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31 January 2024

New Zealand Competition Commission
44 The Terrace
P.O. Box 2351
Wellington 6141
New Zealand

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

Re: Feedback on proposed review of AIAL’s 2022-2027 price setting event

The Qantas Group welcomes the opportunity to provide comments on the Commerce Commission’s approach to assessing Auckland International Airport Limited’s (AIAL) PSE4 proposals.

The Qantas Group appreciates the need for significant investment in AIAL and supports the efficient development of necessary infrastructure. However, the Qantas Group has significant concerns about PSE4 and its impacts on future PSEs including:

- A terminal footprint around twice what is required;
- Construction costs around 40 per cent higher than efficient;
- Unnecessary non-terminal work;
- Inappropriate aero /non aero splits;
- Opex higher than benchmarks in NZ/AU
- The role of PSE4 expenditure in driving future expenditure;
- The quantum of existing expenditure; and
- The risk that the passage of time and the construction of preliminary stages will restrict the ability to change direction.

Overall, the Qantas Group considers that the 10 year aeronautical capital plan is more than \$2 billion over what is necessary and efficient. We would expect aeronautical expenditure to be under \$3.6 billion across ten years and expect a deeper review of airfield and landside work to reduce this amount further.

[Redacted]

[REDACTED]

We have set out our responses to the specific issues raised in Attachment A and included some additional matters that we consider significant.

We are available to assist with any questions the Commerce Commission may have.

Yours sincerely,

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Head of Commercial - Airports

Is Auckland Airport Targeting Excessive Profits?

In the Qantas Group's view, there are five key components to the answer to this question, and these could form separate questions to avoid duplication.

- WACC: AIAL is proposing to charge a WACC above the real costs of capital
 - The WACC claimed is 8.73% as opposed to 8.02% per the recent input methodologies decision.
- Capital: Gold-plating to maximise profitability. The Qantas Group believes that the terminal is substantially over-designed and that elements of the non-terminal capital plan are not required. We believe the terminal (headhouse, apron and pier) should be built for less than \$690m not approximately \$2b, and the overall aeronautical expenditure for the 10 year capital plan should reduce to less than \$3.6b, we expect a deeper review into airfield and landside work to be conducted to potentially reduce this even further.
- Aero/Non-Aero Splits: Inappropriate allocation of costs to aeronautical activities, freeing up additional margin in non-aeronautical businesses. The Qantas Group believes that there are some inherent issues in current methodologies, as well as some unreasonable splits in PSE4. These could form two separate questions: methodology and application.
- Opex: AIAL's opex exceeds multiple Qantas benchmarks by about 200%.
- Locking in Future Expenditure: PSE4 is effectively a Trojan Horse for PSE5 expenditure. The ties between PSE4 and PSE5 mean the decision made now will largely determine the capex that will be included in PSE5. Of the remaining \$3.1bn capital spend planned in PSE5, 63% is linked to projects commenced in PSE4.

We recommend asking:

1. *What is your view of the efficiency of:*

- a) *AIAL's WACC*
- b) *AIAL's Capital Plan*
- c) *AIAL's Operational Expenditure*

2. *What is your view of the fairness of the aero/non-aero allocations?*

- a) *Current Allocation Mechanisms*
- b) *The appropriate allocation*

3. *Do you see any risks beyond PSE4 for decisions taken in PSE4.*

4. *Is the airport earning excess profits through PSE4 pricing and capital plan?*

Is Auckland Airport's Approach to forecasting depreciation reasonable?

Forecasting depreciation has three components:

Quantum of Capex

- This can be addressed within the capex section of inquiry

How the costs of depreciating assets are spread over time within the asset base

- Given that any deferral of depreciation results in the RAB remaining higher and WACC being payable on that higher RAB, the Qantas Group does not see material benefit in aligning depreciation with passenger demand. An early/oversized RAB that flows through to charges will not be materially mitigated by depreciation alone. The core issue is the over-capitalisation which has been described above .
- AIAL's position is that the Integrated Domestic Terminal is necessary as the existing Domestic Terminal Building is no longer suitable for jet usage due to the contingent runway. The Qantas Group disagrees with AIAL's position and therefore we disagree with need for accelerated depreciation. We have raised this issue with AIAL but are not aware of any serious consideration of options to re-use the terminal by AIAL. The Qantas Group believes that the existing terminal can be used for some level of Domestic facilitation, which in turn would reduce the size of the Integrated Domestic Terminal.

