22 March 2013

Ms Ruth Nichols
Senior Legal Counsel
Regulation Branch
Commerce Commission
PO Box 2351
Wellington 6140
New Zealand

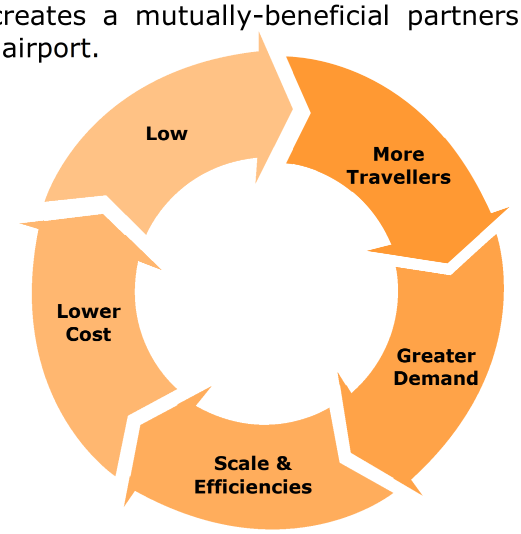
Dear Ms Nichols

Commerce Commission Request for feedback re Christchurch Airports five year Aeronautical Pricing

The Qantas Group (Qantas) consisting of Qantas Airways and Jetstar Airways thanks the Commerce Commission for the opportunity to provide feedback on the Christchurch International Airport Limited (CIAL) five year Aeronautical Pricing effective December 2012.

Summary

Qantas understands that CIAL have made a significant investment in the airport and is entitled to follow a pricing methodology in order to validate a return. At the same time Qantas would like to reemphasise how important a business partnership that encourages the additional capacity and competitive airfares is to Qantas and the Airport's success. The additional passenger numbers and flights will in turn drive more revenue for the airport, which will translate to a further lowering of aeronautical charges through increased scale. Thus this virtuous circle creates a mutually-beneficial partnership of value creation and growth for both airline and airport.



The situation presented in Christchurch is in reverse where aeronautical charges have increased by outrageous and unsupported amounts. Unfortunately Qantas has no choice but to pass these costs on to customers. Experience has shown that across the board increases in prices in highly price sensitive markets (not tied to market demand) will typically lead to a corresponding decline in market demand. Any imposed price increases in the discount sector results in a reduction in passengers, less flights and reduced commercial revenue for the airport. Analysis indicates a $1 reduction in airline revenue results in a $7 reduction for the broader tourism market. Unfortunately the potential impact can be up to three times greater for the broader economy through direct and indirect spending from ticket sales and related travel industry contributions.

Qantas is a large supporter of Christchurch and is keen to see the market return to historic levels. We are therefore extremely concerned that the short term approach the Airport has taken in order to drive excessive returns is putting airline investment at risk to the detriment of airlines, airport, future tourism and the broader community.

Key Issues driving excessive returns

Qantas believes there are a number of key issues driving CIAL's excessive returns:

1. Qantas is concerned that CIAL is taking a conservative approach to its domestic passenger forecasts. With the additional Auckland and Wellington services, Jetstar is forecasting 11% growth in this FY13 and similar growth over the next few years. Airport passenger forecasts are below previous growth rates and do not reflect the level of recovery airlines, media and CIAL's route development team is spruiking in the next five years.

2. The WACC in the pricing diverged significantly from the Commerce Commission's framework and Qantas strongly urges the Airport reconsider its model. While we recognised that CIAL is not bound to apply the Commission's Input Methodologies, Qantas was concerned by the major diversions from the Commission's recommendation and reiterates its request for CIAL to use a revised model that provides a more equitable outcome for all parties. For example, the Commerce Commission's identified a five year risk free rate of 2.78% in the review of in their determination of the cost of capital for CIAL in FY13. This was significantly less than the 6% rate proposed by CIAL. Qantas requests for CIAL to use a more realistic and forward looking cost of debt in its WACC calculation by adopting a risk free rate more in line with the Commission's recommendations. Qantas also requested for CIAL to adopt a five year term of the risk free rate in line with the period of the pricing review as the term should be determined by the length of the time between WACC reviews. By adopting a risk free rate greater than five years it was our view that CIAL was overcompensating for inflation.

