and urban planner reports between WIAL, the airlines and BARNZ and its advisors in this area, and for land valuation in particular.
  - Published these consultation documents on its website to demonstrate the considerable exchange of views between WIAL and its substantial customers.
125. WIAL considers that its valuations were robustly tested in consultation and WIAL's advisers modified their valuations following feedback from the airlines and their advisors<sup>11</sup>. This approach ensured that the asset valuations were robust and reasonable.
126. WIAL confirms that the valuations undertaken as at 31 March 2011 were adopted in WIAL's 2011 audited annual report.

<sup>9</sup> Price Setting Event Disclosure Appendices C to F and during the price setting consultation.

<sup>10</sup> WIAL Final Pricing Document pages 59 and 60

<sup>11</sup> Comments from the respective parties can be viewed in the consultation documents available on WIAL's website

What role has ID played in discussions in the industry about the target return on investment when setting prices?

127. In accordance with prior consultations, WIAL engaged independent experts to provide advice on its cost of capital. WIAL commissioned advice from Sapere regarding its recommended cost of capital. However, during consultation WIAL made commercial concessions from that recommended by Sapere which lowered the cost of capital used <sup>12</sup>.
128. In reviewing the cost of capital, WIAL had regard to the Commission's input methodologies and applied an allowance for debt costs based on the Commission's input methodology rather than a higher actual cost estimate provided by WIAL's main bank ANZ. Notwithstanding the appropriateness of this actual data, WIAL adopted the lower debt cost used by the Commission to remain consistent with its approach adopted during consultation.
129. WIAL also considered the latest cost of capital announcements released by the Commission for WIAL in addition to market and industry cost of capital data. As noted previously, WIAL considered that it was appropriate to apply its own cost of capital for pricing purposes based on WIAL specific parameters as opposed to the Commission's cost of capital which was based on airport industry parameters.
130. In the absence of the Section 53B(2) summary and assessment reports, which are integral to the ID Regime, WIAL notes that it is difficult to draw any direct correlation between the ID Regime and discussions on returns at this time.

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<sup>12</sup> Detailed comment on the consideration of the cost of capital estimate is provided on page 48-52 of WIAL's Final Pricing Document

## Efficiently and effectively operating and investing in airport assets

Where and when do any capacity constraints occur at WIAL, and is additional investment necessary to address these constraints?

131. The nature and timing of the capacity constraints faced by WIAL in providing aeronautical services varies by airport activity and by time of day. Additional investment is required to alleviate some of these constraints. Whether further investment, over and above that planned by WIAL, will be necessary to address the constraints will depend in part on the success of WIAL's new pricing structure as well as developments in the services offered by airlines. WIAL's new pricing structure is intended to encourage efficient use of existing assets and inform investment decisions regarding the willingness of customers to pay for increments of capacity to meet peak demands.
132. The primary constraint on meeting demand for airfield activity during peak periods is runway capacity. WIAL faces very real physical constraints on its ability to expand runway capacity to meet increased demand. The most important constraint is the lack of flat land in close proximity to the existing airport. There is no prospect of building an additional runway on the current site, and extending the existing runway to allow for larger planes could only be achieved at considerable cost, as it would require reclamation of seabed.
133. Within these physical limitations, the 2030 Master Plan outlines several initiatives that will increase the effective capacity of the existing runway. These initiatives include increased use of technology such as satellite navigation systems, and improved localisers and approach lighting, to enable more aircraft movements in poor weather conditions and to minimise any "fade out" from aircraft passing the existing localisers. These initiatives also involve widening two existing stub-ways and adding two new ones to the Western Apron, to enable aircraft to vacate the runway more rapidly. To allow larger aircraft to operate in the future, the Airport Fire Service will also need to be relocated, Calabar Road realigned (to enable widening of the taxiway), and jet-blast deflectors installed at both ends.
134. While in peak periods and particularly in bad weather, there may be excess demand for aircraft movements (with the result that passengers are rescheduled to later flights), outside of the peak periods demand is considerably less. For large periods of time, the airport operates at 50% or less of its maximum capacity. A significant proportion of aircraft at peak times are relatively small (e.g. B-Prop). A different combination of aircraft – a shift to larger aircraft - would therefore change runway capacity substantially if measured by the number of passengers, rather than the number of aircraft movements.
135. Unlike runway capacity, WIAL can increase apron space, though at a cost. The 2030 Master Plan provides for expanding the Eastern Apron from 28 to 42 gates, and expanding the Western Apron to accommodate more and larger aircraft and provide space for a general aviation maintenance hangar and a terminal.
136. There are many choices and trade-offs to be made by the airlines, WIAL and related services providers in terms of apron configuration and use. Some aspects of apron use are affected directly by aircraft movements in terms of the demand for parking space to unload passengers or freight immediately on arrival. Gates are configured for use by aircraft size, which influences how many of these gates can be provided.
137. Other aspects of apron use arise from drivers not directly related to aircraft movements. An important factor in the demand for apron space is the storage of ground service equipment ("GSE") when it is not in use. Storage space for GSE typically occupies about a fifth of the apron area for a modern jet aircraft; demand for GSE storage is counter-cyclical as during



peak times the equipment is in use and demand for storage is correspondingly low. Increased competition among airlines increases demand for storage space, as each airline has its own ground handling arrangements or suppliers.

138. Decisions to park a plane at Wellington airport tend to be counter-cyclical, with the demand for parking highest in off-peak hours when fewer planes are in the air. The form in which space is made available can also be important. For example, re-fuelling by tankers, rather than hydrants, is slower (aircraft occupy space for longer) but is typically less costly for the airlines and requires greater space. Hydrants pump more quickly, but are less flexible in terms of where the aircraft must stand for re-fuelling. Similar issues arise in relation to ground power units (for aircraft start up and auxiliary power while the aircraft is on the ground), air bridges, and the use of “free stands” enable aircraft to “power in and power out” without the need for push-back (and associated equipment and labour requirements).
139. WIAL’s forecasts predict arrival and departure numbers will almost double by 2030. This translates to an increase in the terminal floor area required from 42,000 square metres currently to 75,000 square metres. Additions to terminal capacity are “lumpy” because of scale of economies, and investment in additional capacity would be made only once forecast demand for the peak periods is sufficiently high to justify the cost. Service choices by airlines is an important factor as they are in a position to substitute technological solutions that require less airport space, such as online check-in, and whether dedicated or shared facilities are needed.
140. Not all of the increased floor area will be related to aeronautical services, as food and beverage, and retail facilities are included in this calculation. Increased security requirements may result in the need for additional processing space, but this may be off-set by a reduction in space needed for trans-Tasman passengers if streamlined and harmonised processes are implemented. Check-in space and counters, as well as potentially lounge area and offices, are required by airlines. A staged approach is planned.
141. Capacity constraints in relation to storage of aircraft, freight and equipment tend to be less complex than other potential constants. The costs of providing these services roughly scale approximately in line with the area of use, with the exception of road access to the airside facilities.

#### **Key Considerations in Investing in Capacity**

142. Capacity issues are considered over short periods during consultation to set prices for five yearly periods and considered over the longer term in Airport Master Planning.
143. Major adjustments to capacity occur in stepped increments, require lengthy development and construction periods, and require substantial investment. This has been demonstrated in the recent history of WIAL by the following developments:
  - The current main terminal building opened in 1999 to respond to severe capacity and quality constraints in the former terminals.
  - Similarly the aircraft apron areas were also redesigned to accommodate demand and improve efficiency of operations.
  - Expansion of the Northern pier from late 2005 to 2010 to increase terminal capacity including passenger processing areas, introduce greater flexibility to the pier to enable both domestic and international use and increased aircraft gate capacity.
144. The incremental cost of the expansions is substantial and invariably occurs at a cost that exceeds the current average cost of providing services to passengers. This is particularly

exacerbated at Wellington Airport due to the constrained nature of the site and the requirement for all development works to be undertaken within the current operational envelope and without compromising ongoing operations.

