12 December 2017

Introduction

1. This is the New Zealand Airports Association ("**NZ Airports**") cross-submission on process, timing and changes to the proposed scope set out in the process and issues paper for the review of Auckland International Airport Limited's ("**AIAL**") and Christchurch International Airport Limited's ("**CIAL**") third price setting events (July 2017 - June 2022) ("**Issues Paper**").

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Executive Summary

3. A key theme of the Air New Zealand ("**Air NZ**"), Qantas and BARNZ (**"Airlines"**) submissions is that the scope and extent of the review should be significantly expanded, and that the timeframe should be extended, to expressly address each limb of the Part 4 purpose statement and to include assessment of annual disclosures.

4. We oppose this proposal, and strongly encourage the Commerce Commission ("**Commission**") to retain its proposed scope and timeframe for the review. The Airlines' rationale for their proposal is that summary and analysis should promote a full understanding of performance, and is an important part of maintaining an effective information disclosure ("**ID**") Regime. This rationale has merit, however, the Commission's proposed approach to the review is the better way to achieve it, and is entirely consistent with the Part 4 framework. In particular:

   (a) Section 53B(2) and the Part 4 purpose statement provide the Commission with flexibility to run an efficient and targeted review, according to the topics outlined in the Issues Paper.

   (b) Those topics have been selected to focus on matters that the Commission considers warrant closest scrutiny, bearing in mind the content of price setting disclosures and the circumstances of each airport. It appears to us that the topics provide sufficient scope to consider matters that BARNZ has identified in its reviews as being of concern.

   (c) When considering each topic, the Commission can, and should, consider all information relevant to promoting a proper understanding – which will include quality, innovation and efficiency considerations as relevant.

(d) This approach will be better at promoting an understanding of performance and better contribute to an effective ID Regime. We strongly disagree with assertions by Airlines that the ID Regime is deficient. The airports have a strong history of engaging with the ID Regime and responding to guidance provided by the Commission.

5. NZ Airports acknowledges the concerns raised by Airlines about the absence of summary and analysis for annual disclosures. However, it was not suggested when the section 56G review was carried out after PSE2 that the annual disclosures should be formally incorporated into the pricing review, so we do not understand why it is considered to be necessary now. Relevant information from annual disclosures can be taken into account under this review without the need for a full and formal assessment, which would unjustifiably extend the timeframe for the pricing review process. The appropriate form of summary and analysis for annual disclosures is something that interested parties should continue to engage on following this review.

6. Our experience during the Input Methodologies ("**IM**") review process was that development and application of the ID Regime was becoming much more collaborative between parties, and we would like that to continue. Further, airports greatly appreciate the valuable contributions Airlines make to pricing consultation. Nevertheless, it is not surprising that the Airlines have used this process to repeat their calls for negotiate-arbitrate regulation. We trust that the Commission will not be inappropriately influenced by this lobbying when confirming its process for the review. Equally, the review should not provide a forum that encourages Airlines to raise new arguments that should have been put to airports during consultation - such as the new arguments raised in the Duignan report.[1]

Scope of the Review

7. The Airlines submit that the scope of the review must be expanded so that the Commission:

(a) reviews performance under all limbs of the Part 4 purpose statement including quality, innovation and efficiency;[2] and

(b) carries out a "summary and analysis of price setting disclosure information and annual disclosure information at the same time".[3]

8. The key reasons why, in their view, this is required are as follows:

(a) Section 53B(2) requires the Commission to monitor and analyse ***all*** information disclosed under ID requirements.[4]

(b) All elements within the purpose statement are linked, and the Commission should assess all activities to determine whether each limb of the purpose of Part 4 is being met.[5]

[1] Board of Airline Representatives New Zealand, Review of Auckland and Christchurch Airport's third price setting events – Process & Issues paper, 28 November 2017 ("**BARNZ Submission**") at 16.

[2] Air New Zealand, Response to the Process and Issues Paper: Auckland and Christchurch Airports' third price setting events (July 2017-June 2022), 28 November 2017 ("**Air NZ Submission**") at [2].