   Qantas was also concerned with CIAL's gearing ratio and believes CIAL should apply the 17% ratio presented by the Commerce Commission as an efficient debt structure for airports. Qantas also requested CIAL updated their market risk premium in line with the current situation and adopt a 7% market risk premium in the final pricing decision. Finally Qantas believed an asset beta of 0.7 was unjustified given the Commerce Commission's determination occurred after the major earthquakes suggesting an asset beta of 0.6 was more reflective of the future.

3. Qantas is concerned that CIAL has treated asset revaluations as taxable income. In doing so, CIAL has misrepresented the allowable revenue to be $35m higher than it should be. As per the Commerce Commission, the airport should deduct revaluations from income before calculating the regulatory taxable income and regulatory tax.

4. Qantas is concerned by the proposed level of operating costs and the significant increase from the IPP. Qantas considers that a flat or reducing cost per passenger sets an appropriate benchmark for efficiency and generates innovations. Of particular concern was the significant increase in labour costs over the next five years. The cost of personnel increases by 8.7% and 6.3% in the first two years of the proposal despite passenger forecasts and provision of aeronautical services remaining relatively unchanged. Despite the large increase in retail, the portion of operating expenditure allocated to commercial activities remains relatively unchanged from FY12. We suggested a rebalancing of the allocation of costs toward commercial activities was an more equitable approach.

5. Qantas supported the simplification of charges through including children (aged 2 – 12 years) as passengers eligible for the international terminal charge and requested an associated reduction in the level of charges.

6. Qantas supported the removal of all future capital in the model that has not been committed and the introduction of a 'Necessary New Infrastructure' (NNI) mechanism

whereby CIAL consult with airlines on future capital spend on a regular basis. In the event there is a need to invest in aeronautical capital there will be a corresponding adjustment to the aeronautical charge of future years.

7. Qantas is concerned by the level of assets and capital works allocated to aeronautical activities. For example only 7% of public and common space in the ITF is allocated to commercial activities. Qantas believes public and common space should be allocated equally between CIAL's aeronautical and commercial activities. The Air-conditioning / Artesian works (Civil Landside) should also be shared equally between commercial and aeronautical activities as it benefits both parties.

8. Qantas does not understand why certain capex projects, in particular the Airfield Pavement Maintenance of $30m is more than three times more expensive than other airports of similar size and requested more information prior to supporting its inclusion in any pricing outcome.

9. Significantly lower fixed charge for aircraft under 20 tonne that results in Jet aircraft bearing a disproportionate share of airfield costs. The subsidisation of turboprop aircraft is against the ICAO user pays principles and falsely stimulates demand of an inefficient, costly segment at the expense of other users and the airport. Over time such behaviour will drive congestion and the cost to reset this will be too high for incremental business adjustments to be made. Qantas requested for CIAL to apply consistent movement and MTOW charges for all aircraft types to ensure airfield costs are recovered in an equitable manner.

10. Finally Qantas recommended a long term pricing cycle of 9.5 years (to June 2022) with key elements such as the WACC and passenger forecasts reviewed in consultation with airlines every three to four years. This approach would have enabled CIAL to spread the investment over a longer period of time reducing the price shocks in earlier years.

Conclusion
Qantas appreciated that CIAL consulted with airlines when determining future aeronautical charges however are concerned that feedback was not considered. Qantas remains committed to servicing Christchurch and therefore remain very concerned about the impact pricing shocks will have on the Christchurch market at a time when the collective industry cannot afford this outcome.

If you have any questions or require and further clarification on the points I have raised, please feel free to contact me.

Yours sincerely

Tim CH Castine

Tim Castine
Manager Aviation Charges