145. The most evident example of this is the new terminal development which opened in 1999. The total development cost comprised approximately \$90 million for aeronautical services. WIAL's average revenue per passenger for the 1999 financial period before the terminal opened was \$5.60. The new terminal development provided for a considerable increase in capacity of up to 6 million passengers per year. The incremental cost of the development for the forecast growth in passengers was therefore approximately \$15 per passenger (albeit that an element of this cost reflected an increase in quality for all passengers).
146. This instance of high cost of expansion is also illustrated by the simple addition of a new aircraft gate. This work will include terminal modification works, apron and gate works and installation of a new aerobridge. The cost of this work is approximately \$3 million with no consequential uplift in passenger numbers.
147. These examples show that the long run cost of increasing capacity exceeds the average cost of providing services to existing customers. As a consequence pricing approaches that encourage efficient use of facilities and timely investment in new capacity are essential.
148. WIAL has provided considerable information in the Price Setting Event Disclosure on current capacity constraints and also the pricing approach that has been adopted to encourage efficient use of these facilities. In particular, WIAL's runway and terminal facilities were identified as key areas of capacity constraint. The information disclosed allowed WIAL's substantial customers, and other interested persons, to consider WIAL's capacity constraints and investment plan.
149. WIAL also provided the airlines with a report it commissioned from Sapere evaluating the role that prices could play in optimising the use of WIAL's constrained facilities. Sapere recommended that the following points be considered:
  - Differentiated (peak and off-peak) charges for runway usage;
  - Aircraft movement services and other airfield services (principally aprons and stands) should be priced on the basis of aircraft, not passenger numbers;
  - Aircraft parking charges; and
  - Separate pricing for items such as check-in desk usage and equipment storage.
150. WIAL considered the Sapere advice and determined that there were two key benefits of congestion pricing:
  - The allocation of scarce capacity to those who value it most and lower off-peak charges for airport users likely to be more price sensitive (rebalancing was done within a NPV=0 constraint).
  - Collecting a greater proportion of fixed costs from services that are less price-sensitive assists overall efficiency by lowering any distortion of demand.
151. WIAL concluded that these benefits could be achieved from implementation of a congestion pricing approach in respect of runway, aircraft parking, and ground equipment storage facilities where congestion is occurring or is forecast to intensify.<sup>13</sup>

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<sup>13</sup> Further detailed comment is provided on pages 56-60 of WIAL's Price Setting Event Disclosure

152. WIAL also considered and incorporated passenger survey feedback which provided the lowest ratings in the survey responses for gate waiting areas and passenger washroom facilities available to domestic passengers. Expenditure to improve these facilities was also included in the plan.
153. WIAL provided detailed comment to its substantial customers on the capital works that are planned to address either current or forecast congestion of other facilities, including: <sup>14</sup>
- Southern apron development required to accommodate demand from additional and larger aircraft (\$41 million over 10 years).
  - Terminal building works (\$49 million over 10 years) to address:
    - congestion in baggage handling facilities;
    - congestion in passenger lounge facilities in the South West pier;
    - expansion of the MTB facilities to provide further passenger facilities and accommodate forecast growth.
154. WIAL received considerable feedback during consultation on the investment plans and this feedback was incorporated in revising and amending the forecasts.

What factors outside WIAL's control have contributed to the capex and opex forecast for the second PSE and to changes in expenditure since the first PSE?
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How reasonable are WIAL's opex and capex forecasts for the second PSE, and how do these compare to the forecasts from the first PSE?
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155. WIAL considers that it is appropriate to answer these questions together, as the substance of the answers is inter-related.

**Reasonableness of forecasts**

156. WIAL provided detailed information on its opex and capex forecasts and the drivers of that expenditure to its substantial customers as part of consultation. The reasonableness of these forecasts was consulted on and feedback considered and incorporated as part of the pricing consultation.
157. The consultation information provided included the following:
- Operating Expenditure Forecast 2013-2017 <sup>15</sup> including detailed spreadsheet information. This document provided an explanation of the commencing costs for the period, and changes between these and historically reported costs, and of expected forecast changes in operating costs during the pricing period.
  - Capital and Infrastructure Maintenance Programme 2013-2017 <sup>16</sup> including detailed spreadsheet information. This document provided WIAL's rationale for the large capital projects included in the forecast. Forecasts were provided separately for the replacement and upgrade of facilities and growth or new expenditure.
  - Exchanges of comments on these forecasts were included in WIAL's pricing proposals and airline responses to WIAL's documents. These documents are available on WIAL's website.

<sup>14</sup> Key capital expenditure projects detailed in Appendix G the Price Setting Event Disclosure

<sup>15</sup> These documents are available on WIAL's website

<sup>16</sup> These documents are available on WIAL's website

158. In addition to the pricing consultation process, WIAL consults on capital expenditure with its airlines and stakeholders at other times. This consultation takes two main forms:

- Master Planning – airports undertake master planning at regular intervals, as most recently evidenced by WIAL’s 2030 Master Plan which was completed and issued in 2009. This planning process is extensive with input sought from a large number of stakeholders, including airlines, on the demand and capital expenditure requirements for the airport’s long term horizon.
- Project consultation – the AAA requires WIAL to consult with its substantial customers on large capital expenditure projects with a value greater than 20% of its aeronautical asset base. In practice WIAL consults with its airline customers on projects that fall significantly below this threshold since it is critical that feedback is sought from all key stakeholders. Comment is typically sought from airlines on project design and construction processes to ensure the most efficient outcomes are achieved for the benefit of all parties.

**Making investment decisions (for the replacement, upgrading and addition of new assets)**

159. As part of consultation, WIAL determined its investment programme after receiving feedback from its substantial customers. The investment plans often require judgement to be exercised to ensure a fair and appropriate level of common quality for all users to ensure that investment, or the lack of, does not constrain or hamper competition in the aviation market. WIAL received feedback from its substantial customers on its forecasts provided and modified these as a result.

160. By way of an example, WIAL highlights that its substantial customers did not initially support one particular component of the forecast regarding expected adoption by the CAA of ICAO Annex 14<sup>17</sup>. As a result of this feedback, WIAL deferred much of the forecast expenditure in respect of that component to the next pricing period. The total expenditure retained in the current pricing period for this item was approximately \$3.5 million, resulting in approximately \$10 million being deferred<sup>18</sup>.

**Commercial concessions**

161. Following a suggestion from BARNZ, WIAL also proposed a wash-up arrangement that would allow for a credit to its substantial customers in the next pricing period, should certain terminal projects be deferred by a period exceeding 12 months.

162. WIAL also modified its planning for the separate noise management initiatives required to be undertaken. WIAL initially sought to implement the programme under a commercial agreement with the airlines and it proposed a draft agreement to the airlines in consultation. An agreement was not concluded prior to the end of consultation however WIAL confirmed that it was willing to continue discussions for such an agreement, including potential establishment of risk sharing and pricing mechanisms.

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<sup>17</sup> This was the planned expenditure to achieve Operational Compliance Improvements following the expected adoption by the CAA of ICAO Annex 14. In WIAL’s view adoption of the Annex is likely to result in the CAA reviewing the operating dispensations currently granted to WIAL. The airlines did not agree that this could be the outcome of the adoption of Annex 14 however subsequent development of this adoption by the CAA appears to support WIAL’s judgment.

<sup>18</sup> Page 81 of WIAL’s Final Pricing Document.

### **Managing different customer requirements from common facilities (an example)**

163. WIAL highlights that different airlines have different objectives and requirements, and WIAL needs to ensure that all its airlines have fair and reasonable access to the airport facilities that they require.
164. To illustrate this issue, WIAL notes that Air New Zealand opposed the deployment of the RESAs and North Pier expansion project while the projects were supported by the other major carriers operating at that time, namely Qantas and Pacific Blue. Air New Zealand's opposition appeared to be seeking to maintain existing airport constraints to their advantage, that is, if the projects did not proceed:
- WIAL would have had to shorten the operating length of WIAL's runway (to enable the RESAs to be provided within the existing runway envelop) which would have resulted in payload reductions (the amount of weight that could be carried on aircraft) for Qantas and Pacific Blue. As a result, fewer passengers could be carried by these airlines on each aircraft and the commercial viability of the flights would therefore be reduced.
  - WIAL would not have been able to provide the equivalent apron and air bridge facilities for Pacific Blue's domestic services if it had not proceeded with the terminal works.
165. The entry of Pacific Blue in particular created a significant benefit for travellers as there was a substantial reduction in air fares and a consequent substantial increase in the number of passengers flying at that time on the main trunk routes operated by Pacific Blue.

### **Operating cost efficiency**

166. WIAL considers the efficiency of its operating costs in the ongoing operation of its business and in the forecasting of its operating costs used in the Price Setting Consultation. Operating cost efficiency may be considered from two perspectives:
- Firstly, the change in operating costs per passenger; and
  - Secondly, the benchmark performance against other airports.
167. In respect of operating costs per passenger, the real change in costs per passenger forecast over the pricing period is a reduction of 2.2% per annum. This level of cost reduction is achieved despite an environment where a number of input costs are increasing, including insurance and regulatory management.<sup>19</sup>
168. In respect of benchmark performance, WIAL also compared its cost base for the pricing period with the outcomes for other Australasian airports. This information shows that WIAL's costs per passenger are the lowest of the major Australasian airports<sup>20</sup>.
169. WIAL also notes that this assessment is supported by independent benchmark analysis undertaken by Jacobs and Airbiz which is explained later in this submission and set out in Appendix 1 and 2.
170. WIAL concluded that in addition to the compilation of its robust detailed cost forecasts, these outcomes show that WIAL is focussed on achieving cost efficiencies which are in turn being shared with customers through the setting of lower prices.