[3] BARNZ Submission at [4].

[4] Air NZ Submission at [5]

[5] Air NZ Submission at [7].

(c) An effective regulatory threat is an important part of the ID Regime. The selection of an incorrect scope for this review will have a permanent effect for future section 53B reviews, and will weaken the regime permanently.[6]

9. There is significant common ground between the Airlines and NZ Airports regarding the need for an effective ID Regime. For example, NZ Airports agrees that:

(a) Promotion of each objective of the Part 4 purpose statement should be assessed under the ID Regime.

(b) The objectives of the Part 4 purpose statement are linked. For example, NZ Airports' submission on the Issues Paper noted that we considered "valuable information about quality, innovation and efficiencies" should inform the Commission's analysis of profitability.[7]

(c) Annual disclosures are an important part of the ID Regime.

10. However, as discussed below, NZ Airports believes that the Commission's proposed approach to the review will be lawful and effective, and can accommodate the concerns raised by the Airlines. In particular, the review:

(a) appropriately reflects the nature and content of the price setting disclosures (which do not provide full information on all four limbs of the Part 4 purpose statement); and

(b) avoids the difficulty and confusion that could arise from conflating price setting and annual disclosure reviews. For example, although BARNZ suggests that its proposed review process should be achievable based on the reviews it has presented with its submission, it has not assessed the extensive commentary provided by each airport detailing their achievements during the reporting period or explaining variances from forecasts, which is key to understanding performance.

Section 53B provides flexibility to promote Part 4 purpose statement over time

11. The Airlines' submissions on the requirements of section 53B(2) have not changed NZ Airports' view that the Act allows the Commission's proposed approach to the review.[8] Our view is that:

(a) Section 53B(2)(a) states that the Commission *may* monitor and analyse all information disclosed. This is an empowering clause, and does not translate into an obligation to produce a summary and analysis for all information disclosed, as submitted by Air NZ.[9]

(b) The key obligation is to publish a summary and analysis of disclosed information for the purpose of promoting greater understanding of performance of individual regulated suppliers, their relative performance, and change in performance over time. This is clearly an ongoing obligation, where the Commission will need to

[6] Air NZ Submission at [10].

[7] NZ Airports Association, Submission on process and issues paper on review of Auckland and Christchurch Airports third price setting for airport services, 28 November 2017 ("**NZ Airports Submission**") at [14].

[8] BARNZ Submission at [17] – [22] and Air NZ Submission at [1] – [10].

[9] Air NZ Submission at [5].

exercise judgement on how best to promote the types of understanding sought by section 53B(2), which will be informed by the type of disclosure being reviewed.

(c) There is nothing in the wording of section 53B(2)(b) to suggest that all aspects of the Part 4 purpose statement must be fully assessed at each review. As the Commission acknowledged in its section 56G reviews (which expressly required the Commission to report on how ID regulation is promoting the purpose statement), assessment of each limb of the purpose statement is an ongoing task, and cannot reasonably be completed by a snapshot assessment of each price setting disclosure.

The Commission should focus on promoting understanding of performance

12. We agree with the Airlines that section 53B(2) reviews are an important part of an effective ID Regime. However, it is important to bear in mind that the disclosures by the airports themselves are the primary, and intended, mechanism to achieve the purpose of the ID Regime, and therefore promote the Part 4 purpose statement.

13. We believe that the section 53B(2) reviews will be most effective at promoting the Part 4 purpose statement over time if they are genuinely targeted at improving understanding of performance. This means focussing on performance areas that are most relevant to the disclosures under consideration and/or are of most interest to parties in the circumstances.

14. There are many benefits to the Commission's proposed scope and approach:

(a) It can adjust the focus of its review for the aspects of airport performance that are of most importance to consumers in particular periods, and therefore maximise confidence that the airports are subject to effective monitoring. For this review, the Commission has chosen topics for which, in the circumstances of the price setting context for each airport, greater understanding of performance is desirable. Targeting its focus in this way should help to avoid inefficient duplication in the review process.