How assets flow into the asset base

- What assets flow through to the BBM and charges and how inefficiently incurred expenditure is managed is a more complex question driven by the material inefficiencies in the capital plan and requires consideration of:
 - a) How to determine an efficient asset base:
 - Qantas considers multiple data reference points, including benchmarking to other comparable airport builds, QS reports and also a counterfactual design prepared by Arup on which Qantas and Air New Zealand largely concur, as a good basis for determining efficiency.
 - The non-terminal capital expenditure warrants further discussion given that consultation has failed to deliver alignment.
 - b) What to do about it:
 - A key challenge will be how the NZCC responds in a way that causes AIAL to remedy the inefficiency promptly rather than proceed with its plan and adversely impact shareholders or the industry and consumers.

We recommend asking:

1. *What is your view on the method and timing of depreciation of the asset base?*
2. *What is your view on the timing of assets entering the asset base?*
3. *How do you believe any differences between the timing of construction, and the timing of utilisation of the asset should be addressed.*

To what extent does the demand forecast provided by Auckland Airport in its PSE4 disclosure reasonably reflect expectations for future demand, and why?

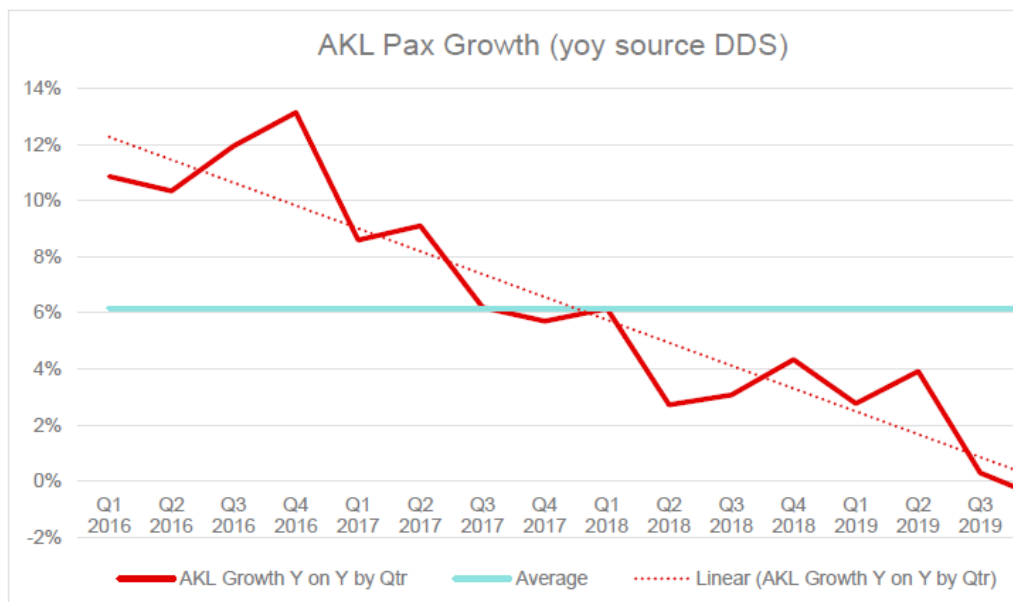
The Qantas Group has serious concerns about the passenger forecast:

- a) We are not convinced that there is any immediate need for the capacity based on the forecast.
- b) While we accept that growth is a possibility, AIAL was trending towards negative growth prior to the COVID-19 pandemic and has recovered more slowly than other ports. Given the costs of sunk investment, it would have been prudent to wait before investment.
- c) The constraints of price-elasticity have not been properly considered by AIAL.
- d) The implications of the capital plan will have a material impact on NZ aviation through:
 - Reducing demand;
 - Reducing capacity;
 - Possibly reducing the level of competition on routes, days of the week with a compounding reduction in capacity; and
 - Cyclical impacts on other airport BBMs at their PSEs and on AIAL's at the next PSE.

The Qantas Group believes the NZCC needs to split its consideration to determine:

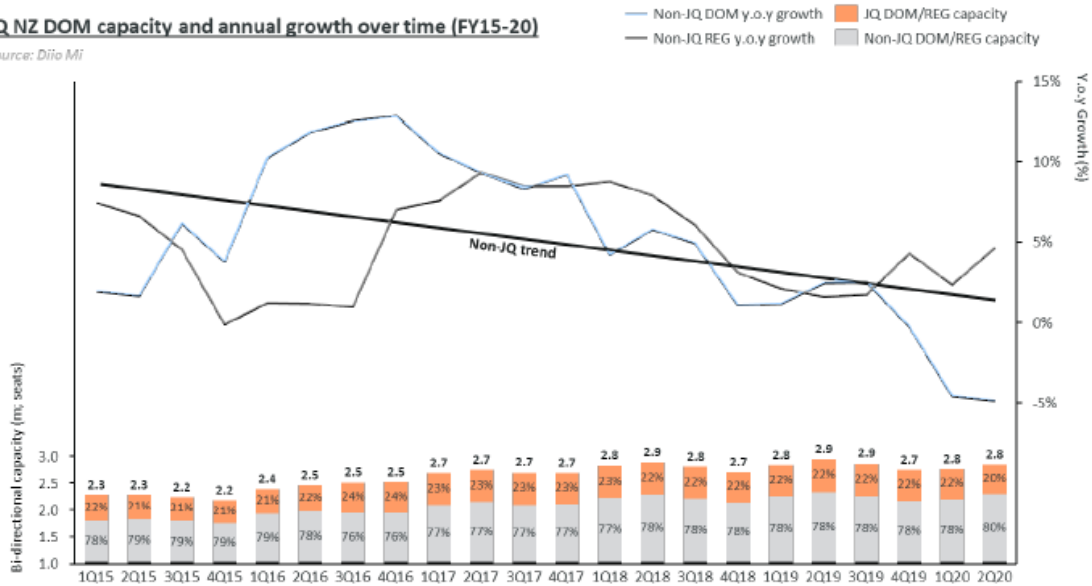
1. *Is the unconstrained growth forecast correct?*

- Prior to the pandemic, growth had been declining to the point that it was expected to be negative in 2020, and the decline was not solely attributable to Jetstar's withdrawal from regional ports.



JQ NZ DOM capacity and annual growth over time (FY15-20)

Source: Dito Mi



2. *Is now the time to invest given the market signals or have we seen a pattern to justify investment?*

- One A320 Neo engine type is experiencing operational difficulties leading to availability issues.
- WLG traffic appears to be flatlining at beneath 90 per cent of 2019 levels which could be a concerning indicator for wider NZ traffic.
- AIAL has a slight lag compared to Sydney and Melbourne and is still around 90 per cent of pre COVID levels. Traffic has not found its plateau yet – we need to see where that plateau is given the increases in costs of operations in New Zealand.
- With the significant threat to international flying of the proposed additional taxes, it may be that some international capacity can be repurposed.

3. *Are the constraints on demand applied by AIAL correctly considered?*

- AIAL has materially underestimated the impact on demand through fundamental flaws in its approach to estimating the impacts.

█ [Redacted text]

4. *What are the implications for aviation?*

█ [Redacted text]

5. *What are the implications for the wider economy?*

■ [REDACTED]
[REDACTED]

recommend you ask the questions in italics above.

Is the two-way wash-up reasonable?

We agree with this question.

- AIAL is investing in capacity when it is uncertain that capacity is even required, against the wishes of its airline customers and despite airlines' view the quantum of the capex will substantially mitigate any need due to reduced demand.
- AIAL is asking airlines to guarantee AIAL's revenues against the consequences of the additional risk created by an over-investment that airlines have actively opposed.
- There was no need to commence construction when AIAL did so, which occurred despite Qantas Group feedback.

Specifically, we believe NZCC should inquire into:

- a) Do airlines support the risks inherent in this investment and should they share it?
- b) What are the risks?
- c) Could uncertainty be mitigated by more work/deferrals of investment?
- d) Is this approach reasonable in a consult and notify environment and what incentives does it create for monopoly airports where the monopoly can unilaterally invest and pass the risk back to airlines?

We recommend you ask:

- 1. Do you support the risk in this investment and how it is shared in PSE4?*
- 2. What are the risks in this investment?*
- 3. Could the risks be better mitigated and if so, how?*
- 4. How does risk sharing impact the consumer now and in the future?*

Is Auckland Airport investing in its assets appropriately and at a quality standard that reflects consumer demands?

We agree with this question.

Qantas does not have a full answer to this question now, but believes it merits inquiry. Our immediate position is:

¹ [iata.org/en/iata-repository/publications/economic-reports/new-zealand--value-of-aviation/](https://www.iata.org/en/iata-repository/publications/economic-reports/new-zealand--value-of-aviation/)

- Whilst capacity requires improvement, the low-fares model does not require the level of integration that is being planned. However, Qantas appreciates that an airport with a full-service carrier and especially a hub would be reasonably expected to explore integrated pathways as capacity is required.
- In addition to questions of charging vs investment, over-ambition on capex and a failure to appropriately phase build should be looked at as a contributor to delays in improving the domestic travel proposition

We would suggest that:

- a) The NZCC should undertake a review of anticipated capex in PSEs 1, 2 and 3 against actual capex.
- b) The NZCC should ask airlines and the airport their views on any drivers of their answers so that we understand how to remedy any gaps between airline and airport expectations

We recommend you ask:

1. *Do the level and timing of forecast capital and operational expenditure for PSE4 appear reasonable?*
2. *Is the capex washup mechanism reasonable*
3. *Do you have any views on historical earnings and investments in facilities?*

Do the level and timing of forecast capital and operational expenditure for PSE4 appear reasonable? Is the capex washup mechanism reasonable?