<sup>19</sup> Further detailed comment is provided on page 40 of WIAL's Price Setting Event Disclosure

<sup>20</sup> WIAL Analysis of ACCC Price Monitoring Reports for Australian Airports 2009-2010 and Wellington, Auckland and Christchurch Airport Disclosure Financial Statements for the year ended 30 June 2010

**Factors outside WIAL's control**

171. WIAL notes that whilst it provides and maintains the airport infrastructure it does not have any direct role in certain aspects of passenger travel, including the check in and processing of passengers which is undertaken by airlines and various Government agencies and the handling of aircraft, which is managed by the airlines and their baggage handlers.
172. As a consequence, WIAL is investing in its assets to satisfy a range of competing stakeholders including passengers, airlines, public, CAA and other regulators.
173. In addition, the air travel market is fast moving with ongoing changes such as the size and type of aircraft (such as Air New Zealand's ongoing fleet changes and its domestic rollout of larger A320 aircraft), check in facilities (such as airline self check in kiosks) and SmartGate processing for international passengers to name but a few recent changes.
174. Despite the preparation of comprehensive forecast cost and investment plans, WIAL has been (and will continue to be) required to respond to market or regulatory changes. As a consequence, WIAL will incur costs or respond to events that were not, and could not have been, anticipated in forecasting. Examples of such events are provided below:

### *Capital Expenditure*

- RESAs – these were required to be developed due to a change in CAA regulatory requirements. Expenditure of \$33 million was required with the projects completed in 2009.
- Terminal changes required to accommodate domestic passenger security screening in the early 2000's, and further subsequent changes also requiring increased screening of passengers.
- Terminal and baggage handling facility changes to accommodate hold stow baggage screening for international services.
- Airline self check in changes.
- SmartGate changes for international passenger processing.

### *Operating Costs*

- Insurance costs have increased markedly by \$0.9 million following the Christchurch earthquakes.
- Regulatory costs have increased \$3.7 million over the last 4 years, mainly in relation to the new ID Regime that was not contemplated.

### *Second PSE*

WIAL has identified certain changes that are expected to take place in the second PSE. However, the specific requirements for these events could not be appropriately determined during consultation and instead will be progressed during the pricing period. Examples include:

- Increased compliance obligations for WIAL's airfield facilities which are expected to develop from CAA's adoption of International Civil Aviation Organisation ("ICAO") annex 14.
- WIAL is endeavouring to achieve greater efficiencies in aircraft slot and gate management and is therefore establishing a more direct role in these functions.

To what extent does the demand forecast presented by WIAL as part of the second PSE, accurately reflect expectations of future demand, and why?

175. WIAL commissioned Booz & Co to prepare a traffic forecast, incorporating passenger and aircraft movement volumes, for the period ending in 2022. The Booz & Co report was provided to WIAL's substantial customers during consultation and is available on WIAL's website.
176. During consultation both Air New Zealand and BARNZ commented that they considered the 2.7% annual growth in domestic passengers reasonable. They noted the international growth assumption of 4.3% per annum but commented that WIAL was best placed to establish this forecast to reflect its own expectations of growth to be achieved from route development. No comment was received on the forecast aircraft movement volumes.
177. As a consequence, WIAL considers that the reasonableness of these forecasts was fully considered during consultation. However, forecasts are by nature inherently uncertain and

will change over time as economic and other factors change, many of which are outside the control of WIAL.

How reasonable is WIAL's demand forecast for the second PSE compared to the forecast from the first PSE?

178. As noted above, WIAL's demand forecasts for the Price Setting Consultation were based on advice provided by Booz and Co. However, WIAL also reiterates that forecasts are inherently uncertain and will change over time as economic and other factors change.
179. Significant factors that have influenced actual outcomes compared to forecast in past years include the following:
- Collapse of local domestic airlines Ansett New Zealand, Qantas New Zealand and Origin Pacific.
  - Pacific Blue's commencement of domestic services in 2007.
  - Pacific Blue's withdrawal from the domestic market in 2011.
  - Jetstar's entry to the domestic market.
  - Air New Zealand's trans-Tasman alliance with Pacific Blue.
  - Global financial crisis.
  - Fuel price increases and the airline response to them.
  - Air New Zealand fleet changes, including the roll out of A320s domestically and change in ATR and Q300 utilisation.
  - Christchurch earthquakes and reduction in services.
180. WIAL believes that any comparison of forecasts from different price setting events must recognise the discrete events that occurred within the respective pricing periods and also the conditions that existed at the time the forecast was prepared.

What role did information disclosure regulation play in negotiations concerning WIAL's expenditure forecasts?

181. WIAL has provided customers with detailed expenditure forecasts over the past several five year pricing periods. WIAL also considers the AAA price consultation over expenditure forecasts to have generally been constructive and involving few material differences. As a result, it is difficult to attribute large improvements to the ID Regime.
182. As noted above, in its Price Setting Consultation, WIAL considered the merits and relevance of the Act as it applies to price setting under the AAA. WIAL considers that it has continued a consistent approach to consideration of the Act disclosure obligations and the input methodologies determined by the Commission, including some changes to its 2007 approach to pricing.
183. WIAL provided considerable information to the airlines to demonstrate how its cost forecast was developed. It also presented the comparative efficiency of WIAL's operating costs compared to other Australasian airports.



184. WIAL made changes to the forecasts following feedback from the airlines, such as removal of certain fire service Category 8 costs. The airlines did not identify any specific cost areas where they considered WIAL was not exhibiting efficient behaviour<sup>21</sup>.

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<sup>21</sup> Further detail is provided in the Price Setting Event Disclosure (pages 33-35, 39-43) and the consultation documents available on WIAL's website

## Innovation

What research and development (R&D) or innovation activities have been undertaken or are forecast to be undertaken by WIAL and what was the outcome these activities (if they have been undertaken), or the expected outcome?

185. Innovation and research and development (“**R&D**”) are important activities at WIAL and support the efficient use of assets, the efficiency of operations, and the delivery of services. This enables WIAL to respond to changes in customer requirements and to enable accommodation of increases in business volumes at WIAL’s small airport site.
186. Innovation is not addressed as a specific matter in consultation and WIAL therefore welcomes the opportunity to outline its R&D activities.

### **Context of R&D and innovation at WIAL**

187. R&D activities at WIAL are undertaken to achieve four specific objectives:
- To maximise utilisation of WIAL which is very constrained for an airport site;
  - To achieve improvements in WIAL and airport user processes to maximise utilisation of WIAL’s facilities;
  - To provide services to our customers and respond to changes in business requirements of customers; and
  - To respond to changes from external parties, in particular Government agencies.

WIAL provides its response to the Commission’s question separately for each of these areas below.

### **Maximising the Utilisation of WIAL’s Small Airport Site**

188. WIAL’s total land holding of 110 hectares is a small footprint for an international airport. This compares to approximately 1,600 hectares for Auckland and 700 hectares for Christchurch. The small footprint requires WIAL to optimise efficiency from the site to accommodate increasing passenger volumes and changes in aircraft mix. WIAL is continually seeking improved land efficiencies through its longer term planning, such as the 2030 Master Plan, and from capital development projects while also seeking to facilitate a competitive aviation market in Wellington.
189. The 2030 Master Plan provides WIAL’s view on long term development of the aviation market in Wellington and how WIAL considers this may be accommodated within the current land envelope, and where necessary, what additional land may need to be acquired by WIAL. The 2030 Master Plan also provides WIAL’s view of the longer term terminal development options for WIAL.
190. In the shorter term WIAL has undertaken, or forecast to undertake, a number of capital developments to enhance the capacity of the site. Examples of these are:
- RESAs – WIAL was required to provide dedicated 90 metre safety areas at each end of the runway to meet new CAA safety requirements. In order to preserve equivalent operating opportunities for the major airlines WIAL developed RESA solutions that preserved the existing runway length for landings while providing some additional runway length for take-offs. At the time, WIAL could have shortened the runway as submitted by Air New Zealand however this would have introduced limitations on

Qantas and Pacific Blue 737-800 aircraft and been detrimental to those airlines and ultimately to competition available for passengers.

