

15 March 2013

Dr Mark Berry
Chair
Commerce Commission
P O Box 2351
Wellington

By email: regulation.branch@comcom.govt.nz

Dear Dr Berry

Submission regarding the s56G Conference for Auckland International Airport Limited

1. This submission is in relation to the conference held by the Commerce Commission ("Commission") on 26 February 2013 regarding the s56G review of Auckland International Airport Limited ("AIAL"). Wellington International Airport Limited ("WIAL") has considered the comments made by the speakers at the Conference and reviewed the transcript published by the Commission.
2. WIAL takes this opportunity to make a submission and we have provided comments on our key concerns below.

Interrelationship Between Investment, Efficiency, Service Quality and Profitability

3. WIAL notes that the Commission intends to use the same approach and analytical framework in its review of AIAL that was applied for WIAL.
4. As submitted previously, WIAL reiterates that it is critical that any assessment fully considers the interrelationship between the four limbs of the Part 4 objectives. As reported by AIAL at the conference, it like WIAL, is committing significant investment in its infrastructure, providing world class and award winning airport services, at a high quality as reported by the high ratings in the Airport Service Quality surveys and at low operating costs as demonstrated by benchmarking information.
5. It is important that the limbs regarding investment, efficiency and quality of service are given appropriate prominence in assessing the effectiveness of the new information disclosure ("ID") regime, as opposed to a narrow or unbalanced focus on the earning of so called excess profits.
6. The Commission has also asked whether there are any areas of superior performance. WIAL considers that the achievements noted above are excellent examples of such performance and reflect the clear interrelationship between investment, efficiency, quality and price.

Internal Rate of Return

7. The Commission commented at the conference that it was intending to apply its internal rate of return ("IRR") approach in respect of AIAL¹. This was reflected in discussions and the request by

¹ Commerce Commission AIAL Transcript pages 2-3

Wellington Airport Limited

Corporate Office TEL +64 (4) 385 5100
Main Terminal Building FAX +64 (4) 385 5139
Stewart Duff Drive EMAIL mail@wellingtonairport.co.nz
PO Box 14175 www.wellingtonairport.co.nz
Wellington 6241
New Zealand

the Commission for AIAL to indicate the approach it intended to take for asset valuation in the price setting process for PSE3².

8. The Commission's IRR approach produces rates of return that presume future pricing behaviour beyond PSE2 by making an assumption that the asset value forecast for the end of PSE2 reflects the long term pricing expectations for the airport for PSE3 and beyond. This notably also assumes that the forecasts regarding investment and asset revaluation (in the case of WIAL) are met exactly as forecast during PSE2.
9. This approach wrongly assumes that the airports will not be influenced by the Commission's s56G reviews or its s53B reviews of annual information disclosures over the coming years. The airports will need to fully consider future pricing in a manner that takes into account conclusions reached by the Commission.
10. In view of the above, WIAL considers that it is inappropriate for the Commission to include prospective or forecast outcomes or those which incorporate assumptions on asset valuation beyond PSE2. The approach to asset values in consultation at a time almost 5 years in the future from now is unknown and far from certain, in fact the only certainty is that the Commission's forecast will be wrong.
11. As a consequence, WIAL reiterates that the Commission should only be assessing airports based on actual outcomes since the commencement of the new ID regime and assess this performance over time.

Commission's Application of the IMs to Price Setting

12. Despite retention of the price setting regime under the Airport Authorities Act 1966 ("AAA") and confirmation by the Commission that the airports are not obliged to apply the input methodologies ("IM") in price setting, the Commission has expressed the view that the IM's provide benchmarks to evaluate the pricing outcomes forecast by the airports.
13. However, this benchmark ascribed by the Commission using the IM's appears to be applied as a bright line or price control approach which was unexpected and unknown when WIAL was undertaking pricing consultation, and presumably also the case for AIAL.
14. The airports faced considerably uncertainties regarding application of the ID regime during their price setting processes including:
 - The ID Regime was new and only recently introduced in December 2010;
 - The airports had not received any indication from the Commission as to how the regime would be applied and assessed, such as through its expected s53B reviews;
 - The airports considered it reasonable that justified variations from the IM's would be appropriate and recognised by the Commission;
 - The airports had no information as to how the Commission would recognise commercial conduct, and arrangements, by the airports in price setting; and
 - The High Court merits review remained unresolved.
15. The Commission's analytical framework was not known until publication of the Commission's draft s56G report for its WIAL review and this was after completion of the AIAL price setting event for PSE2. AIAL, and WIAL, therefore could not have contemplated outcomes calculated in the manner by the Commission's analysis. The Commission's approach of moving the goal posts is unhelpful and misleading.