(b) The information in annual disclosures provides greater detail on other limbs of the Part 4 purpose statement. As it conducts summary and analysis of disclosures over time, the Commission can promote an understanding of whether all elements of Part 4 are being achieved in airport performance.

(c) The Commission can be flexible about what information it considers relevant when assessing performance in the identified focus areas. NZ Airports is open to information contained in historic annual disclosures being considered by the Commission, if it is relevant to understanding the price setting performance areas currently under review. However, it is undesirable to seek to formally assess all previous annual disclosures as part of this review.

(d) Other elements of the purpose statement are already recognised within the Commission's topics (and questions) in the Issues Paper – such as its focus on whether forecast investment is "sufficient to meet expected demand and desired service quality over PSE3". It also appears to us that matters of concern identified in BARNZ's reviews of AIAL and CIAL will be covered by the Commission's topics.

(e) A combination of the above is likely to promote a much better understanding of performance at the time of each review, and cumulatively over time.

Timeframe

15. The Airlines' proposed approach is likely to substantially increase the timeframe for the review. This is unacceptable to NZ Airports. We note that the final report under the current proposed scope is already expected to be a year after the price setting disclosures were released. NZ Airports believes that timely reviews are an important part of an effective ID Regime.

16. BARNZ is incorrect to suggest that a wider scope, including review of the annual disclosures, will not materially increase the time span of the review.[10] BARNZ's review of the annual disclosures did not evaluate the extensive commentary and explanations provided by airports in those disclosures. So, for example, BARNZ has noted that variations occurred, but did not review the explanations airports provided for those variations.

Not an immovable precedent

17. We do not think that the scope of this review can, or should, set an immovable precedent for how future summary and analysis is conducted, as submitted by the Airlines.[11] There is nothing in the Act to suggest that the Commission's decision in respect of the scope of this review will bind it in the future. As set out above, the Commission can adjust its topic focus for each summary and analysis to ensure it is best promoting an understanding of performance over time.

18. That said, for reviews of price setting, the Commission must provide a clear understanding of how it intends to assess price setting decisions in advance of the pricing decisions being made. This will naturally place a constraint on the extent to which the Commission can modify its approach for each summary and analysis of price setting.

19. NZ Airports expects that following a flexible approach will not raise issues so long as:

    (a) the selected performance areas, and how they are analysed, could have been reasonably anticipated by airports at the time they set prices;

    (b) for selected performance areas, all relevant information is considered; and

    (c) an airport's decision-making is assessed based on the information that was reasonably available to it at the time the decisions were made.

20. We look forward to engaging with the Commission and interested parties on how future reviews should be structured to best promote the objectives of section 53B, the Part 4 purpose statement and, more broadly, an effective ID Regime. That includes establishing the best approach to summary and analysis of the annual disclosures, and how this information is best considered in evaluating the Part 4 objectives.

Credible regulatory threat is not weakened

21. NZ Airports disagrees with Airlines assertions that the Commission's proposed scope and approach will weaken information disclosure.[12]

22. To the contrary, we believe it is a very effective approach. A key message that NZ Airports has taken from the Issues Paper is that, when making decisions, airports should expect the

[10] BARNZ Submission at [5].
[11] Air NZ Submission at [10].
[12] Air NZ Submission at [2].

Commission to focus closely on assessing performance areas that, in the circumstances, it has identified as being of the greatest potential concern or interest to consumers.

23. More broadly, the airports have established a strong history of engaging on the development of the regime, producing extensive disclosures, and responding to findings by the Commission (eg the section 56G reviews). It is clear from the price setting disclosures that both AIAL and CIAL were heavily influenced by the input methodologies and other ID Regime requirements when establishing their pricing approaches. NZ Airports considers that unwieldy and untimely reviews, which do not provide interested persons with relevant and focussed information to improve their understanding of performance, threaten the credibility of the ID Regime. In contrast, the Commission's ongoing reviews at the appropriate times continue to provide a credible regulatory threat.