- Terminal development – WIAL commenced development of the Northern Pier in 2004/2005 with the capital works completed in 2010 with opening of “The Rock” terminal extension. While design of “The Rock” is visibly innovative, the operating design of the project included several critical key components to maximise use of the terminal. These included:
  - The project included redesign of the apron to allow an increase in aircraft gate capacity. This was critical to enable WIAL to develop the capacity to accommodate Pacific Blue’s entry to the domestic market in 2007.
  - The design enabled the efficient joining together of four separate buildings ranging in age from 1976 to 1999.
  - The development design enables all aircraft gates in the Northern Pier to be used for international and domestic services, termed “swing gates”. This was achieved through innovative design of the development fit out which provides considerable flexibility in how the Pier is used. It also provides WIAL with substantially greater opportunity to accommodate medium term forecast growth in passengers without the need for major terminal developments or expansion.
- Southern terminal and apron development – WIAL is currently discussing the enhancement of its apron and terminal facilities in the South West Pier with its airline customers and key stakeholders. This development is required to accommodate changes in aircraft type (principally the increased use of larger A320s), relieve gate lounge congestion, improve passenger amenities and servicing of regional routes to be operated in the future.

### **Improvements in Airport User Processes**

191. WIAL has always maintained a close relationship with its airport users to ensure optimum and efficient use of the airport site. This includes discussion of items such as design and operation of aprons with airlines and design and operation of security infrastructure with Aviation Security.
192. More recently WIAL has been working in conjunction with Airways Corporation (“**Airways**”), the airlines and other airports to achieve improvements in aircraft management at WIAL, and other airports. These initiatives include:
  - Development of coordinated slot management for the three regulated airports and Queenstown to be performed by a single slot management company.
  - Working with Airways to consider extension of its functions to oversee flight services from aircraft gate to aircraft gate rather than from runway to runway as is currently in place.
  - Direct management of aircraft gate allocation to be established by WIAL in the near future. This is currently being performed by Air New Zealand on behalf of airlines operating at WIAL.

193. These are examples of initiatives currently underway however improvement of operational processes has been a necessity for WIAL in the past and will continue to be so in the future.

#### **To Provide a Change in Services to Customers**

194. WIAL as an infrastructure provider must at times respond to significant changes in business operations from airlines. This has occurred in the past with short periods of notice for significant changes that are driven by airline requirements. Again because of the constrained nature of WIAL's site these changes can pose considerable design challenges for WIAL.

195. Examples that have occurred in recent years are:

- Air New Zealand self service kiosk check in, and more fundamentally for WIAL, passenger bag drop, in 2009. This was a competitive innovation by Air New Zealand that required WIAL to undertake technical development of the baggage handling system to meet Air New Zealand's objectives. This was challenging for WIAL as it has a common baggage handling system for use by all airlines and for both domestic and international services.
- Other airlines have also introduced kiosk check in services although without the provision for self check in of baggage.
- Introduction of dual boarding/disembarkation for jet aircraft which required investment by WIAL in stairs and terminal facilities for accessing the aircraft.

#### **Respond to Changes Required by Government Agencies**

196. WIAL has also been required to respond to significant changes in operational requirements required by Government Agencies, often with short notice. Three examples of such changes are noted below:

- Introduction of domestic passenger security screening – this commenced in New Zealand on a temporary basis after the 2001 terrorist attack in New York, with the screening subsequently established as a permanent requirement. This required WIAL to consider how it could provide for passengers on jet aircraft to be screened whilst continuing to allow for unscreened passengers in the same aircraft piers. WIAL achieved this through the installation of new partitioning in the terminal however as passenger demand has grown and airlines are operating larger jet aircraft the security screened areas and departure lounges are now becoming congested. WIAL is discussing terminal alterations with the airlines and Aviation Security at present for redesign of the domestic security screening in the South West Pier.
- Introduction of security screening of all hold stow international bags in 2005. This posed significant technical challenges for WIAL from several perspectives:
  - WIAL's baggage hall is a constrained space and could not be extended within the period prior to commencing of the bag screening. WIAL therefore had to design ways for the large screening machines to be located in the baggage hall and for accommodation to be provided in the baggage hall for Aviation Security staff.
  - WIAL's baggage handling system is a common system for all airlines and for domestic and international services. WIAL therefore had to develop changes

to the system that could accommodate the new requirements for international bags while not inhibiting the processing of domestic bags.

- Introduction of SmartGate border processing in 2010 for international passengers in both the departure and arrival areas. This project was led by New Zealand Customs but involved a short lead time and optimum positioning and use of WIAL's limited terminal space.

How does the level of R&D and innovation activities compare now to activities prior to the introduction of ID in January 2011?

197. WIAL has continually sought efficiencies and enhancements in the utilisation of its facilities to accommodate passenger growth and changes in airport customer requirements. This has been encouraged in the long established AAA consultation with airlines, both in respect of pricing, and in respect of capital expenditure and operations on an ongoing basis.
198. WIAL considers that the ID Regime will supplement this by providing increased transparency of the service quality considerations at WIAL and the future investment programmes. However, it is unclear whether this added transparency will materially alter the incentives that have existed under the AAA regime.
199. The publication of further information disclosures over time will provide greater opportunity for interested persons to understand and assess WIAL's R&D and innovation activities.

What innovation has occurred in other airports in New Zealand or overseas in recent years?

200. WIAL and New Zealand is a leader in this industry and an early adopter with technology such as its common user terminal, swing gates, kiosks, international SmartGates and baggage tags.
201. WIAL continually monitors industry developments in New Zealand and overseas. Many of these use new technologies for communication and signage, as well as facility management. WIAL is selective about when to adopt new technology innovations given the costs involved and pace of change. Also, WIAL's compact and simple layout obviates the need for complex systems required in larger multi-terminal airports.
202. WIAL has recently developed a leading mobile responsive website, providing passengers with live flight information and information regarding weather delays directly on their mobile phones. There have also been a number of innovations to ensure continued efficiency and on time departure, including recent enhancements to the baggage handling system.

## Service quality

What changes in quality have occurred since ID was introduced?

203. WIAL's quarterly passenger survey results undertaken in accordance with the Airport Service Quality ("ASQ") standards are set out in WIAL's annual disclosures for the year ended 31 March 2011. Prior to this, WIAL used outcomes from other customer surveys to inform its investment and operational planning prior to consultation with airlines and stakeholders on significant expenditure projects.
204. The passenger survey outcomes included in the 2011 annual information disclosure shows that there was a marked improvement in ratings by international passengers during this year (total rating of 3.7 out of 5 at the commencement of the year increasing to 4.3 at the end of the year).
205. WIAL notes that this increase in rating coincided with commissioning of "the Rock" terminal expansion in late 2010. The improvement in customer service was a result of WIAL's ongoing capital development, innovations, and R&D, including:
- Expansion of aircraft gate capacity;
  - Redevelopment of the entrance to the international passenger processing areas to improve accessibility and amenity for passengers;
  - An increase in the passenger gate lounges and bathroom facilities for international passengers; and
- Reconfiguration of the Government agency processing areas for international passengers to provide increased space and improved efficiency in processing passengers.

What, if any, aspects of quality do you think should or could be improved (or potentially lowered) at WIAL?

What consultation was undertaken on aspects of service quality during WIAL's second PSE? How does this differ from consultation on quality at the first PSE?

206. During consultation with its substantial customers WIAL forecast several terminal capital expenditure projects<sup>22</sup> in the pricing period that were being planned to, in part, respond to feedback from passengers in the ASQ passenger surveys. In particular, passenger ratings for the availability of wash room facilities and comfort of waiting/gate areas have been consistently below those achieved for other facilities at WIAL. As a result, these have been identified as areas requiring an improvement in quality and are being addressed over the pricing period.
207. WIAL also notes that it must meet regulatory requirements for safety and international border requirements. In some instances these requirements must be given priority over customer service requirements such that customer service quality may be below passenger expectation, due to the requirements set by Government agencies, or above expectation due to the requirement to meet a regulatory obligation. A recent example of this includes hold stow baggage screening which is an additional service for international passenger baggage that most passengers are unlikely to be aware of.

<sup>22</sup> The particular projects are detailed in Appendix G of WIAL's Price Setting Event Disclosure

208. As part of consultation, WIAL considered that its current quality levels were appropriate and that there were no aspects which required a reduction. The reasons for this include:

- Deferral of investment would lead to a reduction in quality over time, such as where terminals or departure lounges will become too congested over time should investment not be made. This deferral could also mean that WIAL will risk being unable to respond to forecast growth.
- Deferral of maintenance costs would risk compromising the efficiency and safety of existing services.
- WIAL did not receive any feedback from passengers that indicates services may be above required levels (notwithstanding the comment above concerning services provided for regulatory requirements).
- Airlines did not provide any indication during consultation that reductions in quality should be considered.