The Qantas Group believes that this question should be split into three:

- a) Capital Expenditure Plan – addressed above
- b) Operational Expenditure – addressed above
- c) Washup

We recommend you ask:

1. *Is the capex washup reasonable?*

We also believe that there is a need for a question about the role of PSE4 expenditure in locking in a path to additional PSE5 expenditure e.g. to what extent do PSE4 decisions impact expenditure in future pricing periods.

Although AIAL states that no decisions have been made on the PSE5 aeronautical capital expenditure projects and suggests that prices during PSE5 are uncertain, we know that of the remaining \$3.1bn planned in PSE5, 63 per cent is linked to PSE4. This would be extremely difficult and costly to pivot

away from ahead of setting prices for PSE5, seeing as works could have already commenced. In effect, this decision is also a PSE5 decision.

Are there any concerns that the prices set are not efficient?

This question is effectively answered by other questions. Some generic questions would suffice but are potentially best covered in an introduction or summary position eg.

We recommend you ask:

1. *Given your responses, do you have concerns that the plans and prices are not efficient.*

Is Auckland Airport being innovative?

The Qantas Group support the technical question. We also believe it is important to consider the quality of consultation as part of assessing the level of innovation and in providing context for questions of efficiency and optimal consumer outcomes.

We recommend you ask:

1. *Is Auckland Airport being innovative?*
2. *Do you believe the consultation was effective in delivering efficient and innovative plans and pricing?*

Other Feedback

Sunk Costs

Given significant premature investments by AIAL, the demonstrable inefficiencies in the capital program and excessive charges, and the impact on the New Zealand economy, the Qantas Group believes it is essential to change direction. That invites a question around the treatment of wasted costs. We suggest that the NZCC asks the industry its view on how any sunk costs of changes arising from the review should be managed and what communication airlines have had on this subject with AIAL.

We recommend you ask:

1. *In the event of a decision that the plans and or pricing are determined not to be efficient, and an alternative path is recommended, how do you believe sunk costs should be treated?*

Criticality & Timing

The Qantas Group believes that a rapid solution is critical. We recommend further discussion about how that might be achieved.

We recommend you ask:

1. *Do you have any recommendations on how to expedite PSE4 pricing and recommendations?*

Regulatory Change

The regulatory regime has not worked in this instance.

- a) It is inconceivable that a supplier in a competitive market would invest \$5.6bn in assets that its customers disagree with when its customers are recommending an investment of far less
- b) [REDACTED]
- c) AIAL has sufficient confidence, in spite of airline opposition, to invest significant sums in a development plan that its customers do not want. If regulation were working effectively to prevent gold-plating, the risk of costs being worn by AIAL shareholders should have precluded the airport from proceeding.
- d) The Qantas Group is dissatisfied with the consultation process:
 - a. Suggestions by the Qantas Group were insufficiently explored.
 - b. The airline industry has had to invest significant sums to demonstrate counterfactual points of view on demand and capex plans when a transparent, responsive and constructive consultation could have delivered that outcome from much sooner and much more efficiently.
- e) The NZCC does not have the power to ensure this situation is remedied before AIAL is able to sink sufficient investment into the project to the point that proceeding gains momentum. Qantas Group is concerned that there may be other reasons behind AIAL's unwillingness to meet its customers' requests to reduce the quantum of the proposed capex. These could potentially include impacts to valuations, share sales, reputations or other reasons that are not motivated by a desire to deliver good, efficient services.
- f) There is a post-COVID trend to desynchronize capital and pricing consultations, and to transfer risk back to airlines with true-ups. This has already diminished the usefulness of the ID regime and there is no statutory method to require resynchronisation of consultation processes.
- g) Airports have signalled their intent to diverge from the NZCC's views and to challenge them formally.

Overall, the Qantas Group believes that the current system of regulation is not operating to deter inefficient investment.

We recommend you ask:

1. *How useful is the information disclosure methodology? What challenges does it present with regards to PSE4 and major capital expenditure?*

2. *How useful is the Information Disclosure regulatory approach? Do you believe any changes are required?*
3. *How does AIAL compare and contrast with other airports and are there any other lessons learned from PSE4 that should be applied more widely?*