Matters outside the scope of section 53B(2)

Further regulatory intervention

24. Air NZ notes that the Commission should be able to move to a different regulatory model at the conclusion of the review process, and advocates for a negotiate-arbitrate regime.[13] This is likely informing its views that the section 53B(2) review must be extensive and cover all aspects of performance.

25. As we have said above, over the years airports have spent considerable time and effort on the development and implementation of the ID Regime. Their performance has been materially influenced by it. The section 53B(2) reviews, if properly focussed on promoting understanding of performance consistent with the purpose of ID, will continue to ensure that the ID Regime is effective. The Commission's proposed approach will maintain a credible regulatory threat, and will allow it to identify any material performance concerns.

26. It is common knowledge that Airlines would prefer a negotiate-arbitrate regime. They repeatedly make this clear at every opportunity – to the Commission; to the Ministry of Business, Innovation and Enterprise (**"MBIE**"); and to Ministers. They can (and will) continue to pursue that lobbying with the new Government.

27. We strongly encourage the Commission to maintain its focus on following a review process that best serves the purpose of the ID Regime, and not to be distracted by submissions that the review must somehow be structured or conducted in a way that paves the way for negotiate-arbitrate regulation. NZ Airports notes that, following the section 56G reviews, MBIE consulted on potential change to the ID regime. The clear outcome of that process was that the ID Regime was effective, but that modifications to Part 4 should be considered to enhance the credible threat of further intervention.[14] We understand that it remains the intention to include relevant clarifications in amending legislation (which would be subject to further public consultation processes).

28. In summary, NZ Airports considers that there is already a clear regulatory threat of further intervention, which the Commission does not need to seek to enhance by over-extending the proper role of the section 53B(2) reviews.

[13] Air NZ Submission at 2.

[14] Options included clarifying the Commission's power to report on performance against the Part 4 purpose statement, and clarifying the inquiry process to consider whether further regulation should be imposed.

Lawfulness of charges

29. Air NZ also notes that it considers the Runway Landing Charge ("**RLC**") to be unlawful as, in its view, airports can only charge for the use of current services.[15] However, it accepts that this is outside the scope of the review. NZ Airports agrees that this is out of scope. Airlines have other processes available if they truly believe that airports have acted unlawfully when setting charges.

30. Clearly, airports only set charges that they believe are lawful. Under the Airport Authorities Act ("**AAA**"), aircraft and freight activities, airfield activities and specified passenger terminal activities (together, "**identified activities**") are each defined to include "the holding of any facilities and assets (including land) acquired or held to provide [activities] in the future (whether or not used for any other purpose in the meantime)".

31. Section 4B of the AAA requires an airport to consult with substantial customers before setting charges for identified activities under section 4A. Accordingly, the AAA specifically authorises airports to set charges for assets held for future use.

New matters raised after consultation or with the benefit of hindsight

32. The airports engage in consultation with their substantial customers in good faith. The outcomes reached reflect extensive consideration of their interests. It is a complex and resource intensive task. The consultation participants' views will not always be consistent and will not always align. The submissions by the Airlines demonstrate this tension:

    (a) Air NZ opposes the passenger charging approach at CIAL for favouring "larger wide-body operators at the expense of small operators".[16] Conversely, BARNZ noted its simplicity which it considered reduced costs to the airport and to airlines.[17]

    (b) The Qantas Group questions the quantum, staging and deliverability of several projects.[18] In contrast, Air NZ notes its support of AIAL's capital expenditure programme and that it is vital that the works proceed to address the significant infrastructure deficit from recent years.[19]

33. The consultation participants' views will also not always be consistent over time. This may be caused by new parties to the consultation who are unaware of the history of engagement. The Commission should evaluate the airport's conduct based on what was known at the time prices were set, and not with the benefit of hindsight. For example, a theme of the submissions from the airlines was that Auckland Airport has underinvested over PSE2. The section 56G review record shows that in 2012 both BARNZ and Air NZ were very positive about Auckland Airport's approach to capex consultation and investment forecast. BARNZ told the Commission that AIAL's inclusion of airline priorities as a fundamental part of capex planning is a first for airports in New Zealand.[20] Air NZ told the Commission that it "considers AIAL's forecast capital expenditure for the second PSE to also be reasonable. The process undertaken by AIAL in determining its capital expenditure priorities for this