209. The AAA consultation addresses a common set of services and facilities that are provided to all airlines and passengers to the extent that they require all the available services. For example, airlines not carrying passengers will not require terminal services. Service quality comments are received from substantial customers on the rationale for the changes in certain expenditure and these are considered by WIAL as part of consultation on individual capital works and also during the price setting process. This approach was undertaken for consultation in respect of both the first and second price setting events.

210. Improvements in service quality that were discussed during consultation were:

- The key capital expenditure projects discussed above and outlined in Appendix G of the Price Setting Event Disclosure.
- Improved efficiencies resulting from WIAL assuming responsibility for gate allocation and the consideration of coordination benefits between this and the slot management initiative being undertaken by WIAL and other New Zealand airports.

211. These issues were addressed as part of the consultation on WIAL's operating and capital expenditure forecasts, as discussed above, and WIAL's proposals and responses from its substantial customers are available on WIAL's website.

212. In summary, WIAL consulted on costs with its substantial customers and considers that services are being delivered to a level that reflects common (and appropriate) levels of quality.

What role did information disclosure play in negotiations concerning service quality during WIAL's second PSE?

213. Discussion of service quality with customers is a continuous process that has been further systematised in the ID Regime. As noted earlier, service quality levels are a key reporting tool used to provide input to consultation and discussion of infrastructure or operational changes. Planned upgrades to terminal waiting areas and bathroom facilities are specific examples of capital expenditure proposed in the second PSE that will address service quality issues. It would not be correct to attribute the identification of these projects to the ID Regime, but the data from the ID Regime has assisted the justification and potentially the support of customers.

214. In addition, publication of the survey outcomes in the ID Regime will provide interested parties with greater opportunity to consider WIAL's performance and response to survey outcomes. Over time this will provide greater opportunity for interested persons to understand and assess WIAL's service quality performance.

Do the current ID requirements capture the right measures of quality?

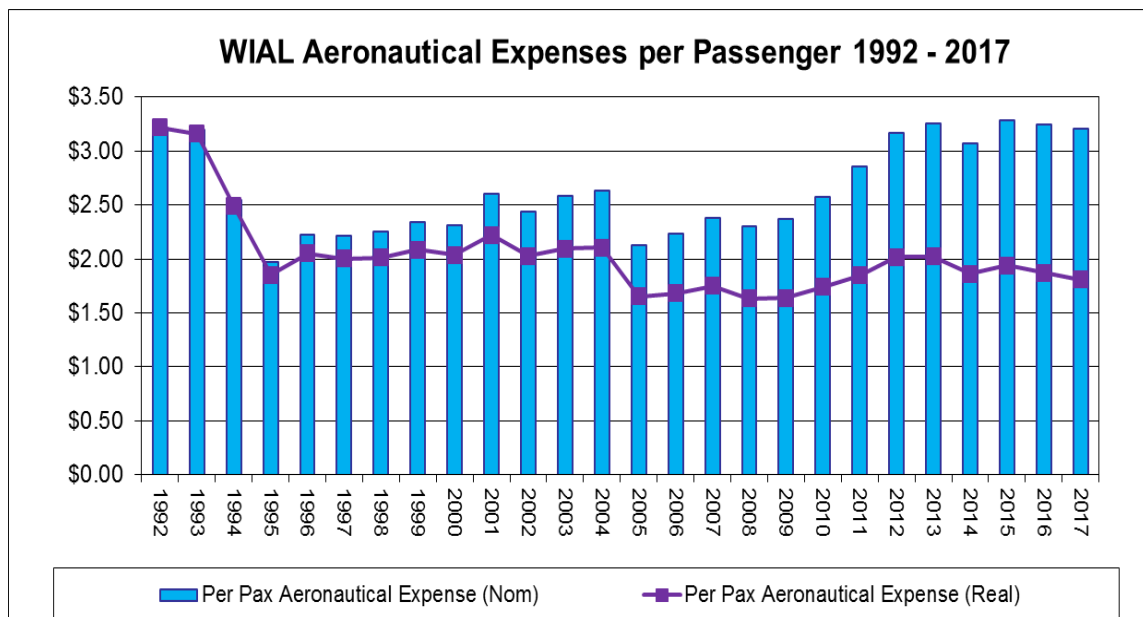
215. The ID requirements were developed following a comprehensive engagement including both airports and airlines. The current measures were agreed as being appropriate by the industry participants and enable comparison between airports and over time.
216. WIAL has committed considerable effort to establish systems and processes to enable the disclosure requirements to be met. However, it is only now (in the third disclosure year) that WIAL will receive and publish all disclosure information from the commencement of the reporting year and have the opportunity to consider how this might be used for management purposes on an ongoing basis. Prior to this transitional arrangements were in place.
217. The ID Regime is still relatively new and there is opportunity for the quality measures to be assessed and reviewed over time. WIAL is supportive of any such fine tuning but suggests that it is premature to reconsider the content of the information disclosures now. This is to provide the airports with the opportunity to fully bed in all aspects of the current regime and to enable assessments of the outcomes from the disclosures to date.
218. This will also allow WIAL to receive feedback on its published annual and price setting event disclosures. To date it has not received any formal feedback on these; either from the Commission or from other interested parties.



## Efficiency gains and efficient pricing principles

How do the prices set by WIAL reflect previous and future expectations of efficiency gains?

219. WIAL is committed to maintaining cost efficient operations and to provide ongoing investment in facilities for its customers.
220. Operating cost per passenger is considered to be an appropriate measure of airport cost efficiency and in consultation BARNZ agreed that this was so <sup>23</sup>. Each time WIAL undertakes consultation a new operating cost forecast is prepared commencing from a “zero base” budget completed for the previous year. Budgets are prepared in detail with each cost item scrutinised to confirm it is appropriate before a budget is approved by WIAL’s Board. Cost efficiencies or reductions adopted by WIAL in its annual budgeting are therefore reflected in cost forecasts used for pricing.
221. As part of consultation WIAL has also demonstrated its commitment to cost efficiency over a long period of time. The graph below shows that WIAL’s cost per passenger has reduced in real terms from the commencement of WIAL as a corporate entity. In more recent years (2009-2012) it is evident that costs have increased. This has been caused mainly by the increasing costs for insurance, regulation and property rates commented on above. However it is also evident from the graph that WIAL’s forecast anticipates this trend changing and real costs per passenger have been forecast to fall during the pricing period.



Note: Aeronautical expenses include costs for aircraft and freight activities to be consistent with historical regulatory reporting.

222. The graph clearly shows WIAL has for a long period of time maintained operating cost efficiencies which are then factored into expense forecasts used to determine pricing.
223. WIAL also seeks to undertake capital investment in a timely manner where demand is met as it occurs. Long lead times that are required for capital development projects mean that a “just in time” approach to investment is difficult to apply in an airport context. Nonetheless, WIAL endeavours to achieve an efficient investment profile where investment

<sup>23</sup> Assessment by BARNZ of WIAL Initial Pricing Proposal for Charges to Apply from 1 April 2012 to 31 March 2017, 10 October 2011, page 19

is made as incremental projects to existing facilities as it is forecast that growth will occur or congestion of specific facilities is forecast to occur.

224. The incremental approach enables WIAL to:

- Only include capital expenditure in pricing calculations progressively as it is required; and
- Achieve greater efficiencies in services at the airport for passengers on a more targeted basis and in an earlier time frame than if investment was undertaken in major increments (such as WIAL's new main terminal building, opened in 1999).

225. In the recent Price Setting Consultation WIAL also initiated a new pricing approach and structure that should seek further improvements in utilisation of its existing assets. This has been noted above in the comments concerning WIAL's pricing approach to address congestion of its runway and airport facilities.

226. A further example of an expected improvement in efficiency is the proposed transfer of aircraft gate allocation responsibilities from Air New Zealand to WIAL. This will result in an increase in staff and other costs for WIAL during the pricing period but will importantly provide WIAL with the opportunity to manage gate allocation for all airlines that operate at WIAL and ensure the most efficient use of its gates and facilities.

To what extent do changes in the pricing structure at WIAL at the second PSE better reflect efficient pricing principles (for example, are prices cost reflective, subsidy-free, do they have regard to service capacity, are they responsive to consumer demands?)

#### **Key Objectives of Pricing Structure**

227. WIAL has provided considerable comment on its new pricing structure, approach and efficiency objectives in the consultation material provided to its substantial customers. This is similarly set out in the Price Setting Event Disclosure <sup>24</sup>.

228. The high level principles of WIAL's pricing approach are that they:

- Seek to encourage efficient use of WIAL's facilities where congestion is occurring or is expected to intensify.
- Seek to incentivise airlines to generate the growth in passengers included in the forecast for the period.
- Seek to align prices for all airport users receiving equivalent services. For airlines carrying passengers this in effect means paying the same average charge per passenger. Seek to recover fixed costs in an efficient manner.