² Commerce Commission AIAL Transcript page 31

16. Consequently in undertaking its review for AIAL, the Commission should have regard to these uncertainties and recognise that in future pricing decisions airports will be more fully informed on its approach.

Commission's Treatment of Consultation Approaches

17. Commercial or risk sharing arrangements can be seen in the consultation approaches taken by each of the three airports subject to the ID regime, including the asset valuation moratorium adopted by AIAL for the period 2007 to 2017. These arrangements can often extend over more than one pricing period and potentially for the long term. As a consequence, the Commission should ensure that it:
- Analyses airport cash flows and not make adjustments to these cash flows due to a different interpretation of commercial arrangements; and
 - Assesses returns over time. For instance returns in one pricing period could be offset by the impact of a commercial arrangement that produced lower cash flows in an earlier pricing period.
18. The Commission should also undertake a qualitative assessment of airport commercial conduct to conclude on whether airports are taking positions in the price setting decisions that are in the long term interests of consumers and the New Zealand economy. For example are airports seeking to incentivise the long term growth in passenger numbers promoting travel and tourism, and are airports adopting risk sharing approaches where forecasts are uncertain or market variations from forecast can occur. Such conduct is undertaken while looking to maintain appropriate investment and service quality levels.
19. Such conduct is consistent with competitive markets and should be recognised in the Commission's conclusion on whether the ID regime is effective and the Part 4 objectives are being achieved.
20. The adjustment of airport cash flows for commercial concessions will put at risk the adoption of such arrangements going forward, since there can be no certainty as to how these may be treated by the Commission.

Airport Sector Performance

21. WIAL considers that the Commission should evaluate AIAL's performance within a market context. An appropriately balanced report to Ministers should confirm:
- Achievements in respect of the specific limbs of Part 4;
 - Airport conduct in seeking to achieve the best outcome for consumers, the New Zealand economy over the long term in terms of impact on price and seeking to encourage volume growth, tourism and travel; and
 - The level of airport performance in New Zealand ie are airport consumers in New Zealand receiving appropriate quality services at an appropriate price. Independent international airport benchmarking information has been provided to the Commission by the airports and BARNZ to enable the Commission to consider these issues.
22. WIAL considers that it is the combination of these factors that provide an informed view of whether ID regulation has been effective and whether the airports are seeking to promote the long term interests of consumers and New Zealand.

Airport Specific Weighted Average Cost of Capital ("WACC")

23. During the s56G review of WIAL, WIAL submitted that it would be appropriate for the Commission to consider variations from its WACC IM that reflects the specific characteristics of WIAL.

24. AIAL has also submitted that variations from the WACC IM are appropriate for AIAL. WIAL again submits that the Commission should consider whether variations to the WACC IM are appropriate for individual airports in setting prices under the AAA.
25. AIAL has provided clear evidence to the Commission that its actual cost of debt exceeds the cost of debt calculated through application of the Commission's IM demonstrating that the Commission's WACC assumptions do not appropriately recognise the real market circumstances faced by AIAL.
26. If this situation persists in the medium to long term, ongoing investment by AIAL, or the other airports, may be compromised. It would not be rational for airports to seek further equity or debt capital for investment if the cost of funds is not met by the WACC used by the Commission to evaluate the outcomes from airport pricing decisions.
27. The Commission's approach to the WACC IM therefore represents a significant risk and disincentive for airports to continue to invest in facilities and promotion of passenger growth which is contrary to the Part 4 objective.
28. If you wish to discuss any comments further please do not hesitate to contact me on 04 385 5105 or at mharrington@wellingtonairport.co.nz.

Yours sincerely



Martin Harrington
Chief Financial Officer