[15] Air NZ Submission at [38] – [40].
[16] Air NZ Submission at [102].
[17] BARNZ Submission at 24.
[18] Qantas Submission at 1
[19] Air NZ Submission at [59].
[20] Auckland International Airport Limited, *Final s56G Report*, 31 July 2013, at 127.

period was robust, transparent and inclusive and the resulting programme included in the forecast is a good reflection of customer requirements during the second PSE". [21]

34. The tension in the submissions between the Airlines, and over time, also demonstrates the complexity of the decisions that airports have to make, and why the Commission should refrain from considering whether airports should have made alternative decisions. It should instead focus on analysing the decisions that have been made, based on information available to the airports at the time decisions were made.

35. As we have previously submitted, NZ Airports believes that it is important that the review process does not discourage airlines from fully participating in the consultation process, or otherwise undermine the value of consultation. This means not establishing the review as a forum where new views and information that airports did not have the opportunity to consider are provided to the Commission, or where the Commission examines whether alternative pricing approaches should have been used. As required by section 53B(2), the focus should be squarely on analysing and summarising the information disclosed by the airports, which explains the decisions they have made.

36. The following are matters that could cause concerns in light of the above discussion:

    (a) Qantas states that it supports the Commission "investigating the viability" of the Capex wash up to ensure the risk does not sit with airlines.[22] BARNZ also raised this in its submission.[23] We are unclear what the Airlines seek here. We understand that the Commission will consider the risk allocation decisions that have been made by airports, but we do not understand it to be intending to go so far as recommending a specific wash-up approach (should it be of the view that an airport should have given greater consideration to departing from the standard risk allocation approach).

    (b) BARNZ also proposes that the Commission should explore what an appropriate cost allocator would be for airports "to apply to shared costs between aeronautical and commercial".[24] Again, we are not sure what is expected of the Commission here, as airports will need to apply the input methodologies when they make their annual disclosures. In any event, both airports extensively considered cost allocation as part of their price setting, in accordance with the guidance provided by the input methodologies. Both airports noted that there has been no material change from prior year asset allocations.[25]

    (c) BARNZ states that CIAL has made a carry forward adjustment, which, at the request of airlines, was reviewed by Deloitte.[26] BARNZ notes it had "not identified any problems with this adjustment". Regardless, it now considers the Commission should review this. NZ Airports submits that this is a good example of a situation in which a precedent could be created that would devalue the time and resource committed to the consultation process.

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[21] Air NZ, *Submission on Auckland Airport Draft s56G Report,* 31 May 2013, at 16.

[22] Qantas, Review of Auckland and Christchurch Airport's third price setting events – Process & Issues paper, 28 November 2017 ("**Qantas Submission**") at 1.

[23] BARNZ Submission at 12.

[24] BARNZ Submission at 18.

[25] Auckland International Airport Limited *Price Setting Disclosure* 1 August 2017, at 39 - 42 and Christchurch International Airport Limited *Pricing Disclosure 1 July 2017 to 30 June 2022* 14 August 2017, at sched 10.

[26] BARNZ Submission at 21.

(d) BARNZ submitted a report by Pat Duignan on AIAL's RLC.[27] Clearly, AIAL would have benefitted from receiving those views during consultation (although it would likely have created some confusion, given that Mr Duignan's apparent support of peak pricing contradicts views provided by the Airlines). Submitting the report now is inconsistent with NZ Airports' strongly held view that this review should not provide a forum for airlines to raise new arguments that were not presented for airport consideration in consultation. Rather, they should be encouraged to put their best foot forward during consultations.

[27] BARNZ Submission at [10(c)].