<sup>24</sup> Further detail is provided in pages 53-60 of the Price Setting Event Disclosure document and the consultation documents available on WIAL's website

229. In considering whether prices are cost reflective, WIAL looked at a number of measures of cost. Traditionally at WIAL, cost in the context of pricing has been interpreted predominantly as average unit cost using total fixed and variable costs and units of passengers or tonnes. In the most recent pricing, WIAL has looked at costs in the context of efficiency and considered marginal and/or incremental costs in the short and long runs. WIAL believes that the resulting price structure improves the cost relatedness of charges from an efficiency perspective.
230. WIAL also looked at the issue of subsidies from the economic standpoint that a subsidy would exist if the price set for a service is not covering its *marginal* cost. In the short term (and excluding externalities), marginal costs are relatively low and therefore WIAL is confident that subsidies do not exist. WIAL acknowledges that subsidies may exist, particularly in the context of runway use in peak periods, if long-run incremental costs or externalities are included. WIAL's move toward peak period charges will progressively make these charges more efficient, noting measurement of externalities is complex and therefore precise costings are difficult.
231. WIAL notes that this rebalancing of prices from that applied in the previous period is being applied progressively over the pricing period.

### **Consumer Demands**

232. WIAL determined its pricing structure after seeking expert economic advice from Sapere and Leigh Fisher and following feedback in consultation.<sup>25</sup> WIAL's substantial customers expressed disagreement with implementation of the peak/off peak pricing approach in the period and proposed instead that WIAL and the airlines seek other opportunities to manage congestion such that the pricing structure could be reviewed in a subsequent pricing period.
233. WIAL considered this feedback but concluded that pricing which encouraged efficient use of facilities was necessary now in conjunction with other measures to develop improvements in capacity. WIAL formed this view because the runway, as its most critical facility, has its capacity exceeded at peak periods now and any material increases in capacity will be difficult to achieve.
234. A measure of runway capacity is the 30th business hour, and as reported in WIAL's 2011 annual information disclosures was 32 movements per hour<sup>26</sup>. This compares to a declared capacity of 36 and 38 movements per hour in visual conditions and 26 and 29 movements per hour in instrument conditions for runways 34 and 16 respectively. As a consequence, in poor weather which requires instrument conditions, runway capacity will already be exceeded at peak domestic flight times.
235. WIAL has therefore implemented a pricing approach that incentivised a shifting of demand from peak times (hence improving utilisation and reducing constraints) and in peak times landing charges are higher than those in off peak periods.
236. During consultation, WIAL proposed that the new pricing structure be introduced gradually over the pricing period. As a result congestion pricing does not commence until the second year of the pricing period and is then increased progressively over subsequent years.

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<sup>25</sup> Refer to consultation documents available on WIAL's website

<sup>26</sup> Refer to capacity table on page 58 of WIAL's Price Setting Event Disclosure

To what extent have airlines and other consumers of WIAL's services been able to make price-quality trade-offs that best meet their needs?

237. WIAL essentially provides a common set of services from its common facilities. WIAL's substantial customers did not propose any price-quality trade offs in respect of its services during consultation and no significant consideration has been given to them.
238. WIAL engages substantial customers extensively at the planning stage of major investments to ensure that new investments are of the quality demanded by customers (airlines and passengers). When costs are comprised primarily of capital costs, this is the most effective time for customers to express price-quality trade-offs.
239. If there were areas of service level provision that could result in meaningful cost avoidance, WIAL would seek to unbundle these.
240. An example where WIAL has sought to facilitate price-quality trade-offs is the provision of check-in facilities. The primary driver for pricing these on a usage basis (consistent with most other airports internationally) is to maximise potential utilisation and avoid bottlenecks and inefficient investment. However, this also provides an opportunity for airline customers to select the appropriate service level for its operation or individual service. WIAL notes Air New Zealand's highly efficient kiosk system complements this approach with a space efficient solution for its volume of operations.

How do airlines and other consumers of WIAL's services expect their demand to change in response to the prices set by WIAL in the second PSE, including the introduction of peak pricing?

#### **Airline Operators of Scheduled Services**

241. This is ultimately a question for airlines and other consumers of WIAL's services to provide specific responses.
242. However, WIAL provided its forecast setting out the proportion of aircraft that would operate at peak and non-peak times over the pricing period and presented this during consultation. WIAL's substantial customers did not provide any comments on its assumptions.
243. WIAL also considered how the extent of the change in prices arising from congestion pricing might influence air fares. This was set out in WIAL's Price Setting Event Disclosure, where WIAL proposed that it did not expect the new pricing structure to have a material influence on air fares <sup>27</sup>:

*"On Wellington's highest capacity route (Wellington-Auckland), which for the most part has a flight every 30 minutes, airline pricing models appear to incorporate Ramsay pricing to allocate peak time capacity to those passengers with the highest willingness to pay. For example, when booking next day travel on Tuesday 8 November 2011 (from airline internet booking site), a peak travel time 7am departure was priced at \$403 one way versus the off-peak 1pm travel option on the same day which was priced at \$102 one way.*

*The change in price structure means that WIAL's charges would lift the airlines costs by approximately \$2 for the peak-time traveller while providing a similar reduction on the off-peak. WIAL therefore intends that the new pricing structure signals to airlines that WIAL is seeking to encourage the efficient use of its facilities but does not expect the new pricing structure to have a material influence on air fares."*

<sup>27</sup> Refer to page 57 of the Price Setting Event Disclosure

244. WIAL notes that the challenges of forecasting demand changes given the complexity of not only passenger demand, but the impact of airline yield models, suggests an incremental approach to implementation. This is the approach WIAL has adopted, with modest initial levels that will be assessed continuously and changed either by agreement with airlines or through future consultation.
245. WIAL also notes that, outside the potential benefits of changes to demand, the introduction of peak pricing will enhance the efficiency of recovery of fixed costs due to the correlation of demand and time as evidenced through air fares that are materially higher in peak periods.

#### **Other Aircraft Operators**

246. Operators of non-scheduled services may be influenced by the introduction of congestion pricing and seek to operate their services in non-peak periods. These airlines carry substantially lower volumes of passengers or are not as time critical as jet services operating at peak times. As a consequence, the new price structure is likely to encourage these operators to no longer operate in the peak period and hence optimise runway efficiency.

What impact will WIAL's proposed prices, pricing structure and associated incentives have on demand and revenues?

#### **Impact on Demand - Incentive Programme**

247. WIAL has included an incentive programme in its pricing schedule that is available to all current or prospective airlines operating at WIAL. The objective of the programme is to encourage airlines to grow passengers at WIAL by provided discounted charges and reducing their start-up costs for new or expanded services.
248. The passenger forecast provided by Booz & Co were submitted to WIAL's substantial customers during consultation and included allowance for the introduction of new services and passenger growth in existing markets. The forecast was predicated on the fact that WIAL would be incentivising airlines to generate passenger growth. This is particularly apparent in the relatively aggressive assumption of 4.3% annual international growth. Following the receipt of consultation comments from its substantial customers a counter factual scenario was presented in WIAL's Final Pricing Document. This counter factual scenario illustrated that the expected passenger growth would be reduced in the absence of an incentive arrangement and that the average charge would consequently be higher by 43 cents per passenger<sup>28</sup>.
249. Sustained growth in the longer term will benefit all passengers in future price setting periods as revenue requirements are derived from a larger passenger base.

#### **Impact on Revenues - Changes from Forecast Demand**

250. WIAL bears the entire risk, or cost, if passenger numbers for the period are below forecast while the benefits are shared if passenger numbers exceed forecast. The extent of the sharing is determined by the market segment and the incentive arrangement, as summarised below:
- Domestic passenger growth – WIAL receives 50% of the standard landing charge in the year the growth occurs with a 25% discount provided in the subsequent year.

<sup>28</sup> Refer to pages 108-111 of WIAL's Final Pricing Document

- New international long haul services – WIAL receives no revenue from charges in the first three years.
- New route international short haul services - WIAL receives no revenue from these services in the first year of operation with discounts on this growth of 50% and 25% in the subsequent two years.
- Additional capacity international short haul services - WIAL receives 50% of the standard landing charge in the year the growth occurs with a 25% discount provided in the subsequent year.

## Benchmarking

What airports provide a useful benchmark for assessing the performance of WIAL, and why? Please provide any relevant benchmarking data if possible.

251. Benchmarking can be a useful means of obtaining indicators of market positioning or to identify performance outliers. However, benchmarking should not be used to form detailed conclusions on specific airports and should be used in conjunction with other measures of assessing performance.
252. The APC included a discussion on benchmarking in its recent report on Australian airports. Some key points the APC made with regard to benchmarking were:
- *“Benchmarking identifies airports’ relative performance. Benchmarking indicators can inform airport management about relative performance against similar overseas and Australian airports.*
  - *Benchmarking can also be used by regulators to foster ‘yardstick competition’ — although such efforts, for airports, have not been successful.*
  - *To be useful, airports should be benchmarked against a sample of Australian and overseas airports that share similar characteristics.*
  - *There are numerous impediments to effective benchmarking. These include differences across airports, data limitations and competing methodologies.*
  - *Unless benchmarking is constructed and interpreted carefully, there is a risk that inaccurate policy inferences will be drawn from unreliable estimates.<sup>29</sup>”*
253. WIAL considers that Australasian airports provide a reasonable benchmark for WIAL because their operating models and regulatory environments are similar.

### Leigh Fisher

254. Leigh Fisher undertakes an annual survey of a sample of international airports and publishes reports annually on Airport Performance Indicators.
255. These surveys report on how Australasian airports perform over a range of indicators. Whilst WIAL is not included in the report, it has calculated its own rating using the Jacobs methodology and this is attached on an extract from the latest 2011 survey in Appendix 1. WIAL considers that this analysis illustrates two key sets of outcomes:
- **Aeronautical revenue per passenger**

WIAL has calculated its aeronautical revenue per passenger SDR <sup>30</sup> as 4.52, Auckland Airport has an SDR of 6.12 as compared to the sample average of 7.44. Sydney’s measure is 7.07 while the other Australian airports are below 6. Australasian airports are in the middle range for international airports.
  - **Operating Costs per passenger**

WIAL has calculated its operating costs per passenger SDR as 1.8. The average SDR of the airports is 7.2 with Auckland Airport’s measure at 2.8 and Sydney at 2.3. Operating costs per passenger at Australasian airports are low compared to international airports.

<sup>29</sup> Australian Government Productivity Commission, Economic Regulation of Airport Services, Productivity Commission Inquiry Report, No 57, 14 December 2011, page 41

<sup>30</sup> Special Drawing Right (SDR) is the Leigh Fisher term for the rates used in converting local currencies to a single unit of currency.

### **Airbiz Limited**

256. Auckland Airport made an announcement on 7 June 2012 concerning changes to its aeronautical charges. This included a comparison of Australasian airport charges commissioned from Airbiz Limited (“**Airbiz**”) in their pricing announcement.
257. The Airbiz report provided more detailed comparisons of charges than are presented by Leigh Fisher and are attached in Appendix 2.
258. The Airbiz comparisons show that New Zealand airport charges are markedly below those charged in Australia with the difference most evident in the charges for the Q300 aircraft which is operated on regional routes in New Zealand.
259. This is a significant outcome and WIAL would suggest that this:
- Provides a strong indication that the AAA consultation regime is effective in producing cost effective charging outcomes for airlines operating within New Zealand.
  - Is an indication of the countervailing power that airlines have in the charge setting process in New Zealand, especially with regard to domestic regional routes.
260. In WIAL’s view it is the Commission’s role to evaluate and undertake appropriate benchmarking for airports, but recognising the concerns expressed above by the APC. WIAL would be happy to provide input to any benchmarking undertaken by the Commission.

### **Strengths and Weaknesses of The Current ID Requirements**

What are the additional costs to WIAL of complying with information disclosure?

261. As noted above, WIAL has devoted considerable time and resource to completing its obligations under the ID Regime. It has also incurred significant external costs during development of the ID Regime, and for completion of the required disclosures. The total regulatory costs over the previous 4 years (including internal staff time) is reported below:

<b>March Financial Year Ended</b>	<b>\$ million</b>
2009	1.0
2010	1.2
2011	0.8
2012	0.7
<b>Total</b>	<b>3.7</b>

262. WIAL notes that the internal staff time has involved the appointment of an additional staff member to complete the disclosures plus significant finance and senior management time. The ID Regime has also taken a significant amount of Board resource and a Disclosure Sub-Committee was established to assist the Board in the management of the new regime.



How much of the information disclosed during the recent price setting round would have been publicly disclosed, or disclosed to airlines, in the absence of information disclosure regulation?

263. The ID Regime replaces the disclosure regime that was previously contained in the AAA, so it is a matter of clear public record the extent to which the ID Regime requires additional detail.
264. Also, WIAL has always been committed to open and transparent consultation with the airlines and regulatory agencies. There has essentially been no limit to the amount of information available to these parties concerning WIAL's aeronautical activities in historical consultations.
265. In the most recent Price Setting Consultation, WIAL also decided to publish the key consultation documents on its website. This did not fundamentally change the amount of information available to customers. Indeed, the level of detail asked for by customers was in some respects less than previous processes due to the history of previous consultations and the extent of information exchange in the development of the ID Regime. Notwithstanding, WIAL considered that the increased transparency would:
- Increase the information available to interested parties (other than customers who have always received this information);
  - Improve the transparency of the consultation process;
  - Demonstrate the comprehensiveness of consultation and the robustness of advice received; and
  - Provide rationale for the pricing decisions made by WIAL.

What are the benefits to WIAL, airlines and other consumers of WIAL's services of using the information disclosed?

#### **WIAL**

266. In WIAL's view greater transparency of its Price Setting Consultation and actual performance outcomes will assist WIAL to receive more informed and improved feedback from customers, stakeholders and the Commission.
267. This in turn allows WIAL to better provide service quality improvements that meet customer demand and undertake appropriate R&D, innovation and investment. The increased transparency should also assist the Commission and Government in understanding the extent of consultation under the existing AAA regulation, countervailing powers of Air New Zealand and actual performance of airports over time.

#### **Airlines**

268. The information disclosures provide assistance to the airlines because they provide a detailed analysis of information in a convenient form for the airlines, thereby providing a more efficient reference point for the airlines to analyse and comment on WIAL's performance.

269. Public availability of customer service quality survey outcomes and 10 year investment planning also provide a further opportunity for WIAL's airline customers and stakeholders to comment on WIAL's investment planning, including the smaller airlines which do not directly participate in pricing consultation.

#### **Other Consumers**

270. The information disclosures provide a wide array of economic, financial and technical information concerning WIAL's performance that has not previously been available to parties other than WIAL's substantial customers and BARNZ. Consequently this provides considerable public transparency of WIAL's performance.

271. In conjunction with the section 53B(2) Commission summary and analysis reports other consumers now have the opportunity to form a view on WIAL's performance that has not previously been available to them.

What additional information (not captured in responses to the questions above) could be added to the current ID requirements that would better help you assess whether the purpose of Part 4 is being met?

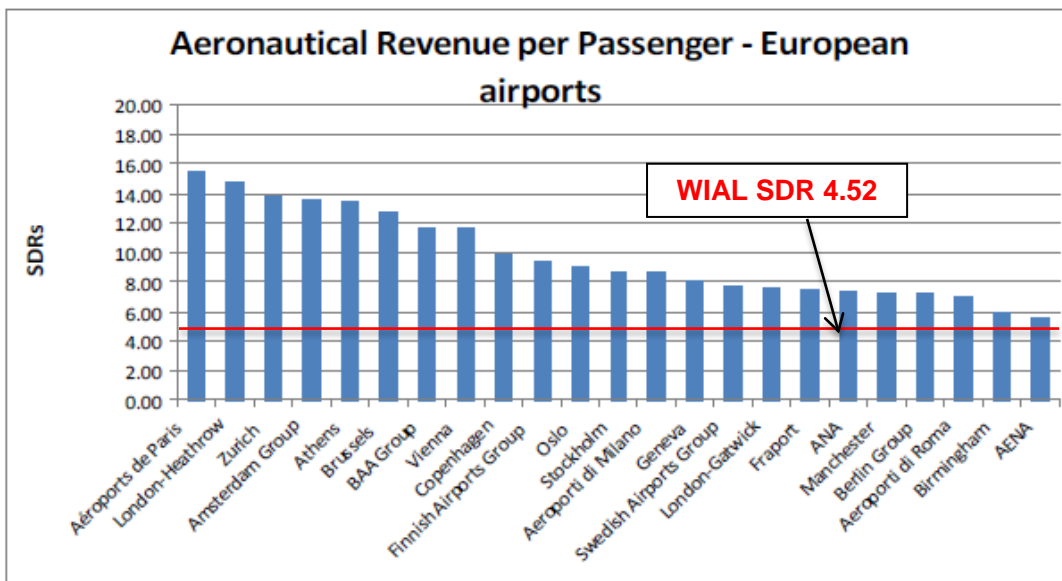
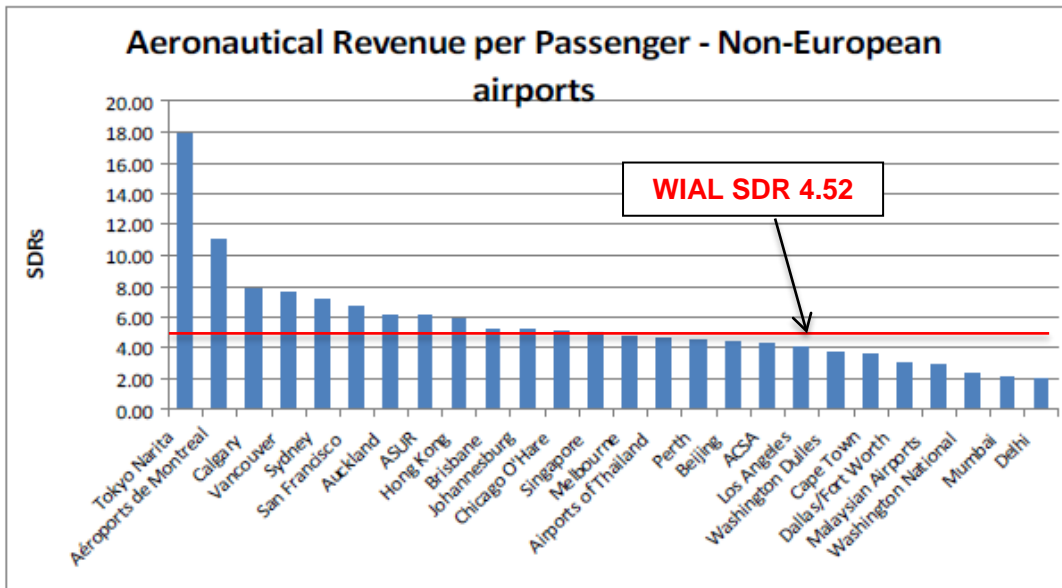
272. The ID Regime has only been in operation from publication of the input methodology and information disclosure Determinations in December 2010. While the airports have published initial annual and price setting event disclosures no feedback has yet been received on these; either from the Commission undertaking its monitoring reports as required in section 53B(2), or from other interested parties.

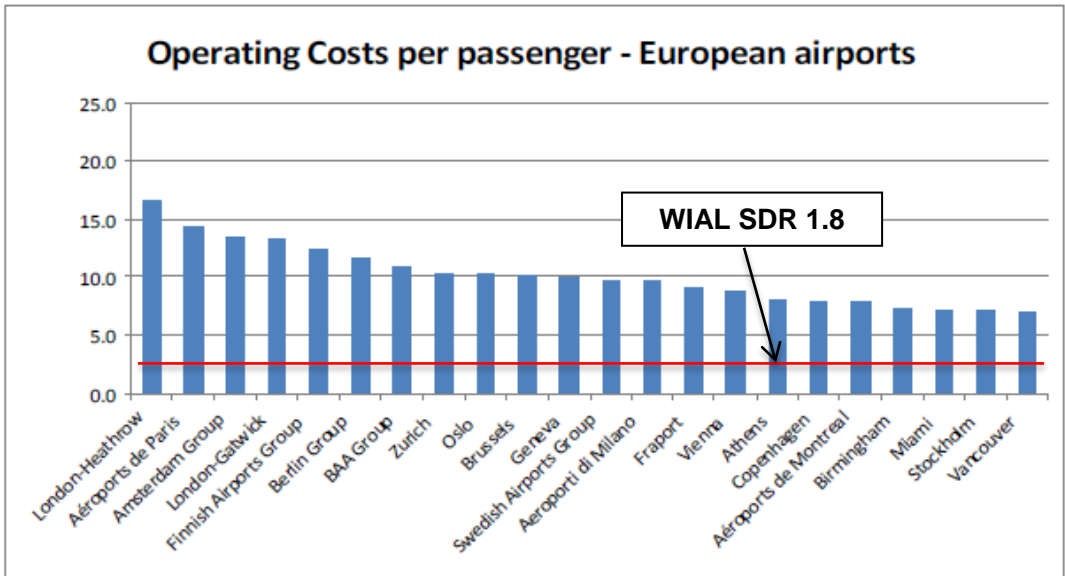
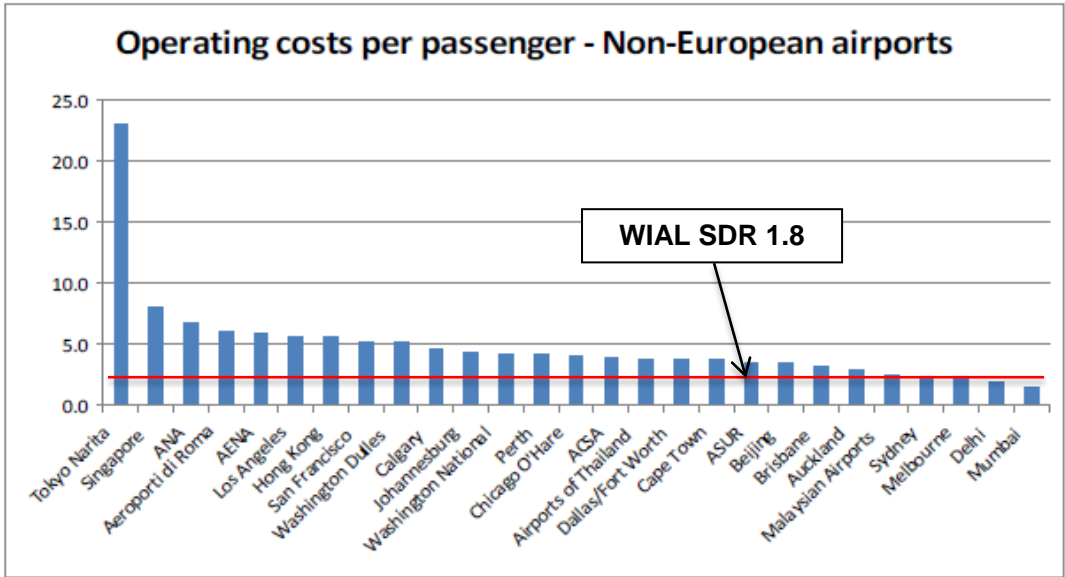
273. WIAL believes that the preparation of its review of the Section 53B(2) reports would greatly inform airports and other interested parties whether or not the disclosure regime is adequate (as well as informing this Review).

## Concluding Comments

274. WIAL has increased the depth and breadth of the information it discloses under the new ID regime. This includes:
- Information on service quality achievement;
  - Information on asset capacity and utilisation;
  - Information on long term capital expenditure planning, which should be considered in conjunction with WIAL's 2030 Master Plan;
  - Information on WIAL's financial outcomes;
  - Information demonstrating the rationale for the pricing calculations and approaches adopted by WIAL;
  - WIAL supplemented the above requirements of the ID Regime by publishing all key consultation documents, including expert reports and airline responses to WIAL's pricing information, on its website.
275. The assessment of the effectiveness of the ID Regime against the purpose statement for Part 4 of the Act will require a suitably long time-series of information to cater for variations in returns, demand and costs. With that said, some initial comments in respect of the performance of WIAL in meeting the purpose statement for Part 4 of the Act are:
- WIAL is presently targeting an overall level of return on investment below its company specific WACC, which was an outcome of the commercial concessions made during the most recent pricing consultation process. While rates of return may vary over time, a business must earn its WACC on average to make ongoing investment attractive.
  - WIAL is investing in the replacement, upgrade and addition of new assets through development of its apron and terminal facilities to meet expected increases in demand.
  - WIAL is seeking to achieve improvements in service quality that reflects consumer demands through the terminal enhancements that will improve passenger amenity.
276. WIAL is innovating and seeking efficiency gains from the ongoing design of capital expenditure projects to seek increasing efficiencies in utilisation of the airport site while forecasting reductions in real operating costs per passenger, which are already the lowest in Australasia.
277. Assessment of actual performance in terms of efficiency gains, sharing those gains with consumers, and the assessment of profitability, needs to be made over a longer timeframe than is currently available under the ID regime.
278. WIAL's actual prices were determined following a comprehensive consultation process and involved commercial compromise. WIAL's future profitability will be dependent on a range of factors, including: actual outturn costs for the operation of the airport, and capital and maintenance projects; actual funding costs; actual passenger numbers (and market factors that drive consumption of the services).
279. We believe that, over time, the information disclosed by WIAL will be sufficient to allow interested persons to assess the performance of airports against the Purpose of Part 4 of the Act.

Appendix 1 – Leigh Fisher Report Extracts





## Appendix 2 – AirBiz Analysis

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